EXECUTIVE BOARD MEETING

SM/18/178

July 2, 2018

To:	Members of the Executive Board
From:	The Secretary
Subject:	**South Africa—Staff Report for the 2018 Article IV Consultation**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Wednesday, July 25, 2018**
Publication:	Yes*
Questions:	Ms. Coronel, AFR (ext. 38119) Mr. Simone, AFR (ext. 36170) Mr. Miyajima, AFR (ext. 39395) Ms. Christiansen, SPR (ext. 36975)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	Wednesday, July 11, 2018—WTO After Board Consideration—African Development Bank, European Investment Bank, Organisation for Economic Cooperation and Development

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

June 29, 2018

KEY ISSUES

Context: Reflecting slow progress on reforms, weakened governance, and elevated policy uncertainty, growth remains subdued. With the economy unable to create enough jobs, the quest for inclusive growth has been elusive, making South Africa one of the most unequal societies. Growing government spending has led to a doubling of public debt in the last decade. Credible monetary policy has kept inflation expectations anchored, albeit at near the top of the target band. The current account deficit remains financed by potentially volatile portfolio inflows. The new administration's immediate priority has focused on improving governance and restoring confidence.

Outlook and Risks: Real GDP growth is projected to remain slightly below 2 percent in the medium term—a level insufficient to raise per-capita income significantly and make a meaningful dent in unemployment. Upside risks include a steadfast implementation of reforms to build on positive announcements, but the scope for comprehensive measures may be constrained by the electoral calendar. External downside risks arising from tighter monetary and financing conditions and capital outflows are significant.

Staff Advice: Bold structural reforms are urgently needed to reignite strong and inclusive growth. These include tackling corruption and strengthening governance; promoting competition in the product markets, including by restructuring weak state-owned enterprises (SOEs); advancing labor market reforms and enhancing the quality of education to foster job creation; and leveraging digitalization. The policy mix should be geared towards stabilizing public debt at levels that provide comfortable buffers, anchoring inflation expectations closer to the midpoint of the target band, and maintaining the resilience of the financial system.

Approved By
Anne-Marie Gulde-Wolf (AFR) and Rupa Duttagupta (SPR)

A staff team comprising Mmes. Coronel (head, AFR) and Christiansen (SPR), and Messrs. Miyajima, Simone, and Thakoor (all AFR) visited Pretoria, Johannesburg, and Cape Town during May 28–June 11, 2018. Mr. Mlachila (senior resident representative) and Ms. Mavee (local economist) assisted the mission. Mr. Sishi (OED) participated in the discussions. The mission held discussions with the National Treasury, the South African Reserve Bank, other sectoral ministers, senior government officials, private sector participants, trade unions, development partners, and academics. Ms. Li, Ms. Masters, Ms. du Plessis, Mr. Radick, and Ms. Wang provided logistical and research support. Ms. Prado and Mr. Alsokhebr supported the preparation of the report.

CONTENTS

BOXES

FIGURES

TABLES

ANNEXES

APPENDICES

A NEW OPPORTUNITY TO REIGNITE GROWTH

1. **South Africa achieved noteworthy progress after the end of apartheid** (Figure 1). Poverty fell, and access to education and healthcare expanded. An expansion in social housing, water, and electricity coverage improved living conditions. Government debt halved to below 30 percent of GDP by the mid-2000s amid strong economic growth, and foreign exchange reserves rose. Unemployment, which had risen to above 30 percent after the transition to democracy, declined to 22.5 percent by the late-2000s. Strong economic institutions supported these advances.

2. **Some of the early achievements have recently unwound amid a marked growth deceleration** (Figure 1). Per-capita growth has turned negative, and the fiscal space has become constrained by growing public debt—now exceeding 50 percent of GDP (Selected Issues Papers (SIP) 1—Debt). Low consumer and business confidence—depressed by structural rigidities, corruption, and policy uncertainty—has dampened productivity growth.[1] The education system has failed to equip the youth with sufficient human capital. The poverty rate stands at around 40 percent and unemployment has crept up to around 27 percent.[2] An income Gini coefficient of 0.68 makes South Africa a highly unequal society.

3. **The structure of the economy complicates the quest for sustainable and inclusive growth**. The economy is globally positioned, sophisticated, and diversified, and it enjoys first-class financial services and corporations. However, physical infrastructure and education of diverse quality create large productivity differentials across the economy. Some population groups have limited structures to sustain growth and remain trapped in unemployment and poverty (SIP 2—Inequality).

Text Figure 1. South Africa: Areas of Reform to Reignite Strong and Inclusive Growth

Source: IMF staff.

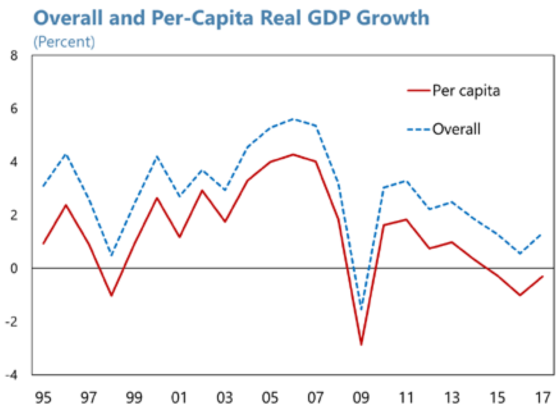
4. **The recent political transition offers a renewed opportunity to advance reforms and exploit the economy's potential**. South Africa's macroeconomic track record and resilience to shocks should support this effort. However, reigniting growth and fostering social inclusion would require addressing governance weaknesses (Annexes I—Governance, II—Eskom), implementing the long-awaited product and labor market reforms, and leveraging the opportunities

[1] During 2008–16, TFP growth was negative in the primary, non-manufacturing secondary, and tertiary sectors, and decelerated in higher-technology manufacturing (World Bank, South Africa Economic Update, September 2017).

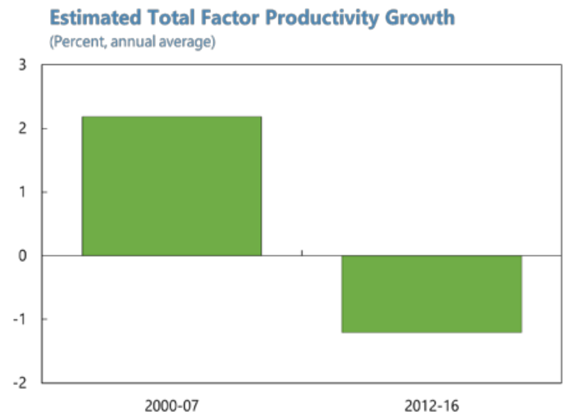
[2] According to official 2015 data, 55.5 percent of the population is below the upper-bound poverty line, 40 percent is below the lower-bound poverty line, and 25.2 percent is in extreme poverty (below the food poverty line).

Figure 1. South Africa: Economic and Social Context

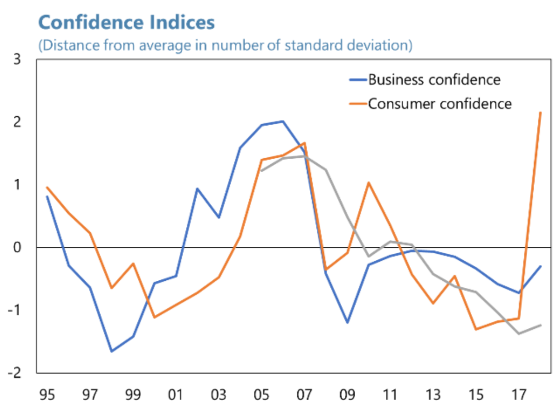
Slow economic growth amid stalled reforms kept per-capita income in negative territory…



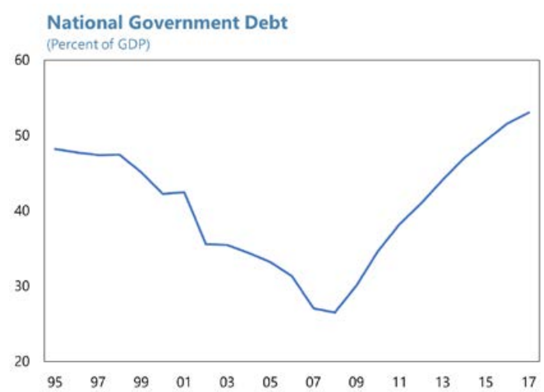
…and the pace of productivity improvements very low…



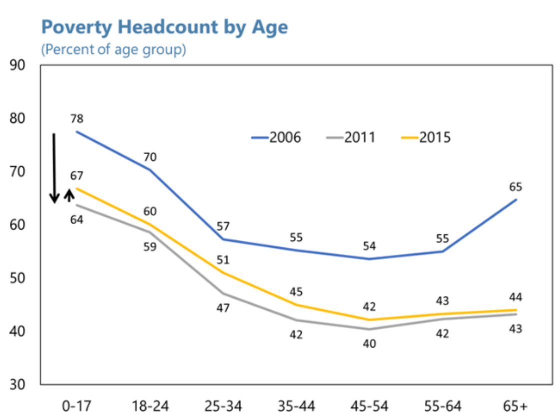
…due to low private sector confidence.



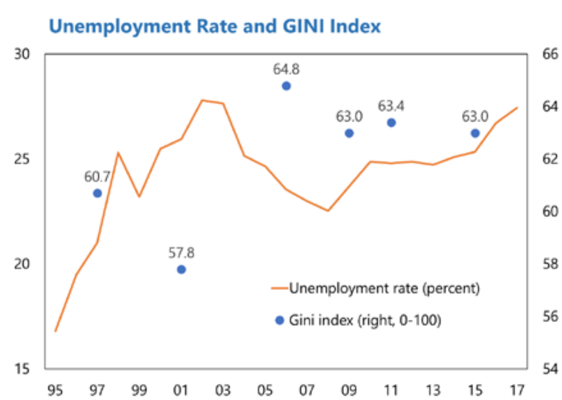
In turn, this reduces fiscal space…



…unwinding some of the reduction in poverty, and…



…kept unemployment and inequality high.



Sources: BER, IMF WEO, Haver Analytics, SARB, StatsSA, World Bank, and IMF staff calculations.

provided by digitalization (Text Figure 1). The reforms would unlock private investment and thus support job creation and poverty reduction. The stated priorities of the new administration, that is, combating "state capture" and promoting jobs and growth, point in the right direction.[3]

RECENT MACRO-FINANCIAL DEVELOPMENTS

5. In an environment of uncertainty, economic activity has been subdued (Figures 2 and 3). Growth recovered from 0.6 percent in 2016 to 1.3 percent in 2017, buoyed by higher commodity prices and the rebound from a drought, but low business confidence continued to impair manufacturing, wholesale, retail, and transport activities. Reflecting better terms of trade, the current account deficit narrowed. The external position in 2017 was moderately weaker than implied by fundamentals and medium-term desirable policies (Annex III—External Sector Assessment). Headline inflation stayed within the target band (3–6 percent), but inflation expectations remained close to the band's upper end. Unemployment increased. While confidence indicators rebounded in early-2018, first-quarter growth was weak, recording a year-on-year expansion of 0.8 percent.

6. Monetary policy was eased amid weak economic growth and bank lending (Figure 4). Private sector credit growth slowed, and household debt declined further as a share of disposable income. Short-term interest rates fell after the South African Reserve Bank (SARB) cut the policy rate by 25 basis points twice—in July 2017 (the first time since 2012) and in March 2018—to 6.5 percent (it kept the policy rate unchanged in May). However, debt service of private non-financial corporations continued to increase as a share of income. Protracted weak economic growth through macro-financial linkages put a damper on banks' asset growth and profitability. To provide for a more holistic approach to oversight and bolster financial stability, the SARB introduced the Twin Peaks regulatory framework.[4]

7. Fiscal performance fell short of budget projections (Figure 4). The 2017 Medium Term Budget Policy Statement (MTBPS) reported a large deviation from the FY17/18 deficit target. Revenue was substantially below projections, and expenditure was pushed up by the injection of funds to the South African Airways (SAA, the national airline) and the post office to avoid triggering cross-default clauses. The consolidated fiscal deficit in FY17/18 is estimated to have exceeded the target in the 2017 budget review (3.1 percent of GDP) by more than 1 percentage point of GDP.

8. Significant asset price volatility followed major political events and policy decisions (Figure 5). Political uncertainty and falling confidence were key drivers of asset prices and capital flow volatility during most of 2017. As sentiment recovered following the ruling party's elective conference and the subsequent change in administration, asset prices rallied and capital inflows strengthened (Box 1). Later, in April–June 2018, as the general sentiment toward emerging markets

[3] "State capture" refers to the influence that connected individuals exert on government regulations and decisions to benefit from public resources.

[4] The twin peaks model is characterised by separate prudential and market conduct regulators.

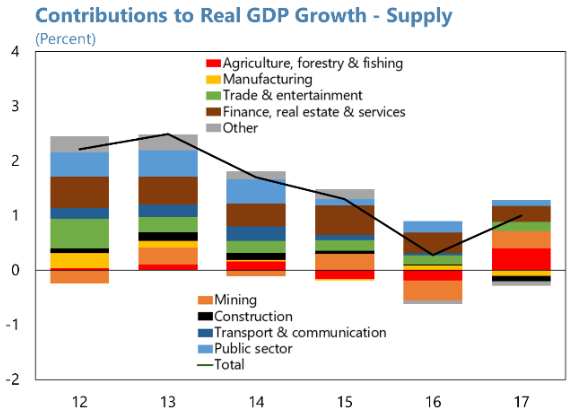
(EM) soured, nonresident investors turned into net sellers of South African portfolio assets and the rand weakened, highlighting the nation's interconnectedness with global markets.

Box 1. Impact of Key Political Events and Policy Decisions on Markets

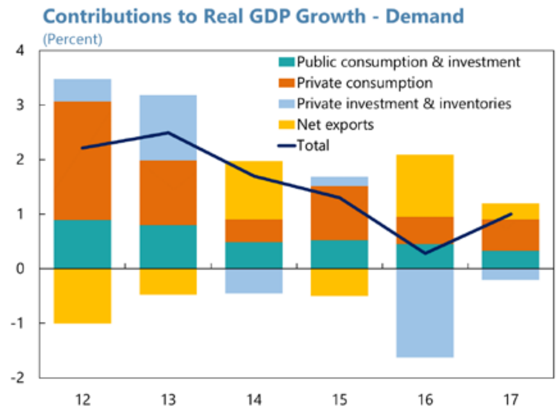
- The replacement of the Finance Minister in March 2017 prompted a 10 percent rand depreciation against the U.S. dollar and a 70-basis point rise in 10-year local currency sovereign bond yields in two weeks.
- Following questions about the SARB's independence and ownership, market tensions rose. They subsided once the authorities successfully defended the SARB's mandate. However, a second cabinet reshuffle in October heightened concerns regarding a nuclear plant procurement, thus triggering another round of selloffs.
- Selloffs intensified after the release of the 2017 MTBPS, which candidly presented the unresolved fiscal challenges without offering adjustments. From mid-October to mid-November, the rand weakened about 10 percent and bond yields rose some 90 basis points.
- The ensuing sovereign local currency credit rating downgrades to below investment grade (except by Moody's) and exclusion of South Africa from a global bond index increased nervousness as more than 40 percent of such debt is held by nonresidents (SIP 3—Buffers).
- Uncertainty surged further in the run-up to the ruling party's elective conference in December 2017, sending implied exchange rate volatility to historical highs.
- Following market concerns about governance and liquidity shortages in Eskom (the electricity company), the Public Investment Corporation (PIC) and the Corporation for Public Deposits (CPD) provided bridge financing until access to credit was restored following changes in Eskom's board and management.
- Asset prices rallied as new appointments at key ministries increased expectations of strengthened governance and economic policies. Between mid-November and end-February, the rand appreciated by 20 percent and bond yields declined by 150 basis points.
- Some gains unwound, as a controversial "land expropriation without compensation" proposal was discussed in parliament.
- Acknowledging improving prospects for institutions and growth, in March 2018 Moody's maintained the sovereign local currency credit rating at the lowest investment grade.
- In April 2018, the authorities signed 27 long-stalled contracts worth R55 billion (about 1 percent of GDP) with independent power producers to supply renewable energy.
- Confidence indicators improved in the first quarter of 2018, and S&P maintained the sovereign's credit ratings unchanged, assigning a stable outlook in May. Leveraging improved confidence, the authorities announced their intention to attract $100 billion (about 25 percent of GDP) in FDI over five years.
- During the global risk-off in April–June, the rand depreciated and domestic bond yields rose. After a volatile year, in mid-June the rand and bond yields traded broadly at levels comparable to those in October last year when the 2017 MTBPS was released.

Figure 2. South Africa: Real Sector Developments

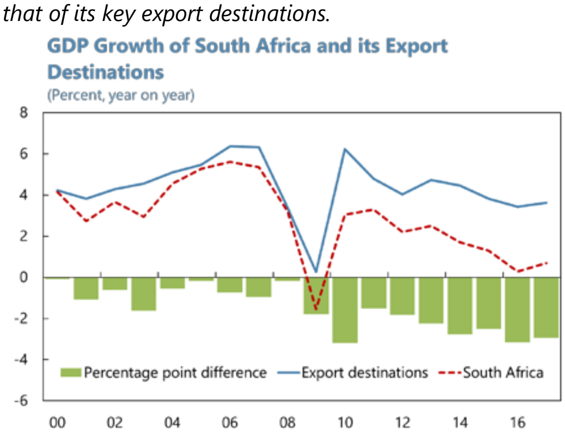
Agricultural and mining production generated growth in 2017…



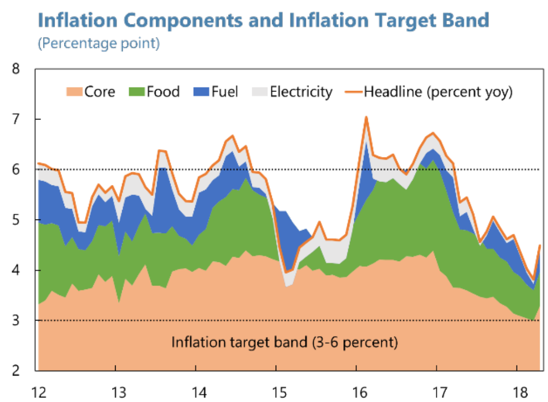
…and private consumption and investment rebounded from low levels…



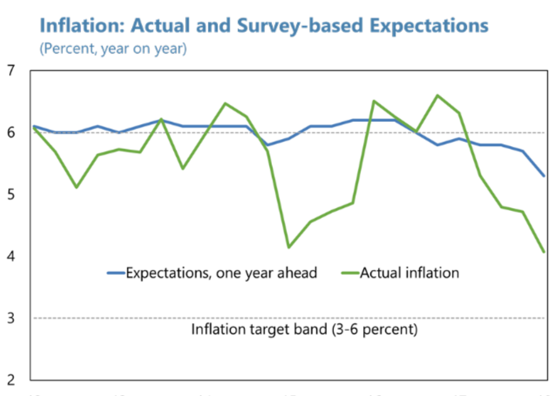
…but South Africa's growth continues to underperform that of its key export destinations.



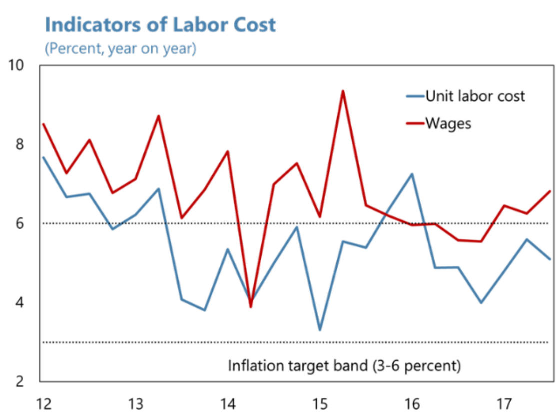
Inflation fell to around the midpoint of the target range…



…and inflation expectations moderated somewhat…



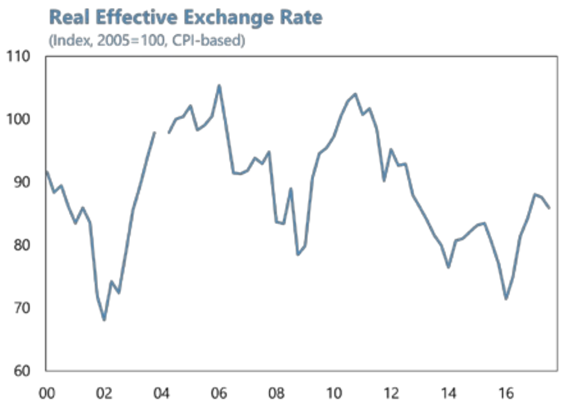
…but wage pressures persist.



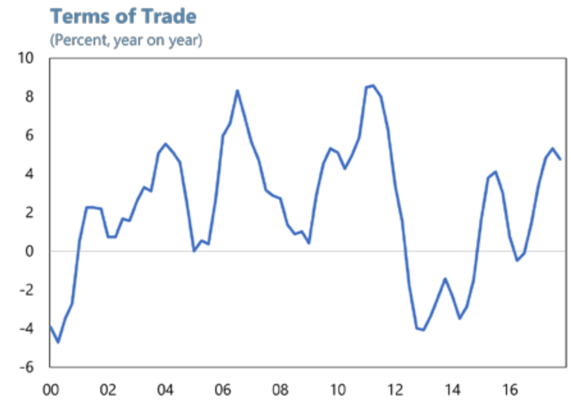
Sources: IMF Direction of Trade, IMF WEO, SARB, and IMF staff calculations.

Figure 3. South Africa: External Sector Developments

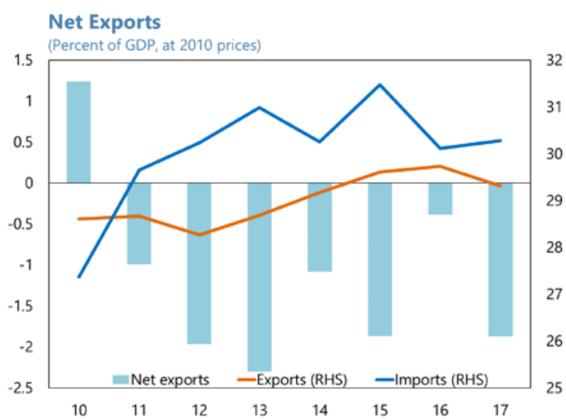
The real effective exchange rate appreciated due to nominal appreciation...



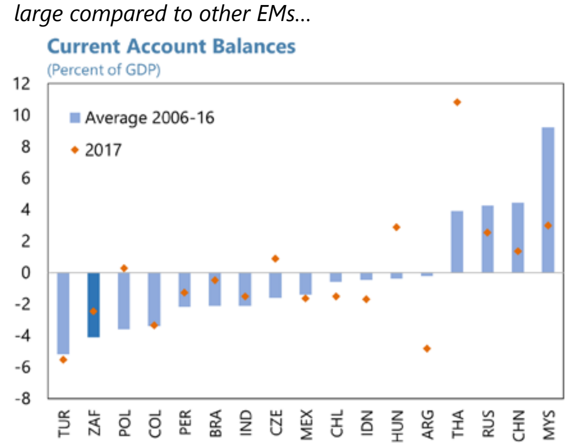
...while the terms of trade improved.



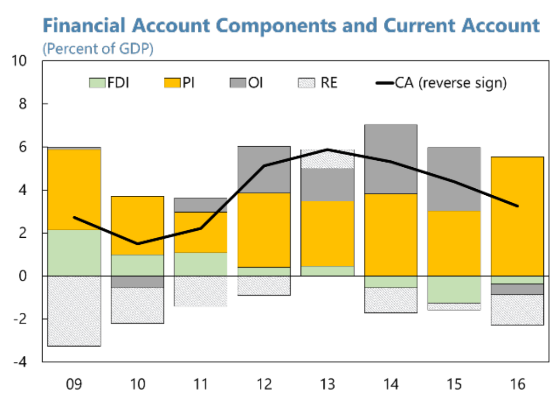
With low economic activity, imports remained weak...



...and the current account deficit narrowed, but remained large compared to other EMs...



...financed by volatile portfolio flows...

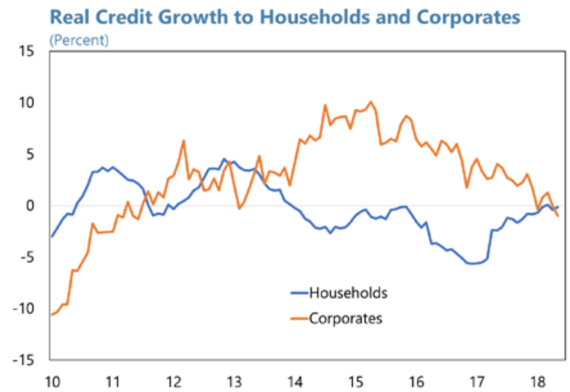


...while forex reserves remained broadly stable.

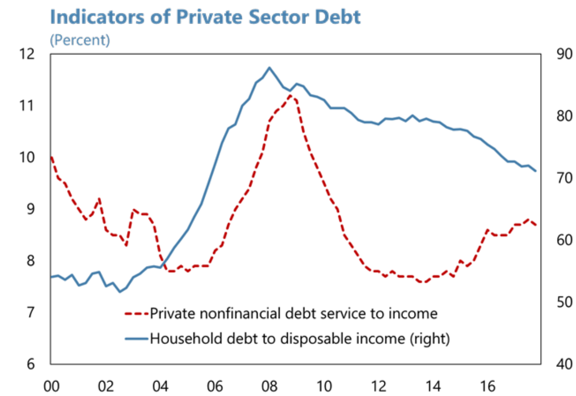
Sources: Haver Analytics, IMF WEO, SARB, and IMF staff calculations.

Figure 4. South Africa: Monetary, Banking, and Fiscal Sector Developments

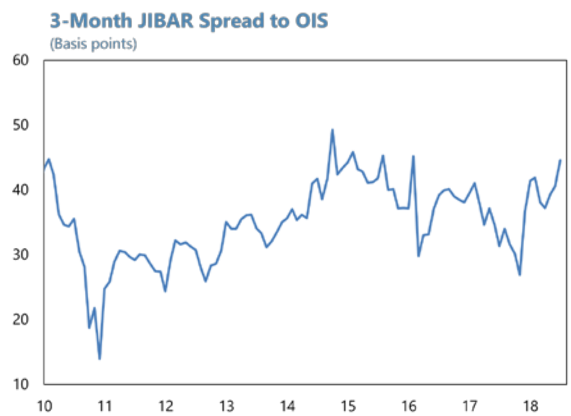
Growth of bank lending to households and corporates declined…



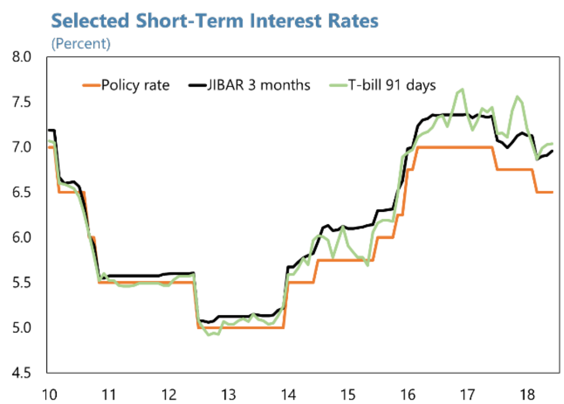
…as households deleveraged, while the private non-financial sector used more income to pay out debt.



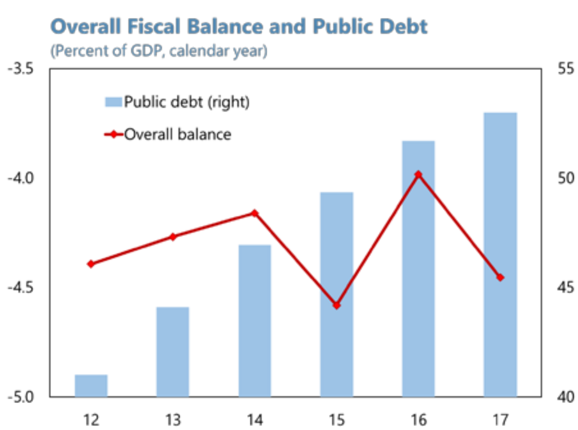
Bank credit risk edged higher.



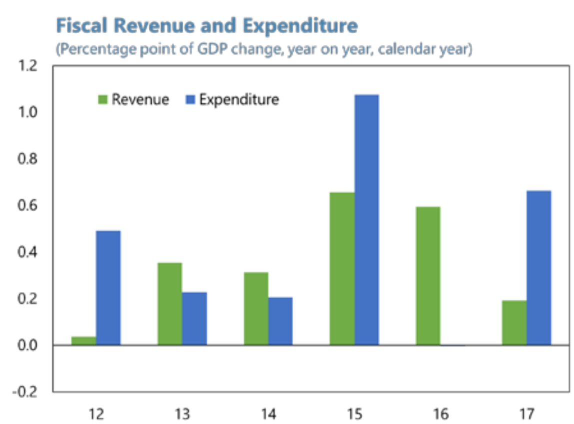
Short-term interest rates declined after two policy rate cuts.



The fiscal deficit and public debt increased in FY17/18…



…as expenditures surged and revenues underperformed.



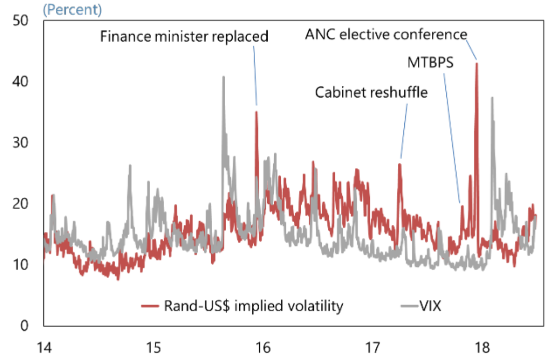
Sources: Bloomberg, L.P., Haver Analytics, SARB, South Africa National Treasury, and IMF staff calculations.

Figure 5. South Africa: Financial Market Developments

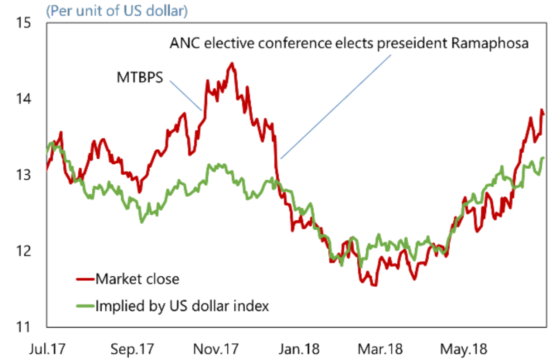
Uncertainty rose since end-2015 and jumped ahead of the ANC elective conference…

…increasing the volatility of the currency…

Volatility of Rand-US Dollar and US Equities (VIX)
(Percent)



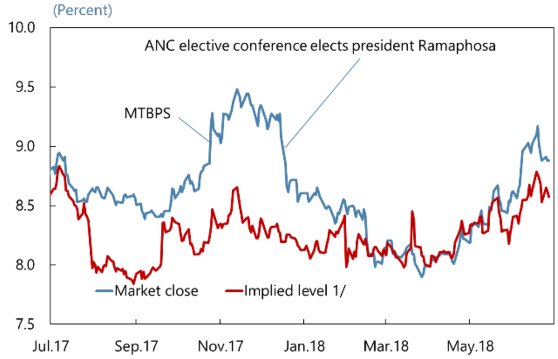
South African Rand
(Per unit of US dollar)



…local currency sovereign bond yields…

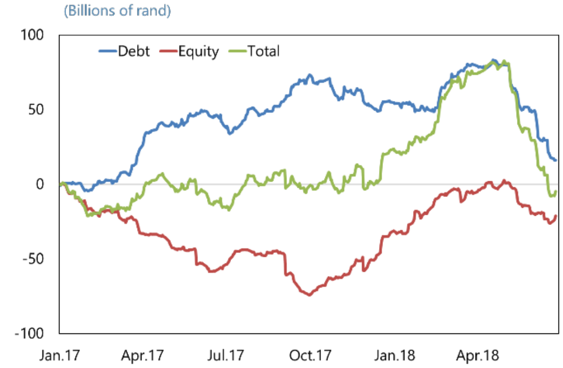
…and foreign net portfolio inflows.

Local Currency Sovereign 10-year Yield
(Percent)



1/ US 10-year yield + 5-year inflation expectations differential + South Africa 10-year sovereign CDS.

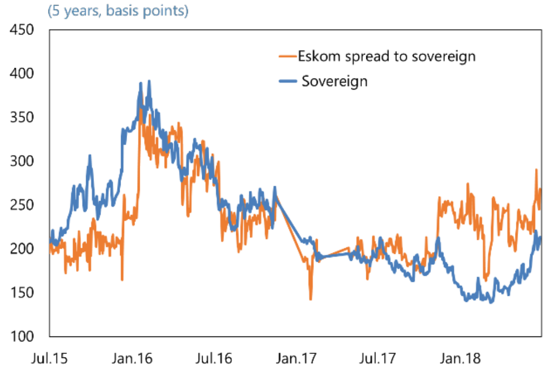
Cumulative Non-Resident Net Portfolio Inflows
(Billions of rand)



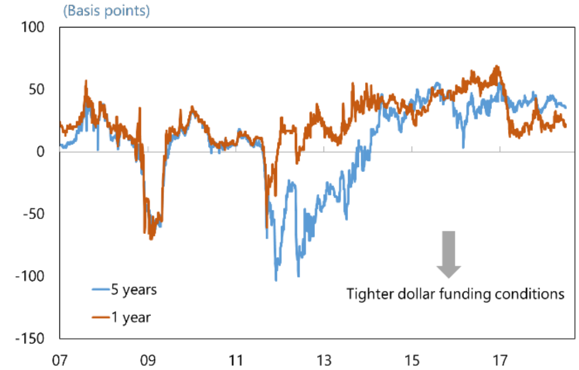
Credit spreads on sovereign and Eskom paper edged up…

… while dollar funding conditions remained favorable.

Public Sector Credit Default Swap Spreads
(5 years, basis points)



Rand-US Dollar Cross-Currency Basis Swap Spread
(Basis points)



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

BASELINE SCENARIO: OUTLOOK ON CURRENT POLICIES

9. Staff's baseline scenario projects a modest growth recovery amid price stability (Text Table 1). Staff projects growth to rise to 1.5 percent in 2018 and 1.8 percent in the medium term, with private consumption and investment supported by stronger confidence and pent-up demand. Public investment would be constrained by reduced budget appropriations and weak activity by financially-constrained SOEs. Bank lending to households would edge moderately higher as they continue to deleverage, but lending will still be constrained by low economic activity and banks' preference for government bonds (Annex IV—Bank Lending). As domestic demand recovers, the current account deficit is expected to widen to 3½ percent of GDP. On current policies, average headline inflation would increase to 5.5 percent in line with inflation expectations, as growth moves closer to its potential and temporary disinflationary effects subside.

Text Table 1. South Africa: Baseline Scenario on Current Policies

	2017	2018	2019	2020	2021	2022	2023	2024-2027	2027-2030
Real GDP Growth (percent)	1.3	1.5	1.7	1.8	1.8	1.8	1.8	1.8	1.8
Real Private Investment Growth (percent)	1.2	1.6	2.8	3.2	3.2	3.2	3.2	3.2	3.2
Consumer Price Inflation (percent, period average)	5.3	4.9	5.3	5.4	5.5	5.5	5.5	5.5	5.5
Private Sector Credit Growth (percent)	4.3	5.6	6.3	6.8	7.1	7.3	7.3	7.3	7.3
Private Sector Credit (percent of GDP)	63.4	62.8	62.4	62.1	62.0	61.9	61.8	61.8	61.8
Fiscal Deficit (percent of GDP) 1/	-4.6	-4.3	-4.0	-4.0	-3.9	-3.9	-3.8	-3.6	-3.4
Gross Government Debt (percent of GDP) 2/	53.0	55.0	56.0	57.0	57.6	58.1	58.5	59.0	59.2
Current Account Balance (percent of GDP)	-2.5	-2.9	-3.3	-3.3	-3.3	-3.4	-3.4	-3.4	-3.4
Unemployment Rate (percent)	27.5	27.9	28.3	28.6	28.7	28.9	29.0	29.3	29.4

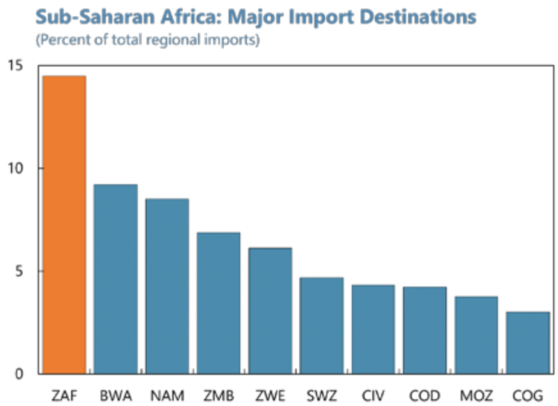
Sources: Haver, South African National Treasury, and Fund staff estimates and projections.
1/ Consolidated government unless otherwise indicated.
2/ National government.

10. The FY18/19 budget contemplates a moderate fiscal consolidation. On the revenue side, the budget mainly relies on a 1 percentage point VAT rate increase. On the expenditure side, a reallocation allows for a significant expansion in tertiary education subsidies, offset by cuts in spending on goods and services, transfers to public entities, and investment grants to subnational governments. The consequent fiscal consolidation, in the context of staff's growth projections, results in a decline in the deficit of about 0.4 percent of GDP in 2018 and another similar decline in the medium term. Debt would increase to uncomfortably elevated levels (58–60 percent of GDP in the medium term, Annex V—Public DSA).

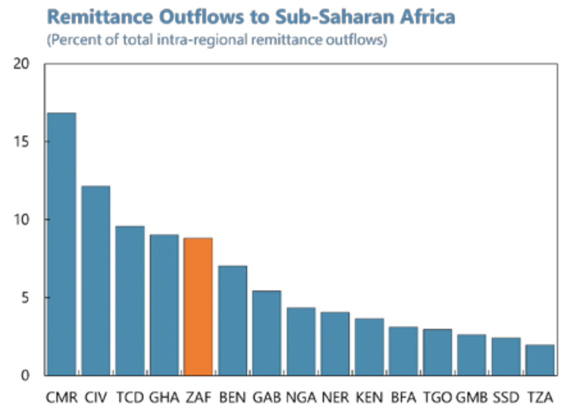
11. The subdued medium-term outlook falls well short of exploiting South Africa's economic potential and could have unwelcome social implications and outward spillovers (Figure 6). An average annual real increase in investment of only around 3 percent constrains GDP growth to below 2 percent—too low to generate meaningful per-capita income gains and reduce unemployment and poverty. Subdued growth in South Africa would also have adverse implications for its neighbors as regional interlinkages through the Southern African Customs Union (SACU) transfers, trade, FDI, and remittances have risen. Financial interlinkages have also strengthened through the presence of large South African banks and the peg to the rand in the SACU.

Figure 6. South Africa: Regional Spillovers from South Africa

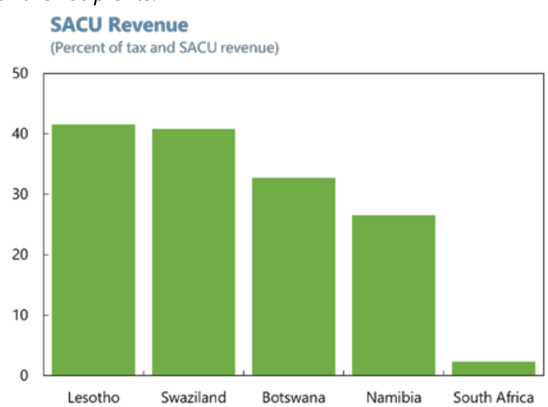
In sub-Saharan Africa, South Africa is a major source of import demand…



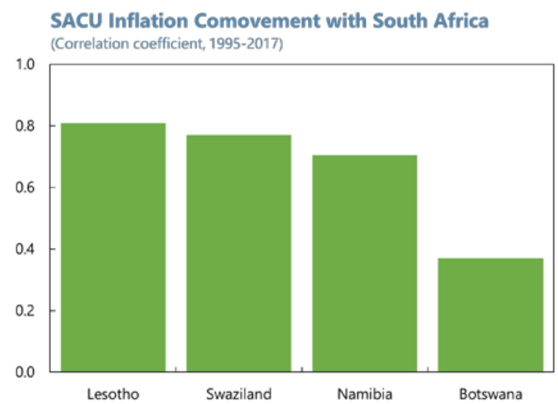
…and remittance outflows.



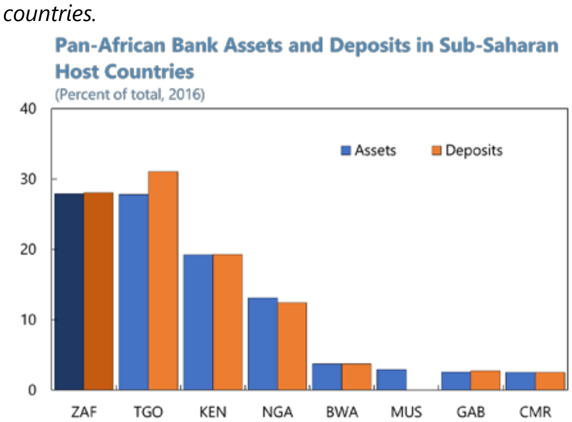
SACU transfers represent an important source of revenue for the recipients.



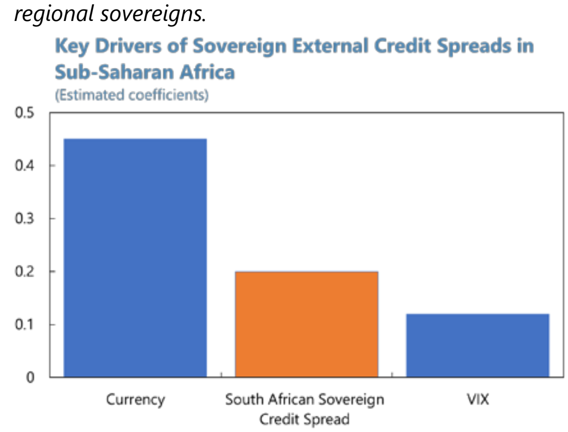
Inflation rates of SACU countries are synchronized with South Africa's via the currency pegs.



South African banks have large operations in regional host countries.



South Africa's sovereign credit worthiness spills over to regional sovereigns.



Sources: Country authorities, IMF WEO, and IMF staff calculations.

***Authorities' Views on the Baseline Scenario*:**

12. The authorities' baseline growth outlook is broadly aligned with staff's projections for the near term, but more optimistic for the medium term. Considering the ongoing improvement in confidence and actions taken to strengthen SOEs' governance, the National Treasury projects a greater recovery in private consumption and public investment, leading to GDP growth of about 2.5 percent in the medium term. In the SARB's projections, the inflation outlook is aligned with staff's, while the current account deficit deteriorates marginally faster on account of a slightly sharper worsening of terms of trade and the income account.

RISK ASSESSMENT

13. The economy has a range of buffers but remains subject to vulnerabilities (SIP 3–Buffers, Figures 7 and 8). The floating exchange rate absorbs shocks, the financial markets are deep, and large pension fund assets provide a solid domestic investor base. Moreover, South Africa's susceptibility to exchange rate risk is limited by its relatively low foreign currency exposures; the public sector's rollover risk is contained by its long debt maturities; and foreign exchange reserves are complemented by access to segments of the global financial safety net. However, significant vulnerabilities arise from SOE-related fiscal risks, large gross external financing needs, and a current account deficit financed by flows that are prone to sudden slowdowns or reversals in response to abrupt changes in global financial conditions and sovereign credit ratings (short-term external debt at remaining maturity stood at above 14 percent of GDP at end-2017).

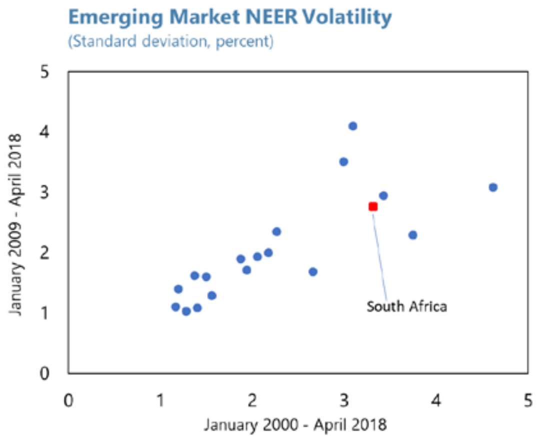
14. There are upside risks to the baseline scenario, but downside risks seem more prominent. On the upside, with the necessary political consensus to address structural bottlenecks, South Africa has broad-based potential to boost growth beyond 2 percent. Downside risks arise from domestic and external sources (Annex VI—Risk Assessment Matrix). Should financial market sentiment toward EMs worsen, potentially combined with the materialization of downside domestic risks, capital outflows could increase significantly (SIP 3—Buffers).

- ***Domestic risks***. Renewed spending pressures (e.g., education subsidies, public sector wages, and materialization of SOE contingent liabilities) would worsen public finances, and could trigger additional rating downgrades and increase financing costs. Continued policy uncertainty would dampen capital inflows, investment, and growth. Protracted low growth would weaken the domestic financial system.

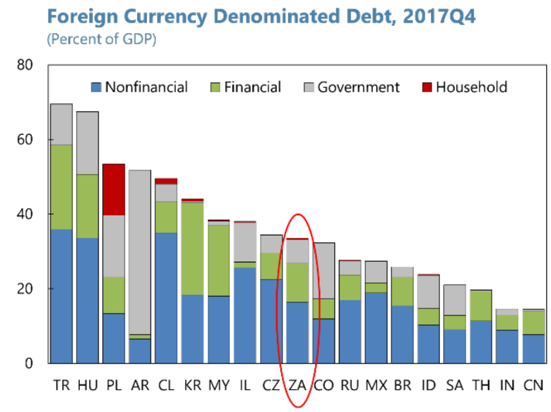
- ***External risks***. Tighter global financial conditions arising from a sudden change in global risk appetite (e.g., due to U.S. monetary policy or contagion from other EMs) could lead to capital outflows, challenging South Africa's ability to meet its large gross external financing requirements (Annex VII—External Debt Sustainability Analysis (DSA)). The consequent significant exchange rate depreciation could create inflation risk. Structurally weak growth in key advanced markets, disruption in trade flows arising from a retreat in cross border integration, or a fall in commodity prices (minerals and precious metals) would worsen the twin deficits and dampen growth.

Figure 7. South Africa: Buffers

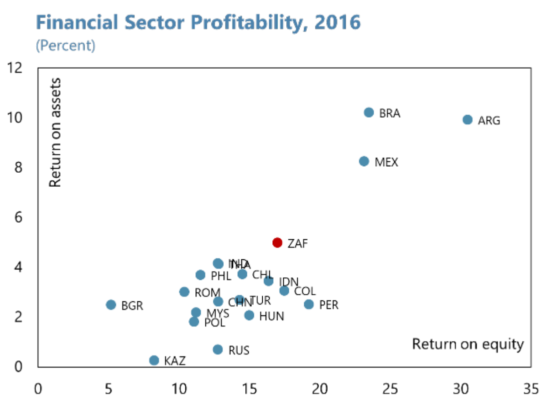
The rand volatility is high due partly to the floating exchange rate regime...



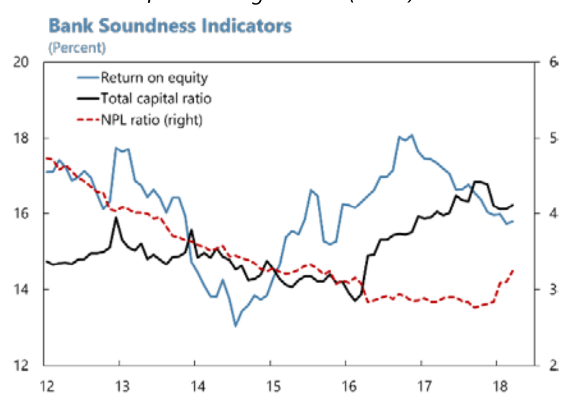
...while South Africa does not stand out in terms of the stock of foreign currency debt.



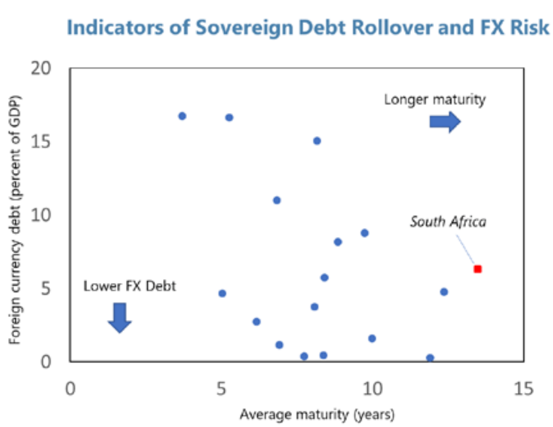
Financial corporates are profitable.



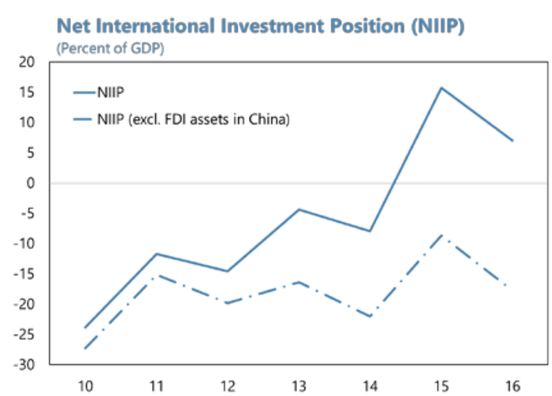
Banks are strong, despite soundness indicators having moderated after new regulations (IFRS9) were introduced.



Sovereign debt is largely in rand and have long maturities.



The net IIP is positive, with important exposures to China.

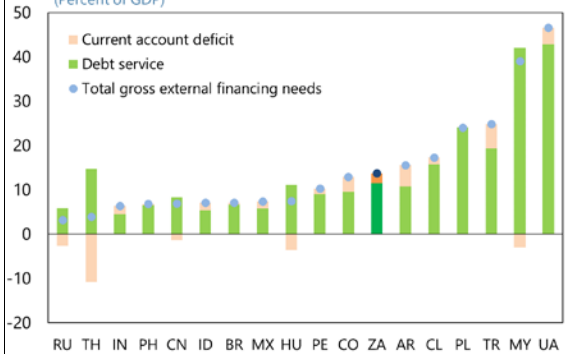


Sources: BIS, CDIS, Haver Analytics, IIF, IMF CVU, SARB, and IMF staff calculations.

Figure 8. South Africa: Vulnerabilities

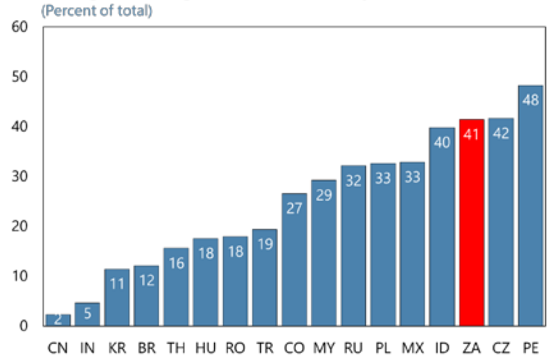
Gross external financing needs are relatively large.

Gross External Financing Needs, 2017
(Percent of GDP)



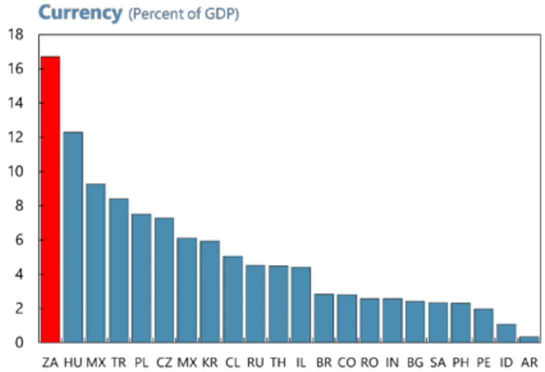
Nonresidents hold a large share of local currency government bonds.

Foreign Holdings of Local Currency Government Bonds
(Percent of total)



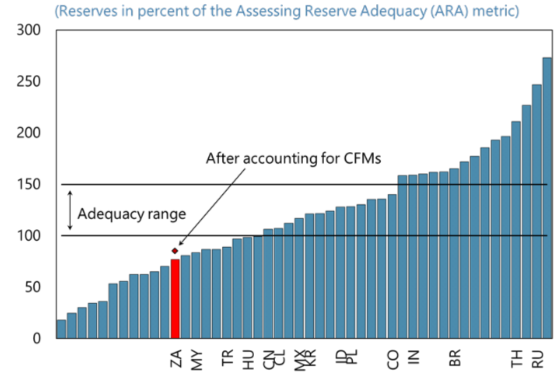
Global FX turnover is large relative to the size of the economy.

Daily Average Turnover of OTC FX Instruments by Currency (Percent of GDP)



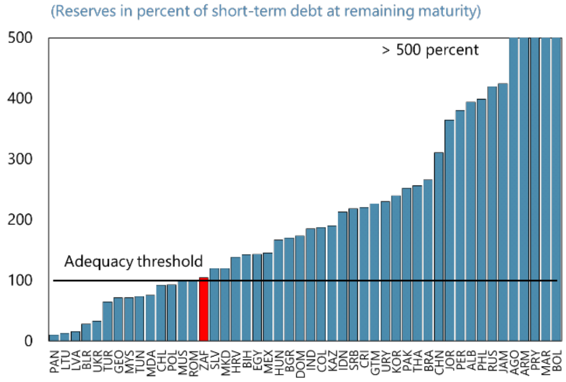
There is room for increasing the stock of FX reserves.

Reserve Adequacy Based on the ARA Metric, 2016
(Reserves in percent of the Assessing Reserve Adequacy (ARA) metric)



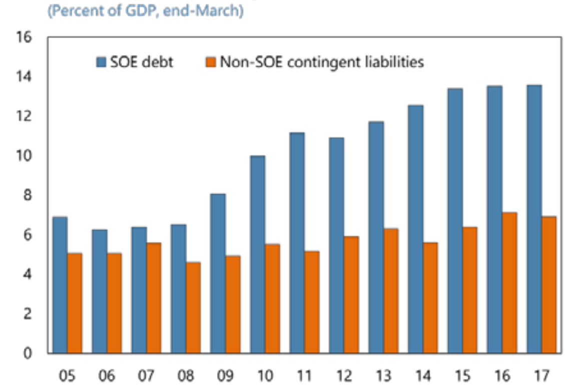
Reserves relative to short-term debt are above adequacy but do not compare favorably with other economies.

Reserve Adequacy Based on Short-Term Debt, 2016
(Reserves in percent of short-term debt at remaining maturity)



SOE debt continued to increase.

SOE Debt and Contingent Liabilities
(Percent of GDP, end-March)



Sources: BIS, IIF, IMF WEO, and IMF staff calculations.

Authorities' Views on the Risk Assessment:

15. The authorities broadly agreed with the main sources of risk identified by staff. Strong macroeconomic fundamentals and institutions would mitigate the likelihood of contagion to South Africa from market volatility in other EMs. Treasury officials noted potential upsides to growth from the implementation of structural reforms. SARB officials highlighted the resilience of the South African economy, including by noting that a large share of gross external financing needs is denominated in rand. It also agreed that there could be room for accumulating foreign exchange reserves as opportunities arise. The SARB's enhancements to its financial stability framework will further the analysis of interconnectedness among financial intermediaries. The Financial Sector Contingency Forum (FSCF) conducted additional simulations to assess a range of risks.[5]

REFORM SCENARIO: COMPLETING UNFINISHED TASKS

16. Staff presented an illustrative scenario that incorporates the impact of implementing a bold and comprehensive package of reforms together with a rebalancing of the policy mix.

- ***Structural reforms*** should aim at attracting private investment, including by encouraging product market competition, making labor markets more flexible and addressing skills mismatches, tackling corruption and leveraging digitalization (Figure 9). By leveraging the full potential of a young and growing population, the existing capacity in all economic sectors, and the opportunities provided by digitalization, growth could increase significantly above the baseline. While advancing these reforms is not an easy task, South Africa has the potential to implement them successfully now that the domestic environment is more conducive to reforms (Text Figure 2).

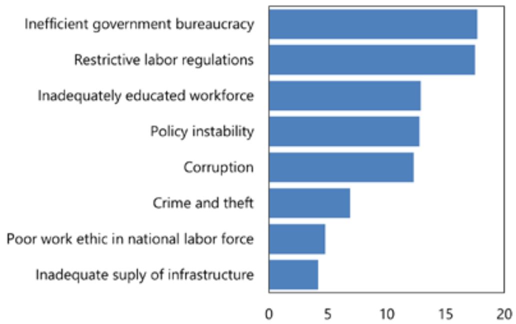
- ***A well-calibrated policy mix*** needs to supplement the needed reform agenda over the medium term. The rapidly shrinking fiscal space has left little room for policy stimulus. A somewhat contractionary policy mix beyond what is already planned, would be needed over the medium term to build up policy buffers. The inflation targeting (IT) framework could be enhanced to support the SARB's stated intention to bring inflation toward the midpoint of the official target band. Financial sector policy should continue to be mindful of pockets of vulnerabilities.

[5] The FSCF is a financial sector-wide forum, in place since 2002, which became a statutory body in terms of the Financial Sector Regulation (FSR) Act. The FSCF identifies and mitigates systemic risk in the financial system. In October 2017, the FSCF conducted a crisis simulation exercise, facilitated by the World Bank and coordinated by the SARB, as part of its ongoing efforts to strengthen its crisis management capacities.

Figure 9. South Africa: Constraints to Growth

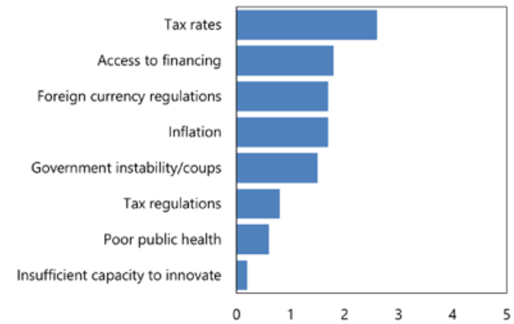
Investor surveys point to inefficient bureaucracy, restrictive labor regulations…

Most Problematic Factors for Doing Business, Top 8



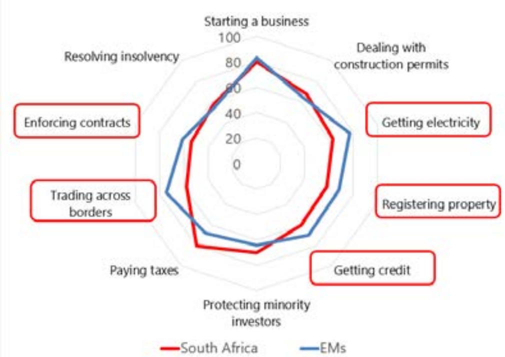
… skills shortages, policy uncertainty, and corruption as the main constraints to investment.

Most Problematic Factors for Doing Business, Bottom 8



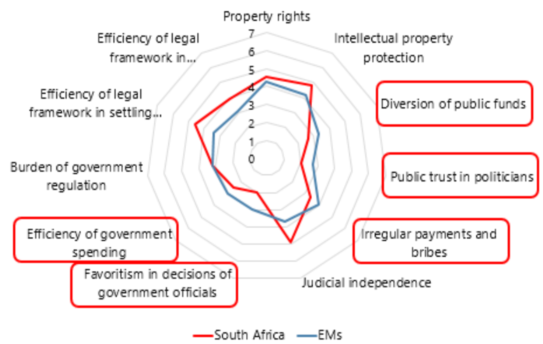
Underperformance in the business environment relative to EMs particularly entail getting electricity and credit, registering property, trading across borders, and enforcing contracts.

Doing Business 2018



"State capture" has weakened institutions, increased inefficiencies, and reduced trust.

GCI Score, 2017-18, Institution Related Part I



Labor relations, hiring/firing practices, and flexibility of wage determination are among the key issues South Africa needs to address.

Labor Related Scores

Sources: Africa Competitiveness Report 2017, World Economic Forum Executive Opinion Survey, World Economic Forum Global Competitiveness Report 2016-17, and IMF staff calculations.

17. Full implementation of the reform package would deliver a sustained private investment-led growth recovery (Text Table 2). Informed by historical trends in private investment and estimates of reform impacts, staff projects that real GDP growth could rise to 4 percent by 2022.[6] A meaningful reduction of unemployment and poverty would follow. Public debt would decline to close to 50 percent of GDP by 2023—as much as 10 percentage points of GDP below that in the baseline scenario. Bank lending would rise, creating virtuous macro-financial feedback loops and further financial deepening. Inflation would decline to the midpoint of the band (4.5 percent) partly as higher competition counter-balances the impact of robust domestic demand. The current account deficit would initially widen as investment-related imports expand, before narrowing as higher competitiveness boosts exports. FDI's contribution to external financing would increase markedly.

Text Table 2. South Africa: Reform Scenario on Policies to Exploit Growth Potential

	2017	2018	2019	2020	2021	2022	2023	2024-2027	2027-2030
Real GDP Growth (percent)	1.3	1.5	2.3	3.0	3.5	4.0	4.0	4.0	4.0
Real Private Investment Growth (percent)	1.2	1.6	3.4	5.5	6.0	6.7	6.6	6.6	6.6
Consumer Price Inflation (percent, period average)	5.3	4.9	5.3	5.8	5.7	5.1	4.5	4.5	4.5
Private Sector Credit Growth (percent)	4.3	5.6	7.3	9.1	10.4	11.5	12.6	12.6	12.6
Private Sector Credit (percent of GDP)	63.4	62.8	62.6	62.7	63.3	64.5	66.9	66.9	66.9
Fiscal Deficit (percent of GDP) 1/	-4.6	-4.3	-3.7	-3.4	-3.2	-3.2	-3.2	-3.1	-3.1
Gross Government Debt (percent of GDP) 2/	53.0	55.0	55.4	54.4	53.0	51.8	51.0	48.4	45.7
Current Account Balance (percent of GDP)	-2.5	-2.9	-3.6	-4.3	-4.9	-4.4	-3.9	-2.2	-1.5
Unemployment Rate (percent)	27.5	27.9	28.0	27.6	26.8	25.6	24.4	21.9	17.3

Sources: Haver, South African National Treasury, and IMF staff estimates and projections.

1/ Consolidated government unless otherwise indicated.

2/ National government.

Authorities' Views on the Reform Scenario:

18. The authorities see space for lifting growth to 4 percent or more should the reforms materialize. The 2018 Budget Review points to growth driven by reforms in the telecommunication sector, lower barriers to entry more generally, and a boost to confidence from reforms. Stronger growth would improve tax buoyancy and expand fiscal space, allowing public debt to stabilize.

[6] The literature suggests that quantifying the impact of structural reforms on growth involves uncertainty, reflecting challenges in measuring the magnitude and timing of the gains. Given the broad-based reforms being considered and the fact that South Africa is more tightly regulated than the OECD average, staff views an increase in growth to 4 percent as achievable. In fact, in the mid-2000s, real GDP growth exceeded 5 percent, supported by steady growth in private investment. However, since 2011, private investment growth has decelerated drastically, with just a marginal improvement in 2017. Had the contribution of private investment to growth been equal to the peak after the global financial crisis, real GDP growth would have reached 3–4 percent, much above the 0.5–1.5 percent registered in recent years. Moreover, as an EM, South Africa (with a GDP per capita of $6,180) has significant catch-up potential relative to other OECD countries. The authorities' own estimates—which combine OECD and South Africa specific parameters—point to growth increasing to 4 percent in the reform scenario.

ADVANCING THE STRUCTURAL REFORM AGENDA

19. Staff advised the authorities to advance the broad package of reforms urgently (Text Figure 2 and Figure 10). Cross-country experiences hint that the growth payoff of comprehensive reform implementation could be large and followed by a durable decline in unemployment. As many other countries, South Africa could benefit from a social compact to convincingly build trust and secure implementation, particularly when addressing areas that generate short-term costs in exchange for sustainable long-term benefits.[7]

Text Figure 2. South Africa: Reforms to Reignite Strong and Inclusive Growth

Strong and Inclusive Growth

Structural Reforms Cover Four Cross-Cutting Areas…

Governance —To ensure efficient use of resources

Product market —To promote competition in business, increase quality, and lower prices

Labor market —To strengthen skills and remove rigidities in employment contracts

Digitalization —To reap the benefits of technological advances

…and Apply to Individual Sectors of the Economy.

Agriculture & Mining	Electricity	Transport & Communication	Finance	Public Sector	Education & Training	Trade & Tourism
Growth friendly land reform	Secure funding, cut costs, and increase revenue of Eskom	Auction broadband spectrum efficiently	Leverage technology to increase competition and foster financial inclusion	Eliminate illegal and wasteful expenditure	Improve basic education	Ease visa regulations
Unlock private investment through regulatory clarify (eg., mining charter)	Optimize energy mix	Targeted transport subsidy for poor	Reduce entry cost	Contain risks from decentralized entities	Train teachers and strengthen their accountability	Limit exclusivity of business leases
Greater farmer access to credit	Increase strategic private sector equity partnership	Establish single transport economic regulator		Reduce red tape	Align training with business requirement	
Affordable agricultural insurance	Transparent electricity tariff determination	Disinvest in port and rail (Transnet, PRASA)		Improve accountability and efficiency of SOEs		
Provide input and training to smaller farmers	Minimize municipal reliance on electricity revenue	Divest SAA				
	Unbundle Eskom					

Sources: Authorities, OECD, World Bank, and IMF Staff.

[7] These include, for instance, Denmark, Ireland, Mexico, the Netherlands, and the U.K. Notably, the Pact of Mexico achieved greater labor market flexibility and legislative changes to boost products market competition, in the context of new social protections guarantees.

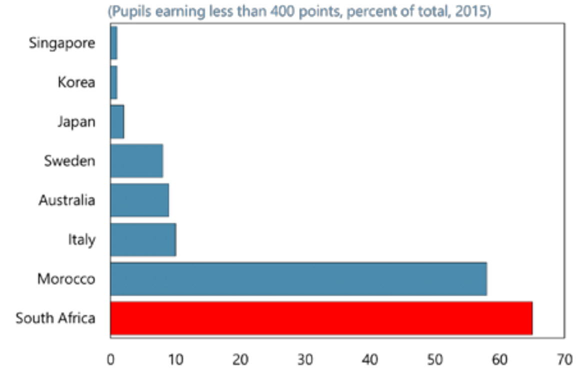
Figure 10. South Africa: Restarting Growth

To revitalize private investment and growth…

Growth of Private Investment and Real GDP
(Percent)

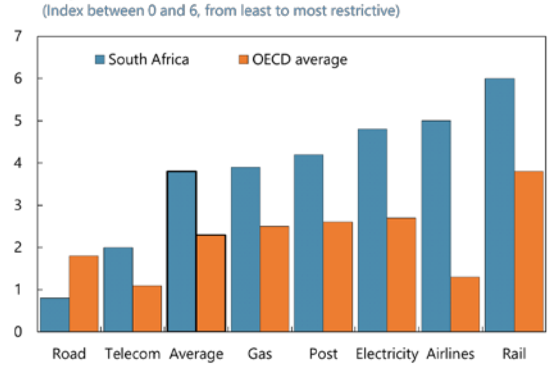
…improve education attainment and skills mismatches …

Selected TIMMS Math Score
(Pupils earning less than 400 points, percent of total, 2015)



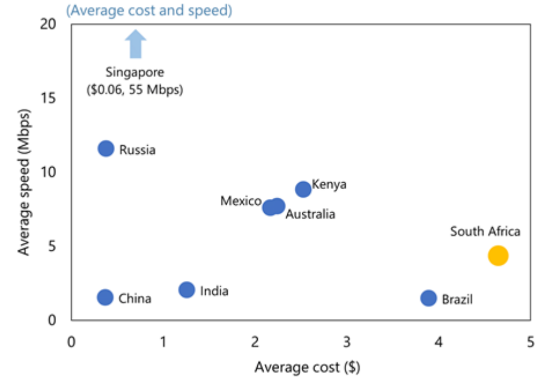
… improve SOEs' performance, including those in key network services…

Regulation of Network Industries
(Index between 0 and 6, from least to most restrictive)



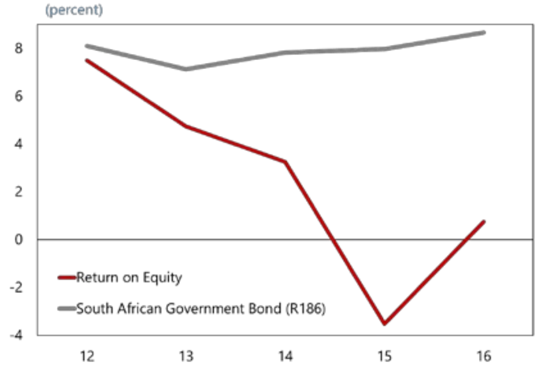
…including in the telecom sector…

Broadband Performance
(Average cost and speed)



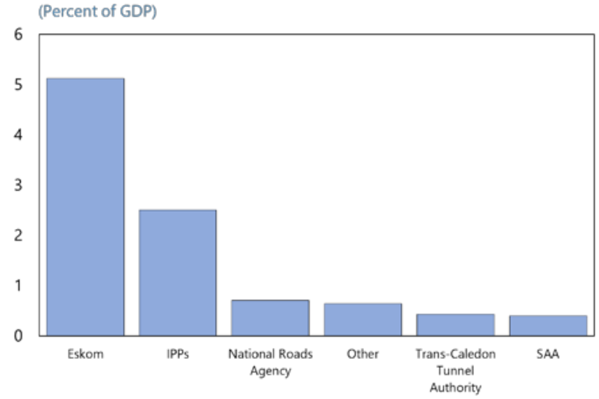
…partly by reducing operating costs…

Returns on SOEs' Equity and Bond Rates
(percent)



…which would mitigate fiscal risks.

Government Guarantees
(Percent of GDP)



Sources: BRDC Continental, Cable.co.uk, OECD, South Africa National Treasury, TIMMS, IMF WEO, and IMF staff calculations.

20. The outlined reforms would help advance the fight against poverty and inequality, particularly if accompanied by targeted interventions to support the poor. Private investment will create job opportunities. Low-income households will benefit relatively more from higher real income, low and stable inflation, a clearer regulatory environment, and lower costs of basic services. Moreover, rightly-tailored government interventions (e.g., increasing the efficiency of health and education spending, and facilitating commute to the centers of economic activity) could usefully complement this impact. These efforts should be supported by fiscal policy, which by design has an income redistributive role, and by monetary policy, which ensures success in achieving low and stable inflation, in turn benefiting the disadvantaged more (Box 2).

Box 2. Distributional Impact of Fiscal Policy and Low Inflation

Fiscal Spending Distribution (SIP 2—Inequality).

- Fiscal policy plays an important role in addressing poverty and inequality in South Africa. Compared to other EMs, cash transfers are larger and tax revenues rely more on progressive direct taxes.
- An analysis of fiscal incidence based on the latest survey data suggests that the tax system is mildly progressive while social spending is progressive. Notably, targeted transfers are more cost effective in reducing income inequality than in other EMs.

Inflation (Annex VIII—Inflation and Inequality).

- The SARB has successfully maintained low and stable inflation. Inflation was anchored at the upper end of the 3–6 percent target range in the 2010s and has recently fallen to around the midpoint.
- Econometric analysis hints to mildly progressive effects of monetary policy effort to keep inflation low. That is, the poorest have benefited the most or have been hurt the least in terms of real spending.

21. Sequencing reform implementation adequately is important. Staff advised bringing to fruition the ongoing effort to tackle governance and corruption issues, as well as urgently completing stalled reforms to reduce regulatory uncertainty and rebuild trust. Some key product and labor market reforms could be implemented expeditiously (see Sections B and C). While some reforms will require longer time to implement, as they need to go through the parliamentary decision-making process, they should be initiated as soon as possible.

22. Notwithstanding the broader benefits to the economy, these reforms will entail costs. There may be a need to compensate those negatively affected by the reforms by incurring fiscal costs, and deal with strikes and disruptions in reaction to perceived losses in acquired rights. At the same time, governance reforms in the areas of procurement and SOE operations have the potential to reduce government costs and even return to the government some of the illegally procured wealth. The longer-term financing needs of SOE restructuring could also be aided by increased equity participation from the private sector.

A. Improving Governance and Fighting Corruption

23. Noting that governance weaknesses in South Africa are macro-critical, staff welcomed the efforts of the new administration to combat corruption and reestablish trust. "State capture" weakened institutions and increased inefficiencies by distorting the playing field for investors, reducing tax revenue, and creating incentives to circumvent regulations to deviate from good public procurement practices. (Annex I—Governance). The Auditor General estimated irregular and wasteful expenditure at around 1 percent of GDP. A forceful anti-corruption drive has started and has the support of civil society (Box 3).

24. Institutional frameworks and institutional capacity need to be rebuilt. The economy will benefit from reversing the practice of non-adherence to already existing good laws and regulations, and giving anti-corruption institutions greater autonomy and independence in the conduct of their functions. Further improving corporate governance, and building checks and balances will help support the ongoing governance initiatives. This includes implementing measures related to customer due diligence, beneficial ownership, asset declarations, and politically exposed persons that can support an effective AML/CFT framework and improve governance.

Box 3. Recent Actions Taken by the Government to Fight Corruption and Improve Governance

- **Change in SOEs' boards and management**. The management teams of Eskom, Denel, SAA, and other SOEs were changed following governance concerns.
- **Strengthening of checks and balances**. Public procurement has been strengthened by enforcing adherence to existing laws and leveraging digitalization for monitoring and transparency. To limit political pressures from line ministries, the role of non-executive directors of SOEs in procurement was curtailed.
- **Action by the Asset Forfeiture Unit**. The unit identified and sanctioned individuals after an empowerment scheme was circumvented and the benefits captured by a few individuals.
- **Revamping of the South African Revenue Service (SARS)**. The SARS commissioner was suspended and a commission of inquiry into tax administration was established to restore the institution's capacity and credibility.
- **Prosecution of politicians and advisory firms**. The National Prosecuting Authority pressed charges of fraud, racketeering, and money laundering against politicians. Major advisory firms had their accounts frozen, and others were fined and barred from conducting business with the government.

B. Advancing Product Market Reforms

25. The adverse impact of policy uncertainty and regulatory overreach has hindered private investment. Several regulations are tighter than in most OECD countries and South Africa's peers, while others reflect flawed application of state-approved regulatory requirements by government entities, particularly SOEs. As a result, services are more inefficient and costly than in peer countries, including for telecommunications, water, transport, and electricity, with adverse implications for competitiveness. Staff called for a streamlined and more transparent regulatory environment to foster policy predictability, rebuild trust, unlock long-term investment, and benefit the poor.

26. Three key product market reforms could be implemented in the near term to signal the decision to encourage private investment and reap the benefits of digitalization. The cabinet approved a private sector participation framework that could support these reforms.

- ***Attracting investment to the mining sector***. Despite its potential, South Africa ranks low on investor perceptions in mining. The earlier adoption of a mining charter without adequate consultation has exacerbated policy uncertainty and further complicated investment prospects.[8] Staff recommended a consensual revision of the charter, involving all stakeholders, as a crucial step to turn around mining activity—and with it spur exports and job creation, and benefit sectors with linkages to mining (electricity, timber, and banking).

- ***Reducing the cost of broadband***. South Africa has slower internet speed and higher data prices than most comparators. Staff advised expediting the allocation of broadband spectrum through auctions and leveraging private sector capabilities. A more cost-efficient network would foster technology adoption and innovation, with broader spillovers.

- ***Maximizing the benefits of social grants to the poor***.[9] The mode of cash transfers delivery is eroding the benefits from an otherwise effective social protection system. Intermediaries often prompt beneficiaries to get costly contracts for other services. Staff supported introducing new service providers in the delivery of grants to reduce intermediation costs and enhancing financial literacy to improve spending decisions.

27. Other reforms in the products markets may take longer to be completed but should be also expeditiously started. These include (i) leveraging the forthcoming competition bill to rethink the role of SOEs in the economy to improve market structure in key network industries, price determination, and economic competitiveness; and (ii) clarifying the framework governing the proposed land reform to deter uncertainty.

Addressing SOEs' Challenges

- ***SOEs have a dominant presence and weak finances***. Governance weaknesses, flawed procurement, and overstaffing are sources of fiscal vulnerability.[10] Eskom—the large monopoly that generates, transmits, and distributes electricity—struggles with balance sheet and liquidity problems (Annex II—Eskom). Transnet, the transportation company, faces inefficiencies that permeate into the economy such as high freight costs. Denel, the defense and logistics company, suffers from governance slippages. Recent developments in aviation

[8] A revised mining charter has been issued recently for public comment.

[9] Court rulings have determined that the contract to *Cash Paymaster Services* was marred by irregularities and had to be voided.

[10] SOEs receive government funds for more than 1 percent of GDP annually in the form of direct transfers, subsidies, and recapitalizations. Government guarantees for growing SOE debt represent 56 percent of all contingent liabilities, equivalent to 9 percent of GDP.

companies (SAA, SAA Express, and Mango) expose the fundamental weaknesses of the national airline industry.

- ***Staff advised considering well-defined strategic equity partnership in key segments of business in line with the authorities' private sector participation framework*** (Box 4). There is limited fiscal space for government recapitalization of SOEs, and inefficiencies have translated into higher costs for consumers. Thus, private sector participation is warranted, and its modalities need to be carefully assessed to maximize benefits for the population, paying attention to ownership patterns. In any event, sectoral regulations should be clarified, costs should be optimized, the complex ownership oversight models and procurement contracts should be reviewed, and SOEs should be commercially run.

Box 4. Improving Efficiency and Reducing Fiscal Costs of SOEs

The authorities aim to improve the governance of SOEs, stabilize their balance sheets, and reassess their strategic orientations. In doing so, some key elements need to be considered:

- ***Consider strategic equity partnership***. Market discipline can increase incentives for greater efficiency. The airline and transport industries are key candidates. Also, countries that have successfully unbundled their electricity utilities and benefited from modern technologies have opted for increased competition and private participation.
- ***Improve SOE governance***. Good practices point to introducing a unified legal framework for SOEs, consistent with the PFM Act and corporate laws, to improve oversight and accountability, including by centralizing the oversight of SOEs. Board appointments must be competency-based and their independence ringfenced from undue political interference. Board accountability must be improved through clear and focused legal mandates.
- ***Reassess business models***. Many SOEs face outdated business models. In Eskom, for example, the emergence of greener and cost-efficient sources makes coal an increasingly uncompetitive option for electricity generation, pointing to the need to reassess the company's generation mix for its longer-term viability.
- ***Run SOEs commercially, and compensate them for any public service obligations through budget transfers***. For greater transparency and awareness of budget constraints, consider, for example, paying for the provision of electricity subsidies to poor households through budget transfers rather than cross-subsidization schemes.
- ***Avoid risky contingent liabilities***. Any government guarantees of SOE debt, if indispensable, should be contingent on turnaround plans with well-specified implementation performance targets.
- ***Stabilize operations***. On the expenditure side, there is a need to review expensive and improperly allocated contracts without disrupting supply, review the size of the workforce and compensation packages, rebuild R&D capacity, and discontinue non-core operations. On the revenue side, reviewing pricing models, selling non-productive assets, and collecting arrears are crucial.

Clarifying Land Reform

- ***There is high demand for land redistribution given historical legacies***. The Constitution allows for land expropriation in public interest with compensation. A parliamentary committee is reviewing whether expropriation without compensation is feasible to address the demand for land (Box 5).

- **Staff recommended the authorities to expedite action to remove uncertainty about property rights and tenure security**. In a way, this debate is undermining the credibility of the government's stated priorities to attract investment. In line with best international experience, land reform should focus on enhancing agricultural productivity, improving land administration to strengthen security of tenure, and reducing poverty. At the same time, there is a need to mitigate any potential negative effects of land reform on the agricultural base and the financial spillovers from changes in the value of land as collateral.

Box 5. Land Reform Considerations

Land reform. In 1994, the government initiated land reform to address skewed ownership through land redistribution, restitution, and tenure. However, land reform has not progressed as envisaged because of insufficient planning and post-settlement difficulties.

Land redistribution. Given high demand for land redistribution, "land expropriation without compensation" is being considered. The government will have to finely balance social and economic considerations when deciding the type of land to be redistributed and the modalities surrounding the process to make land tenure more productive. The "without compensation" clause, which has accentuated uncertainty over property rights, is identified as a concern for investment.

C. Increasing Labor Market Flexibility and Improving the Quality of Basic Education

28. The rigid labor market practice that hinders job creation by inflating labor costs needs to be revisited.[11] Wage agreements between large unions and businesses through a centralized wage settlement process are imposed on SMEs and other firms that often cannot afford them given very different business models. Wage levels thus become too high to absorb the unemployed. Further, wage increases exceed the pace of productivity improvements in several economic sectors, presenting a barrier to entry, and limiting competition and opportunities for investment. A large group of youth is at risk of social exclusion—one in two young people in the labor market is unemployed and nearly one in three young people is neither in employment, education, nor training (NEET).[12] Staff recommended finding ways of ensuring that collective bargaining agreements are not binding for those not involved in negotiation. Employers and workers should be able to agree on wage levels and increases based on economic needs and the pace of productivity gains.

[11] Labor costs also rise due to shortages of skilled labor, high costs of commuting long distances, hiring and firing barriers, and onerous costs for resolving labor disputes.

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

29. The impact of the new national minimum wage (NMW) on employment will need to be carefully monitored to minimize possible adverse employment effects. The planned introduction of NMW legislation and a code of good practice for collective bargaining has the potential to improve living standards for millions of workers, and reduce the likelihood of disruptive and protracted strikes.[13] However, the envisaged wage level is relatively high by international standards and may have adverse employment effects on SMEs and the youth, with the possibility of increased informalization. Therefore, the authorities should stand ready to introduce complementary measures, such as temporary exemptions from the NMW.

30. Consideration should also be given to reducing hiring and firing barriers, and facilitating the settlements of labor lawsuits. Dismissal of workers for performance reasons often entails a protracted court process and significant compensation costs, reducing the incentive to hire. To mitigate these constraints, relevant regulations could be reviewed with a view to streamlining the settlement of labor lawsuits and limiting compensation for dismissals. Temporary workers would remain an important source of labor supply and employment.

Box 6. Addressing the Challenges of Low Education Quality[1]

Low Education Quality. South Africa suffers from low educational quality by almost any metric. Although school enrollment has improved, most learners do not have the requisite literacy and numeracy skills commensurate with their grade levels.

Explanatory Factors. While South Africa's education budget is comparable to that of the OECD countries and exceeds that of most peer countries, low educational quality is associated with poor content knowledge of teachers, history, race, language, geographic location, and socio-economic status. Poor education achievement constrains productivity growth.

Addressing the challenge

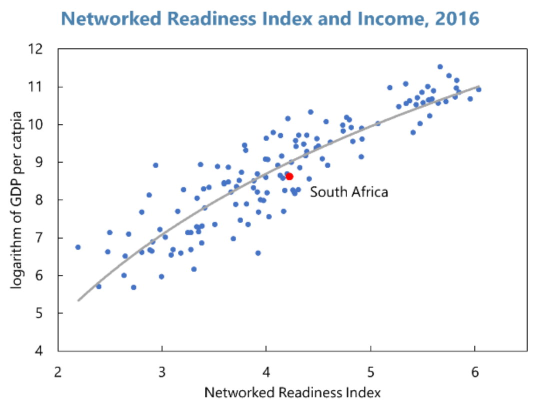
- *Teacher-side and leader-side interventions*. Providing continuous and localized teacher training in pedagogy and subject matter knowledge. Enhancing principals' roles to include instructional leadership. Increasing accountability of teachers, including by sanctioning absenteeism.
- *Parent-side interventions*. Providing additional support to school governing bodies to make schools more accountable. More frequent face-to-face meetings between teachers and parents.
- *Student-side interventions*. Providing every learner with textbooks and other learning tools. Assigning frequent homework to improve learner performance.
- *Other interventions*. Making national assessments mandatory at lower levels of education and having them externally monitored.

[1] Mlachila and Moeletsi, forthcoming, "Failing to Make the Grade: A Review of the Causes and Consequences of South Africa's Low Educational Performance," African Departmental Paper. This paper contains an extensive literature review, including work done by the World Bank.

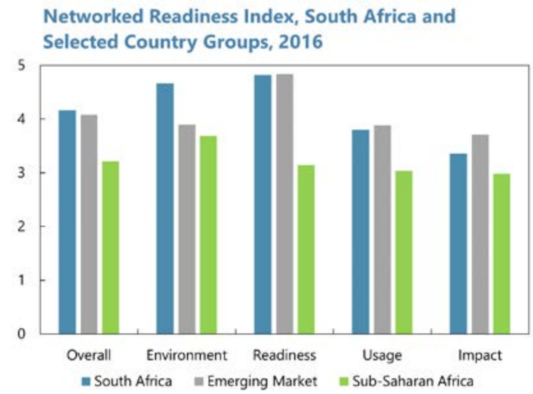
[13] See the 2017 Article IV Staff Report Annex X for details. The NMW was approved by the Parliament in May 2018.

Figure 11. South Africa: Readiness for Digitalization

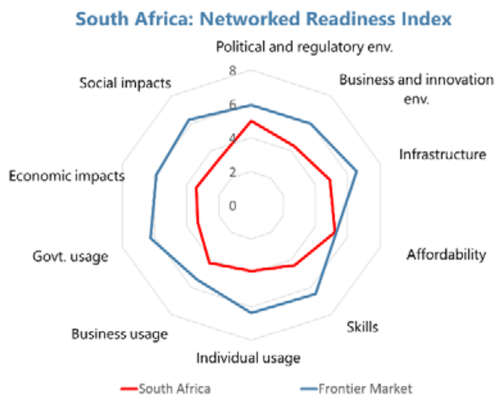
South Africa's network readiness is at par with its income level…



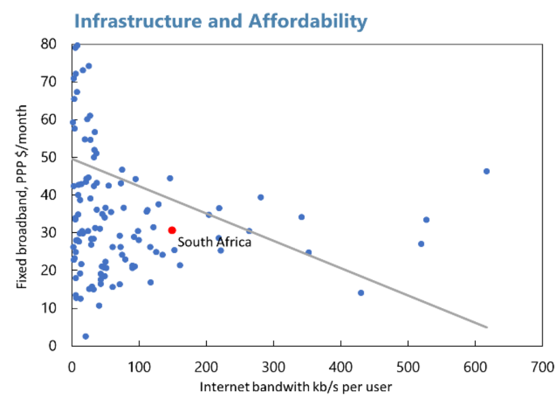
…its scores are higher than the EM and SSA averages.



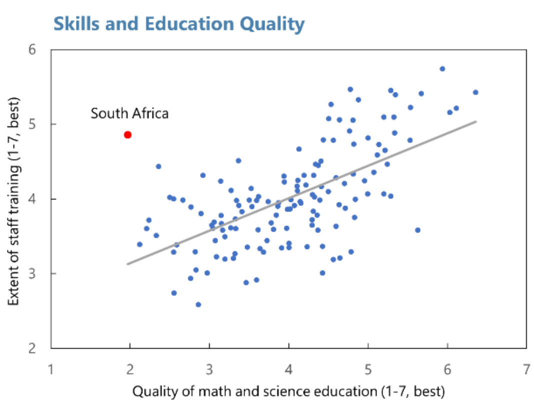
However, some areas represent challenges.



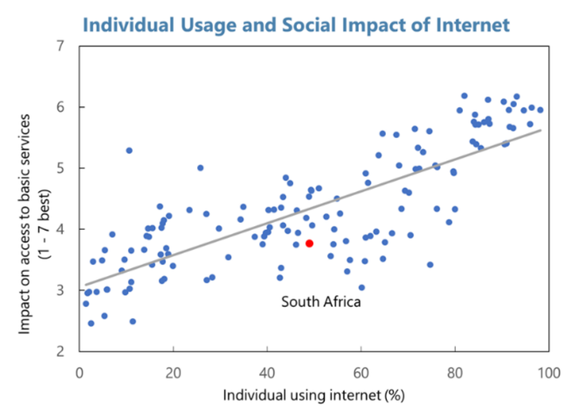
Particularly, the cost of data is significantly higher than that for its main competitors, although bandwidth is improving.



Staff training and availability can be improved further.



Increasing internet usage is critical for digitalization.



Sources: World Economic Forum Global Technology Report 2016, and IMF staff calculations.

31. To reduce skills mismatches, basic education outcomes and vocational training need to be improved. Companies that generate jobs often find it difficult to obtain the employees they need, and workers that are unemployed do not find jobs that suit their skills. This mismatch is largely related to education weaknesses (Box 6). While improving the quality of education would take time, more immediately, the restrictions for skilled immigrants need to be eased to mitigate skills shortages.

D. Leveraging Digitalization

32. Digitalization is at the core of the authorities' and private sector's agenda (Figure 11). The government's new emphasis in electronic processing of tax submissions, refund payments, and customs declarations saves time and reduces costs. Procurement by SOEs, provinces, and local governments is now aligned to the central government portal to promote transparency and competition, and support law enforcement agencies. The recently established Fintech Unit of the SARB is already seen as a regional model. It is now piloting interbank clearing and settlement using distributed ledger technology. Market players are also modernizing business models, with emerging SME financing, mobile banking, and student financing companies. Companies are exploring ways of leveraging technology to promote financial inclusion.

33. South Africa has the potential to leverage its regional leadership in digitalization. Several multinational corporations manage their African operations from South Africa. However, to compete globally—scalability matters significantly for some market segments—infrastructure and skills constraints need to be addressed. Lowering the cost of data will support digital inclusion.

Authorities' Views on the Structural Reform Agenda:

34. The authorities strongly concurred with staff's views on the urgency to advance structural reforms. They are committed to continuing reforms to attract private investment and generate jobs.

- ***On poverty and inequality***, the authorities assign utmost importance to job creation. Targeted fiscal transfers will continue to play a key role, and the efficiency of government services, particularly in education and health is to be enhanced. They also intend to support those migrating to regional economic hubs to address broader spatial inequalities, while acknowledging the contribution from a more efficient transportation sector.

- ***On product markets***, the authorities are aware that clarifying the regulatory environment is crucial for attracting private investment, including as part of SOE reform. They see the appointment of new Board members and the establishment of a Presidential SOE Council as a major step for SOE turnaround, and indicated that a process to assess areas for strategic private equity partnership is underway. The negotiations on the mining charter are in the final stages. The release of broadband spectrum needs to be urgently prioritized. As for land reform, the authorities noted the sensitivities surrounding the issue, and emphasized the government's commitment not to jeopardize economic growth and food security.

- ***On labor markets***, the authorities do not see a short-term change in centralized wage settlements as viable. However, they are taking action to bring more people to the labor force, including by aligning educational outcomes to business needs through support for apprenticeships of the youth in cooperation with the private sector. Access to work is expected to benefit from the expansion of affordable and integrated public transport systems, and urban development interventions.

- ***On governance***, the authorities noted the complexity of the anti-corruption process, particularly related to uprooting already established networks, but were confident of succeeding. They see the cases of fraud under judicial review and the efforts to rebuild institutional capacity in various governmental agencies, including in the SARS, as key and unprecedented events. They welcomed the suggestion to undertake a review of government regulations to streamline procedures to facilitate business and reduce corruption opportunities. They also noted the forthcoming strengthening of the legal power of the Auditor General to transmit findings to law enforcement agencies for potential prosecution.

- ***On digitalization***, the authorities see it as a tool to improve governance, increase efficiency, facilitate payments, and promote financial inclusion. Big data approaches are being used to monitor adherence to good governance practices. Product developments in the private sector point to the dynamism of the South African technology industry. However, digitalization is disrupting the jobs market by reducing the scope for job creation in traditional industries, and increasing the need to train the workforce of the future.

STABILIZING DEBT AT COMFORTABLE LEVELS

35. Public debt as a share of GDP has doubled in the last decade due to elevated primary expenditure and interest payment levels amid low growth (SIP 1—Debt, Annex V—DSA, Figure 12). Driven by significant spending expansion—which was used as stimulus during the global financial crisis and continued after it—and a slowdown in real GDP growth, the fiscal deficit widened markedly and public debt expanded from 27 percent of GDP in FY07/08 to 53 percent in FY17/18. The doubling of debt, accompanied by a six-fold increase in public gross financing needs (to about 12 percent of GDP in FY17/18), has deepened expenditure rigidities, and reduced capacity to smooth business cycles and react to temporary shocks.

36. Staff called for building fiscal space by targeting a more conservative debt level than contemplated in the budget. Noting that the past doubling of debt was not foreseen, staff recommended basing debt projections on more conservative growth assumptions. While the current fiscal anchor—the nominal primary spending ceiling—has the advantage of reducing pro-cyclicality, it usually does not flexibly adjust to revenue shortfalls. To contain debt accumulation and the consequent growth in debt service costs, staff recommended subjecting macroeconomic assumptions to independent scrutiny (e.g., a fiscal council or a panel of experts), or alternatively, complementing the expenditure ceiling with an explicit debt ceiling. Other EMs have found a debt ceiling suitable to help secure room for counter-cyclical fiscal policy in the future.[14]

37. Increased expenditures responded mainly to large and rigid allocations to wages. The public wage bill is high compared to that of other EMs, driven by high compensation—public employment (as a share of working age population) is lower than the peer average but wage payments (as a share of GDP or public expenditure) is well above the EM average. Moreover, the wage bill increased beyond budgeted levels, forcing compression in investment grants and other items that are more growth-enhancing. A meaningful reduction in the wage bill would improve budget soundness, and flexibility and spread more fairly the burden of adjustment. Staff estimates that replacing only half of officials expected to leave public employment and limiting wage indexation to strict CPI would result in savings of about 1 percent of GDP by FY21/22.

38. Under staff's baseline projections, some additional fiscal tightening will be needed to stabilize debt and rebuild buffers. Staff proposed a growth friendly fiscal consolidation of ¾–1 percent of GDP over the next three years. Wage savings should be the priority measure, complemented by measures to boost efficiency of other current spending while supporting social outlays, including by better targeting education subsidies; making transfers to public entities contingent on downsizing; and eliminating irregular and wasteful expenditure. Staff also advised strengthening tax administration to reduce transfer pricing and profit shifting. The proposed consolidation represents a reasonable trade-off between adjustment and growth given its gradualism and the relatively modest size of the multipliers.[15]

Authorities' Views on Fiscal Policy:

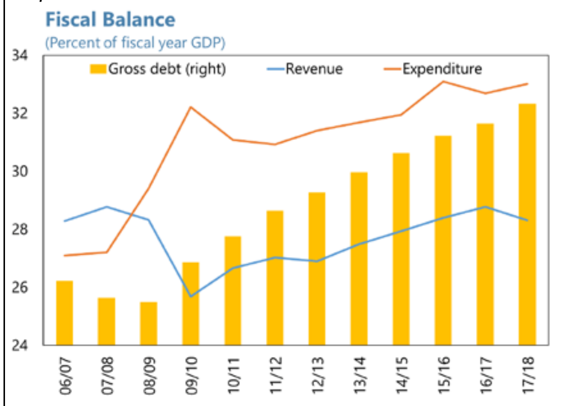
39. The authorities acknowledged the additional role fiscal policy could play in stabilizing debt, but highlighted the need to reignite growth to durably achieve that goal. They noted that the countercyclical approach they took with the nominal expenditure ceilings contributed to the debt accumulation. They added, however, that current expenditure has already been significantly cut to accommodate other priorities, and that the rigid nature of wages in South Africa makes it a general economic issue rather than a fiscal one. In this context, the authorities highlighted the need for structural reforms to accelerate growth and achieve a durable stabilization of the debt ratio.

[14] According to FAD's fiscal rules database, 14 EMs had national expenditure rules (ER) as of 2015. In most of them, the ER is accompanied by a debt rule (Botswana, Brazil, Bulgaria, Croatia, Ecuador, Georgia, Namibia, Peru, Poland, and Romania).

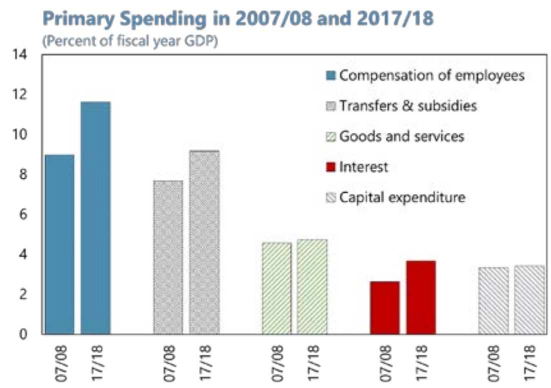
[15] Using the approach in Batini *et al.* (2014), "Fiscal Multipliers: Size, Determinants, and Use in Macroeconomic Projects", staff estimates first-year fiscal multipliers in South Africa to be between 0.4–0.9.

Figure 12. South Africa: Stabilizing Debt

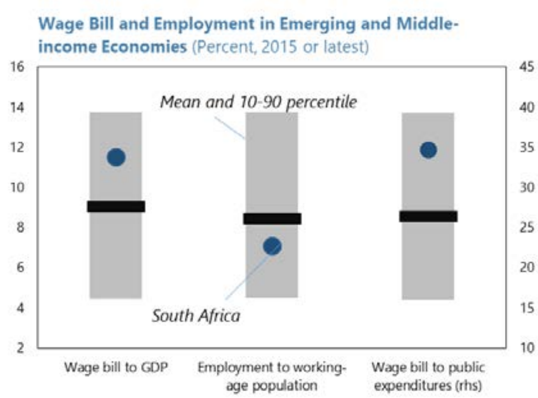
Public debt has increased mainly due to increases in public expenditure…



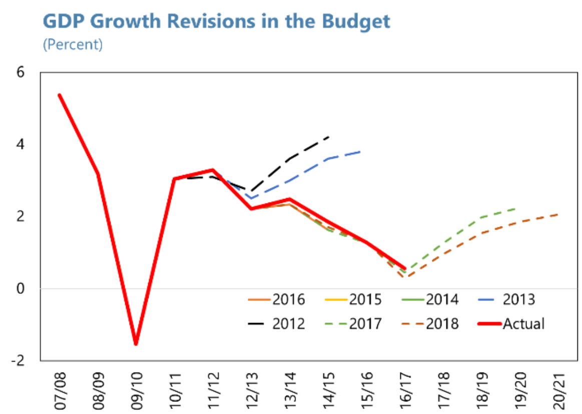
…especially on wages and salaries…



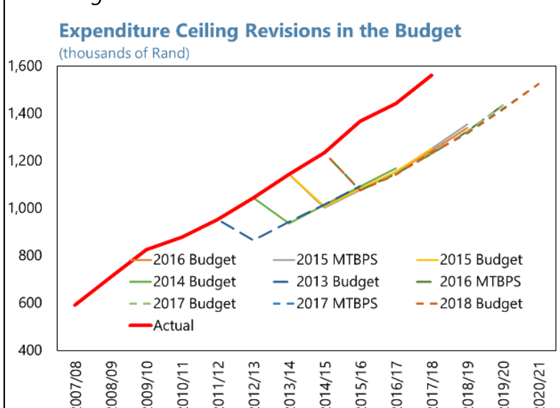
…due to relatively high compensation expenditure.



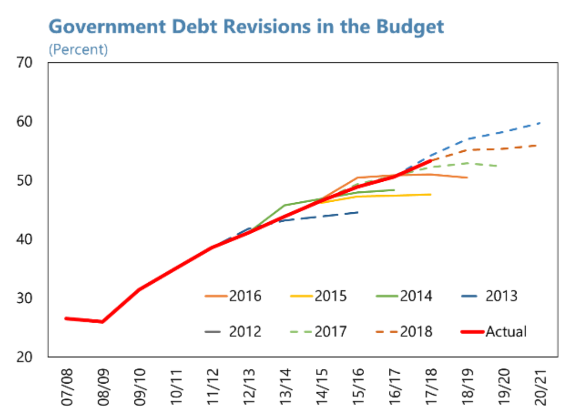
Despite growth having been revised significantly lower, …



…nominal primary spending ceilings were kept broadly unchanged…



…and gross debt projections systematically revised up.

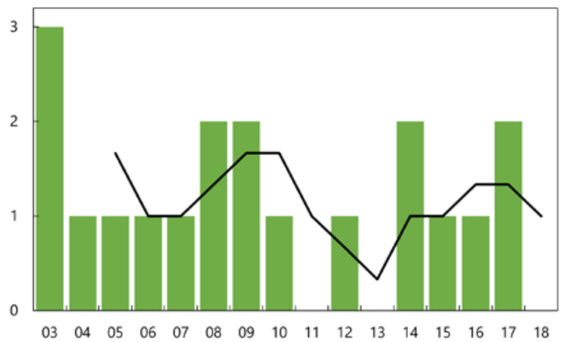


Sources: FAD Expenditure Assessment Tool, IMF WEO, South Africa National Treasury, and IMF staff calculations.

Figure 13. South Africa: Anchoring Inflation Expectations and Financial Stability

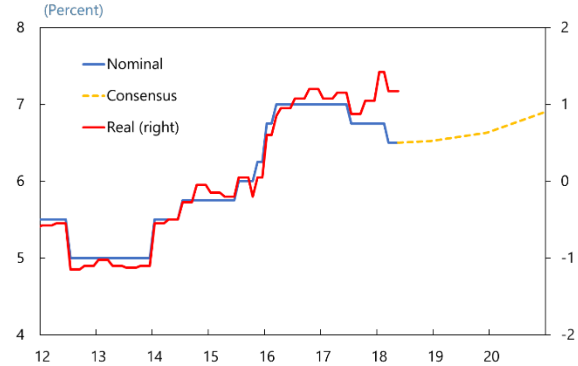
Monetary Policy Committee decisions generated some surprises.

Number of MPC Meetings with Surprise Decisions
(Annual count and 3-year moving average)



The policy rate remains little changed in real terms after two cuts, and is expected to edge higher.

Policy Rate
(Percent)

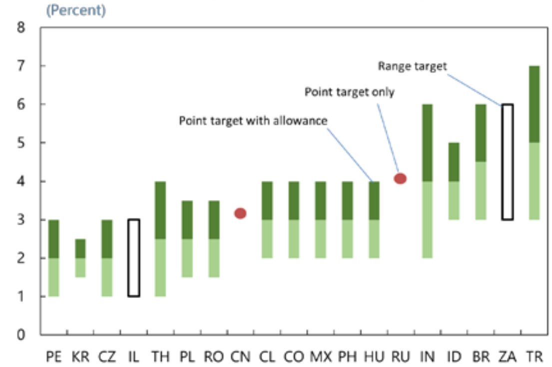


Inflation in export destinations declined.

Inflation in Export Destinations

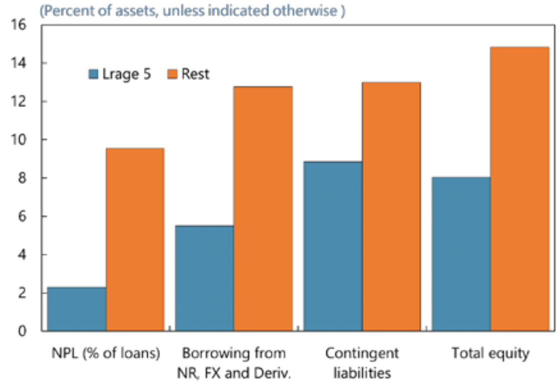
South Africa is one of the few inflation range targeting emerging economies.

Selected Emerging Market Inflation Targets in 2017
(Percent)



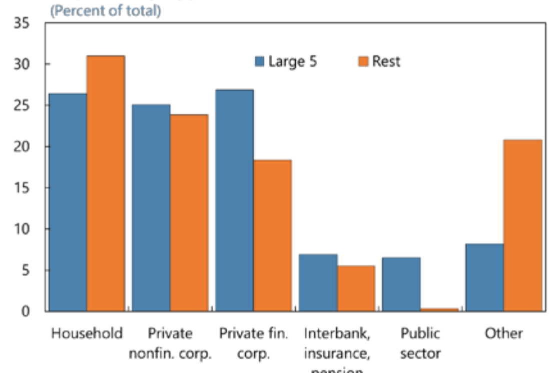
Medium-sized and smaller banks have higher NPLs and capital than large 5 banks do.

Financial Soundness Indicators
(Percent of assets, unless indicated otherwise)



Wholesale markets generally represent a large source of funding for banks.

Deposits by Type
(Percent of total)



Sources: Haver Analytics, bank balance sheet data (BA900) as of November 2017, and IMF staff calculations.

ANCHORING INFLATION EXPECTATIONS AT LOWER LEVELS

40. The SARB has continued to enhance its successful IT framework (Figure 13). It now uses the Quarterly Projection Model as the main tool to inform decisions of the Monetary Policy Committee and publishes the results as part of its communication policy. In the context of reduced policy and political uncertainty, the frequency of surprise monetary policy decisions has declined.

41. The SARB intends to bring inflation expectations lower from near the top of the target band. Economic agents appear to base price setting on a combination of historical inflation and the belief that the SARB targets inflation at or above the upper end of the official target range (Annex VIIII—Inflation Expectations). The SARB publicly stated its preference to anchor inflation expectations at 4.5 percent. In that regard and amid recent fiscal performance, the policy rate cut in March may have been premature.

42. Monetary policy should continue to be mindful of fiscal policy developments and inflation risks. Should a fiscal correction and bold structural reforms take place, like in staff's reform scenario, the SARB could keep the current monetary policy stance. In this case, it must be mindful of the relatively high inflation expectations and the risks to inflation of exchange rate pass-through stemming from tighter global financing conditions and weaker investor appetite for EM assets. In the absence of fiscal consolidation and meaningful reforms, as assumed in staff's baseline scenario, a tighter monetary policy stance would support the reduction in inflation expectations. In such a case, the pace of tightening should be gradual, paying due attention to the negative output gap, even if the "sacrifice ratio" is believed to be relatively small.

43. Staff recommended buttressing the reserve buffer opportunistically. Foreign exchange reserves are assessed to be below adequacy—64 percent of the unadjusted assessing reserve adequacy (ARA) metric and 70 percent of the ARA metric adjusted for capital flow measures (CFMs). Therefore, opportunities for accumulation—such as large foreign exchange inflow transactions—should be seized. Staff welcomed that the authorities continue relaxing long-standing CFMs.

44. Staff called for moving at an opportune time from a band to a point target with allowance to help reduce inflation expectations. It argued that if the recent moderation in inflation expectations proves durable, the authorities could take advantage of the momentum to officially adopt a 4.5 percent point target with an allowance of ±1.5 percent. To facilitate a further reduction in inflation expectations, the midpoint could be lowered to 4 percent and the allowance to ±1 percent. Such a reduction would foster greater convergence of South Africa's inflation to its trading partners' declining inflation, reduce risk premiums, and support growth.

Authorities' Views on Monetary Policy:

45. SARB officials agreed the monetary policy stance should be consistent with the objective of lowering inflation and inflation expectations closer to 4.5 percent over time.

SARB officials discussed the evolution of the balance of risks affecting monetary policy decisions. They highlighted that the balance of risks to the inflation outlook was tilted to the upside. On the merits of officially adopting a point target, SARB officials noted that the focus on the midpoint of 4.5 percent via effective communication with stakeholders would serve the country better at this stage. They also agreed that implementation of structural reforms will assist in reducing South Africa's inflation.

SAFEGUARDING FINANCIAL STABILITY AND DEEPENING INCLUSION

46. **The banking sector is large, highly concentrated, and well capitalized**. As of end-2017, banking sector assets corresponded to around 110 percent of GDP, with more than 90 percent accounted for by the five largest banks. On average, capital adequacy is above regulatory requirements and profitability, while having declined moderately amid weak economic growth, remains strong. The non-performing loan (NPL) ratio edged higher to 3.2 percent, and the liquidity ratio exceeds the regulatory requirement.

47. **The system-wide picture masks significant diversity among banks** (Figure 13). The operations of medium-sized and small banks appear more sensitive to economic activity, notably if growth remains low for a protracted period, as they target riskier customers. These banks have lower asset quality compared to large banks and, although accompanied by larger holdings of equity capital, appear to have some pockets of vulnerabilities (SIP 3—Buffers). While in isolation these banks are small, the broader banking system could be affected negatively through confidence effects, triggering vicious macro-financial feedback loops. The recognition of contagion risk prompted the SARB to take a firm action when African Bank's balance sheet conditions deteriorated in 2014, and VBS Mutual Bank faced liquidity shortages in March 2018.[16]

48. **Staff welcomed ongoing initiatives to further buttress financial sector stability**. The new Financial Sector Regulation Act lays the foundation of the Twin Peaks model of financial regulation and confers on the SARB an explicit statutory mandate to enhance and protect financial stability. Putting in place a deposit insurance scheme will help stem the potential contagion from a localized event. Upgrading the stress-testing framework and conducting it at least annually will help identify potential bank vulnerabilities, notably risks associated with large reliance on wholesale funding, exposures to SOEs, changes in domestic and global conditions, and potential pockets of vulnerabilities related to medium-sized and small banks (SIP 3—Buffers and Annex II—Eskom).

[16] VBS Mutual had been accepting a small number of large deposits from municipalities and extending a large number of small long-term loans. After the SARB informed municipalities that such investments breached the Municipal Financial Management Act, they began to withdraw their funds which created severe liquidity issues. The SARB had warned VBS about its risky lending model.

49. South Africa has deep and sophisticated financial markets, but competition and access are limited. Bank account ownership is skewed to the wealthier population and most of the poor households' access is limited to withdrawing cash from social grants accounts, with little usage of other banking services such as savings or loans. Limited financial inclusion in South Africa appears to reflect both demand and supply-side constraints—high unemployment and excessive costs of opening and maintaining bank accounts.[17] Efforts are needed to enhance competition within existing banks, leverage the use of technology, and strengthen financial literacy. In this respect, the planned entry of new banks, including a full service digital one to cater to the "emerging to middle class segment" will be helpful. The dynamically evolving digitalization presents itself as a promising medium for South Africa to enhance financial inclusion (see ¶ 32 and ¶ 33).

Authorities' Views on Financial Sector Policy:

50. The authorities view the transition to the new Twin Peaks model as a way of further strengthening the financial stability framework. They agreed that supervision of small and medium-sized banks will continue to receive due attention. The envisaged resolution framework will allow failed small and medium-sized banks to exit the system, thus limiting depositors' losses without a negative impact on financial stability. The SARB intends to expand stress tests (produced in cooperation with IMF capacity development) to include insurance companies. SARB officials highlighted that the Twin Peaks framework will help promote better market conduct and consumer protection. It acknowledged that there is room for greater competition in the banking system, pointing out that the entry of new banks and technological progress may assist in this process.

51. Promoting financial inclusion is a key objective of the government. To improve access to credit by SMEs, the government is proposing credit information sharing, credit guarantee schemes, and a movable assets register. The authorities argued that any efforts to enhance financial inclusion should duly consider the fact that low-income earners already have high debt levels.

STAFF APPRAISAL

52. Over the past five years, the South African economy has decoupled from the global growth recovery. While growth has progressively recovered in the rest of the world, it has been negative in per-capita terms in South Africa, unwinding some of previous gains in poverty reduction and inequality. A key explanatory factor is the high degree of policy uncertainty, which derives from delayed reforms, inconsistent policy announcements, and concerns about governance. Uncertainty has led to weak private investment and consumption growth. The most vulnerable segments of the population have been the most adversely affected.

53. South Africa should continue bolstering buffers, particularly as prospects for growth remain lackluster in the absence of reforms. Resilience to shocks should be enhanced by attracting more FDI, increasing opportunistically the stock of international reserves, and stabilizing

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

public debt at a more conservative level. Stronger buffers would improve the composition of financing of the current account (currently too reliant on portfolio inflows), and strengthen the external position, which is moderately weaker than implied by fundamentals and desirable policy settings. Buffers will also shield the economy from renewed risks from diminished investor appetite for EM credit and its impact on capital flows. On the upside, the track record of exchange rate flexibility, the low share of foreign-currency denominated public-sector external debt, and the sound financial sector are sources of economic strength.

54. The recent political transition offers the opportunity to start afresh and advance the reform agenda for the benefit of all South Africans. The authorities have rightly announced measures aimed at boosting business and consumer confidence, including by changing management and boards of key SOEs to address poor governance, launching a judicial inquiry into "state capture", signing renewable energy contracts with independent power producers (IPP), and enhancing the economic management team. Nonetheless, the "wait and see" attitude among investors is likely to continue until the new leadership forcefully addresses the perceived obstacles to private investment. Durable private investment is the only way to unleash the economy's significant potential and foster greater economic inclusion through job creation.

55. Leveraging this favorable momentum, ambitious reforms in labor and product markets need to be launched now, and the fight against corruption deepened. Private sector participation in all areas of the economy would help drive growth by increasing efficiency and promoting competition. Greater labor market flexibility is critical for boosting productivity and employment. Improving the weak educational attainment, especially at the primary and secondary levels, will further enhance the gains. Facilitating competition through the entry of new firms and reduction in the costs of network industries will translate investor interest into investments. The gains from product market reform would accrue more on the poor, reducing income inequality. Leveraging digitalization will revamp efficiency. Tackling corruption and improving governance will be needed to crystalize all these reforms.

56. To facilitate the reform implementation, there is a need to start with quick wins to rebuild trust between the government and its citizens. Measures such as the consensual adoption of a new mining charter and the allocation of broadband spectrum to leverage the opportunities from digitalization would foster greater private investment. Ensuring a more efficient delivery and responsible conduct of product offerings associated with social grants will make meaningful improvements in the lives of the 30 percent of population who rely on such grants. To mitigate skill shortages, quick wins could be obtained from addressing the restrictions for skilled immigrants. In turn, these gains would foster support for the other structural reforms, which, although difficult, need to be implemented as soon as possible.

57. Further progress is needed to address remaining governance issues and rethink the business models of SOEs. Penalties should be enforced against breaches to the PFM Act, and procurement guidelines should be tightened, with greater oversight to prevent undue exemptions. Given fiscal constraints and efficiency considerations, a bigger role of the private sector in the provision of basic services is warranted. Meanwhile, SOEs should operate on a commercial basis to the extent possible, with explicit transfers funded from the budget to pay for any public service obligation. Turnaround plans that optimize costs should be a requirement for SOEs, and future government guarantees, if indispensable, must be made strictly contingent on efficient financial and operational performance. SOEs' governance could be strengthened by harmonizing the legal and regulatory frameworks and creating a central agency responsible for oversight.

58. Implementation of these structural reforms would help reduce poverty and inequality, but there is also a need for enhancing the efficiency of interventions. With limited fiscal space, the focus of progressive fiscal policy needs to turn to reallocating expenditure toward more productive outlays and increasing the efficiency of education and health spending given their progressivity. Low and stable inflation would benefit poorer households who tend to face the largest burden of high inflation, and will have to be accompanied by further action to deepen financial inclusion and increase access to credit for small and medium-sized enterprises.

59. Additional fine-tuning in the areas of fiscal, monetary, and financial sector policies would support the effort to attract private investment and reignite growth.

- ***Fiscal policy needs to focus on building buffers against potential shocks***. The doubling of public debt in the last decade and the risks associated with a protracted low growth outlook and SOE contingent liabilities point to the need for greater current spending based fiscal consolidation in the next few years. Specifically, the high wage bill should be reduced and the overall quality of expenditure improved to strengthen the role of fiscal policy in addressing inequality. To ensure debt remains at comfortable levels amid low growth, the primary expenditure ceiling could usefully be accompanied by a debt-to-GDP ceiling.

- ***Monetary policy should remain cautious to safeguard hard-won credibility and aim at lowering inflation expectations***. The SARB should continue to pay attention to upside inflation risks in the context of stubbornly high inflation expectations. The SARB's stated intention to bring inflation toward the midpoint of the official target band, to be in line with current trends in global inflation and international best practices, is welcome. The authorities could upgrade its inflation targeting framework by moving at an opportune time from a range to an explicit point target with an allowance.

- ***Financial sector policy should continue to be mindful of pockets of vulnerabilities***. The authorities' introduction of the Twin Peaks approach promises a welcome overhaul of the regulatory framework. Pockets of vulnerabilities in medium-sized and small banks' balance sheets should continue to be monitored by further upgrading stress-testing capabilities. Efforts to enhance financial inclusion should continue, including through the promotion of entry of new financial institutions and technological solutions.

60. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. South Africa: Selected Economic Indicators, 2013–19

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2017, billions of US dollars)	349	Lower national poverty line (2015)	40.0
GDP per capita (2017, in US dollars)	6,180	Undernourishment (2015)	5.0
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2017, million)	56.5	Highest 10 percent of population	51.3
Urban population (2014, percent of total)	64	Lowest 20 percent of population	2.5
Life expectancy at birth (2016, number of years)	62	Gini coefficient (2015)	63.0

Economic Indicators

	2013	2014	2015	2016	2017	2018	2019
					Est.	Proj.	
National income and prices (annual percentage change unless otherwise indicated)							
Real GDP	2.5	1.8	1.3	0.6	1.3	1.5	1.7
Real GDP per capita	1.0	0.3	-0.3	-1.0	-0.3	-0.1	0.1
Real domestic demand	3.1	0.5	2.1	-0.9	1.8	1.6	1.9
GDP deflator	6.2	5.5	5.1	6.8	5.5	4.9	5.3
CPI (annual average)	5.8	6.1	4.6	6.3	5.3	4.9	5.3
CPI (end of period)	5.4	5.3	5.3	6.7	4.7	5.3	5.3
Labor market (annual percentage change unless otherwise indicated)							
Unemployment rate (percent of labor force, annual average)	24.7	25.1	25.4	26.7	27.5	27.9	28.3
Average remuneration (formal nonagricultural, nominal)	7.2	6.6	7.0	5.8	7.1	6.7	7.1
Labor productivity (formal nonagricultural)	1.8	1.5	1.8	0.5	1.8	1.8	1.8
Unit labor costs (formal nonagricultural)	5.2	5.1	5.2	5.2	5.3	4.9	5.3
Savings and Investment (percent of GDP)							
Gross national saving	15.4	15.4	16.4	16.6	16.1	15.6	15.4
Public (incl. public enterprises)	-0.9	1.1	1.0	0.8	0.3	0.5	0.6
Private	16.2	14.3	15.3	15.7	15.8	15.1	14.8
Investment (including inventories)	21.2	20.5	21.0	19.4	18.6	18.5	18.7
Public (incl. public enterprises)	7.1	6.9	7.4	7.2	6.9	6.9	6.8
Private	13.3	13.5	13.0	12.3	11.8	11.8	12.0
Fiscal position (percent of GDP unless otherwise indicated) 1/							
Revenue, including grants 2/	27.3	27.6	28.1	28.6	28.3	29.0	29.5
Expenditure and net lending	31.6	31.9	32.9	32.7	32.9	33.3	33.6
Overall balance	-4.3	-4.3	-4.8	-4.1	-4.6	-4.3	-4.0
Primary balance	-1.3	-1.2	-1.5	-0.6	-1.0	-0.5	0.0
Structural balance (percent of potential GDP)	-4.1	-4.1	-4.1	-3.8	-3.9	-3.7	-3.5
Gross government debt 3/	44.1	47.0	49.3	51.6	53.0	55.0	56.0
Government bond yield (10-year and over, percent) 4/	8.2	8.0	9.7	8.9	9.2	8.6	...
Money and credit (annual percentage change unless otherwise indicated)							
Broad money	5.8	7.2	10.5	6.1	6.9	6.4	7.1
Credit to the private sector	7.1	7.2	8.0	4.7	4.3	5.6	6.3
Repo rate (percent, end-period) 5/	5.0	5.8	6.3	7.0	6.8	6.5	...
3-month Treasury bill interest rate (percent) 6/	5.1	5.8	6.1	7.2	7.3	7.1	...
Balance of payments (annual percentage change unless otherwise indicated)							
Current account balance (billions of U.S. dollars)	-21.2	-17.8	-14.6	-8.2	-8.6	-11.0	-12.7
percent of GDP	-5.8	-5.1	-4.6	-2.8	-2.5	-2.9	-3.3
Exports growth (volume)	4.0	3.6	2.8	1.0	-0.1	3.7	3.4
Imports growth (volume)	5.0	-0.6	5.4	-3.8	1.9	4.0	3.9
Terms of trade	-1.4	-1.5	3.0	1.4	4.7	-2.7	-1.3
Overall balance (percent of GDP)	0.1	0.4	-0.3	0.9	0.5	0.2	-0.2
Gross reserves (billions of U.S. dollars)	49.6	49.1	45.8	47.4	50.7	51.5	50.7
Total external debt (percent of GDP)	37.2	41.3	39.1	48.3	49.6	46.1	47.0
Nominal effective exchange rate (period average)	-13.7	-10.2	-4.0	-11.9	11.8	...	...
Real effective exchange rate (period average)	-10.5	-6.2	-0.5	-7.1	12.7	...	...
Exchange rate (Rand/U.S. dollar, end-period)	10.5	11.6	15.6	13.7	12.3	...	...

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

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

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

3/ Central government.

4/ The 2018 value is as of end May 2018.

5/ January-May 2018 average.

6/ January-May 2018 average.

Table 2. South Africa: Consolidated Government Operations, 2012/13–2020/21/1

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18		2018/19		2019/20		2020/21	
						Auth.	Staff	Auth.	Staff	Auth.	Staff	Auth.	Staff
	(In billions of rand)												
Total revenue and grants	893.6	992.1	1,080.0	1,171.9	1,267.5	1,335.2	1,334.6	1,482.6	1,476.3	1,608.8	1,601.0	1,735.7	1,725.5
Tax revenue	771.7	856.6	934.6	1,019.0	1,104.6	1,161.4	1,160.5	1,296.7	1,290.4	1,408.5	1,401.1	1,521.8	1,514.1
Non-tax revenue 2/	14.5	14.8	15.6	13.9	15.1	14.8	15.1	16.4	16.4	18.4	18.4	19.7	19.7
Provinces, social security, and other entities	107.4	120.7	129.9	139.0	147.8	159.0	158.9	169.6	169.4	181.9	181.5	194.2	191.8
Total expenditure	1,043.4	1,143.4	1,235.0	1,366.2	1,441.8	1,558.0	1,561.0	1,671.2	1,678.6	1,803.0	1,813.9	1,941.9	1,953.3
Current expenditure	919.6	1,005.4	1,083.3	1,177.5	1,283.5	1,376.4	1,379.5	1,490.6	1,498.0	1,617.6	1,628.5	1,743.8	1,755.1
Wages and salaries	376.3	408.0	437.4	472.8	510.8	548.9	548.9	587.1	587.1	630.5	630.5	677.3	677.3
Other goods and services	162.9	174.2	186.0	195.3	214.6	223.7	223.7	233.6	233.6	251.1	251.1	269.1	269.1
Interest	93.3	109.6	121.4	138.5	156.8	170.4	173.4	187.8	195.2	206.1	217.0	223.9	235.2
Transfers	287.1	313.7	338.6	370.9	401.3	433.5	433.5	482.1	482.1	529.9	529.9	573.5	573.5
Capital expenditure	118.7	133.8	145.5	157.7	150.1	161.2	161.2	166.5	166.5	171.2	171.2	181.6	181.6
Payment for financial assets	5.1	4.2	6.2	31.0	8.2	20.4	20.4	6.0	6.0	6.2	6.2	6.6	6.6
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.0	8.0	8.0	8.0	10.0	10.0
Primary balance	-56.6	-41.8	-33.6	-55.9	-17.5	-52.4	-53.0	-0.8	-7.1	12.0	4.1	17.6	7.5
Overall balance	-149.8	-151.3	-155.0	-194.4	-174.3	-222.7	-226.4	-188.6	-202.3	-194.1	-212.9	-206.3	-227.8
Financing	149.8	151.3	155.0	194.4	174.3	222.7	226.4	188.6	202.3	194.1	212.9	206.3	227.8
Domestic Debt (net)	143.5	173.6	164.2	160.6	157.1	151.6	154.2	158.7	172.4	159.4	178.2	185.3	206.8
External Debt (net)	-10.6	-0.4	7.3	-6.1	41.6	19.6	19.6	25.4	25.4	-19.9	-19.9	29.4	29.4
Transations in Assets and Liabilities	14.0	16.0	15.3	43.4	18.2	18.4	19.6	8.1	8.1	0.8	0.8	1.2	1.2
Use of cash and other balances	2.9	-37.8	-31.8	-3.6	-42.6	33.1	33.1	-3.6	-3.6	53.7	53.7	-9.6	-9.6
Structural primary balance	-47.8	-38.5	-29.7	-40.4	-1.5	n.a	-18.7	n.a	14.4	n.a	31.2	n.a	28.4
Gross government debt	1,366	1,585	1,799	2,019	2,233	2,506	2,513	2,771	2,794	2,983	3,029	3,250	3,309
	(In percent of GDP)												
Total revenue and grants	26.9	27.5	27.9	28.4	28.7	28.4	28.3	29.5	29.3	29.8	29.7	29.9	29.8
Tax revenue	23.2	23.7	24.2	24.7	25.1	24.7	24.6	25.8	25.6	26.1	26.0	26.2	26.2
Non-tax revenue	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Provinces, social security, and other entities	3.2	3.3	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.3	3.3
Total expenditure	31.4	31.7	31.9	33.1	32.7	33.2	33.0	33.3	33.3	33.4	33.6	33.4	33.7
Current expenditure	27.7	27.9	28.0	28.5	29.1	29.3	29.2	29.7	29.7	30.0	30.2	30.0	30.3
Wages and salaries	11.3	11.3	11.3	11.5	11.6	11.7	11.6	11.7	11.7	11.7	11.7	11.7	11.7
Other goods and services	4.9	4.8	4.8	4.7	4.9	4.8	4.7	4.6	4.6	4.7	4.7	4.6	4.6
Interest	2.8	3.0	3.1	3.4	3.6	3.6	3.7	3.7	3.9	3.8	4.0	3.9	4.1
Transfers	8.6	8.7	8.8	9.0	9.1	9.2	9.2	9.6	9.6	9.8	9.8	9.9	9.9
Capital expenditure	3.6	3.7	3.8	3.8	3.4	3.4	3.4	3.3	3.3	3.2	3.2	3.1	3.1
Payment for financial assets	0.2	0.1	0.2	0.8	0.2	0.4	0.4	0.1	0.1	0.1	0.1	0.1	0.1
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.1	0.2	0.2
Primary balance	-1.7	-1.2	-0.9	-1.4	-0.4	-1.1	-1.1	0.0	-0.1	0.2	0.1	0.3	0.1
Overall balance	-4.5	-4.2	-4.0	-4.7	-4.0	-4.7	-4.8	-3.8	-4.0	-3.6	-3.9	-3.6	-3.9
Financing	4.5	4.2	4.0	4.7	4.0	4.7	4.8	3.8	4.0	3.6	3.9	3.6	3.9
Domestic Debt (net)	4.3	4.8	4.2	3.9	3.6	3.2	3.3	3.2	3.4	3.0	3.3	3.2	3.6
External Debt (net)	-0.3	0.0	0.2	-0.1	0.9	0.4	0.4	0.5	0.5	-0.4	-0.4	0.5	0.5
Transations in Assets and Liabilities	0.4	0.4	0.4	1.1	0.4	0.4	0.4	0.2	0.2	0.0	0.0	0.0	0.0
Use of cash and other balances	0.1	-1.0	-0.8	-0.1	-1.0	0.7	0.7	-0.1	-0.1	1.0	1.0	-0.2	-0.2
Structural primary balance (percent of potential GDP)	-1.4	-1.1	-0.8	-1.0	0.0	n.a	-0.4	n.a	0.3	n.a	0.6	n.a	0.5
Gross government debt 3/	41.1	43.9	46.5	48.9	50.6	53.3	53.2	55.1	55.5	55.3	56.2	56.0	57.2
Memorandum items:													
National budget primary balance (percent of GDP)	-2.7	-2.1	-1.7	-2.0	-0.9	-1.5	-1.4	-0.4	-0.5	-0.1	-0.3	0.0	-0.2
National budget overall balance (percent of GDP)	-5.4	-4.9	-4.7	-5.1	-4.2	-5.0	-4.8	-4.0	-4.2	-3.8	-4.1	-3.7	-4.1
Fiscal year GDP (billions of rand)	3,322	3,609	3,866	4,127	4,409	4,699	4,724	5,025	5,036	5,390	5,394	5,808	5,788
Fiscal year real GDP growth (percent)	2.2	2.6	1.8	0.5	1.0	1.3	1.4	1.5	1.7	1.9	1.5	2.1	2.0
Fiscal year GDP Deflator growth (in percent)	5.6	5.9	5.2	6.2	5.8	5.2	5.6	5.4	4.8	5.3	5.6	5.5	5.2
Fiscal year nominal GDP growth (percent)	7.9	8.6	7.1	6.8	6.8	6.6	7.1	6.9	6.6	7.3	7.1	7.8	7.3

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

1/ Data are on a fiscal year basis (April 1-March 31). Consolidated government corresponds to the national government, social security funds, provincial governments, and some public entities. Local governments are only partially captured through the transfers sent to them by the national government. The authorities' projections are based on the 2018 Budget Review.

2/ Non- tax revenue excludes transactions in financial assets and liabilities. These transactions are classified as a domestic financing item given that they involve primarily revenues associated with realized exchange rate valuation gains from the holding of foreign currency deposits and other conceptually similar smaller items.

3/ Covers only national government debt.

Table 3. South Africa: Balance of Payments, 2013–23

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Est.			Proj.			
	(In billions of US dollars)										
Balance on current account	-21.2	-17.8	-14.6	-8.2	-8.6	-11.0	-12.7	-13.4	-14.0	-14.8	-15.6
Balance on goods and services	-8.4	-5.3	-4.1	1.8	4.8	1.9	-0.1	-0.7	-0.7	-0.8	-1.0
Exports of goods and services	113.6	110.4	95.8	90.8	104.0	112.5	116.3	120.7	126.4	132.0	137.8
Imports of goods and services	-122.0	-115.7	-99.9	-89.0	-99.2	-110.6	-116.4	-121.4	-127.0	-132.7	-138.9
Balance on income	-9.6	-9.4	-7.9	-8.2	-10.5	-10.1	-10.2	-10.4	-11.0	-11.5	-12.0
Income receipts	6.7	7.6	7.7	6.0	6.1	14.3	16.7	18.4	16.3	14.6	14.5
Income payments	-16.3	-16.9	-15.6	-14.2	-16.6	-24.5	-27.0	-28.8	-27.2	-26.1	-26.5
Balance on transfers	-3.2	-3.2	-2.6	-1.9	-2.9	-2.7	-2.3	-2.3	-2.4	-2.5	-2.6
Capital flows (including errors and omissions)	21.7	19.2	13.5	11.0	10.5	11.7	11.8	13.0	14.0	14.7	15.6
Balance on capital and financial account	19.1	24.3	15.3	11.7	9.5	11.7	11.8	13.0	14.0	14.7	15.6
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	19.1	24.3	15.3	11.7	9.5	11.7	11.8	13.0	14.0	14.7	15.5
Direct investment	1.7	-1.9	-4.0	-2.2	-6.0	-2.6	-0.8	-0.4	0.0	0.0	0.0
Liabilities	8.3	5.8	1.7	2.2	1.3	3.0	3.1	3.6	4.2	4.4	4.6
Assets	-6.7	-7.7	-5.7	-4.5	-7.4	-5.6	-3.9	-4.0	-4.2	-4.4	-4.6
Portfolio investment	11.1	13.4	9.6	16.4	16.5	9.8	10.1	10.9	11.8	12.3	12.7
Liabilities	13.5	13.6	9.5	9.5	20.9	9.8	10.1	10.9	11.8	12.3	12.7
Assets	-2.4	-0.1	0.1	6.8	-4.4	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.8	1.5	0.4	-0.9	-0.3	0.2	0.2	0.2	0.2	0.2	0.2
Liabilities	-19.5	-18.0	-25.2	-33.9	-17.1	-17.6	-17.8	-18.2	-18.5	-18.8	-19.1
Assets	20.3	19.5	25.5	33.0	16.8	17.8	18.0	18.4	18.7	19.0	19.3
Other investment	5.6	11.2	9.3	-1.5	-0.7	4.4	2.3	2.3	2.0	2.3	2.6
Liabilities	5.2	13.7	5.7	-0.3	4.6	9.6	7.6	7.5	7.3	7.5	7.8
Assets	0.3	-2.4	3.7	-1.3	-5.2	-5.2	-5.2	-5.2	-5.2	-5.2	-5.2
Errors and omissions	2.6	-5.1	-1.8	-0.7	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.5	1.4	-1.1	2.7	1.9	0.8	-0.8	-0.4	0.0	0.0	-0.1
Gross reserves (end of period)	49.6	49.1	45.8	47.4	50.7	51.5	50.7	50.3	50.3	50.2	50.2
	(In percent of GDP)										
Balance on current account	-5.8	-5.1	-4.6	-2.8	-2.5	-2.9	-3.3	-3.3	-3.3	-3.4	-3.4
Balance on goods and services	-2.3	-1.5	-1.3	0.6	1.4	0.5	0.0	-0.2	-0.2	-0.2	-0.2
Balance on goods	-2.0	-1.4	-1.1	0.8	1.5	0.7	0.2	0.0	-0.1	-0.1	-0.1
Balance on services	-0.3	-0.1	-0.1	-0.2	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Exports of goods and services	31.0	31.5	30.2	30.7	29.8	30.0	30.0	29.9	30.1	30.1	30.3
Imports of goods and services	-33.3	-33.0	-31.4	-30.1	-28.4	-29.5	-30.1	-30.0	-30.2	-30.3	-30.5
Balance on income	-2.6	-2.7	-2.5	-2.8	-3.0	-2.7	-2.6	-2.6	-2.6	-2.6	-2.6
Balance on transfers	-0.9	-0.9	-0.8	-0.6	-0.8	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6
Capital flows (including errors and omissions)	5.9	5.5	4.2	3.7	3.0	3.1	3.1	3.2	3.3	3.4	3.4
Balance on capital and financial account	5.2	6.9	4.8	4.0	2.7	3.1	3.1	3.2	3.3	3.4	3.4
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	5.2	6.9	4.8	3.9	2.7	3.1	3.0	3.2	3.3	3.4	3.4
Direct investment	0.5	-0.5	-1.3	-0.8	-1.7	-0.7	-0.2	-0.1	0.0	0.0	0.0
Portfolio investment	3.0	3.8	3.0	5.5	4.7	2.6	2.6	2.7	2.8	2.8	2.8
Financial derivatives	0.2	0.4	0.1	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	1.5	3.2	2.9	-0.5	-0.2	1.2	0.6	0.6	0.5	0.5	0.6
Errors and omissions	0.7	-1.5	-0.6	-0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.1	0.4	-0.3	0.9	0.5	0.2	-0.2	-0.1	0.0	0.0	0.0
Gross reserves (end of period)	13.5	14.0	14.4	16.0	14.5	13.7	13.1	12.4	12.0	11.5	11.0
Memorandum items:											
Total external debt	37.2	41.3	39.1	48.3	49.6	46.1	47.0	47.5	48.0	48.4	48.8
International investment position (net)	-4.4	-7.9	15.7	7.0	12.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
GDP at current prices (US$ billion)	366.8	350.9	317.7	295.7	349.3	375.1	387.3	404.2	420.5	438.0	455.2

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

Table 4. South Africa: Financial Corporations, 2013–23

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Est.	Proj.					
	(In billions of rand)										
Central Bank											
Net foreign assets	486	528	668	607	585	653	664	680	702	726	750
Net domestic assets	-295	-323	-444	-367	-329	-379	-371	-366	-365	-363	-360
Domestic claims	-277	-306	-431	-352	-313	-311	-301	-297	-297	-298	-298
Central government (net)	-318	-353	-484	-418	-382	-396	-386	-382	-383	-384	-384
State and local government	0	0	0	0	0	1	0	0	0	0	0
Public nonfinancial corporations	1	1	1	1	1	1	1	1	1	1	1
Private sector	0	0	0	0	0	0	0	0	0	0	0
Other depository corporations	39	45	51	59	62	78	78	78	78	78	78
Other financial corporations	0	0	0	5	5	6	6	6	6	6	5
Other items net	-18	-17	-13	-15	-15	-69	-70	-69	-67	-65	-62
Monetary base	191	205	224	240	257	274	293	314	338	363	390
Other Depository Corporations											
Net foreign assets	156	72	117	96	113	120	129	138	148	160	171
Net domestic assets	2,424	2,673	2,971	3,123	3,392	3,620	3,899	4,222	4,579	4,967	5,382
Domestic claims	3,016	3,305	3,670	3,904	4,182	4,420	4,704	5,027	5,384	5,772	6,187
Central government (net)	203	245	284	361	432	455	484	516	549	585	619
State and local government	21	21	19	18	19	20	21	23	25	26	28
Public nonfinancial corporations	29	45	48	59	76	81	87	93	100	107	115
Private sector	2,381	2,552	2,764	2,903	3,051	3,221	3,423	3,656	3,917	4,201	4,509
of which loans and securities	*2,333*	*2,500*	*2,699*	*2,826*	*2,948*	*3,111*	*3,307*	*3,533*	*3,784*	*4,059*	*4,356*
Central Bank	113	121	126	139	145	154	165	177	190	205	220
Other financial corporations	269	322	428	424	459	489	523	561	603	648	696
Other items net	(593)	(632)	(699)	(781)	(790)	(800)	(805)	(805)	(805)	(805)	(805)
Depository Corporations											
Net foreign assets	641	600	785	704	699	773	793	818	851	885	921
Net domestic assets	1,872	2,097	2,190	2,453	2,660	2,819	3,054	3,308	3,581	3,876	4,193
Domestic claims	2,587	2,834	3,062	3,354	3,661	3,877	4,160	4,475	4,818	5,191	5,592
Central government (net)	-115	-108	-199	-57	49	59	98	133	166	201	236
State and local government	21	21	20	18	19	20	22	23	25	27	29
Public nonfinancial corporations	30	46	49	60	77	82	88	94	101	108	116
Private sector	2,381	2,552	2,764	2,904	3,052	3,221	3,423	3,657	3,917	4,202	4,509
of which loans and securities	*2,333*	*2,500*	*2,699*	*2,826*	*2,948*	*3,111*	*3,307*	*3,533*	*3,784*	*4,059*	*4,356*
Other financial corporations	269	322	428	429	464	495	529	567	608	653	701
Other items net	-714	-737	-872	-901	-1,001	-1,058	-1,106	-1,167	-1,237	-1,316	-1,399
Broad money	2,514	2,697	2,975	3,156	3,359	3,593	3,846	4,126	4,432	4,761	5,115
Other Financial Corporations											
Net foreign assets	532	606	796	774	878	972	996	1028	1069	1112	1158
Net domestic assets	3,248	3,539	3,472	3,685	3,855	3,761	3,737	3,705	3,664	3,620	3,575
Domestic claims	5,032	5,412	5,496	5,845	6,133	6,528	6,983	7,484	8,028	8,614	9,236
Central government (net)	763	886	882	928	924	983	1,047	1,116	1,188	1,266	1,342
State and local government	12	14	14	16	15	16	17	18	20	21	23
Public nonfinancial corporations	445	438	407	439	469	500	535	574	616	662	711
Private sector	2,901	3,199	3,217	3,373	3,533	3,761	4,026	4,319	4,639	4,984	5,354
of which loans and securities	*617*	*713*	*770*	*849*	*886*	*935*	*994*	*1,061*	*1,137*	*1,219*	*1,309*
Central Bank	12	13	14	15	12	13	14	15	16	18	19
Other Depository Corporations	898	862	963	1,074	1,179	1,255	1,344	1,441	1,548	1,663	1,787
Other items net	-1,784	-1,873	-2,024	-2,160	-2,278	-2,767	-3,247	-3,779	-4,364	-4,993	-5,661
Non-liquid liabilities	3,780	4,145	4,268	4,459	4,732	4,732	4,732	4,732	4,732	4,732	4,732
Financial Corporations											
Net foreign assets	1,173	1,207	1,581	1,478	1,576	1,745	1,789	1,846	1,920	1,997	2,079
Net domestic assets	4,274	4,734	4,731	5,109	5,068	5,362	5,819	6,316	6,846	7,420	8,037
Domestic claims	6,440	7,048	7,153	7,682	8,138	8,642	9,257	9,935	10,673	11,471	12,320
Central government (net)	648	778	683	872	973	1,042	1,145	1,249	1,354	1,467	1,578
State and local government	34	36	33	34	34	36	39	42	45	48	51
Public nonfinancial corporations	475	484	457	499	547	582	623	668	717	771	828
Private sector	5,283	5,751	5,980	6,277	6,585	6,982	7,449	7,976	8,556	9,185	9,863
of which loans and securities	*2,950*	*3,213*	*3,469*	*3,675*	*3,833*	*4,046*	*4,300*	*4,594*	*4,921*	*5,278*	*5,665*
Other items net	-2,166	-2,314	-2,422	-2,572	-3,070	-3,280	-3,437	-3,619	-3,827	-4,051	-4,283
Liabilities	5,447	5,940	6,312	6,587	6,644	7,107	7,608	8,162	8,765	9,417	10,117
Liquid	1,539	1,689	1,876	2,009	1,960	2,097	2,245	2,408	2,586	2,779	2,985
Nonliquid	3,909	4,251	4,436	4,578	4,684	5,010	5,363	5,753	6,179	6,638	7,131
Memorandum items:											
Year-on-year growth (percent)											
Monetary base	9.8	7.3	9.0	7.3	7.0	6.5	7.1	7.3	7.4	7.4	7.4
Broad money	5.9	7.3	10.3	6.1	6.4	7.0	7.1	7.3	7.4	7.4	7.4
Claims on private sector											
Dep. Corp.	6.6	7.2	8.3	5.1	5.1	5.6	6.3	6.8	7.1	7.3	7.3
Dep. Corp., loans and securities	7.1	7.2	8.0	4.7	4.3	5.6	6.3	6.8	7.1	7.3	7.3
Fin. Corp., loans and securities	7.4	8.9	8.0	5.9	4.3	5.6	6.3	6.8	7.1	7.3	7.3
Broad money multiplier (ratio)	13.2	13.1	13.3	13.2	13.1	13.1	13.1	13.1	13.1	13.1	13.1

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

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

	2012	2013	2014	2015	2016	2017
Capital adequacy						
Risk-weighted capital adequacy ratio	15.9	15.6	14.8	14.2	15.9	16.8
of which Teir 1 capital	14.0	14.1	13.6	13.8	14.5	15.6
Capital to asset ratio	7.8	7.9	7.6	7.0	8.2	8.5
Asset quality						
Nonperforming loans to total of loans	4.0	3.6	3.2	3.1	2.9	2.8
Nonperforming loans net of provisions to capital	21.5	18.1	16.3	16.5	14.8	13.9
Earnings, profitability, and efficiency						
Return on assets	1.5	1.4	1.4	1.5	1.7	1.7
Return on equity	20.5	18.6	18.8	20.7	22.2	19.6
Interest margin to gross income	41.3	48.1	53.3	49.7	51.7	55.1
Trading income to total income	8.9	7.8	2.8	2.0	6.4	5.1
Non-interest expenses to gross income	55.0	56.3	53.5	47.8	53.3	65.2
Personnel expenses to non-interest expenses	38.7	47.3	50.7	41.4	46.0	48.1
Liquidity						
Liquid assets to total assets	16.2	16.6	17.6	17.7	16.0	15.9
Liquid assets to short-term liabilities	33.0	33.0	33.5	35.0	30.9	33.8
Customer deposits to total loans	52.2	53.1	53.5	54.3	54.5	55.0
Exposure to FX risk						
Net open FX position to capital	0.5	0.3	0.3	-0.3	1.0	1.2
Foreign-currency-denominated loans to total loans	8.3	8.7	10.1	11.3	10.0	10.2
Foreign-currency-denominated liabilities total liabilities	5.7	6.3	8.1	9.4	8.5	7.8
Sectoral distribution of loans and advances						
Residents	90.5	89.2	88.2	87.4	88.5	88.0
Central Bank and other financial corporations	12.7	12.3	12.2	13.8	13.7	13.9
General government	0.8	0.7	0.7	0.6	0.5	0.5
Nonfinancial corporations	31.0	31.1	32.2	32.4	34.7	34.5
Households	46.0	45.1	43.1	40.6	39.6	39.1
Nonresidents	9.5	10.8	11.9	12.6	11.5	12.0
Derivatives						
Gross asset position in financial derivatives to capital	88.6	70.4	64.5	113.7	51.6	46.0
Gross liability position in financial derivatives to capital	87.6	75.4	69.5	129.2	54.2	50.4
Real Estate Mark						
Residential real estate prices	7.4	8.6	9.1	5.4	7.3	3.8
Residential real estate loans	30.3	28.5	26.6	24.8	24.8	24.5
Commercial real estate loanns	9.1	8.8	9.1	9.2	7.4	7.5
Household debt						
Household debt to GDP	47.7	46.3	45.8	46.2	43.5	42.9
Household debt to disposable income	76.3	78.8	77.8	77.8	73.4	71.2
Household debt service to disposable income	7.7	8.6	9.3	9.7	9.5	9.3

Sources: Financial Soundness Indicators Database and Haver.

Table 6. South Africa: Medium Term Macroeconomic Framework, 2013–23

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Est.				Proj.		
National income and prices (annual percentage change)											
Real GDP	2.5	1.8	1.3	0.6	1.3	1.5	1.7	1.8	1.8	1.8	1.8
CPI (annual average)	5.8	6.1	4.6	6.3	5.3	4.9	5.3	5.4	5.5	5.5	5.5
Output gap (percent of potential real GDP)	0.0	-0.1	-0.1	-0.7	-0.6	-0.5	-0.3	-0.2	-0.1	-0.1	-0.1
Labor market (annual percentage change)											
Unemployment rate (percent of labor force, annual average)	24.7	25.1	25.4	26.7	27.5	27.9	28.3	28.6	28.7	28.9	29.0
Savings and Investment (percent of GDP)											
Gross national saving	15.4	15.4	16.4	16.6	16.1	15.6	15.4	15.5	15.6	16.0	16.4
Public (incl. public enterprises)	-0.9	1.1	1.0	0.8	0.3	0.5	0.6	0.6	0.6	0.7	0.8
Private	16.2	14.3	15.3	15.7	15.8	15.1	14.8	14.9	15.0	15.3	15.6
Investment (including inventories)	21.2	20.5	21.0	19.4	18.6	18.5	18.7	18.8	18.9	19.4	19.8
Public (incl. public enterprises)	7.1	6.9	7.4	7.2	6.9	6.9	6.8	6.8	6.8	6.8	6.8
Private	13.3	13.5	13.0	12.3	11.8	11.8	12.0	12.1	12.3	12.4	12.5
Fiscal position (percent of GDP) 1/											
Revenue, including grants	27.3	27.6	28.1	28.6	28.3	29.0	29.5	29.7	29.8	30.0	30.1
Expenditure and net lending	31.6	31.9	32.9	32.7	32.9	33.3	33.6	33.7	33.8	33.8	33.8
Overall balance	-4.3	-4.3	-4.8	-4.1	-4.6	-4.3	-4.0	-4.0	-3.9	-3.9	-3.8
Primary balance	-1.3	-1.2	-1.5	-0.6	-1.0	-0.5	0.0	0.1	0.2	0.3	0.5
Gross government debt 2/	44.1	47.0	49.3	51.6	53.0	55.0	56.0	57.0	57.6	58.1	58.5
Balance of payments (percent of GDP unless otherwise indicated)											
Exports of Goods and Services (volume, annual percentage change)	4.0	3.6	2.8	1.0	-0.1	3.7	3.4	3.3	3.3	3.3	3.3
Imports of Goods and Services (volume, annual percentage change)	5.0	-0.6	5.4	-3.8	1.9	4.0	3.9	3.3	3.3	3.3	3.3
Current account balance (billions of U.S. dollars)	-21.2	-17.8	-14.6	-8.2	-8.6	-11.0	-12.7	-13.4	-14.0	-14.8	-15.6
percent of GDP	-5.8	-5.1	-4.6	-2.8	-2.5	-2.9	-3.3	-3.3	-3.3	-3.4	-3.4
Overall balance	0.1	0.4	-0.3	0.9	0.5	0.2	-0.2	-0.1	0.0	0.0	0.0
Gross reserves (billions of U.S. dollars)	49.6	49.1	45.8	47.4	50.7	51.5	50.7	50.3	50.3	50.2	50.2
percent of short-term debt (residual maturity)	125.9	100.5	106.9	118.3	102.0	94.9	76.7	79.1	76.3	73.8	71.2
Total external debt	37.2	41.3	39.1	48.3	49.6	46.1	47.0	47.5	48.0	48.4	48.8

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

1/ Consolidated government unless otherwise indicated.

2/ National government.

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

	2012	2013	2014	2015	2016	2017
Financial indicators						
Gross government debt (percent of GDP)	41.0	44.1	47.0	49.3	51.6	53.0
Broad money (annual percentage change)	5.2	5.8	7.2	10.5	6.1	6.9
Private sector credit (annual percentage change)	9.3	7.1	7.2	8.0	4.7	4.4
91 day Treasury bill yield (percent, end-period)	5.3	5.1	5.8	6.1	7.2	7.5
91 day Treasury bill yield (real, percent, end-period) 1/	-0.4	-0.7	-0.3	1.5	0.6	2.0
External indicators						
Exports (annual percentage change in U.S. dollars)	-8.4	-3.5	-3.3	-13.7	-5.4	15.4
Export volume (goods and services, annual percentage change)	0.8	4.0	3.6	2.8	1.0	-0.1
Imports (annual percentage change in U.S. dollars)	2.1	-0.6	-5.2	-14.4	-12.2	12.1
Import volume (goods and services, annual percentage change)	4.2	5.0	-0.6	5.4	-3.8	1.9
Terms of trade (annual percentage change) 2/	-4.0	-1.4	-1.5	3.0	1.4	4.7
Current account balance (percent of GDP)	-5.1	-5.8	-5.1	-4.6	-2.8	-2.5
Capital and financial account, excl. financial derivatives (percent of GDP)	6.0	5.0	6.5	4.7	4.3	2.8
of which: Net portfolio investment (debt and equity)	3.5	3.0	3.8	3.0	5.5	4.7
Other investment (loans, trade credits, etc.)	2.2	1.5	3.2	2.9	-0.5	-0.2
Net foreign direct investment	0.4	0.5	-0.5	-1.3	-0.8	-1.7
Gross international reserves (billions of U.S. dollars)	50.7	49.6	49.1	45.8	47.4	50.7
in months of prospective imports of goods and services	5.0	5.1	5.9	6.2	5.7	5.6
in percent of broad money	18.2	20.7	21.1	24.0	20.5	18.5
in percent of short-term debt, residual maturity	112.3	125.9	100.5	106.9	118.3	102.0
Net international reserves (billions of U.S. dollars)	47.9	45.5	42.7	40.7	40.8	42.9
Foreign currency forward position (billions of U.S. dollars)	5.2	3.6	2.0	1.4	1.8	1.2
Total external debt (percent of GDP)	35.8	37.2	41.3	39.1	48.3	49.6
percent of export earnings	114.6	113.5	131.4	129.6	157.3	166.7
External interest payments (percent of export earnings)	4.4	4.9	5.2	7.0	7.1	7.6
External amortization payments (percent of export earnings)	29.4	39.8	35.7	51.0	47.2	38.5
Exchange rate (Rand/U.S. dollar, period average)	8.2	9.7	10.8	12.8	14.7	13.3
Real effective exchange rate (annual percentage change, period average)	-5.4	-10.5	-6.2	-0.5	-7.2	12.8
Financial market indicators						
Stock market index (end-period)	39,250	46,256	49,771	50,694	50,654	59,505
Net purchases of bonds by nonresidents (billions of U.S. dollars)	10.4	0.1	-5.1	-2.3	-2.4	1.7
Net purchases of shares by nonresidents (billions of U.S. dollars)	-0.4	0.0	1.2	-0.3	-8.2	-3.6

Sources: Haver and IMF staff calculations.

1/ Nominal yield deflated by current CPI inflation.

2/ The terms of trade include gold.

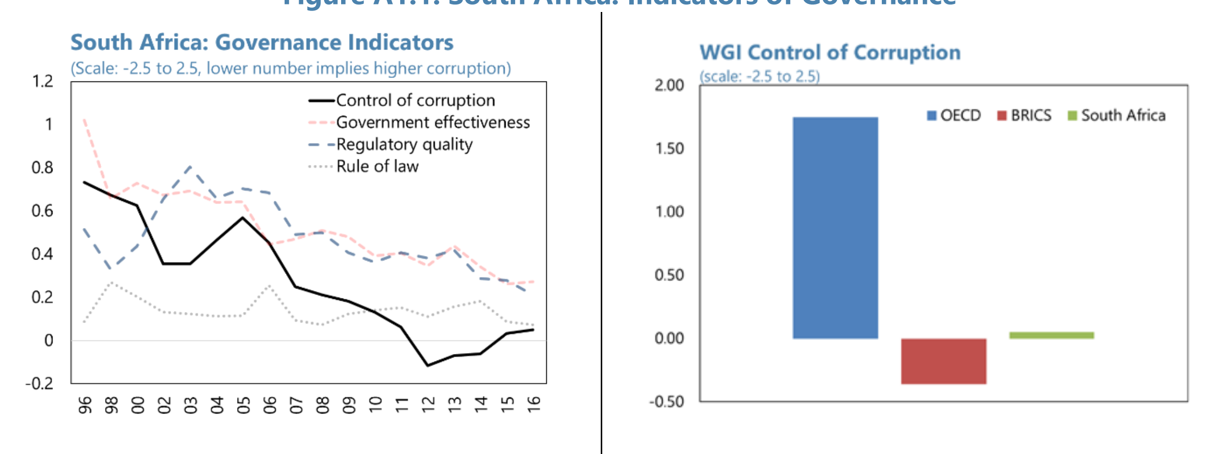
Annex I. Governance, Corruption, and Economic Performance[1]

Most governance indicators, notably the perception of corruption, have deteriorated markedly in South Africa since the turn of the century. This deterioration has gone hand in hand with stalling economic performance and rising fiscal risks. The new administration has committed to improve governance and reduce corruption, and has already implemented some important measures, which could usefully be complemented with additional efforts to strengthen the legal framework and capacity of institutions. The gains from improved governance and combating corruption could be significant in terms of growth, employment creation, and social inclusion.

Rising Corruption, Deteriorating Governance

1. **The perception of corruption in South Africa has deteriorated markedly in the last two decades**. The Worldwide Governance Indicators control of corruption has been on a clear deteriorating trend.[2] This indicator measures the "perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests." This deterioration is associated with a decline in government effectiveness, regulatory quality, and the rule of law. While South Africa's score fares somewhat better than the BRICS average, it lags significantly compared to the OECD average.

Figure A1.1. South Africa: Indicators of Governance



Source: IMF staff estimates based on WEF.

Sources: IFS, IMF staff estimates.

2. **The mechanics of corruption in the South African economy are summarized most prominently in the "State of Capture" report released by the public protector in 2016**. It points to the extent to which established policies and executive nominations were influenced by private individuals with access to power. The report states that contracts in SOEs were tailored to benefit specific companies and individuals, contravening good governance practices and, in various

[1] Prepared by Vimal Thakoor.

[2] Broadly similar trends are also apparent from other corruption indicators (ICRG Corruption Index and Transparency International CPI).

instances, violating the PFM Act. The report adds that ministers, public officials, and SOE Board members perceived as inflexible were removed from their positions and replaced by others perceived as more malleable. The departure of key officials also saw a hollowing out of government institutions, particularly at the National Treasury and SARS. Policies adopted in the environment of state capture led to elevated levels of policy uncertainty.

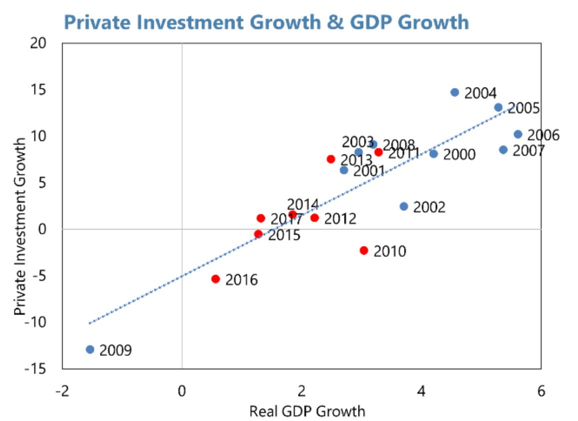
Adverse Economic Impact

3. Governance and corruption have been associated with worsening economic performance in South Africa:

- **Private investment has been subdued.** The business environment has deteriorated, with corruption consistently ranked as one of the top five deterring factors for investment. Other factors, such as red tape, inefficient bureaucracy, and policy instability, are also linked to corruption. The slowdown in private investment—a consequence of the problematic business environment—has led in turn to the overall slowdown in economic growth.

Figure A1.2. South Africa: Indicators of Governance

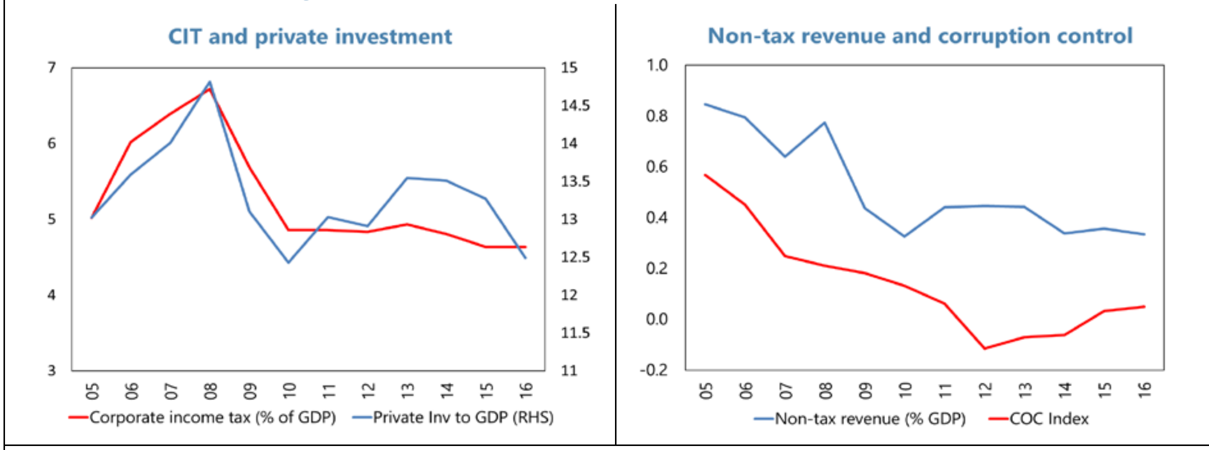
Source: IMF staff estimates based on WEF.



Sources: IFS, IMF staff estimates.

- **The efficiency of the tax system has been compromised**. The Davis Tax Committee noted that the SARS had been constrained in its ability to collect taxes due to personnel and policy changes, resulting in, among other things, poor compliance of high net worth individuals and multinationals. There have also been broader concerns regarding declining tax morality, which is linked to the unwillingness of taxpayers to comply in the absence of improved public services. A disaggregation of the tax revenue shows that corporate income tax and non-tax revenue have declined markedly. While it is hard to estimate the share of the decline that can be attributed to governance weaknesses, the slowdown in private investment and the SARS capacity constraints certainly played a role in this behavior.

Figure A1.3. South Africa: Indicators of Governance



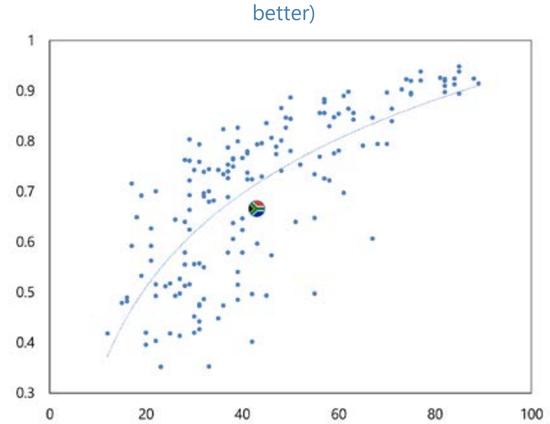
Source: World Governance Indicators, South African authorities, and IMF staff calculations.

- **Public procurement has weakened.** Weak enforcement of existing rules has undermined public procurement as the procedures applied in practice (e.g., cash payments and open bids) and widespread exceptions to competitive bidding (e.g., for emergencies, single provider availability and difficulty in compiling specifications) have led to irregularities, lack of transparency, and perceptions of unfairness. Small tenders with contracts that account for nearly 2 percent of GDP have not been subject to open bids. Additionally, some government programs have been diverted by the service providers, which in turn has blunted their efficiency and efficacy.

- **The financial performance of SOEs has deteriorated markedly**. Official analysis of the situation of SOEs, such as Eskom, Denel and SAA, attributes cost overruns to weak governance and tailored contracts. SOEs, in turn, have continued to weigh on the fiscus, both from the materialization of contingent liabilities and their low returns.

Figure A1.4. South Africa: Corruption Perception Index and Human Development

(scales: 0-100 for CPI and 0-1 for HDI; Higher scores better)



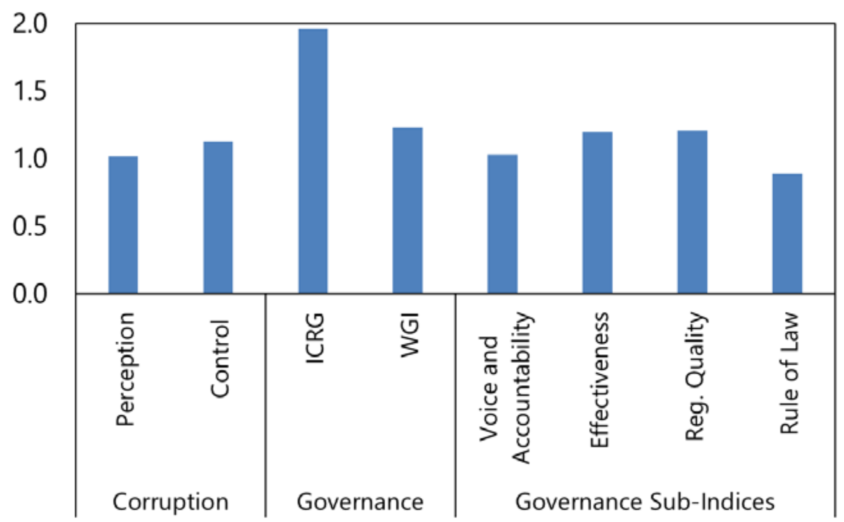
Source: World Development Indicators

Significant Gains from Improving Governance and Reducing Corruption

4. Improving governance, particularly reducing corruption, could be associated with significant development benefits for the economy. The possibility of higher private investment, more efficient government spending, and increased investment in human capital will provide equality of opportunities and level the playing field. Figure A1.4 shows that lower levels of corruption perception are associated with higher levels of human development.

5. The growth gains from reducing corruption could be significant. Notwithstanding concerns regarding the definition of corruption and endogeneity (Hammadi et al, forthcoming), there is a clear association between the level of corruption and growth. To isolate the causal effects of corruption on growth, the authors use system GMM and control for other determinants of growth and include an SSA dummy to isolate the specificities of the region. The results, in line with other studies on SSA, are shown in Figure A1.5. A 10-point improvement in corruption perceptions in the average SSA country is associated with an increase in GDP per capita growth of about 1 percentage point. South Africa's corruption perception index (43) is slightly lower than the global average (44.3). Improving the score by 10 points, 2 points higher than its 2007 score, could be associated with a 1 percentage point increase in growth. Of course, significantly higher gains could be achieved if South Africa increases beyond these levels. There are thus clear gains to be achieved by delivering on the fight against corruption and building on the policies already initiated.

Figure A1.5. South Africa: Correlation between Growth and 10-point Improvement in Indices



Source: Hammadi et al, IMF Working Paper (Forthcoming).

Annex II. Containing Fiscal Risks from Eskom, the Electricity Public Utility[1]

Eskom's weak financial operations and significant financing needs heighten fiscal risks, constrain economic growth, and could have significant spillovers on financial markets. Eskom's difficulties reflect a combination of weak governance, operational inefficiencies, and an increasingly outdated business model. Near-term policy action needs to focus on containing the deterioration in Eskom's balance sheet and addressing the governance concerns. In parallel, there is a need to rethink the strategic orientation of Eskom with a view to updating its business model and encouraging strategic equity partnership with the private sector to leverage emerging technological advances in electricity generation. An efficient electricity sector is vital for South Africa's economic competitiveness.

Macro-Criticality of Eskom

1. Eskom's role and size make it macro-critical for the South African economy. The utility is the largest producer of electricity in Africa. It stands among the top seven utilities in the world in terms of generation capacity and among the top nine in terms of sales. Eskom supplies over 90 percent of the electricity used in South Africa and exports to other countries in the region. It is the largest SOE in the country, with assets estimated at $65 billion, or about 16 percent of GDP. The deterioration in its governance and finances poses significant fiscal and financial risks, as well as broader risks to the economy should Eskom's inability to finance its operations disrupt the electricity supply. On the fiscal side, the main risks arise from the needed direct government support and the materialization of contingent liabilities (government guarantees). Given the direct and indirect linkages, significant risks also arise for the banking system and financial sector.

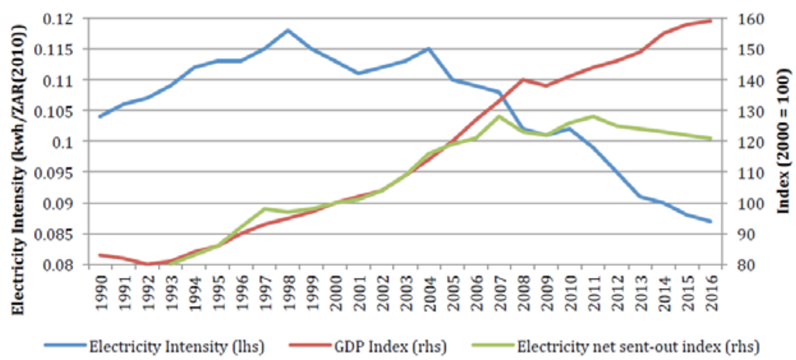
Weakening Financial Operations

2. Eskom's weaker revenue reflects a combination of lower demand, lower than expected price adjustments, and increasing municipal arrears:

- ***Demand has been lower than projected*** due to lower-than-anticipated economic growth relative to Eskom's projections. Moreover, the existing cross-subsidization from industrial to domestic consumers has accentuated grid defection, increasing incentives for major private firms (particularly, in energy-intensive sectors like mining) to set up their own plants and generate electricity at a lower cost, or increase their energy efficiency. Eskom's market share is also affected by independent power producers that have joined the grid following the energy crisis in 2013. Hence, overall demand has plateaued relative to projections (Figure A2.1). Electricity sales in FY17/18 are also expected to be lower relative to projections.

[1] Prepared by Vimal Thakoor.

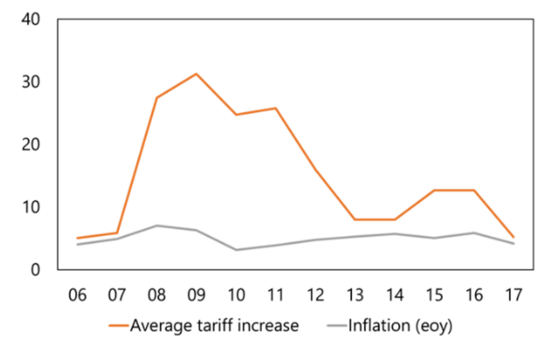
Figure A2.1. South Africa: Eskom's Provision of Electricity and GDP



Source: Lovins and Eberhard (2018).

- ***Price adjustments have been insufficient to cover operational and investment costs.*** Tensions with the energy regulator (NERSA) have significantly affected Eskom's revenues. While Eskom's multi-year price determination plan (MYPD3) was premised on price increases averaging 8 percent a year over FY13–18, the actual price adjustment has been more in line with inflation. In FY17/18, Eskom applied for a tariff adjustment of 19.9 percent, but was granted only 5.2 percent. NERSA argued that Eskom should not pass its inefficiencies to end-users, and that increases of the proposed magnitude are not economically and politically sustainable. Should the magnitude of price adjustments remain aligned with inflation, additional shortfalls for Eskom could arise relative to expectations. Price uncertainties complicate business investment decisions, particularly in energy intensive sectors.

Figure A2.2. South Africa: Eskom: Average Tariff Increase FY06/07–17/18
(Percent)



Sources: Authorities and IMF staff calculations.

- ***Eskom's arrears from municipalities*** have continued to accumulate and now stands at over $1 billion. Since municipalities collect electricity payments on behalf of Eskom for a fee, the resolution to these arrears becomes a political decision with fiscal implications, given the parlous state of the municipal finances. While awaiting a resolution, these arrears continue to weigh on Eskom's balance sheets.

3. Higher expenditure is the result of governance problems resulting in excessive procurement expenses and cost overruns related to investment projects.

- ***Eskom is one of the SOEs adversely affected by "state capture"***. Several analyses, including official ones, state that Eskom's deteriorated governance and procurement structures led to renegotiation of several contracts, sidelining previous long-term suppliers in favor of a new provider with limited experience, who delivered inferior quality coal at a higher price. Moreover, there were various departures from the PFM Act with conflicts of interest as a segment of Eskom staff engaged in procurement and service delivery to Eskom. Finally, as the internal capacity was wound down, key services were outsourced to consultancy firms at inflated costs.

- ***The procurement process for important investment projects was also jeopardized by cost overruns.*** This reflected both delays in project completion and higher-than-market costs. In addition, tenders for selected projects were tailored at a higher cost without going through proper procurement processes.

4. Higher net operating costs worsened Eskom's indebtedness, raised financing costs, and increased the risk to the sovereign. Despite the above-inflation tariff adjustments—in part to cover its investment program—Eskom produces at a loss and its paper is rated as sub-investment. Notwithstanding a R23 billion (0.5 percent of GDP) state bailout and the transformation of an earlier R60 billion (1.2 percent of GDP) subordinated loan into equity in 2015, and state guarantees of R350 billion (7 percent of GDP), Eskom has been forced to procure financing from development finance institutions. Eskom's debt to equity ratio is above 70 percent and it needs R60–80 billion (1½ percent of GDP) per year for the next five years to cover its capital spending. Eskom's liquidity is under increasing pressures, and the spread on its bonds is now above 100 basis points relative to the benchmark.

5. Concerns regarding the deteriorating governance and Eskom's solvency brought the company to the brink of default in early 2018. The appointment of a new board and management restored the access to the market, and the clarification of the role of the tender committee in contract allocations is expected to contain slippages.

6. Measures are needed to contain the deterioration in Eskom's balance sheet and consider the future of Eskom and electricity provision in South Africa. The appointment of the new Eskom board is a step in the right direction towards dismantling the networks that jeopardized the governance structures of the institution. Further steps are needed to lower costs, particularly revisiting expensive contracts, reducing overstaffing, and disposing of unproductive and non-core assets to raise revenue. In parallel, it is essential to rethink the business model for electricity provision in South Africa, as coal generation is becoming increasingly costly relative to cleaner sources, exposing Eskom to the risk of stranded assets. Given Eskom's size, restructuring the company is not easy. Hence, it is necessary to unbundle the generation, transmission, and distribution segments and allow strategic equity partnership with the private sector in the process. Running Eskom on a commercial basis will have the advantage of improving the quality and lowering the inefficiencies in its operations.

Annex III. External Sector Assessment

<table>
<tr><th></th><th>South Africa</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. South Africa’s economy is highly integrated into international financial markets, with large external assets and liabilities. After valuation effects led to a marked improvement of the net international investment position (NIIP) in 2015 (from –8 percent of GDP at end-2014 to 16 percent of GDP one year later), the NIIP has remained strong, standing at 12 percent of GDP as of end-2017. However, the NIIP is expected to weaken somewhat over the medium term on account of current account deficits (CA). Gross external debt rose to 49.6 percent of GDP at end-2017 from 26 percent of GDP at end-2008 on the back of an increase in long-term debt. Short-term external debt (residual maturity) amounted to 14.2 percent of GDP at end-2017.
Assessment. Large gross external liabilities pose risks. Mitigating factors include the comfortable external asset position and the sizable rand-denominated share of external debt (about half of total external debt).</td><td rowspan="6">Overall assessment:
The external position of South Africa in 2017 was moderately weaker than implied by fundamentals and desirable policy settings.

In 2017, the CA gap remained broadly unchanged, and South Africa remains highly reliant on non-FDI flows to finance its relatively high current account deficit. Despite several years of REER depreciation until recently, structural rigidities result in a relatively slow pace of CA adjustment. Developments since end-2017 do not change the assessment.
Potential policy responses:
Several measures would help to reduce the external position gap, including improving competitiveness and increasing employment and savings. These measures include fostering entry into key product markets (such as power generation, transportation, and telecommunications); upgrades in infrastructure and education/skills within the fiscal envelope; and greater financial inclusion. Preserving government debt sustainability, and accelerating labor and product market reforms are also essential to continue to attract foreign inflows, especially durable inflows such as FDI. Seizing opportunities—such as large FDI inflow transactions—to accumulate reserves would strengthen the country’s ability to deal with FX liquidity shocks.</td></tr>
<tr><td>Current account</td><td>Background. The CA deficit narrowed to 2.5 percent of GDP in 2017 from 2.8 percent in 2016, owing to a further improvement in the trade balance as terms-of-trade gains more than outweighed a pick-up in domestic demand. The CA deficit is projected to widen to around 3 percent of GDP in 2018 as the surplus on the trade balance moderates.
Assessment. The CA regression model estimates a CA norm surplus of 0.7 percent of GDP. However, an adjustment to the norm of 1.1 percent of GDP is needed given special demographic factors relative to other countries in the regression sample. 1/ Therefore, staff considers a CA norm of -0.4 percent of GDP. Over time, as policy uncertainty may unwind following the new administration’s initial announcements, the CA norm may be further reduced. The cyclically-adjusted CA stood at -2.5 percent of GDP in 2017. However, given statistical treatments related to the transfers and income accounts, an additional adjustment of 0.8 percent of GDP is needed. Hence, staff considers a revised cyclically-adjusted CA of -1.7 percent of GDP, implying a CA gap of -1.3 percent of GDP. The CA gap is largely explained by structural factors not captured by the model. 1/</td></tr>
<tr><td>CA Assessment 2017</td><td><table><tr><td>Actual CA</td><td>-2.5</td><td>Cycl. Adj. CA</td><td>-2.5</td><td>EBA CA Norm</td><td>0.7</td><td>EBA CA Gap</td><td>-3.2</td><td>Staff Adj.</td><td>-1.9</td><td>Staff CA Gap</td><td>-1.3</td></tr></table></td></tr>
<tr><td>Real exchange rate</td><td>Background. After several years of REER depreciation, the CPI-REER appreciated by 12.4 percent on average in 2017 relative to 2016. Despite renewed depreciation in the second half of 2017, a marked appreciation at the turn of the year more than reversed this weakening. As of May 2018, the REER had appreciated an additional 5.6 percent relative to the 2017 average.
Assessment. The REER is assessed through two REER-based regressions and by computing the implied REER gap from the CA gaps. The CA approaches, to which staff puts greater weight, point to overvaluation of 2–9 percent. The REER approaches point to undervaluation of between 7.4 percent (level approach) and 13.4 percent (index approach), but these results are considered less reliable. 2/ Staff assesses a REER overvaluation of 0–10 percent for 2017, broadly consistent with the CA gap. 3/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. Net FDI flows at -1.7 percent of GDP in 2017 marked the fourth consecutive year with net FDI outflows. Portfolio investment remained strong at 4.7 percent of GDP, becoming the main source of financing of the CA deficit. Gross external financing needs stood at 14 percent of GDP in 2017.
Assessment. High reliance on non-FDI flows and high nonresident holdings of local financial assets pose risks. These are mitigated by a floating exchange rate, the fact that nonresident portfolio holdings are mainly denominated in local currency, and a large domestic institutional investor base.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. South Africa has a floating exchange rate regime. Foreign exchange intervention is rare. At end-2017, international reserves were the equivalent to 14.5 percent of GDP, down from 16 percent the year before. They cover 5½ months of projected imports, but are below the IMF’s composite adequacy metric (64 percent of the metric without considering existing capital flow management measures, and 70 percent of the metric after considering them).
Assessment. As conditions allow, reserve accumulation is desirable to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.</td></tr>
</table>

Technical background notes

1/ The staff-assessed CA gap uses results from the EBA CA regression, the External Sustainability (ES) approaches, and staff's judgment.

- As South Africa is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime-age and exit age from the workforce. This results in an adjustor of -1.1 percent of GDP to the model-estimated CA norm.
- Net current transfers related to the Southern African Customs Union (SACU), which are assessed to have a net negative impact on the CA, are not accounted for in the regression model and therefore warrant an adjustment of the cyclically adjusted CA. In addition, large and positive IIP valuation changes relative to other countries in the sample point to the need for adjusting the cyclically-adjusted CA gap. The adjustment is 0.8 percent of GDP.
- The ES approach compares the CA balance expected to prevail in the medium term with the one that would stabilize South Africa's stock of net foreign assets at its EM peers' benchmark (-35 percent of GDP). According to the ES approach, stabilizing South Africa's NIIP at the level of EM peers would require a CA deficit of 1.4 percent of GDP. Compared to staff's adjusted medium term projection of a CA deficit of 3.6 percent of GDP, the latter implies a CA gap of -2.3 percent of GDP.

2/ Gauging the appropriate REER for South Africa is challenging as the pre-2000 average REER was at a more appreciated level than the post-2000 average. In this context, REER regression-based models are likely to point to undervaluation, unless they can link the full downward trend of the REER to deteriorating fundamentals.

3/ Applying a long-run elasticity estimate of 0.27 would suggest a REER overvaluation of 2–9 percent. However, considering the uncertainty regarding the estimates as well as the REER-regression results, staff assesses REER overvaluation in the order of 0–10 percent.

Annex IV. Bank Lending and Economic Growth[1]

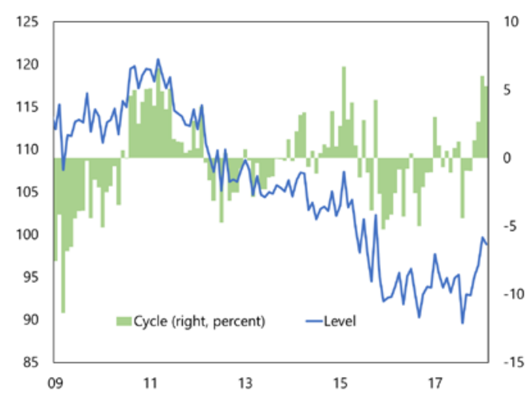
Relying on three complementary econometric approaches, this note assesses macro-financial linkages in South Africa by including medium-sized and small banks in the analysis, and assessing the role of business confidence in these linkages. Results show that (i) the decline in business confidence since 2011 has adversely affected bank lending, particularly that of medium-sized and, to a lesser extent, small banks; (ii) in the last decade, bank balance sheet conditions have weakened with macroeconomic factors, but the extent of spillback from bank lending to economic growth has been muted due likely to low confidence and growth; and (iii) the spillback from back lending to economic activity was stronger in the past, through 2007. Looking ahead, banks would support growth recovery as aggregate demand becomes more responsive to bank lending following the recovery in confidence and growth.

1. This note brings two innovations to the assessment of macro-financial linkages in South Africa by:

- ***Adding medium-sized and small banks to the analysis.*** Preceding studies focused on the largest 4–5 banks representing more than 90 percent of the system assets. However, the aggregate picture could mask significant diversity in the banking system. This analysis adds data on medium-sized and small banks available from the South African Reserve Bank (SARB). Medium-sized and small banks tend to have higher equity capital and non-performing loans, and different funding profiles compared to large banks (SIP 3—Buffers).

- ***Looking at the impact of business confidence on bank lending.*** The hypothesis is that business confidence, which has declined since 2011 to very low levels (Figure A4.1), could have depressed private investment, and dampened economic growth and demand for bank credit.[2] At the same time, banks would have allocated their portfolio away from lending to safer assets, such as government bonds. The impact of confidence on bank lending could have been larger for medium-sized and small banks. This could be the case as these banks tend to lend relatively more to corporates. Corporates' demand for credit is dictated by investment decisions that would be sensitive to the degrees of confidence and uncertainty. Alternatively,

Figure A4.1. South Africa: Indicator of Business Confidence in South Africa



Sources: SACCI Business onfidence Index (NSA, 2015=100) and IMF staff calculations.

[1] Prepared by Ken Miyajima.

[2] In the regression analysis, confidence and GDP growth are likely correlated, are introduced one at a time and together to see if results change.

these banks may be perceived as less resilient and thus more constrained from the funding side. In anticipation, these banks may have curtailed lending even before facing funding constraints.

2. **Results of the first econometric model suggest that the decline in business confidence since 2011 has impacted banks differently** (Table A4.1). In the econometric model, bank-level lending growth in real terms is explained by monthly bank-level data for 2009M1–17M11 and macro-level data (Box A4.1). Looking at models with bank dummies, which capture different lending behavior, confidence has had a particularly important effect on bank lending by medium-sized banks (and to some extent, small ones). Lending by large banks has been more dependent on economic activity. Bank balance sheet conditions affect bank lending policies in diverse ways—large and small banks rely more importantly on asset quality, while medium-sized banks' lending is more dependent on capital (even though the coefficients for medium-sized and small banks lose statistical significance when bank dummies are introduced).[3]

Box A4.1. South Africa: The Model

Starting from a pooled model, individual bank dummies are introduced. The explanatory variables are interacted with bank-size dummies to account for bank heterogeneity. An indicator of business confidence (detrended) captures the impact of a range of factors, including policy and political uncertainty. Real GDP growth represents 12-month ahead constant horizon forecasts built from current year and one-year ahead growth surveyed by Consensus Economics. Non-performing loans (NPLs) and total capital ratios capture balance sheet conditions of more than 30 banks, including those beyond the largest banks. The VIX (detrended) captures global financial conditions. Bank-level variables are lagged by one period. Macro-level variables are used contemporaneously.

3. **A second analysis suggests that since 2009, weakening macroeconomic factors have negatively affected bank balance sheets, but the extent of spillback has been muted**. To assess how much spillback bank lending exerts on macroeconomic variables, a panel VAR was estimated. This approach is more suited to capture the role of medium-sized and small banks than a pooled VAR, whose results are influenced mainly by large banks. The model uses a set of macro-level (confidence and GDP growth) and bank-level (real growth rates of credit and deposits) variables. The hypothesis is that in a context of weak confidence and growth, higher bank lending would hardly stimulate demand. Similarly, withdrawal of lending by one bank would not lead to lower domestic demand to the extent that it would be replaced by provision of credit by another bank as they compete for creditworthy customers. Key findings, illustrated in Figure A4.2, are as follows:

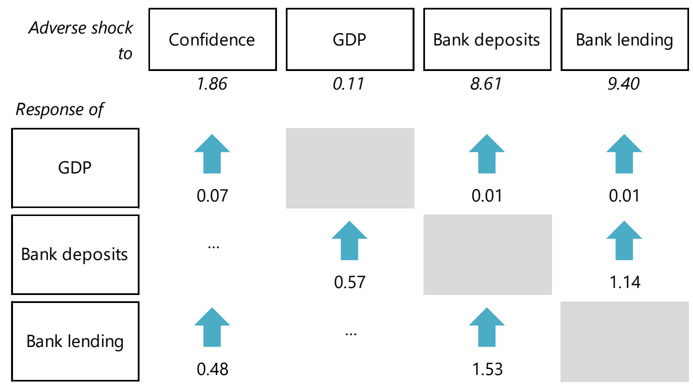
- ***Stronger confidence boosts output growth and moderately increases credit growth***. An increase in confidence by one standard deviation (1.9 percentage points) raises output growth by 0.05–0.1 percentage point (1/2 of a standard deviation) and real credit by 0.5 percentage point (a minor increase relative to one standard deviation movement). Here, business confidence may capture anticipated demand for credit. An increase in output

[3] Results were broadly similar when confidence was treated as a proxy for anticipated loan demand and lagged (a three-period lag worked best).

growth by one standard deviation (0.1 percentage points) lifts growth of deposits by 0.6 percentage point.

- ***Feedback loops between deposits and credit are clear.*** Higher deposits allow banks to lend more while greater credit extension prompt banks to collect more deposits. For instance, when deposit growth increases by one standard deviation (8.6 percentage points), credit growth is boosted by 1.5 percentage points.

Figure A4.2. Monthly Panel Model of Macro-Financial Linkages in South Africa[1/]

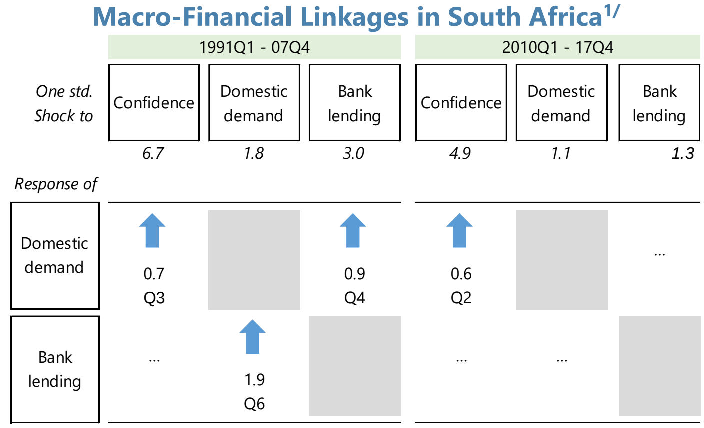


Sources: Haver and IMF staff estimates.
1/ Panel VAR in Love I. and L. Zicchino. 2006. "Financial development and dynamic investment behavior: Evidence from panel VAR" Quarterly Review of Economics and Finance, 190-210. Twelve lags. Monthly data for 2009M1-2017M11. Confidence in cycle around HP trend and GDP growth. Bank level data for real growth rates of deposits and lending. Numbers represent percentage point response to a one standard deviation shock, indicated underneath variable name.

- ***Balance sheet conditions have limited spillback to output growth.*** The extent to which higher growth of deposits or credit (by one standard deviation) boosts output growth is economically insignificant (by one-tenth of its one standard deviation movement).

4. **A third analysis reveals that the spillback from bank lending to economic activity was stronger through 2007**. A different VAR model that uses only macro-level variables (detrended business confidence, and real growth rates of domestic demand and bank credit) for an extended period (1991Q1–17Q4) was estimated for two sub-periods, 1991Q1–07Q4 and 2010Q1–17Q4. Figure A4.3 shows that during the first sub-period, stronger confidence boosts domestic demand, which in turn increases bank credit (stronger confidence does not directly transmit to higher bank credit). In turn, higher bank credit spills back to boost domestic demand, creating a positive feedback loop between the two variables. This channel of transmission appears to be absent during the second sub-period—stronger confidence boosts domestic demand, but other linkages are

Figure A4.3. South Africa: Quarterly Macro Model of Macro-Financial Linkages in South Africa[1/]



Sources: Haver and IMF staff estimates.
1/ Confidence represents cycle around HP trend, domestic demand and bank lending real year on year growth. VAR with 4 lags. Generalized impulse response. Arrows illustrate the direction of response to one standard deviation shock (size indicated underneath variable name), value underneath arrows percentage point response, and quarter reaching peak. "..." when statistically insignificant.

statistically weak. This is consistent with the previous analysis using the monthly panel VAR (see the previous paragraph for the discussion of the hypothesis).

5. Looking ahead, as the nexus between bank lending and economic growth is enhanced, banks would support growth recovery. The linkage between bank lending and domestic demand has weakened in the presence of weak confidence and growth. As confidence recovers and output growth takes off, aggregate demand is expected to become more responsive to credit. Bank lending would then reestablish its role of supporting economic activity. Higher capital ratios and lower NPLs would further facilitate banks' responsiveness to credit demand, creating virtuous macro-financial feedback loops.

Table A4.1. South Africa: Determinants of Bank Level Real Credit Growth: 2009M01–17M11

Model		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
Real credit growth	L1	0.841***	0.840***	0.840***	0.841***	0.809***	0.810***	0.829***	0.830***	0.807***	0.808***	0.827***	0.827***	0.804***	0.805***	0.827***	0.827***	0.804***	0.804***
NPL ratio	L1	-0.707*	-0.711*	-0.709*	-0.709*	-0.741	-0.75	...	...	...	...	...	...	...	...	...	...	...	...
... * large bank	L1	...	...	...	...	...	...	-1.066**	-0.713	-4.163***	-7.785**	-1.000**	-1.040**	-4.403***	-4.543***	-1.087**	-1.132**	-4.467***	-4.610***
... * medium bank	L1	...	...	...	...	...	...	-0.715	-0.671	1.236	1.353	-0.731	-0.728	1.17	1.162	-0.716	-0.714	1.316	1.303
... * small bank	L1	...	...	...	...	...	...	-1.155***	-1.148***	-1.943	-1.576	-1.171***	-1.164***	-2.003	-2.009	-1.162***	-1.156***	-2.006	-2.014
Total capital ratio	L1	0.089**	0.088**	0.088*	0.087*	0.068	0.066	...	...	...	...	...	...	...	...	...	...	...	...
... * large bank	L1	...	...	...	...	...	...	-0.059	0.006	-0.148	0.510*	-0.049	-0.061	-0.059	-0.088	-0.07	-0.082	-0.142	-0.176
... * medium bank	L1	...	...	...	...	...	...	0.192***	0.188***	-0.035	-0.021	0.194***	0.193***	-0.052	-0.059	0.192***	0.190***	-0.051	-0.058
... * small bank	L1	...	...	...	...	...	...	0.045	0.036	0.112	0.053	0.043	0.043	0.105	0.105	0.043	0.042	0.106	0.106
GDP growth		0.578	...	-0.093	-0.072	-0.069	-0.053	...	...	...	...	...	...	...	...	...	...	...	...
...* large bank		...	...	...	...	...	...	0.604***	1.556	0.658***	1.252	...	...	...	...	0.432***	0.622	0.455***	0.332
... * medium bank		...	...	...	...	...	...	0.57	1.508	0.594	1.226	...	...	...	...	-0.725	-0.548	-0.858	-0.897
... * small bank		...	...	...	...	...	...	0.586	1.526	0.634	1.267	...	...	...	...	-0.012	0.164	0.065	0.015
Confidence		...	0.203***	0.214***	0.199**	0.221***	0.210**	...	...	...	...	...	...	...	...	...	...	...	...
... * large bank		...	...	...	...	...	...	...	...	...	...	0.108***	0.097***	0.119***	0.109***	0.057*	0.043	0.066**	0.053
... * medium bank		...	...	...	...	...	...	...	...	...	...	0.329**	0.318**	0.365**	0.354**	0.409***	0.395***	0.458***	0.445***
... * small bank		...	...	...	...	...	...	...	...	...	...	0.191**	0.180**	0.191**	0.180*	0.192*	0.180*	0.183*	0.171
VIX		...	...	...	-0.032	...	-0.025	...	-0.056	...	-0.057	...	-0.029	...	-0.028	...	-0.028	...	-0.028
Bank dummies		...	...	...	...	Y	Y	...	...	Y	Y	...	...	Y	Y	...	...	Y	Y
_cons		-0.926	-0.901	-0.9	-2.735**	-1.331	-3.056	-1.131	-2.911**	-5.000**	-17.158**	-1.108	-3.105**	-6.003***	-16.941***	-1.081	-3.061**	-5.495***	-16.411**
N		2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837	2837
r2_a		0.726	0.727	0.726	0.725	0.729	0.728	0.727	0.726	0.729	0.728	0.728	0.727	0.729	0.728	0.727	0.726	0.729	0.728

Source: Author's calculations.

Note: " ...* large bank" represents an interaction term with the above mentioned variable. L1 when lagged by one period. Large bank = top 5, medium bank = next 7, small bank = rest. ***, **, * when significant at 1%, 5%, 10% level.

Annex V. Public Debt Sustainability Analysis[1,2]

The DSA framework suggests that South Africa's government debt is sustainable, but highly sensitive to growth and contingent liability shocks. Such shocks could push South Africa's gross financing needs and debt level above the high-risk benchmarks of 15 and 70 percent of GDP. Gross financing needs and the debt level could also increase significantly if the economy were buffeted by a combination of macro-fiscal shocks. The DSA results suggest that the economy would greatly benefit from rebuilding buffers to respond to eventual adverse shocks.

Context

1. **Public debt has almost doubled in the last decade and gross financing needs have risen steeply in the aftermath of the global financial crisis.** While revenue has largely recovered to pre-crisis levels, expenditure has remained permanently higher, generating large central government deficits (4.9 percent of GDP average in FY10/11–FY17/18) that pushed public debt up to 53 percent of GDP in FY17/18. In parallel, gross financing needs increased from about 2 percent of GDP in FY07/08 to about 12 percent in FY17/18. An attenuating factor is the debt composition, with low shares in foreign currency (9 percent), in short term debt instruments (12 percent), and a term to maturity of 15 years.

2. **Contingent liabilities have also witnessed significant growth primarily due to increasing government guarantees to SOE loans.** Total contingent liabilities grew from 8 percent of GDP in FY07/08 to 16 percent in FY17/18. Of the overall increase, 78 percent is explained by SOE loan guarantees, reflecting growing weaknesses in SOE finances. SOE loan related guarantees account for 9 percent of GDP.[3] Contingent claims against the road accident fund, post-retirement medical assistance for public employees, government departments, public-private partnerships, among others account for the remaining 7 percentage points of GDP.

Baseline Projections

3. **Under staff's baseline projections, the debt-to-GDP ratio is sustainable but leaves limited fiscal space to accommodate shocks.** Based on the assumptions discussed in Box 1, the combination of relatively modest medium-term growth projections and the envisaged fiscal consolidation is not expected to stabilize the debt-to-GDP ratio at the current level. Public debt would continue to expand during the projection period and reach 58.5 percent of GDP in 2023. The debt-to-GDP increase would slow down if compared to past years and would remain below the 70 percent high-risk threshold (Figure A5.3). However, the high debt level—in a context of spending

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

[2] Prepared by Alejandro Simone.

[3] These estimates are from Table 11 of the Statistical Annex of the 2018 budget.

rigidities and borderline investment grade for the sovereign in local currency—leaves limited buffers for countercyclical fiscal policy in the future.

4. Gross financing needs are expected to remain high. They are anticipated to peak at close to 13 percent of GDP in 2019 as a large external maturity is coming due. Notwithstanding the favorable maturity and currency structure, gross financing needs are higher than in many other EMs. They illustrate the availability of limited fiscal space of the South African economy, as the level is only 3 percentage points of GDP below the high-risk threshold.

Box A5.1. South Africa: Staff Assumptions Underlying the Debt Sustainability Analysis

Data coverage

- Consistent with the debt coverage used by the authorities, calculations are based on the national government's main budget (central government). While this methodology excludes provincial governments, social security funds, and extra-budgetary institutions, these entities are not allowed to incur debt. Even though municipalities can incur debt, most provincial and municipal expenditure is funded through transfers from the national government, and thus is already captured to a considerable extent. However, the DSA also excludes SOEs, whose indebtedness has increased rapidly in recent years (Figure H, page 33).

Macroeconomic assumptions

- Real GDP growth is projected to improve to 1.5 percent in 2018 from 1.3 percent in 2017 as stronger confidence is expected to lift investment from low levels. Over the medium term, growth is projected at 1.8 percent. GDP deflator inflation is expected to average 5.3 percent in 2018–23, consistent with CPI inflation remaining close to the ceiling of the official inflation targeting band (3–6 percent).

Fiscal assumptions.

- Debt projections include stock-flow adjustments to capture discounts on new issuance of existing benchmark bonds as well as valuation effects on inflation-linked bonds. The primary deficit is expected to improve over the medium term as the fiscal measures adopted in the 2018 budget take effect and growth gradually recovers. No additional fiscal measures are assumed. Projections assume contingency reserves averaging about 0.2 percent of GDP for each fiscal year starting in FY18/19, and a continuation of budget expenditure and financing trends after FY20/21 for which budget projections are not available.

- The projected fiscal adjustment is realistically based on South Africa's recent experience and that of countries with market access (Figure A.2.2). The fiscal consolidation, which occurred in a context of slowing growth, reduced the national government deficit marginally (0.2 percent of GDP since FY12/13), but had a more significant impact on the primary deficit (1 percent of GDP) because of rising interest costs. Looking forward, the maximum three-year adjustment in the cyclically-adjusted primary balance over the projection period (1 percent of GDP), as well as the maximum three-year average level of the cyclically-adjusted primary balance (0.5 percent of GDP), are well below the thresholds in the distributions reflecting market access country experiences of 3 and 3.5 percent of GDP respectively.

5. The baseline scenario is subject to a variety of risks:

- ***Growth.*** The forecasting track record suggests persistent over projections of real growth (Figure A5.2). Between 2008–16, the median real GDP forecast error was -1.3 percentage points (in line with other surveillance countries). Growth over projections poses an upside risk to the debt-to-GDP forecasts.

- ***Primary balance***. While primary balance projections have not been systematically biased, upward pressure on the primary balance could stem from a further revenue decline or higher-than-expected spending related to national health insurance, tertiary education subsidies, or public wages.

- ***Interest rates.*** Higher borrowing costs may arise from a tightening of global financial conditions.

- **Contingent liabilities.** The weak situation of SOEs' balance sheets could trigger further government support or lead to calls of guarantees on loans.

Scenario Analysis

6. The DSA suggests South Africa's government debt is highly sensitive to an individual or a combination of shocks (Figures A5.3 through A5.5)**.**

- ***Persistent low growth scenario.*** If growth were permanently lower than the baseline by 1 percentage point, on average during 2019–23, this would result in a debt-to-GDP ratio of 74 percent of GDP in 2023. This scenario factors in the adverse impact of lower tax revenue elasticities and higher interest rates as well as the denominator effects of the lower GDP.

- ***Primary balance shock scenario.*** If the primary balance failed to improve during the rest of the projection period, the projected debt level would increase to almost 60 percent of GDP in 2023 (Figure A5.4). The debt-to-GDP ratio would reach 62 percent if a one-standard-deviation temporary shock to growth were to materialize in 2019 and 2020.

- ***Combined macro-fiscal shocks scenario.*** A combination of standard shocks to growth and interest rates, a primary balance shock (a temporary half of a 10-year historical standard deviation deterioration), and an exchange rate shock (consistent with the maximum movement over the past 10 years and an exchange rate pass-through of 0.25) results in an increase in the debt-to-GDP ratio to 67 percent by 2023 and gross financing needs marginally below the 15 percent high-risk threshold during most of the projection period.

- ***Contingent liability shock scenario.*** Should all SOE loan guarantees and the contingent liabilities of the Road Accident Fund be called, public debt would rise to 75 percent of GDP by 2023, well above the high-risk threshold of 70 percent of GDP. While extreme because it implies the materialization of 84 percent of contingent liabilities, this scenario underscores the growing risks posed by these liabilities, directly to the fiscal outlook, and indirectly through its impact on investor confidence, borrowing costs, and growth.

7. The heat map that summarizes South Africa's risks to the debt outlook shows its sensitivity to growth and contingent liability shocks (Figure A5.1).[4] Mitigating factors are the large domestic institutional investor base, and the low share of foreign currency and short-term debt. However, South Africa's high bond spreads (slightly below 600 bps), its significant external financing requirements, and the relatively high share of debt held by non-residents add to the risks.

8. The fan charts highlight the importance of structural reforms in reducing the probability of debt distress. The analysis of the impact of historical volatility of macro-fiscal variables on the debt path allows to estimate the probable debt trajectory under downside and upside events (Figure A5.1, middle panel). Under the predominance of asymmetric shocks, there is a slightly above 10 percent chance that the debt-to-GDP ratio could exceed 70 percent of GDP by 2023. Conversely, under the predominance of symmetric shocks (e.g., a faster progress on structural reforms), the probability of the debt exceeding the same level is halved.

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

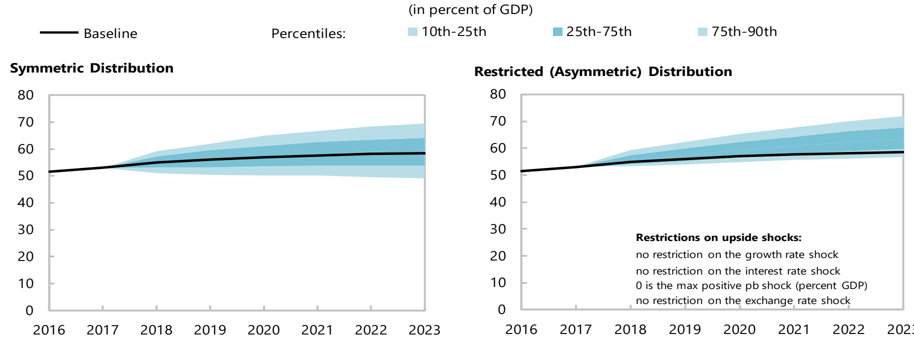
Figure A5.1. South Africa: Public DSA Risk Assessment

Heat Map

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

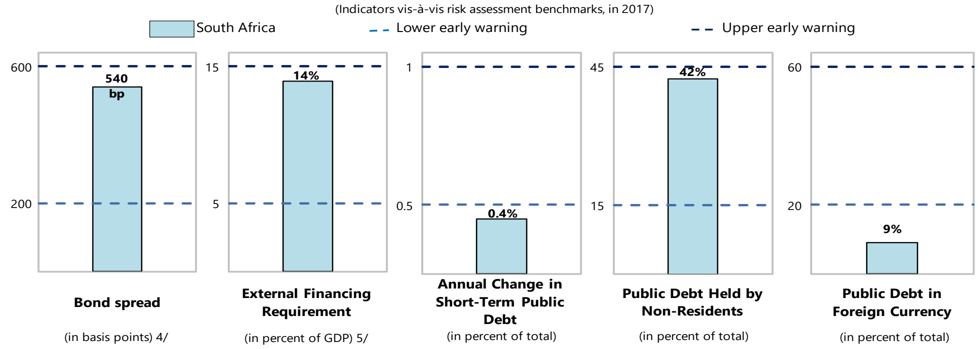
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

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

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

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

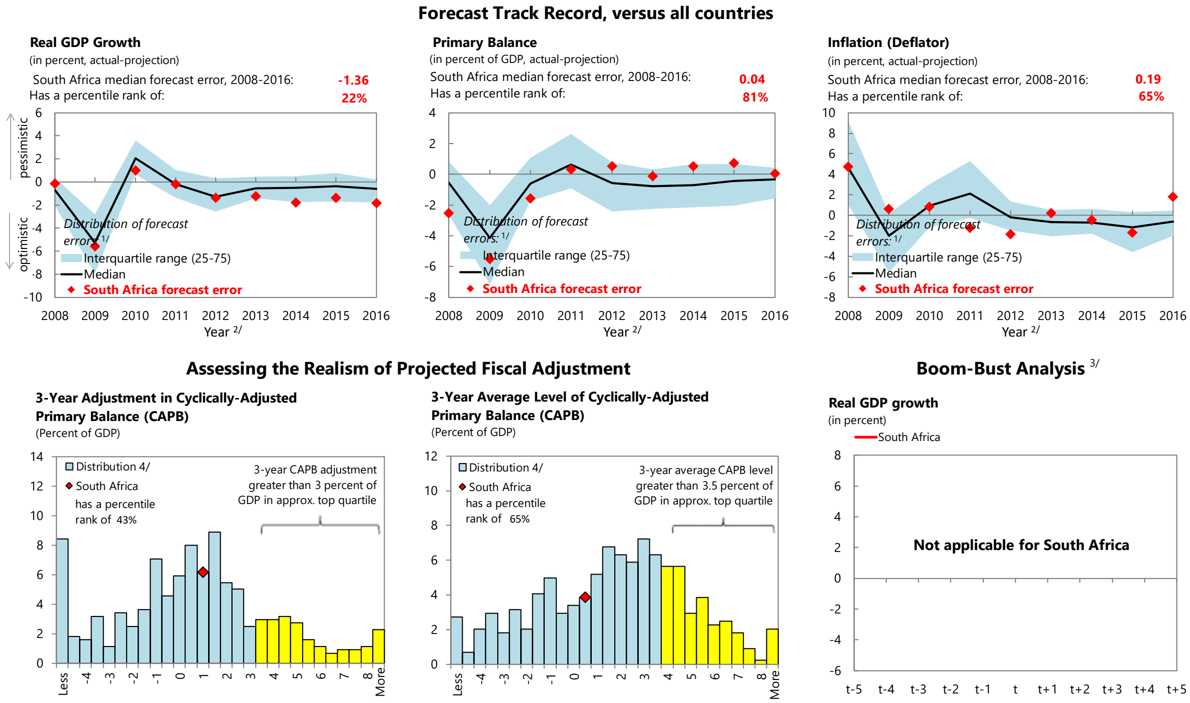
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 13-Jan-18 through 13-Apr-18.

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

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

Figure A5.2. South Africa: Realism of Baseline Assumptions



Source : IMF Staff.

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

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

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

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

Figure A5.3. South Africa: Public Sector Debt Sustainability Analysis (DSA) Baseline Scenario

(In percent of GDP unless otherwise indicated)

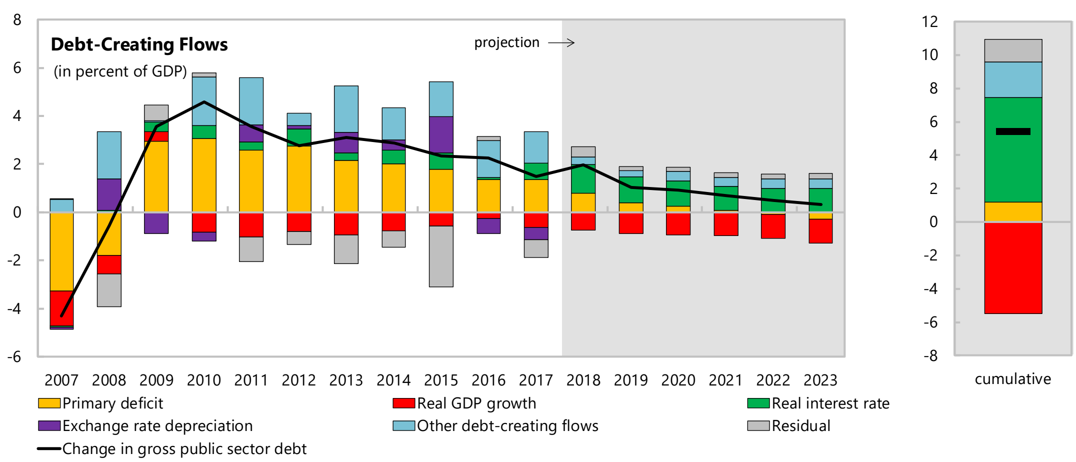
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	37.5	51.6	53.0	55.0	56.0	57.0	57.6	58.1	58.5
Public gross financing needs	8.8	11.8	12.1	12.1	12.9	12.1	12.0	11.9	11.7
Real GDP growth (in percent)	2.4	0.6	1.3	1.5	1.7	1.8	1.8	1.8	1.8
Inflation (GDP deflator, in percent)	6.7	6.8	5.5	4.9	5.3	5.4	5.5	5.5	5.5
Nominal GDP growth (in percent)	9.2	7.4	6.9	6.4	7.1	7.3	7.4	7.4	7.4
Effective interest rate (in percent) [4/]	8.0	7.0	7.0	7.3	7.4	7.5	7.4	7.4	7.4

As of April 13, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		525
5Y CDS (bp)		155
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BB+	BB+
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.0	2.3	1.5	2.0	1.0	0.9	0.7	0.5	0.3	5.4	
Identified debt-creating flows	2.7	2.1	2.2	1.5	0.8	0.8	0.5	0.3	0.1	4.1	
Primary deficit	1.4	1.4	1.4	0.8	0.4	0.3	0.1	-0.1	-0.3	1.2	0.4
Primary (noninterest) revenue and grants	24.3	25.3	24.9	25.6	26.2	26.4	26.6	26.7	26.9	158.4	
Primary (noninterest) expenditure	25.6	26.7	26.3	26.4	26.6	26.7	26.7	26.6	26.6	159.6	
Automatic debt dynamics [5/]	0.0	-0.8	-0.5	0.4	0.2	0.1	0.0	0.0	0.0	0.8	
Interest rate/growth differential [6/]	-0.4	-0.2	0.0	0.4	0.2	0.1	0.0	0.0	0.0	0.8	
Of which: real interest rate	0.4	0.1	0.7	1.2	1.1	1.0	1.0	1.0	1.0	6.3	
Of which: real GDP growth	-0.8	-0.3	-0.6	-0.7	-0.9	-0.9	-1.0	-1.0	-1.0	-5.5	
Exchange rate depreciation [7/]	0.4	-0.6	-0.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.3	1.5	1.3	0.3	0.2	0.4	0.4	0.4	0.4	2.1	
Privatization/Drawdown of Deposits	0.5	1.2	0.0	0.3	-0.5	-0.3	-0.1	-0.1	-0.1	-0.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock-Flow adjustment	0.8	0.3	1.3	0.0	0.8	0.7	0.5	0.5	0.5	2.9	
Residual, including asset changes [8/]	-0.7	0.2	-0.7	0.4	0.2	0.2	0.2	0.2	0.2	1.3	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

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

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

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

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

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

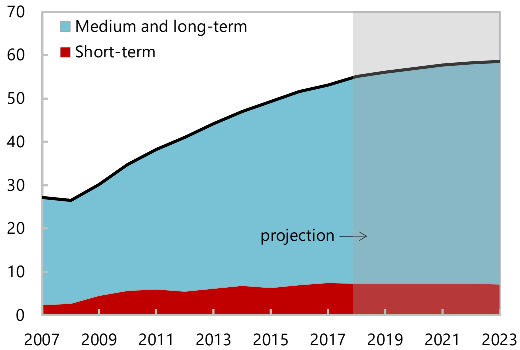
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

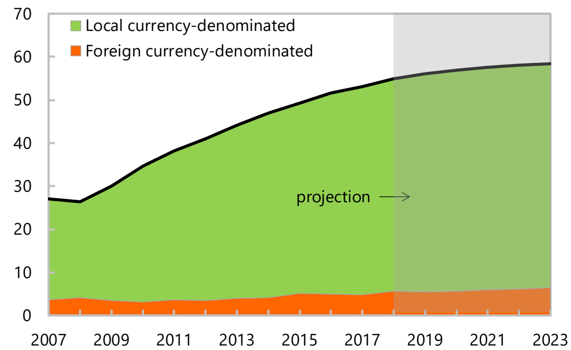
Figure A5.4. South Africa DSA: Composition of Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



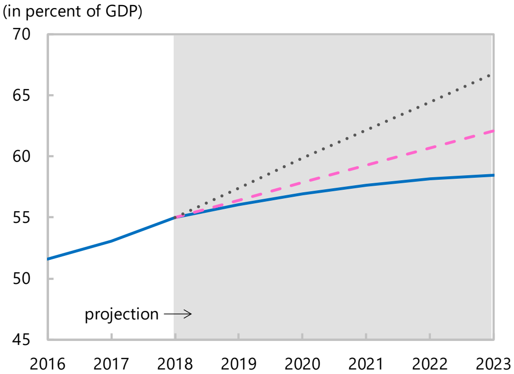
By Currency
(in percent of GDP)



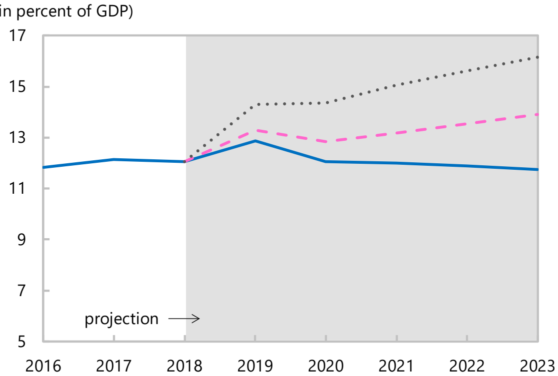
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

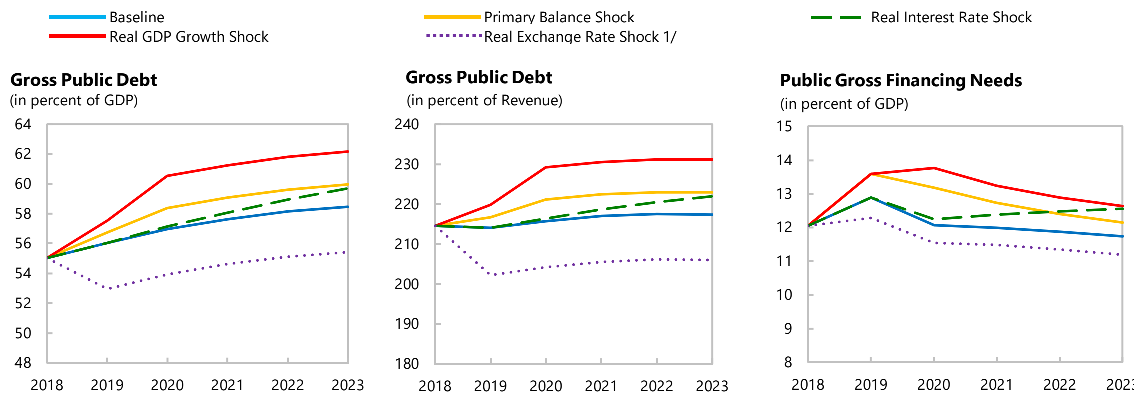
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.5	1.7	1.8	1.8	1.8	1.8
Inflation	4.9	5.3	5.4	5.5	5.5	5.5
Primary Balance	-0.8	-0.4	-0.3	-0.1	0.1	0.3
Effective interest rate	7.3	7.4	7.5	7.4	7.4	7.4
Constant Primary Balance Scenario						
Real GDP growth	1.5	1.7	1.8	1.8	1.8	1.8
Inflation	4.9	5.3	5.4	5.5	5.5	5.5
Primary Balance	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	7.3	7.4	7.4	7.4	7.4	7.4

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.5	1.8	1.8	1.8	1.8	1.8
Inflation	4.9	5.3	5.4	5.5	5.5	5.5
Primary Balance	-0.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	7.3	7.4	7.3	7.2	7.2	7.1

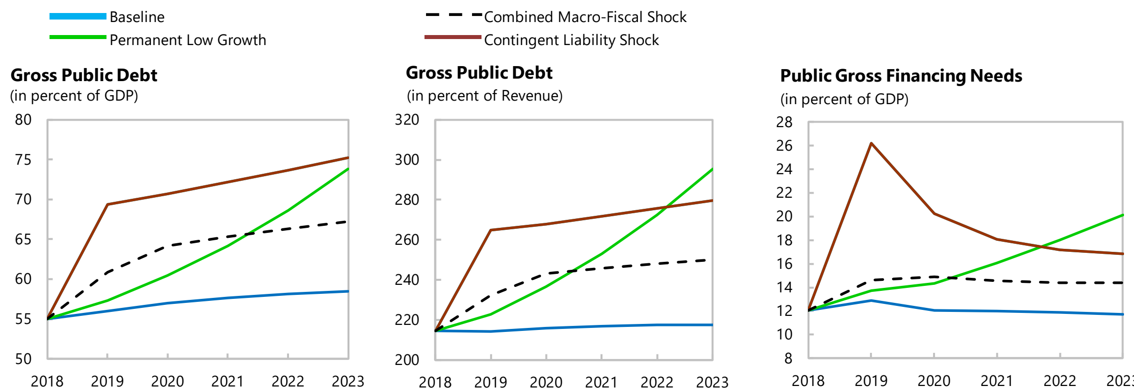
Source: IMF staff.

Figure A5.5. South Africa Public DSA: Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2018	2019	2020	2021	2022	2023
Primary Balance Shock						
Real GDP growth	1.5	1.7	1.8	1.8	1.8	1.8
Inflation	4.9	5.3	5.4	5.5	5.5	5.5
Primary balance	-0.8	-1.1	-1.0	-0.1	0.1	0.3
Effective interest rate	7.3	7.4	7.5	7.5	7.5	7.5
Real Interest Rate Shock						
Real GDP growth	1.5	1.7	1.8	1.8	1.8	1.8
Inflation	4.9	5.3	5.4	5.5	5.5	5.5
Primary balance	-0.8	-0.4	-0.3	-0.1	0.1	0.3
Effective interest rate	7.3	7.4	7.8	8.0	8.1	8.2
Combined Shock						
Real GDP growth	1.5	0.2	0.3	1.8	1.8	1.8
Inflation	4.9	4.9	5.0	5.5	5.5	5.5
Primary balance	-0.8	-1.1	-1.2	-0.1	0.1	0.3
Effective interest rate	7.3	8.1	7.9	8.0	8.1	8.3

	2018	2019	2020	2021	2022	2023
Real GDP Growth Shock						
Real GDP growth	1.5	0.2	0.3	1.8	1.8	1.8
Inflation	4.9	4.9	5.0	5.5	5.5	5.5
Primary balance	-0.8	-0.9	-1.2	-0.1	0.1	0.3
Effective interest rate	7.3	7.4	7.5	7.5	7.5	7.5
Real Exchange Rate Shock						
Real GDP growth	1.5	1.7	1.8	1.8	1.8	1.8
Inflation	4.9	17.5	5.4	5.5	5.5	5.5
Primary balance	-0.8	-0.4	-0.3	-0.1	0.1	0.3
Effective interest rate	7.3	8.1	7.6	7.5	7.4	7.4
Contingent Liability Shock						
Real GDP growth	1.5	1.7	1.8	1.8	1.8	1.8
Inflation	4.9	5.3	5.4	5.5	5.5	5.5
Primary balance	-0.8	-13.7	-0.3	-0.1	0.1	0.3
Effective interest rate	7.3	7.4	8.0	8.5	8.9	9.1

Source: IMF staff.

Annex VI. Risk Assessment Matrix[1]

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Global risks				
Tighter global financial conditions. An abrupt change in global risk appetite could lead to sudden, sharp increases in interest rates and associated tightening of financial conditions.	***High***	*ST, MT*	***H***/*M*. Capital flow reversals (including prompted by rating downgrades) affect the external and fiscal positions. Spillovers to the financial system likely.	Increase policy rate if depreciation pushes inflation expectations above target. Provide foreign exchange liquidity if dollar shortages appear in disorderly market conditions. If financing becomes problematic, tighten fiscal policy protecting the poor.
Global growth. • Structurally weak growth in key advanced markets.	***High***	*MT*	*M*. Protracted period of lower growth and worse twin deficits, especially if accompanied by lower commodity prices.	Structural measures to promote growth domestically. Fiscal action to ensure debt stabilization over the medium term while protecting the poor.
• Significant U.S. slowdown and its spillovers. • Significant China slowdown and its spillovers.	***Medium*** ***Low/ Medium***	*MT* *ST-MT*	***H***/*M*. Deterioration in growth, employment, and worse twin deficits, especially if accompanied by lower commodity prices. Could also lead to capital flow reversal.	Structural measures to promote growth domestically. If external financing becomes problematic, tighten monetary and fiscal policy while protecting the poor. Provide foreign exchange liquidity if shortages appear in disorderly market conditions.
Retreat from cross-border integration.	***Medium***	*ST, MT*	***H***/*M*. Impact on the external accounts and growth depends on the extent to which trade flows are disrupted (see below).	Structural measures to drive growth domestically. Fiscal action to ensure medium-term debt stabilization while protecting the poor.
Policy uncertainty. Two-sided risks to U.S. growth; uncertainty associated with negotiating post-Brexit arrangements & NAFTA.	***Medium***	*ST, MT*	***H***/*M*. Impact on growth and inflation depends on whether capital flow reversals occur and how big they are.	Measures to address capital flows (see below).
Domestic risks				
Protracted domestic policy uncertainty, deterioration in governance.	***Medium***	*ST-MT*	***H***. Growth remains low, fiscal deficit deteriorates, debt rises, ratings downgrades trigger capital outflows. A financing crisis could ensue.	Greater consistency in policy statements, and centralized evaluation of policy proposals. Structural measures to strengthen governance in SOEs. Anti-corruption and anti-money laundering measures to boost confidence.
Excessive budget deficits or other policy missteps that reduce market confidence.	***Medium***	*ST-MT*	***H***. Increases in interest rates, downgrades to speculative grade, capital outflows, financial instability.	Fiscal measures to reduce deficit while protecting the poor, improve governance, and improve spending composition. Asset sales to reduce market borrowing. Take measures as below to address financial risks.
Deterioration in banks' asset quality and liquidity shortfalls owing to protracted low growth.	***Medium***	*MT*	***H***. Lower lending to households and corporates as bank balance sheets condition weaken, with adverse impact on growth, fiscal outlook, and financial and external stability.	Conduct asset quality reviews and adjust provisioning. Step up risk analysis, and take action to mitigate risks. If dollar shortages appear in disorderly market conditions, provide foreign exchange liquidity.

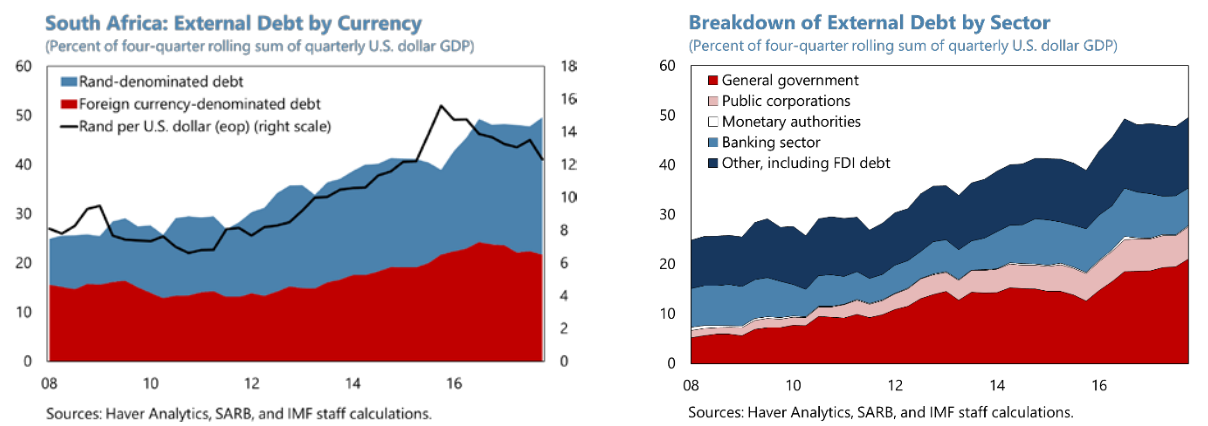
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate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

Annex VII. External Debt Sustainability Analysis[1]

The external DSA framework suggests that South Africa's external debt will remain sustainable over the medium term, but is vulnerable to shocks. Gross external financing needs are large, and external financing is reliant on portfolio flows subject to risk of reversals. A deceleration in economic activity or higher interest rates may lead to moderate increases in external debt, already at relatively elevated levels. A currency depreciation could have a significantly larger impact, albeit mitigated by the large share of local currency-denominated external debt.

1. **External debt increased in 2017 amid a pickup in government financing needs**. As of end-2017, South Africa's external debt, valued in U.S. dollars, stood at just below 50 percent of GDP, up from about 48 percent of GDP a year earlier. While foreign currency-denominated debt moderated as a share of GDP, local currency-denominated debt (when expressed in U.S. dollars) increased—partly as general government external debt picked up moderately (Figure A7.1). In turn, total external debt rose somewhat during the year, following a faster trend increase during 2012–16, which was primarily associated with an increase in long-term general government external debt.

Figure A7.1. South Africa: External Debt



2. **Gross external financing needs (GEFNs) are projected to average about 18 percent of GDP during 2018–23, broadly unchanged from recent years.** Amid a steady decline in the non-interest current account deficit since 2013, GEFNs have recently moderated. However, with short-term external debt (remaining maturity) expected to increase moderately relative to GDP, GEFNs (i.e. the sum of the previous year's short-term debt at remaining maturity and the current-year projected current account deficit) remain large and are projected at around 18 percent of GDP over the medium term. Short-term external debt (remaining maturity) stood at just above 14 percent of GDP at end-2017, and is expected to continue to account for about 80 percent of total GEFNs over the medium term.

[1] Prepared by Lone Christiansen.

3. **On current policies, financing of the current account deficit is projected to continue to come from non-FDI inflows.** During the past two years, portfolio investment inflows have been the largest financing item in the financial account (5.5 and 4.7 percent of GDP in 2016 and 2017, respectively), while other investments have recently recorded net outflows, and FDI net outflows have intensified to 1.7 percent of GDP in 2017. With net FDI flows anticipated to remain negative or very low during the projection period, net portfolio investment is expected to continue to provide the bulk of financing, supported by other investment inflows (primarily bank loans), which historically have supported the financing of the current account deficit.

4. **Sizable GEFNs would keep South Africa's external vulnerabilities elevated.** External debt is projected to remain slightly below 50 percent of GDP over the forecast horizon. The debt-stabilizing non-interest current account deficit is estimated at 2 percent of GDP (Table A7.1). Stress tests indicate that a 30 percent currency depreciation could push external debt above 60 percent of GDP, given the importance of price and valuation changes as the shock hits. Other standard shocks simulated in the external debt sustainability analysis—such as a widening of the non-interest current account deficit, a deceleration in real GDP growth, and a rise in the interest rate—would lead to moderate increases in external debt. The impact of these shocks would be mitigated by the high share of rand-denominated external debt (more than half of external debt is denominated in rand).

Table A7.1. South Africa: External Debt Sustainability Framework, 2013–23
(Percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	Projections 2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	37.2	41.3	39.1	48.3	49.6	**46.1**	**47.0**	**47.5**	**48.0**	**48.4**	**48.8**	**-2.0**
2 Change in external debt	1.4	4.1	-2.3	9.2	1.3	-3.5	0.9	0.5	0.5	0.4	0.4	
3 Identified external debt-creating flows (4+8+9)	2.6	1.3	2.6	2.4	-3.5	1.5	1.8	1.8	1.8	1.8	1.9	
4 Current account deficit, excluding interest payments	4.7	3.7	2.6	1.4	1.3	1.5	2.0	2.0	2.0	2.0	2.1	
5 Deficit in balance of goods and services	2.3	1.5	1.3	-0.6	-1.4	-0.5	0.0	0.2	0.2	0.2	0.2	
6 Exports	31.0	31.5	30.2	30.7	29.8	30.0	30.0	29.9	30.1	30.1	30.3	
7 Imports	33.3	33.0	31.4	30.1	28.4	29.5	30.1	30.0	30.2	30.3	30.5	
8 Net non-debt creating capital inflows (negative)	-2.7	-3.0	-2.5	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
9 Automatic debt dynamics 1/	0.6	0.6	2.5	1.8	-4.1	0.7	0.6	0.5	0.5	0.5	0.5	
10 Contribution from nominal interest rate	1.1	1.3	2.0	1.4	1.1	1.4	1.3	1.3	1.3	1.4	1.4	
11 Contribution from real GDP growth	-1.0	-0.7	-0.6	-0.2	-0.5	-0.7	-0.8	-0.8	-0.8	-0.8	-0.9	
12 Contribution from price and exchange rate changes 2/	0.4	0.0	1.1	0.6	-4.7	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-1.1	2.8	-4.9	6.8	4.8	-5.0	-0.9	-1.3	-1.3	-1.4	-1.5	
External debt-to-exports ratio (in percent)	120.2	131.4	129.6	157.3	166.7	153.8	156.6	159.1	159.7	160.5	161.0	
Gross external financing need (in billions of US dollars) 4/	66.4	57.2	63.4	51.1	48.6	60.7	67.0	79.5	77.7	80.7	83.7	
in percent of GDP	18.1	16.3	20.0	17.3	13.9	16.2	17.3	19.7	18.5	18.4	18.4	
Scenario with key variables at their historical averages 5/						**46.1**	**47.3**	**48.5**	**49.6**	**50.7**	**51.6**	**-2.1**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.5	1.8	1.3	0.6	1.3	1.5	1.7	1.8	1.8	1.8	1.8	
GDP deflator in US dollars (change in percent)	-9.7	-6.1	-10.6	-7.5	16.6	5.8	1.5	2.5	2.2	2.3	2.1	
Nominal external interest rate (in percent)	2.9	3.4	4.4	3.4	2.8	3.0	2.9	2.9	2.9	2.9	3.0	
Growth of exports (US dollar terms, in percent)	-3.6	-2.8	-13.2	-5.2	14.6	8.2	3.3	3.8	4.7	4.4	4.4	
Growth of imports (US dollar terms, in percent)	-1.2	-5.2	-13.6	-10.9	11.5	11.5	5.2	4.2	4.7	4.5	4.6	
Current account balance, excluding interest payments	-4.7	-3.7	-2.6	-1.4	-1.3	-1.5	-2.0	-2.0	-2.0	-2.0	-2.1	
Net non-debt creating capital inflows	2.7	3.0	2.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	

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

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

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

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

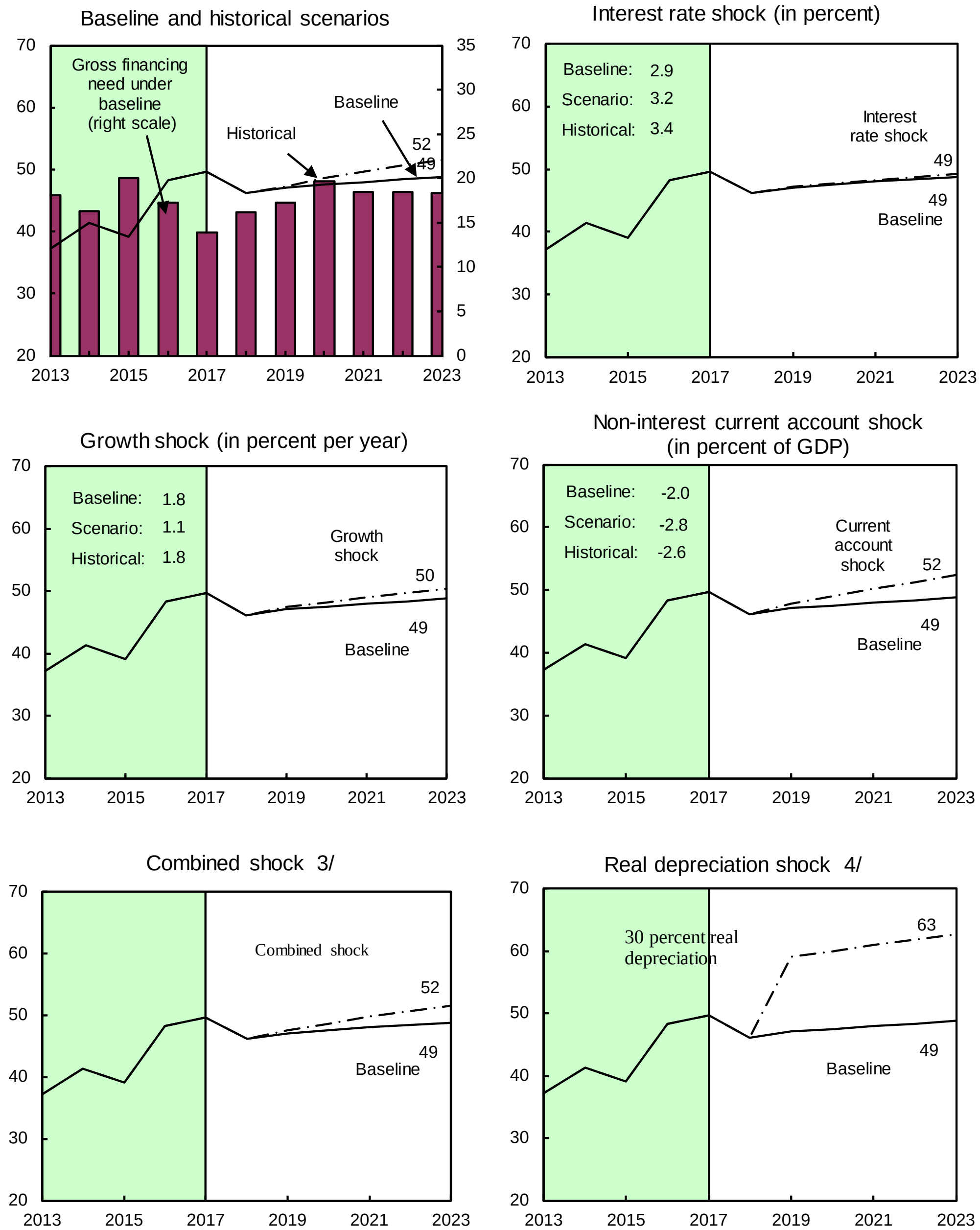
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

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

Source: IMF staff.

Figure A7.2. South Africa: External Debt Sustainability: Bound Tests 1/ 2/

(Percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2019.

Annex VIII. The Distributional Impact of Inflation[1]

This note explores the distributional impact of inflation. To mitigate against econometric problems, it develops an indicator of unanticipated monetary policy shocks. It provides evidence that low and stable inflation as a result of monetary policy tightening tends to affect the poor proportionately less than the better-off and could reduce expenditure inequality in South Africa. An unanticipated monetary policy shock exerts a modest and less unfavorable effect, or even a favorable effect, on the expenditure of poorer individuals. Poorer individuals, who rely more on government transfers, appear to benefit mainly from lower inflation, while wealthier individuals are affected mainly by lower asset price appreciation and higher debt service costs.

1. **The *ex-ante* effects of monetary policy tightening on inequality in the literature appear mixed.** The mechanisms linking monetary policy and inequality are complex, as they depend on a multitude of factors, including macroeconomic conditions and the distributions of income and wealth. In theory, contractionary monetary policy could either reduce inequality by dampening asset and goods price inflation, or increase it by benefiting savers (wealthier) over borrowers (less wealthy). Some studies find that monetary policy tightening tends to increase inequality in terms of income, consumption, or expenditure (Doepke and Schneider, 2006, Heathcote et al, 2010). However, more recent work argues that the impact is modest at best (Amaral, 2017) and varies across countries (Furceri *et al.*, 2017). The type of a monetary policy shock matters. An "unexpected" monetary policy tightening could increase inequality, but increases in policy rates driven by macroeconomic circumstances (a wider positive output gap or higher-than-desirable inflation) would reduce inequality (Furceri *et al.*, 2017).

2. **In South Africa, there is an indication that poorer individuals would be less adversely affected by, or even benefit from, monetary policy tightening to keep inflation low.** One reason is that these individuals tend to suffer the most from high inflation while depending largely on government transfers for income. Table A5.1 shows inflation statistics for different expenditure quintiles. The first row shows that individuals in the lowest expenditure quintiles, thus the least affluent, tend to face the highest inflation in general. The second row shows that in any given month, the probability that the poorest individuals face the highest inflation among different quintiles is 56 percent, by far the highest compared to the other quintiles. The third row shows that this tends to happen when overall inflation is high, or the economy is in a "high inflation" regime. To show this, the average inflation during the months in which each quintile faces the highest inflation is computed (e.g., for the lowest expenditure quintile, 56 percent of the total number of months). The 7 percent inflation rate estimated for the lowest expenditure quintile is one of the highest among the five expenditure quintiles. This is due partly to the fact that food prices account for 35–40 percent of the CPI basket for the lowest expenditure quintile, almost four times the share for the highest expenditure quintile. It reflects also the fact that poorer individuals are subject to core

[1] Prepared by Ken Miyajima.

inflation, for which monetary policy has a role to play. Meanwhile, nearly one third of the population live on grants, a stream of nominal income affected by monetary policy to a limited extent.

Table A8.1. South Africa: Inflation Facing Different Quintiles in South Africa, 2009M01–2017M12

(Percent)

Expenditure Quintile	1	2	3	4	5
Average inflation	6.1	6.0	5.9	5.8	5.4
Probability of facing highest inflation	56	7	4	6	22
Average inflation, given particular quintile faces highest inflation	7.0	8.3	6.7	5.4	5.1

Sources: Stats SA and the author's calculations.

3. **Poorer individuals may be affected by monetary policy action through holdings of assets and debt**. Table A8.2 shows holdings of net total assets as well as financial assets and debt for different deciles (see next paragraph for discussion on the underlying data). Overall net assets are positive while net financial assets appear negative across the deciles. The impact of monetary policy action on debt service cost would depend on the extent to which poorer individual borrow from lenders charging very high interest rates which are likely little affected by monetary policy action in 25 or 50 basis point increments.

Table A8.2. South Africa: Net Total Assets, Financial Assets, and Financial Debt by Decile in South Africa

(Rand)

Decile	Net total assets	Financial assets	Financial debt
10	900	-	300
20	3,000	-	667
30	5,300	11	1,000
40	9,414	100	1,800
50	15,633	250	3,000
60	29,165	500	5,000
70	52,800	1,000	8,477
80	120,000	2,600	14,964
90	355,966	6,000	32,000

Sources: NIDS Wave 4 and the author's calculations.

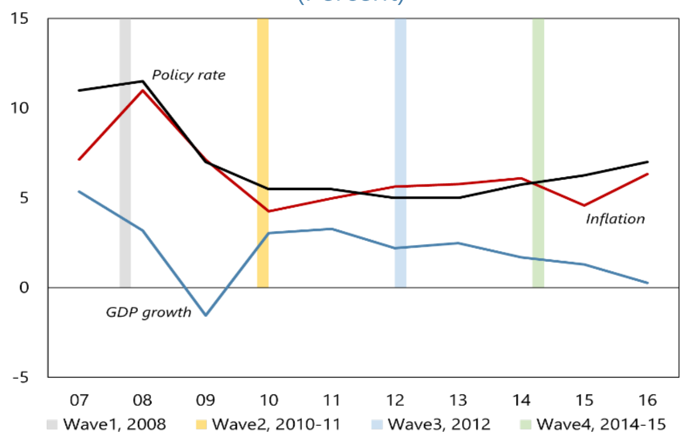
Note: In nominal terms. Using weights. Net total assets include financial and other assets in net terms.

4. **To shed further light, household survey data to estimate the impact of monetary policy on expenditure are used.** The study relies on the National Income Dynamics Study (NIDS), which tracks the same individuals across 4 waves (2008, 2010–11, 2012, and 2014–15, Figure A8.1). Table A5.3 shows how NIDS expenditure data compare with national poverty lines. Roughly

speaking, the food poverty line corresponds to the 3–4th deciles of surveyed expenditure, the lower-bound poverty line to the 4–6th deciles, and the upper-bound poverty line to the 6–7th deciles**.**

Figure A8.1 South Africa: Macroeconomic Variables and NIDS Waves

(Percent)



Sources: Haver and IMF staff.

Table A8.3. South Africa: Annualized Monthly Expenditure across 4 Waves

(Rand)

Wave	1	2	3	4
Year	2008	2010-11	2012	2014-15
Expenditure decile	Monthly expenditure x 12			
10	1,884	1,894	2,346	3,560
20	2,669	2,748	3,360	5,082
30	3,497	3,633	4,533	6,751
40	4,556	4,748	6,097	9,192
50	5,971	6,210	8,160	12,060
60	7,999	8,507	11,059	16,037
70	11,620	12,213	16,608	22,467
80	18,768	20,064	25,020	35,268
90	38,325	43,430	50,010	64,689
Memorandum item				
GDP per capita	47,512	56,191	62,297	72,870
Disposable income per capita	28,211	32,973	37,237	42,959
Poverty lines				
Food	3,288	3,930	4,392	5,148
Lower bound	5,364	5,802	6,492	7,560
Upper bound	8,184	9,072	10,008	11,604

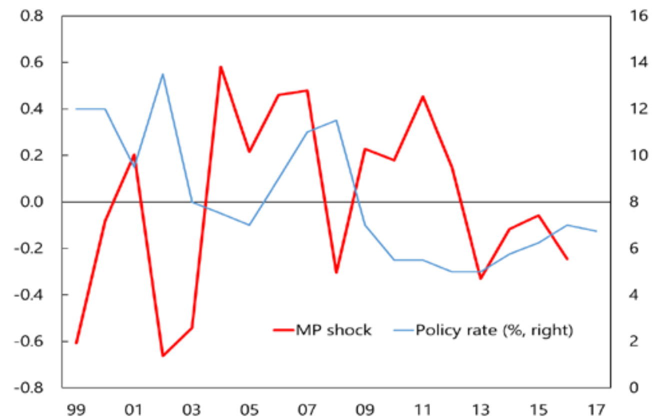
Sources: Haver, NIDS, Stats SA, and the author's calculations.

Note: In nominal values. Using weights.

5. Methodologically, estimating the causal effect of monetary policy on real expenditure growth requires using "unanticipated" monetary policy shocks. This is because economic conditions can influence both monetary policy action and expenditure, thereby making identification difficult. Following Furceri *et al.* (2017), the forecast error (FE) of the policy rate, GDP growth, and inflation was calculated as end-year actual values less forecasts in October. The residuals obtained from the regression of the policy rate FE on the growth FE and the inflation FE represent the unanticipated monetary policy shock. A rise in the unanticipated monetary policy shock (indicating tightening) reduces inflation but has a muted impact on growth. The unanticipated monetary policy shock estimated for South Africa (Figure A8.2) is similar to that for the US estimated by Furceri *at al.* (2017) and Romer and Romer (2004). This is consistent with the view that global central banks' reaction functions may have become similar as shocks facing these central banks have become similar.

Figure A8.2. South Africa: Exogenous Monetary Policy Shock and Policy Rate

(Percent)

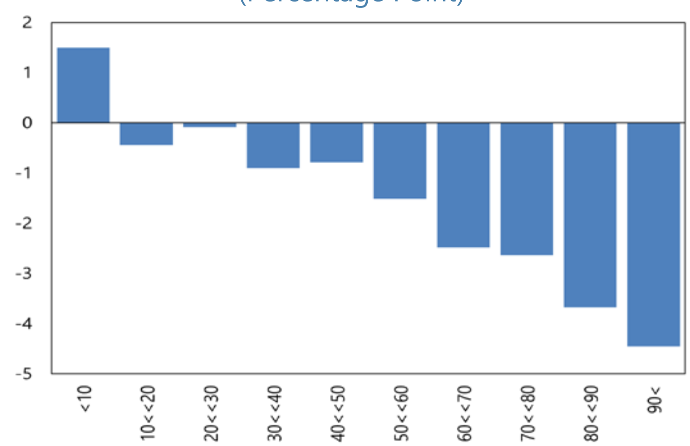


Sources: Haver and IMF staff.

6. Econometric results suggest that lower inflation as a result of contractionary monetary policy affects the poor less adversely, or even favorably. Real expenditure growth is regressed on an "unanticipated" monetary policy shock, controlling for a range of individual characteristics (age, education attainment, gender, and race, employment status) and economic activity. To help identify heterogenous response, the monetary policy shock is interacted with expenditure decile dummies. Estimated results show that the impact of monetary policy tightening differs significantly across different expenditure deciles (Figure A8.3 and Table A8.4). Real expenditure growth of the lowest expenditure decile tends to increase following monetary policy tightening, likely as lower inflation helps those relying mainly on government transfers. Moving up the expenditure spectrum, the

Figure A8.3. South Africa: Impact of Exogenous Monetary Policy Shock on Real Expenditure Growth

(Percentage Point)



Source: Author's calculations.

Note: Results are scaled by the average size of exogenous monetary policy shock during 2010–16.

impact turns negative but with its magnitude remaining relatively small. For the upper half of the surveyed population, the size of the negative impact increases steadily with expenditure level, such that the highest expenditure decile is affected by several times more than some of those in lower expenditure deciles. Expenditure growth is stronger when economic growth is higher, and for employed and younger population.

Table A8.4. South Africa: Impact of Exogenous Monetary Policy Shock on Real Expenditure Growth in South Africa

Model #	1	2	3	4	5	6	7	8	9
Monetary policy shock	-5.76***	-21.25***	-20.73***	-22.89***	-22.33***	-22.42***	-22.37***	-22.02***	-20.36***
Monetary policy shock * expenditure group dummy									
<10	.	28.78***	27.14***	31.21***	29.55***	29.59***	29.53***	28.59***	27.20***
10<<20	.	19.98***	18.42***	23.35***	21.73***	21.87***	21.81***	20.47***	18.36***
20<<30	.	20.93***	19.81***	24.17***	22.97***	23.05***	22.98***	22.09***	19.99***
30<<40	.	17.48***	15.77***	21.05***	19.28***	19.44***	19.37***	18.32***	16.24***
40<<50	.	17.65***	16.62***	20.65***	19.56***	19.73***	19.63***	18.58***	16.78***
50<<60	.	14.19***	13.52***	16.91***	16.16***	16.27***	16.18***	15.07***	13.46***
60<<70	.	9.37**	9.71**	12.10***	12.33***	12.40***	12.33***	11.12***	9.00**
70<<80	.	10.01**	9.64**	11.96***	11.53***	11.56***	11.47***	10.51**	8.29*
80<<90	.	4.29	4.85	5.21	5.72	5.75	5.69	4.75	3.57
Real GDP growth	.	.	5.99***	.	5.75***	5.74***	5.74***	5.87***	5.83***
Employment status	.	.	.	9.66***	9.31***	9.09***	9.11***	8.67***	8.85***
Female	.	.	.	.	.	-1.25*	-1.23	-0.9	-0.73
Education	.	.	.	.	.	.	-0.03	0.03	0.04
Age	.	.	.	.	.	.	.	-0.19***	-0.16***
Race dummies	N	N	N	N	N	N	N	N	Y
_cons	19.83***	20.76***	9.42***	16.29***	5.56***	6.41***	6.75***	13.39***	7.50***
N	18805	18805	18805	18805	18805	18805	18805	18805	18805
r2	0	0.01	0.02	0.02	0.03	0.03	0.03	0.04	0.04

Source: Author's calculations.

Note: * p<.1; ** p<.05; *** p<.01. Using NIDS data Waves 1-4. Dependent Variable is winsorized at (10, 90).

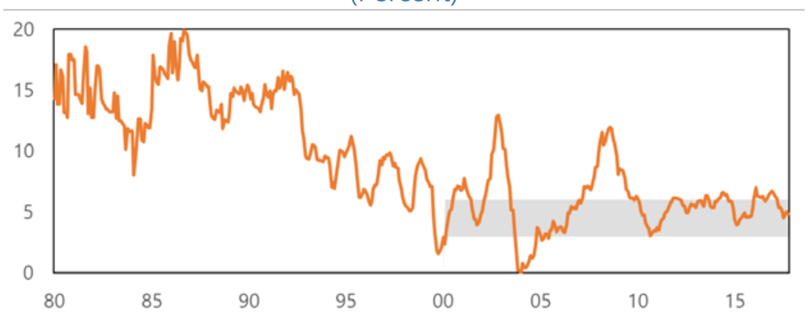
Annex IX. How Robustly are Inflation Expectations Anchored?[1]

This note estimates a long-run inflation anchor as perceived by economic agents, or an "implicit inflation anchor" using actual and projected inflation. Fitting the model with agent-level data for South Africa, results suggest that inflation expectations have increasingly been set in a forward-looking manner. That is, the degree to which the implicit inflation anchor pins down inflation expectations at longer horizons has generally increased. However, the levels of these implicit anchors for businesses and trade unions have remained above the upper end of the official inflation target range of 3–6 percent and tended to drift away. While structural rigidities could account for at least some of this behavior, consideration could be given to upgrading the inflation targeting framework to better anchor inflation expectations.

Inflation Developments

1. **Inflation in South Africa declined substantially during the two decades in the run-up to the introduction of the inflation targeting framework (IT)**. Interest rates started to pay a pivotal role after direct monetary controls were replaced with market-based monetary policy in 1980. Inflation fluctuated in the range of 10–20 percent during the 1980s and early-1990s (Figure A9.1). It started to register single-digit outturns in end-1992 and averaged slightly below 8 percent in 1993–99. During this period, exchange controls were gradually abolished following democratic elections (1994), and the South African Reserve Bank (SARB) adopted eclectic monetary policy (1996), monitoring a range of economic indicators. Inflation performance generally improved relative to global trends, moving South Africa's position closer to the global median (Figure A9.2).

Figure A9.1. South Africa: Headline Inflation and 3–6 Percent Official Inflation Target Range
(Percent)



Sources: Haver and IMF staff.

2. **Inflation remained volatile after the inception of IT but started to become anchored at the upper end of the 3–6 percent target range in the 2010s.** The intention to adopt inflation targeting was announced in August 1999. Originally, the authorities planned to narrow the target range from 3–6 percent in 2002–03 to 3–5 percent in 2004–05. However, the planned switch was put off as inflation spiked after the rand weakened sharply toward the end of 2001. Inflation volatility

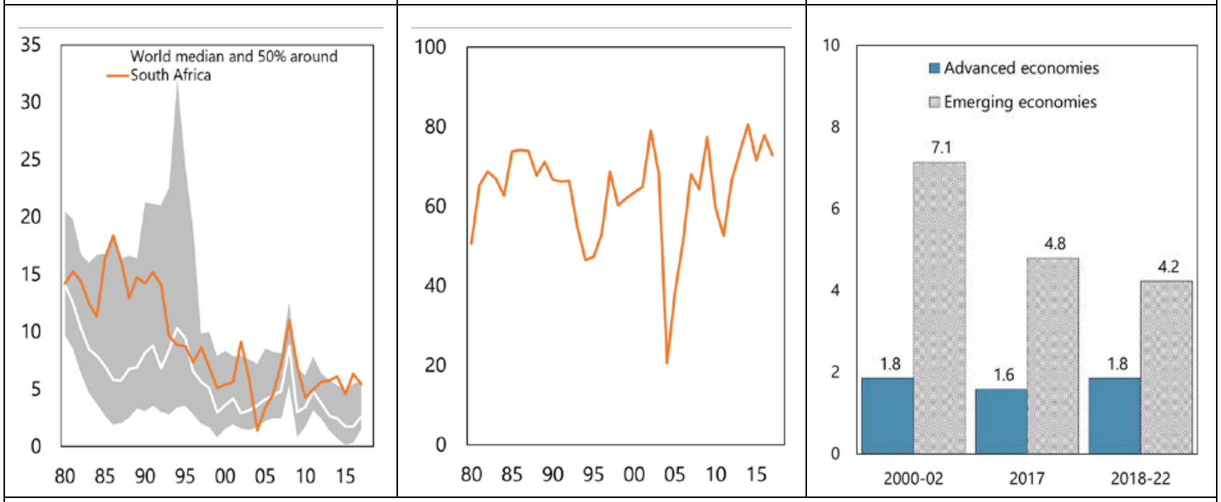
---

[1] Prepared by Ken Miyajima.

rose again after inflation surged in 2008 on higher commodity prices, and subsequently fell to the lower end of the target range. Since late-2011, inflation remained at around the upper end of the target range.[2] Most recently, inflation has moderated to around the midpoint of the target range, aided by strong crop food price disinflation as production has rebounded from a severe drought.

Figure A9.2. South Africa: Indicators of South Africa's Inflation Performance

Inflation in South Africa and 50 percent around world median (Percent) | Countries with inflation below South Africa's (Percent share) | Inflation in export destination countries (Percent)



Sources: IMF October 2017 WEO, and IMF staff calculations.

Note: Unbalanced panel data for 192 countries.

3. Despite inflation having declined earlier and stabilized more recently, South Africa has lagged the global disinflation trend (Figure A9.2). South Africa's inflation level rose to somewhat above the 50 percent range around the median. Consequently, the nation's inflation ranking rose to near the highest 20 percent in the world. A similar message emerges from estimated average inflation of trading partners. An approach similar in spirit to what the authorities used two decades ago to guide their decision on the level of the official inflation target band is applied. Average inflation in the emerging economies to which South Africa exports its products declined, from 7 percent in 2000–02 to around 5 percent in 2017. In the advanced economies it remained steady at around 2 percent. During the same period, inflation in South Africa remained at around 6 percent.

Developments in Inflation Expectations

4. Survey results show that inflation expectations of economic agents are heterogeneous in South Africa. Expectations of analysts are relatively well anchored within the official target band. Those of businesses and trade unions are more volatile and generally slightly above the upper end

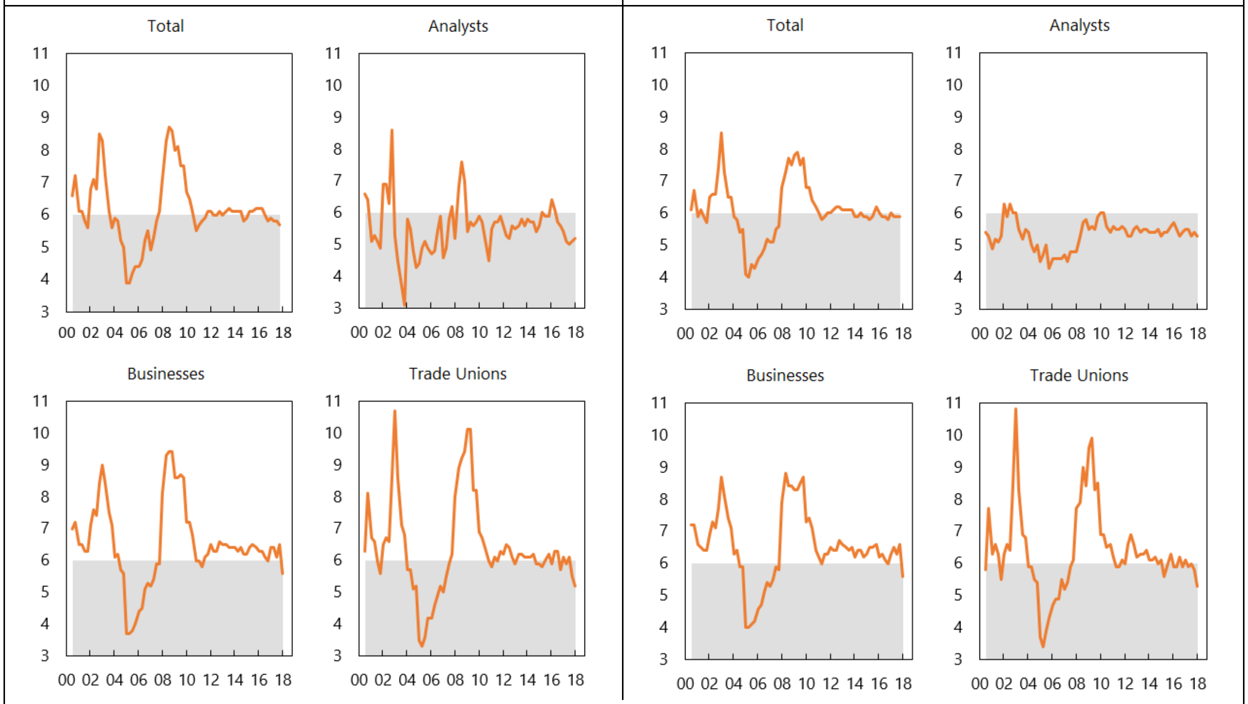
[2] In 2009, the reference inflation rate for the IT changed from the CPIX (CPI less the interest on mortgage bonds) to the CPI.

of the target band. Recently, inflation expectations fell markedly, likely reflecting favorable inflation outturns. Anticipation of faster structural reform implementation by the new administration could be another reason. Expectations of business and trade unions influence inflation directly, and are more relevant for policymakers.[3] Their inflation expectations are highly correlated since firms form their expectations based on information revealed by wage setters on the future path of wage inflation. Consistent with the modelling assumptions, two calendar years ahead inflation expectations are better anchored than their one calendar year ahead counterpart.

Figure A9.3. South Africa: Inflation Expectations and Inflation Target Range, 2000Q3–18Q1

(Percent)

One calendar year ahead | Two calendar years ahead



Sources: Beaureu of Economic Resarch South Africa and IMF staff.

Model and Data

5. To assess how well anchored inflation expectations are in South Africa, the "*implicit inflation anchor*" is estimated using so-called decay functions. The approach is motivated by the assumption that inflation forecasts made sufficiently far in advance may be anchored at a level that bears little relationship with actual inflation—both at the time that the forecast is made and for the period being forecast. For inflation targeting economies, the level of the implicit inflation anchor could correspond to the central bank's inflation target. However, this need not be the case. If the central bank lacks credibility, then long-horizon inflation forecasts may be anchored to a constant

[3] However, one view is that surveyed inflation expectations for businesses and trade unions may not be as meaningful or reliable as those for analysts.

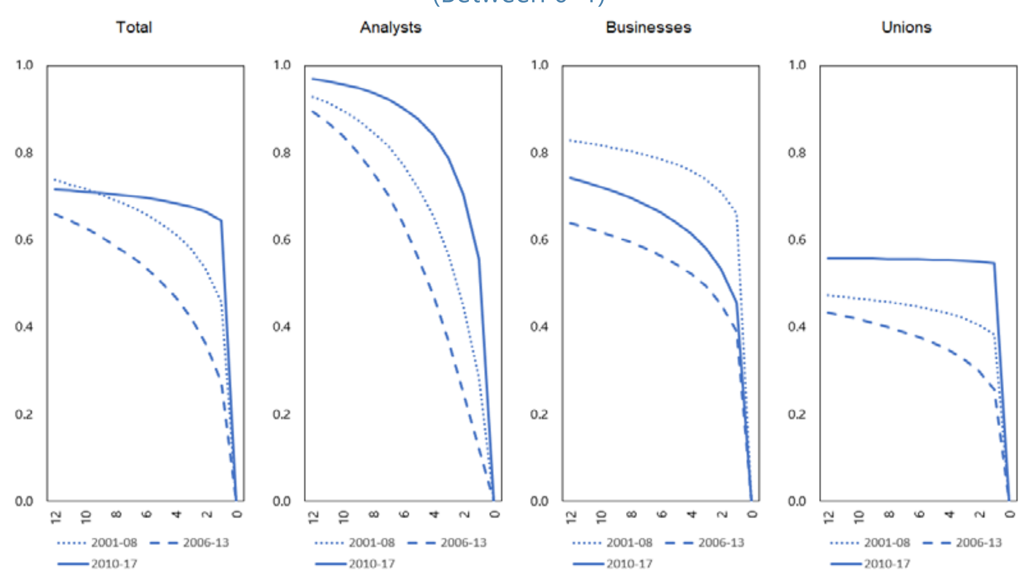
level that differs from the stated target, or may be heavily influenced by the actual inflation rate at the time the forecast is made. Regardless, as the forecasting horizon reduces, any role that the implicit inflation anchor may have played in affecting inflation forecasts is likely to decrease as forecasters learn more about the realization of shocks to inflation for a given period. The modelling strategy used allows for all these possibilities. The model is applied to survey-based inflation expecations collected by the Bureau of Economic Research of South Africa (BER) available for analysts, businesses, and trade unions for 2001–17 with quarterly frequency.

Results

6. There are two ways to assess anchoring within the empirical framework: (a) the weight of the implicit anchor in explaining inflation expectations (a higher weight at a given horizon implies tighter anchoring), and (b) the level of the implicit anchor. Importantly, the results do not incorporate Q1 2018 data showing a marked decline in inflation expectations.

7. The degree of anchoring, or the estimated weights assigned to the implicit anchor over inflation outturns in setting inflation forecasts, generally improved overtime (Figure A9.4). Anchoring was stronger for analysts than for businesses and trade unions. Anchoring was the weakest during 2006–13 for all agents. As a notable exception, the extent of anchoring for businesses worsened from 2001–08 to 2010–17 to the similar extent of anchoring for trade unions. The behavior of businesses may have become increasingly influenced by wage setting by trade unions.

Figure A9.4. South Africa: Weight on Anchor Over Different Forecast Horizons
(Between 0–1)

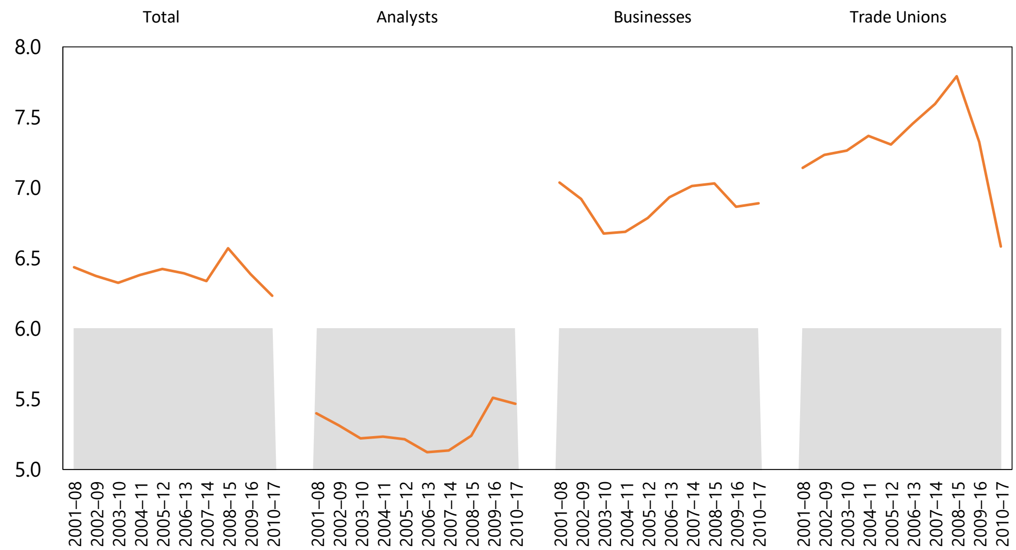


Source: Author's calculations.

Note: X-axis represents the forecast horizon in the number of quarters.

8. The estimated anchor levels varied significantly across the different types of forecasters (Figure A9.5). They were roughly 5–5.5 percent for analysts, below the upper range of the target range. The estimated anchors were above the target range for businesses and trade unions (in the range of 6.5–7 percent for businesses, and 7–8 percent for trade unions). The anchor for businesses declined initially, but started to trail the anchor for trade unions, consistent with the view that wage demand affects firms' views on future wage levels, and inflation generally. The anchor for trade unions exhibited a notable fall in the final few rolling samples, down some 1.5 percentage points to around 6.5 percent. One interpretation is that protracted low economic growth might have started to dent prospects for strong wage growth.

Figure A9.5. South Africa: Implied Inflation Anchor



Source: Author's calculations.

Policy Implications

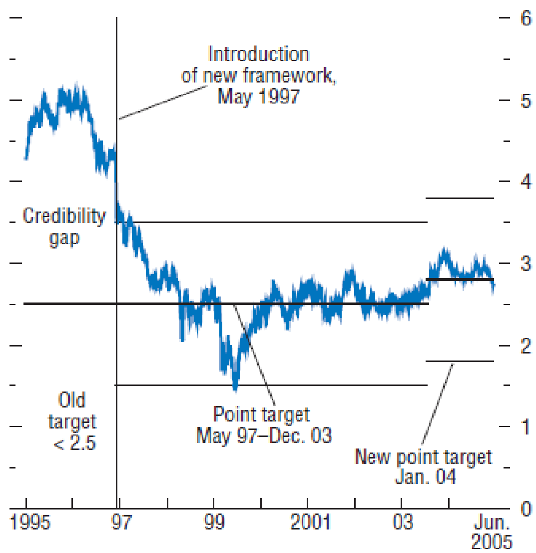
9. Maintaining low and stable inflation helps enhance central bank credibility and reduce inflation expectations.[4] The SARB has successfully stabilized inflation expectations, but at levels around the upper end of the official target range of 3–6 percent. An analysis, surveying data through 2017Q4, revealed that business and trade unions, critical for domestic inflation dynamics, have kept the "implicit inflation anchor" above the official target range and that it has even drifted away. One view is that inflation is a supply side phenomenon, or that "the Philips curve is flat" in South Africa (Kabundi et. al., 2016). To this end, increasing flexibility in the labor and product markets would help lower inflation and inflation expectations. Greater labor market flexibility should allow wages to be more consistently aligned with productivity gains. Lower barriers to entry and greater competition in product markets should reduce the cost of inputs for households and businesses.

[4] For a more detailed analysis of SARB monetary policy credibility, see Kabundi and Mlachila (forthcoming).

10. Consideration could be given to further enhancing the IT framework to help reduce inflation expectations, leveraging the most recent decline in inflation expectations. As a first step, the SARB could assess the merit of setting a midpoint target. A midpoint target helps emphasize the objective of price stability and, to the extent that it anchors inflation expectations better, allows greater monetary policy flexibility than a range target. This view is consistent with the experience in Canada (Yetman, 2017) and the UK (IMF, 2005; Figure A9.6). The point target could be set at 4.5 percent initially, with a tolerance of ±1½ percentage points. As a next step, the point target could be reduced to 4 percent, and the tolerance tightened to ±1 percentage point. An integer point target would help clarify the communication of the IT framework. In fact, when IT was introduced, the SARB intended to gradually tighten the official target range to 3–5 percent. The tighter range would be consistent with the inflation performance of South Africa's trading partners, which was used to guide the SARB set the 3–6 percent range two decades ago.

Figure A9.6. United Kingdom: Retail Price Index Inflation Expectations 10 Years Ahead[1]

(Percent)



Source: Bank of England.

[1]The definition and magnitude of the target changed in January 2004. It is now set at 2.0 percent and is expressed in terms of the year-on-year percent change in the HICP (Harmonized Index of Consumer Price). This is consistent with an estimate of 2.8 percent for the RPI (Retail Price Index), which is the definition used for the indexed bonds.

References

Amaral, P. 2017. "Monetary policy and inequality", Economic Commentary, Federal Reserve Bank of Cleveland, November.

Doepke, M., and M. Schneider. 2006. "Inflation and the redistribution of nominal wealth", Journal pf Political Economy, 114, 6, 1069–97.

Furceri, D., P. Loungani, and A. Zdzienicka. 2016. "The effects of monetary policy shocks in inequality", IMF Working Paper 16/245.

Hammadi, A., M. Mills, N. Sobrinho, V. Thakoor, and R. Velloso. (forthcoming). "Does Governance Hinder Economic Performance in Sub-Saharan Africa?", IMF Working Paper.

Heathcote, J., K. Storesletten, and G. Violante. 2010. "The macroeconomic implications of rising wage inequality in the United States", Journal of Political Economy, 118, 4, 681–722.

International Monetary Fund. 2005. World Economic Outlook, Chapter 4, Box 4.2, September.

Kabundi, A., and M. Mlachila. (*forthcoming*). "Monetary Policy Credibility and Exchange Rate Pass-through in South Africa," IMF Working Paper.

Kabundi, A., E. Schaling, and M. Some. 2016. "Estimating a time-varying Phillips curve for South Africa", South African Reserve Bank Working Papers 7277.

Love, I., and L. Zicchino. 2006. "Financial development and dynamic investment behavior: Evidence from panel VAR", Quarterly Review of Economics and Finance, 46, 2, 190–210.

Lovins, A., and A. Eberhard. 2018. "South Africa's Electricity Choice", University of Cape Town Occasional Paper Theories.

Yetman, J. 2017. "The evolution of inflation expectations in Canada and the US", Canadian Journal of Economics, 50, 3, 711–37.

Appendix I. Status of Key Recommendations from the 2017 Article IV Consultation

	Recommendation	Status
Fiscal policy	- Implement prudent fiscal policy aimed at maintaining debt sustainability while prioritizing pro-growth and pro-poor spending. - Strengthen budget execution and the implementation of revenue and fiscal reform measures to ensure that government debt stabilizes.	- Fiscal policy has been constrained by lower-than-expected revenues and bailouts to SOEs. The 2018 budget seeks a path to debt stabilization on the premise of a fiscal adjustment based on a confidence-based growth recovery. Public debt projected by the authorities, to peak at 56 percent of GDP in 2021/22, is subject to risks. - The authorities have increased the progressivity of the fiscal consolidation and continued to provide significant grants to the poor. There is significant scope to improve public spending effectiveness.
Monetary policy	- Keep policy rates on hold given that headline inflation is projected marginally below the upper threshold of the official target band.	- The SARB reduced the policy rates by 25 basis points in July 2017 and another 25 basis points in March 2018 to 6.5 percent. The decisions were based on an improved inflation outlook. However, inflation expectations remain relatively high.
Financial sector	- Bring to fruition ongoing reforms in the financial sector to adapt prudential regulation fully to international best practice and enhance the resolution framework.	- The Financial Sector Regulation Bill, signed into law in August 2017 and implemented in April 2018, has strengthened the SARB's financial stability mandate. A privately funded deposit insurance scheme is under discussion. The stress-testing framework is being further bolstered.
Structural reforms and SOEs	- Accelerate the pace of reforms in product, service, and labor markets to spur economic growth and job creation. - Strengthen governance and fight corruption. - Monitor and manage fiscal risks from explicit or implicit government guarantees, and the importance of reform of state-owned enterprises.	- The pace of reform implementation was hampered by political and policy uncertainty. The national minimum wage has been approved following a broad consultative process. - The new administration has made governance a main priority. Investigations emanating from the "state capture" report have been reinvigorated and several individuals linked to malpractices have been under investigation or arrested. - The Board and management of the largest SOE were replaced to address rising governance concerns and secure financing. The new SOE minister has expressed his determination to push ahead with the needed reforms.

Appendix II. Implementation of FSAP Recommendations

FINALIZED IN MOST AREAS OR NEAR COMPLETION

Twin Peaks Reform

Priority Recommendation 1: Define clear and comprehensive institutional, governance and accountability arrangements for prudential and market conduct regulation, including National Credit Regulator (NCR) and other relevant institutions.

Progress Update:

The Financial Sector Regulation Act No. 9 of 2017 (FSR Act) was signed into law on 21 August 2017 and came into effect on 1 April 2018.[1] The FSR Act (a) gave the SARB an explicit mandate to maintain and enhance financial stability; (b) created a prudential regulator, the Prudential Authority (PA), responsible for regulating banks, insurers, cooperative financial institutions, financial conglomerates and certain market infrastructures; and (c) established a market conduct regulator, the Financial Sector Conduct Authority (FSCA), located outside of the SARB. The FSR Act prescribes Memoranda of Understanding between the financial sector regulators, including the NCR.

Priority Recommendation 2: Publish a roadmap for regulatory reform, with adequate resource allocation, monitoring, and evaluation, to carefully implement the move to twin peaks and minimize transition risks.

Progress Update:

In terms of the FSR Act (clause 47), the PA must within 6 months from the date of its establishment adopt a regulatory strategy on how to achieve its objectives and perform its regulatory and supervisory functions. The regulatory strategy will be published on the PA's website. Sixty staff members from the former Financial Services Board (FSB) and the Cooperative Banks Development Agency (CBDA) were moved to the PA in October 2017.

SUBSTANTIAL PROGRESS

Micro-Prudential

Priority Recommendation 3: Strengthen group-wide supervision of financial conglomerates, focusing on interconnectedness by monitoring intra-group transactions and aggregate exposures, and conducting joint on-site visits.

[1] Available at http://www.prudentialauthority.co.za/Publications/Detail-Item-View/Pages/Publications.aspx?sarbweb=3b6aa07d-92ab-441f-b7bf-bb7dfb1bedb4&sarblist=21b5222e-7125-4e55-bb65-56fd3333371e&sarbitem=7922.

Progress Update:

The former Bank Supervision Department of the SARB and FSB conducted joint supervisory visits and reviews prior to the promulgation of the FSR Act. The PA and FSCA will continue to cooperate closely. The PA will regulate financial conglomerates, including related non-financial entities. A separate Conglomerate Supervision Department has been established within the PA and a draft "Financial Conglomerate Supervision Framework" was published on the PA's website on 26 March 2018.[2]

Priority Recommendation 4: Clarify objectives and strengthen the operational independence of all financial sector supervisors in the relevant legislation in line with international standards.

Progress Update:

Under Principle 1, Essential Criteria 1 (EC1) of the Detailed Assessment Report (DAR), one of the weaknesses identified for South Africa is that the Banks Act and other legislation do not provide the objective of the Bank Supervisor or the Registrar of Banks. This is now sufficiently addressed under the FSR Act as it provides the objectives of the PA (section 33) and FSCA (section 57). The PA's primary objective is to promote and enhance the safety and soundness of financial institutions/market infrastructures and assist in maintaining financial stability.

EC1 under Principle 2 of the DAR requires that the operational independence, accountability, and governance of supervisors are prescribed in legislation and publicly disclosed. The FSR Act now provides for this. The FSR Act reiterates the independence of the FSCA and PA. Sections 34 and 58 of the FSR Act require the financial sector supervisors to perform their functions without fear, favor, or prejudice. The Act also provides for the financial sector supervisors to establish and implement appropriate and effective governance systems and processes.

A finding was made under EC2 of Principle 2 of the DAR that "laws define neither a minimum term nor specific reasons for removal from the office of the Registrar/Head of Bank Supervision." The FSR Act now addresses this. The process for the appointment, the term of office, and both the process and grounds for removal from office of both the PA CEO and the Commissioner and Deputy Commissioners of the FSCA is now provided for under the FSR Act. The PA's CEO and the FSCA's Commissioner and Deputy Commissioners may be appointed for a period not exceeding 5 years and are eligible for reappointment for one further term.

Financial sector supervisors are required to adopt and publish a regulatory strategy to give general guidance to the regulators in the achievement of their objectives and performance of their regulatory and supervisory functions. The regulatory strategy is reviewed and updated at least annually. This will show progress made in respect of the DAR finding under Principle 2, EC3 which requires that a supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives—the Regulatory Strategy

[2] Available at http://www.prudentialauthority.co.za/Policies_and_Frameworks/Pages/default.aspx.

provided for under the FSR Act addresses this weakness.

The regulators have the necessary powers under the FSR Act to determine their personnel, assets, and other resources that they require to function effectively. The regulators determine their own budgets as well as the fees and levies to fund their operations. The fees and levies are, however, determined through a transparent process that also involves a public consultation process. The issues around funding and budgets are fundamental in the determination of the independence of regulators (see EC6 of Principle 2 of the DAR). The new regulatory framework now addresses the issues around the budgets and funding of the BSD identified before.

The FSR Act requires memoranda of understanding to be entered into among all regulators to ensure independence and collaboration on shared objectives. The various memoranda of understanding are currently being drafted.

Priority Recommendation 5: Enhance regulatory requirements of Collective Investment Schemes (CIS), particularly for disclosure, valuation and accounting, introduce variable net asset valuation, and strengthen the supervision of CIS managers.

Progress Update:

The draft NAV Calculation Standard was circulated to industry and considerable comments were received and are being reviewed. Industry workshops were held during December 2017 to address some of the commentary received. Guidelines are being developed to be published with the standard, in support of the standard and providing guidance to industry of some of the technicalities around the application of the standard. Following the last meeting with ASISA, various aspects of the Guidelines need to be re-worked, which ideally need to be published together with the regulations.

Board Notice 90 is currently under review—structural changes are being considered, including adding additional chapters, i.e. ETF's and benchmarking where applicable against international frameworks (IOSCO principles).

Board Notice 92 of 2014 outlines the requirements for disclosures is currently under review. Any additions to BN 90 and the NAV Calculation standard, which results in additional disclosure requirements, will be accommodated for in BN 92.

Priority Recommendation 6: Fully implement the Solvency Assessment and Management (SAM) regime and Treating Customers Fairly Initiative (TCF); give high priority in legislation to protecting policyholder rights and entitlements.

Progress Update:

SAM

The PA is responsible for the prudential aspects of insurance supervision. The Insurance Act, promulgated on 18 January 2018 will take effect on 1 July 2018 and give effect to the SAM framework. The SAM framework introduces a forward-looking risk-based approach to solvency, by aligning the capital requirements with the underlying risks of an insurer. Its primary objective is the protection of policyholders and beneficiaries. It also has the following additional objectives:

- alignment of capital requirements with the underlying risks of an insurer;
- establishment of a proportionate, risk-based approach to supervision with appropriate treatment of small and large insurers, and cross-border insurance groups;
- provision of incentives to insurers to adopt more sophisticated risk monitoring and risk management tools; and
- maintenance of financial stability.

The SAM framework is principles-based regulation based on an economic balance sheet, and utilizes a three-pillar structure of capital adequacy (Pillar 1), systems of governance (Pillar 2), and reporting requirements (Pillar 3). The substance of the SAM framework will be given effect to Prudential Standards issued under the Insurance Act. On 9 March 2018, draft Prudential Standards (Financial Soundness and Governance Standards) was published for public comment. Comments are due on 23 April 2018. It is envisaged that full implementation of the SAM framework will take effect on 1 July 2018.

TCF

TCF conduct matters are already being implemented by the FSCA (previously FSB) through its TCF Roadmap. The Conduct of Financial Institutions Bill (CoFI Bill) is in the process of being drafted, consolidating 13 sectoral laws, and will further enhance the rights of customers. The CoFI Bill will be published for public comment during 2018. Policyholders and depositor's rights and entitlements will be addressed as part of the amendments to the FSR Act.

An update of the Retail Distribution Review (RDR) discussion document was published in December 2015. A further update, "Status Update: Retail Distribution Review—status as at December 2016" was published on December 13, 2016. The RDR discussion document issued in November 2014 proposed reforms to the regulatory framework for distributing financial products to customers. The RDR discussion document proposes 55 specific regulatory objectives. The RDR status update confirms that these proposals would be implemented in three broad phases and aligned to the broader reform of financial regulation in terms of the Twin Peaks regulatory model.

Proposed amendments to the Regulations made under the Long-term Insurance Act, 1998 and Short-term Insurance Act, 1998 (collectively referred to as the "Insurance Acts") giving effect to a number of regulatory reforms (including RDR Phase 1 Proposals) focusing on conduct of business that cannot be deferred until the enactment of the CoFI Bill were gazetted on 15 December 2017 with an effective date of 1 January 2018.

The proposed replacement of the Policyholder Protection Rules (PPRs) made under the Insurance Acts giving effect to several regulatory reforms (including RDR Phase 1 Proposals) focusing on conduct of business that cannot be deferred until the enactment of the CoFI Bill was gazetted on

15 December 2017 with an effective date of 1 January 2018. The amendment to the PPRs to a large extent codifies the TCF principles.

Macro-Prudential

Priority Recommendation 7: Continue building a top-down stress test framework for both the banking and insurance sectors and give SARB more resources for data collection and analysis.

Progress Update:

During 2015/16, the Financial Stability Department (Finstab) developed a top-down (TD) and bottom-up (BU) stress testing framework to evaluate solvency risk, an exercise that was run in 2016. The aggregated results were published for the first time by SARB in the first edition of the FSR of 2016. Two independent assessments/peer-reviews were subsequently conducted by the Deutsche Bundesbank and the IMF and the suggestions from this exercise were incorporated in the updated framework of 2018.

In 2017 the IMF provided TA in the improvement and expansion of the SARB stress testing framework to include both market and liquidity risk in addition to some enhancements to the original solvency framework. The technical assistance comprised of two phases which were concluded in April 2018. The 2018 TD and BU stress testing cycle is currently underway and results should be published at the end of 2018. The current ST only includes the banking sector.

Financial Safety Nets

Priority Recommendation 8: Introduce a resolution regime compliant with the Key Attributes for, and make the SARB the resolution authority of, all banks and SIFIs.

Progress Update:

In August 2015, National Treasury (NT), SARB and FSB-SA jointly published a discussion paper "Strengthening SA's resolution framework for financial institutions" for public comment and held a series of public consultations thereafter. The proposals contained in the discussion paper have been incorporated into draft legislation which will be published as amendments to the FSR Act and will form the foundation of the strengthened framework. The legislation will designate the SARB as resolution authority and provides it with additional powers, including, amongst others, the explicit ability to assign losses to shareholders and creditors through write down and conversion, building on the 2015 amendments to the Banks Act, 1990. The legislation will also allow for the establishment of an explicit deposit insurance scheme for South Africa.

Priority Recommendation 9: Adopt depositor preference and introduce an ex- ante funded deposit insurance scheme, with a back-up credit line from the National Treasury.

Progress Update:

The SARB, in cooperation with National Treasury, published a policy paper on 30 May 2017 with the proposals for the establishment of a deposit insurance scheme (DIS) for South Africa. These proposals have been incorporated into the draft legislation which will be published as amendments to the FSR Act. The detailed reporting and funding requirements from the banks to the DIS will be included in standards to be issued after the adoption of the legislation.

The level of deposit insurance coverage is to be R100 000 per covered depositor per bank. The funding of the DIS will be done on an ex ante basis. The funding mechanism will have three tiers consisting of an equity layer (premium contributions by banks), a liquidity layer (loans from banks to the DIS) and the emergency funding by the SARB. The equity and liquidity layers together will provide a fund size of approximately 3 percent of total covered deposits.

In terms of the draft legislation, covered depositors will have depositor preference in a resolution. If pay-out of covered depositors takes place, the covered depositors' claims against the failed institution will become subrogated to the DIS.

Priority Recommendation 10: Remove constraints to early intervention powers and improve legal protection for resolution officials.

Progress Update:

The proposed amendments to the FSR Act will create a strengthened resolution framework providing the SARB with sufficient flexibility and powers to take prompt action not only when a bank or SIFI fails, but also when it is likely to fail. This should ensure that action is taken early enough to mitigate any preventable loss of value. The envisaged legislation will also provide the SARB and its officials with sufficient legal action when conducting a resolution or exercising resolution-related powers.

OTC DERIVATIVES MARKET REFORMS AND OVERSIGHT

Priority Recommendation 11: Improve data collection of OTC derivatives and enhance surveillance of the OTC derivatives market.

Progress Update:

In January 2018, the Minister of Finance gazetted Regulations in terms of the Financial Markets Act, 2012 to bring regulatory clarity and certainty to certain aspects of the regulatory framework for over-the-counter (OTC) derivative transactions and financial market infrastructures (FMIs). In the case of OTC derivative transactions, the Regulations introduce the concept of an OTC derivative provider (ODP) as a new category of "regulated person"; requires the reporting of OTC derivative transactions to a trade repository (TR); and incentivizes the clearing of OTC derivative transactions through a central counterparty (CCP). The FSCA, with the concurrence of the PA, will determine eligibility criteria for OTC derivative transactions that will be subjected to mandatory clearing.

In the case of FMIs, the Regulations set out the requirements for the approval of an external central securities depository (CSD) as a participant and the requirements for establishing an external link with an external CSD; sets out the assets and resources requirements for exchanges, CSDs, and TRs;

and creates a regulatory framework for the licensing and regulation of CCPs

The FSCA and the PA also need to make certain additional standards to give effect to the OTC derivative reform agenda. To this end, the FSCA has submitted the following conduct standards to Parliament as part of the required parliamentary process: (i) the Code of Conduct for ODPs; (ii) the Criteria for Authorization of an ODP and (iii) the Reporting Obligations (for the reporting of OTC derivative transactions to a licensed trade repository). In addition, the PA and the FSCA have submitted the Joint Standard on the Requirements and Duties of a Trade Repository to Parliament for the required parliamentary process. These standards are expected to the implemented in 2018.

The PA and the FSCA are in the process of publishing a revised Joint Standard on the Margin Requirements for Non-Centrally Cleared OTC Derivative Transactions. At this stage, it is anticipated that this Joint Standard will be released for a final round of public consultation before being submitted to Parliament during August 2018 for the required parliamentary process. A Financial Markets Implementation Committee (formerly the OTC steering committee) consisting of officials from NT, FSCA, the PA and SARB has been established to provide strategic inputs and policy coordination on the OTC reform agenda. Given the large size of the OTC derivative market, timely data collection is vital for risk monitoring.

Priority Recommendation 12: Consider establishing a local CCP, with credit lines to the central bank and securities collateral placed at a central securities depository to reduce dependency on local banks.

Progress Update:

The consequential amendments to the Financial Markets Act, 2012 (which were affected with the coming into force of the Financial Sector Regulation Act, 2017) and the Ministerial Regulations issued in terms of the Financial Markets Act during January 2018 create an enabling framework for the licensing and regulation of a CCP.

JSE Clear currently operates as an associated clearing house licensed in terms of the Financial Markets Act (FMA), 2012. In terms of the consequential amendments to FMA 2012, a clearing house performing the functions of a central counterparty must comply with any requirements imposed by regulations or standards, and must until 31 December 2021, be licensed as either an associated clearing house or an independent clearing house, and be approved by the PA, in the manner and form prescribed by the PA, to perform the functions of a central counterparty and as of 1 January 2022, be licensed as both an independent clearing house and a central counterparty.

SOME PROGRESS

Competition

Priority Recommendation 13: Adopt the international best practices on provision and disclosure of market information to retail customers and to potential entrants into the payments and clearance systems.

Progress Update:

The National Payment System Act, 1998 (NPS Act) does not specifically provide requirements for payment participants in relation to retail customers. Although the National Payment System Department (NPSD) has been applying the CPSS Core principles for systemically important payment system and subsequently the CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs), these principles have not been formally adopted into domestic law. NPSD has publicly expressed its commitment and support to adopting the PFMIs.

The FSR Act makes provision for conduct regulation of payment services providers (PSPs) by FSCA for consumer protection purposes. The FSR Act provides legal authority for the regulation and supervision of PSPs and their conduct in relation to retail customers. The FSCA is also in the process of developing the COFI Bill which will apply to PSPs and include provisions on, among others, disclosure to retail customers by PSPs. The NPSD is part of the Working Group on the COFI Bill. In addition, further clarity will also be provided in the National Payment System Amendment Bill. In this regard, the NPSD is also in the process of reviewing the NPS Act to align it with FSR Act, and among others, to align with international standards, including the PFMIs.

With regard to disclosure to potential market entrants, section 6A (3), (4) and (5) of the NPS Act make provision for market access. In addition, once the PFMIs have been adopted, these provisions will be fully aligned to the PFMIs principle on access and participation, and the broad public policy on disclosure and transparency.

Priority Recommendation 14: Adopt a rules-based entry and exit framework, and lower entry hurdles to the financial system.

Progress Update:

NPSD is currently reviewing the NPS Act to address among others, entry and exit frameworks in line with the PFMIs and other applicable international standards. In this regard, NPSD has taken a policy view to include a broader definition of payment services in the NPS Amendment Bill and to ensure that NPS is more accessible to non-banks.

It is envisaged that restrictions relating to bank sponsorships for non-banks in the clearing and settlement systems would be removed, provided that the non-banks meet entry requirements to help increase competition in the NPS particularly in the remittance, mobile money/payments, clearing and settlement environment. The proposal has been included in the NPS Act Review Policy paper to be submitted to Treasury during the second half of 2018 for translation into the NPS Amendment Bill.

Appendix III. Summary of Capacity Development Strategy

June 2018

Macroeconomic Environment

Reviving real GDP growth and fighting high unemployment by implementing sound reforms is a key priority for South Africa. Other priorities are recalibrating the fiscal policy stance, and continuing to implement cautious monetary policy.

- Structural reforms to make labor and product markets more flexible, and measures to improve governance are the main policy levers to boost growth and make it more inclusive. Higher productivity and competitiveness would strengthen the economy's resilience to shocks and bring more citizens to the labor force.
- The nation faces the triple challenges of maintaining debt sustainability, safeguarding the fragile recovery, and addressing demands for social spending. The recent recovery in investor confidence, boosted by announcements of the new administration, should help.
- As inflation expectations are anchored close to the top of the official target band, and external conditions could turn less supportive, the current inflation targeting framework needs to be maintained. It could be upgraded at an opportune time to lower inflation expectations. Exchange rate flexibility should remain the main policy response tool.

CD Assessment

Technical assistance (TA) in South Africa is highly (and appropriately) demand-driven. The country's strong institutions often preclude the need for traditional TA. Given the overall strength of institutions, Fund surveillance has relatively limited impact on capacity development, although it does have an impact on economic policy. Highly focused capacity development (CD) initiatives (mainly peer-reviewing) on issues that the authorities care about, such as the recent MCM TA on stress-testing in a Basel III environment, worked well. The authorities particularly appreciate Fund peer reviews on on-going policy initiatives, and joint analytical workshops. Recent examples include a staff assessment of the South African Reserve Bank (SARB)'s monetary policy analysis model (QPM), and a review of the paper on proposed SARB macroprudential framework (deposit insurance).

CD Priorities

Looking ahead, areas of priority relate to monetary policy, financial stability, and crisis management for the SARB; tax collection and administration for the South African Revenue Service (SARS); risk management, public investment efficiency, and adoption of GFS reporting for the National Treasury (NT); and property prices for Statistics South Africa (STAT SA).

Authorities' Views

The authorities broadly agreed with the staff assessment of CD priorities. The SARB highlighted the need for international partners to continue peer-reviewing South Africa's: (i) transition to the twin peaks model; and (ii) enhancement of micro- and macro-prudential frameworks. Treasury officials highlighted the need to urgently address significant skill gaps in the area of financial risk management at all levels (technical staff, management, and as an organization). In particular, the implementation of legislation, policies, and procedures needs to be elevated to an "acceptable level".

South Africa: Capacity Development	
Priorities	**Objectives**
SARB	
Strengthen stress-testing technical capacity.	Enhance the technical capacity to assess independently banks' models within a Basel III environment.
Enhance the micro and macro prudential frameworks.	Support the transition to the twin peaks model, as well as the exploration of macroprudential policy, including its instruments.
Strengthen the monetary policy framework.	Enhance the projection models to support monetary policy, its communication, and its coordination with fiscal policy. Carry out analytical projects to help support greater anchoring of inflation expectations.
Enhance the crisis management framework.	As a first step, identify areas with room for enhancement in collaboration with MCM.
Promote Fintech developments	Assist the authorities in Fintech and other payment innovations.
SARS	
Enhance capacity to confront base erosion and profit shifting.	Reduce revenue leakages from multinational companies.
More generally, increase tax administration capacity.	Help develop new reform baseline and refine medium-term plans.
National Treasury	
Enhance risk management capacity across all three spheres of the government.	Use long term expert to support the development of risk management capacity. In particular, help the authorities maintain the competency framework for risk management (including SOE risks), develop occupational qualifications, and carry out training.
Adopt GFS reporting of the fiscal accounts.	Assist NT staff to adopt GFS.
Enhance public investment efficiency.	Undertake a PIMA assessment.
Promote capital market development.	Assist the authorities particularly in the structuring of municipal bond markets.
STAT SA	
Expand the capacity to compile property price indices.	Facilitate monitoring of property prices.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Appendix IV. Draft Press Release

Press Release No. 18/xx
FOR IMMEDIATE RELEASE
July 25, 2018

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

IMF Executive Board Concludes 2018 Article IV Consultation with South Africa

On July 25, 2018, the Executive Board of the International Monetary Fund concluded the Article IV consultation with South Africa.[1]

Amid a marked growth deceleration, some of South Africa's economic and social achievements after the end of apartheid have recently unwound. While the economy is globally positioned, sophisticated, and diversified, gaps on physical infrastructure and education create large productivity differentials across sectors. Low consumer and business confidence has dampened productivity growth. Fast growing debt has constrained policy space. As a result, per-capita growth has turned negative, the poverty rate stands at around 40 percent, unemployment has crept up to 27 percent—almost twice that level for the youth—and income inequality is one of the highest globally.

Fiscal and monetary policies were eased, but growth remained subdued. The FY17/18 consolidated fiscal deficit is estimated to have expanded to 4.8 percent of GDP from 4 percent of GDP in FY16/17. Monetary policy was eased by a total of 50 basis points, in July 2017 and March 2018. Nonetheless, GDP growth edged up only slightly from 0.6 percent in 2016 to 1.3 percent in 2017. Major obstacles to growth included a regulatory environment not conducive to private investment, inefficiencies in SOEs increasing the cost of key inputs, labor market rigidities, insufficient competition in product markets, corruption, and policy uncertainty. Inflation moderated to 5.3 percent and the current account deficit narrowed to 2.5 percent of GDP in 2017.

The recent political transition offers a renewed opportunity to advance reforms and exploit the economy's potential. The stated priorities of the new administration—combating "state capture" and promoting jobs and growth—point in the right direction.

[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.

On current policies, staff projects a modest growth recovery to 1.5 percent in 2018 and 1.8 percent in the outer years, slightly above population growth. Inflation is projected to ease to 4.9 percent in 2018 and edge higher to 5.5 percent in the outer years. The current account deficit is expected to widen to 2.9 percent of GDP in 2018 and to around 3½ percent of GDP over the medium term.

This baseline scenario is subject to upside developments, but downside risks seem more prominent. Should structural bottlenecks be addressed, South Africa has broad-based potential to boost growth significantly, aided by deep and liquid financial markets, a solid domestic investor base, a floating exchange rate, and limited susceptibility to exchange rate risk (low foreign currency exposures) and rollover risk (long debt maturities and access to segments of the global financial safety net). However, significant vulnerabilities arise from fiscal risks related to weak and poorly managed state-owned enterprises and other spending pressures. External risks include large gross external financing needs, and a current account deficit financed by flows that are prone to sudden reversals in response to abrupt changes in global financial conditions and sovereign credit ratings. Disruption in trade flows and a fall in commodity prices would worsen the twin deficits and dampen growth.

Executive Board Assessment[2]

<   >

[2] At the conclusion of the discussion, the First Deputy 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 summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Table 1. South Africa: Selected Economic Indicators, 2013–19

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2017, billions of US dollars)	349	Lower national poverty line (2015)	40.0
GDP per capita (2017, in US dollars)	6,180	Undernourishment (2015)	5.0
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2017, million)	56.5	Highest 10 percent of population	51.3
Urban population (2014, percent of total)	64	Lowest 20 percent of population	2.5
Life expectancy at birth (2016, number of years)	62	Gini coefficient (2015)	63.0

Economic Indicators

	2013	2014	2015	2016	2017	2018	2019
					Est.	Proj.	
National income and prices (annual percentage change unless otherwise indicated)							
Real GDP	2.5	1.8	1.3	0.6	1.3	1.5	1.7
Real GDP per capita	1.0	0.3	-0.3	-1.0	-0.3	-0.1	0.1
Real domestic demand	3.1	0.5	2.1	-0.9	1.8	1.6	1.9
GDP deflator	6.2	5.5	5.1	6.8	5.5	4.9	5.3
CPI (annual average)	5.8	6.1	4.6	6.3	5.3	4.9	5.3
CPI (end of period)	5.4	5.3	5.3	6.7	4.7	5.3	5.3
Labor market (annual percentage change unless otherwise indicated)							
Unemployment rate (percent of labor force, annual average)	24.7	25.1	25.4	26.7	27.5	27.9	28.3
Average remuneration (formal nonagricultural, nominal)	7.2	6.6	7.0	5.8	7.1	6.7	7.1
Labor productivity (formal nonagricultural)	1.8	1.5	1.8	0.5	1.8	1.8	1.8
Unit labor costs (formal nonagricultural)	5.2	5.1	5.2	5.2	5.3	4.9	5.3
Savings and Investment (percent of GDP)							
Gross national saving	15.4	15.4	16.4	16.6	16.1	15.6	15.4
Public (incl. public enterprises)	-0.9	1.1	1.0	0.8	0.3	0.5	0.6
Private	16.2	14.3	15.3	15.7	15.8	15.1	14.8
Investment (including inventories)	21.2	20.5	21.0	19.4	18.6	18.5	18.7
Public (incl. public enterprises)	7.1	6.9	7.4	7.2	6.9	6.9	6.8
Private	13.3	13.5	13.0	12.3	11.8	11.8	12.0
Fiscal position (percent of GDP unless otherwise indicated) 1/							
Revenue, including grants 2/	27.3	27.6	28.1	28.6	28.3	29.0	29.5
Expenditure and net lending	31.6	31.9	32.9	32.7	32.9	33.3	33.6
Overall balance	-4.3	-4.3	-4.8	-4.1	-4.6	-4.3	-4.0
Primary balance	-1.3	-1.2	-1.5	-0.6	-1.0	-0.5	0.0
Structural balance (percent of potential GDP)	-4.1	-4.1	-4.1	-3.8	-3.9	-3.7	-3.5
Gross government debt 3/	44.1	47.0	49.3	51.6	53.0	55.0	56.0
Government bond yield (10-year and over, percent) 4/	8.2	8.0	9.7	8.9	9.2	8.6	...
Money and credit (annual percentage change unless otherwise indicated)							
Broad money	5.8	7.2	10.5	6.1	6.9	6.4	7.1
Credit to the private sector	7.1	7.2	8.0	4.7	4.3	5.6	6.3
Repo rate (percent, end-period) 5/	5.0	5.8	6.3	7.0	6.8	6.5	...
3-month Treasury bill interest rate (percent) 6/	5.1	5.8	6.1	7.2	7.3	7.1	...
Balance of payments (annual percentage change unless otherwise indicated)							
Current account balance (billions of U.S. dollars)	-21.2	-17.8	-14.6	-8.2	-8.6	-11.0	-12.7
percent of GDP	-5.8	-5.1	-4.6	-2.8	-2.5	-2.9	-3.3
Exports growth (volume)	4.0	3.6	2.8	1.0	-0.1	3.7	3.4
Imports growth (volume)	5.0	-0.6	5.4	-3.8	1.9	4.0	3.9
Terms of trade	-1.4	-1.5	3.0	1.4	4.7	-2.7	-1.3
Overall balance (percent of GDP)	0.1	0.4	-0.3	0.9	0.5	0.2	-0.2
Gross reserves (billions of U.S. dollars)	49.6	49.1	45.8	47.4	50.7	51.5	50.7
Total external debt (percent of GDP)	37.2	41.3	39.1	48.3	49.6	46.1	47.0
Nominal effective exchange rate (period average)	-13.7	-10.2	-4.0	-11.9	11.8	...	...
Real effective exchange rate (period average)	-10.5	-6.2	-0.5	-7.1	12.7	...	...
Exchange rate (Rand/U.S. dollar, end-period)	10.5	11.6	15.6	13.7	12.3	...	...

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

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

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

3/ Central government.

4/ The 2018 value is as of end May 2018.

5/ January-May 2018 average.

6/ January-May 2018 average.