INTERNATIONAL MONETARY FUND

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SOUTH AFRICA

June 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SOUTH AFRICA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with South Africa, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 22, 2023, consideration of the staff report that concluded the Article IV consultation with South Africa.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 22, 2023, following discussions that ended on March 1–17, 2023, with the officials of South Africa on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 5, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for South Africa.

The documents listed below have been or will be separately released.

Selected Issues

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

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PRESS RELEASE

PR23/198

IMF Executive Board Concludes 2023 Article IV Consultation with South Africa

FOR IMMEDIATE RELEASE

Washington, DC – **June 6, 2023:** On May 22, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with South Africa.

South Africa's economy is facing mounting economic and social challenges. Growth moderated from 4.9 percent in 2021 to 2.0 percent in 2022 as the country was buffeted by Russia's war in Ukraine, global monetary policy tightening, severe floods, and an unprecedented energy crisis. Business and consumer confidence and investor sentiment remain weak, and the sovereign spread for South Africa remains higher than the pre-pandemic level. The average employment level in 2022 was still about 5 percent lower than in 2019, threatening social cohesion.

Headline inflation has risen above the South African Reserve Bank (SARB)'s 3–6 percent target range amid higher food and energy prices. Inflation expectations have inched up but remained within the target range. In 2022, the current account balance decreased to a -0.5% GDP deficit from a 3.7% GDP surplus in 2021, due to lower commodity prices and logistical bottlenecks. This, together with tighter global financial conditions, shifts in investors sentiment, and increased domestic political uncertainty have weakened the rand.

The fiscal deficit has continued to narrow, reaching 4.2 percent of GDP in FY2022/23, from 4.8 percent in FY2021/22, thanks to buoyant revenue and expenditure restraint. Despite this improvement, the government debt-to-GDP ratio is estimated to have increased to 70 percent. The SARB has proactively raised interest rates to bring down inflation within the target range and anchor inflation expectations, continuing the removal of monetary accommodation.

Looking ahead real GDP growth is projected at 0.1 percent in 2023, reflecting a significant increase in the intensity of power outages, and weaker commodity prices and external environment. Annual growth is expected at about 1½ percent over the medium term, as long-standing structural impediments, such as product and labor market rigidities and human capital constraints offset expected improvements in energy supply, higher private spending on energy-related infrastructure, and a more supportive external environment. The growth level would be too low to create enough jobs to absorb the new labor market entrants. The fiscal position is projected to deteriorate due to weakening mineral revenue, the Eskom debt relief arrangement, wage bill pressures, and rising debt service. As a result, public debt is not expected to stabilize. Headline inflation would return to the midpoint of the target range by end 2024. The current account deficit is projected to deteriorate to about 2½ percent of GDP in the near term. The outlook is subject to significant uncertainty related to the pace of reform domestically and the challenging external environment.

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[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.

Executive Board Assessment[2]

While recognizing South Africa's strong fundamentals, Directors noted that the post-pandemic recovery is petering out amid several shocks, exacerbating economic and social challenges in a context of elevated poverty and inequality. They stressed the urgency of reforms to promote the sustained and inclusive growth needed to address these challenges.

Directors commended the South African Reserve Bank's commitment to price stability and endorsed the pace of monetary policy normalization, which should bring inflation back within the target. They recommended maintaining a data dependent approach to monetary policy decisions. Directors supported enhancing the inflation targeting framework by formalizing the current focus on the midpoint of the target range and lowering the inflation target, as conditions allow and with adequate communication.

Directors praised the recent reduction in the fiscal deficit, reflecting efforts to contain public spending and improve revenue administration. They encouraged stronger fiscal consolidation under a credible medium-term framework to put public debt on a firmly declining path while protecting productive investment and well-targeted social spending. This should be supported by reforms to the fiscal framework, procurement system, and public investment management.

Directors welcomed the resilience of the financial sector, particularly amid the recent global financial market volatility. They called for continued implementation of the FSAP recommendations to strengthen the financial safety net and supervision. Directors acknowledged that while advancing fiscal consolidation will mitigate risks from the sovereign-financial nexus, carefully calibrated and communicated prudential measures could play a complementary role while being mindful of procyclicality and potential unintended consequences on financial institutions' balance sheets.

Directors emphasized that promoting a sustainable, inclusive, and green recovery requires reforms that foster private investment, a balanced energy transition, and good governance. They recommended further measures to reform SOEs, open key network industries to private sector participation, reduce the regulatory burden, and enhance labor market flexibility and the quality of education to tackle high structural unemployment. Directors recognized that resolving the ongoing energy crisis remains the top priority, providing an opportunity to accelerate the rollout of renewables. They supported steadfast implementation of the government's energy transition plan and emphasized the importance of well-targeted fiscal support for affected communities and workers. Directors also recommended to forcefully tackle governance weaknesses and corruption. They noted that timely implementation of the Financial Action Task Force's action plan is crucial to exit its grey list swiftly.

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

South Africa: Selected Economic Indicators, 2020–2025

Social Indicators

GDP		**Poverty (Percent of population)**	
Nominal GDP (2022, billions of US dollars)	406	Lower national poverty line (2015)	40
GDP per capita (2022, in US dollars)	6,694	Undernourishment (2019)	7
Population Characteristics		**Inequality (Income shares unless otherwise specified)**	
Total (2022, million)	61	Highest 10 percent of population (2015)	53
Urban population (2020, percent of total)	67	Lowest 40 percent of population (2015)	7
Life expectancy at birth (2020, number of years)	64	Gini coefficient (2015)	65

Economic Indicators

	2020	2021	2022	2023	2024	2025
			Est.		Proj.	
National Income and Prices (Annual percentage change unless otherwise indicated)						
Real GDP	-6.3	4.9	2.0	0.1	1.8	1.6
Real GDP per capita 1/	-7.7	4.0	1.3	-1.4	0.3	0.1
Real domestic demand	-7.8	4.7	3.8	0.8	1.8	1.2
GDP deflator	5.7	6.2	5.1	5.3	4.8	4.5
CPI (annual average)	3.3	4.6	6.9	6.0	4.9	4.5
CPI (end of period)	3.2	5.4	7.4	5.3	4.6	4.5
Labor Market (Annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	29.2	34.3	33.5	34.7	34.7	34.8
Unit labor costs (formal nonagricultural)	2.8	1.5	6.9	6.0	4.9	4.5
Savings and Investment (Percent of GDP)						
Gross national saving	14.4	16.5	14.6	13.9	14.0	14.5
Public (incl. public enterprises) 2/	-6.0	-1.5	0.0	-0.9	-1.4	-1.8
Private	20.4	17.9	14.6	14.8	15.4	16.3
Investment (including inventories) 3/	12.4	12.8	15.1	16.1	16.6	16.8
Public (incl. public enterprises)	4.0	3.8	3.9	3.9	4.0	4.0
Private	9.8	9.2	10.2	10.6	11.0	11.3
Fiscal Position (Percent of GDP unless otherwise indicated) 4/						
Revenue, including grants 5/	25.0	27.1	27.7	27.5	27.2	27.2
Expenditure and net lending	34.6	32.7	32.2	33.4	33.3	33.9
Overall balance	-9.6	-5.6	-4.5	-5.8	-6.1	-6.7
Primary balance	-5.4	-1.2	0.2	-0.7	-0.5	-0.6
Structural balance (percent of potential GDP)	-5.7	-5.0	-5.5	-6.3	-6.4	-6.2
Gross government debt 6/	69.0	69.0	71.0	72.2	73.8	76.9
Government bond yield (10-year and over, percent) 7/	9.7	9.9	11.3	11.1	...	...
Money and Credit (Annual percentage change unless otherwise indicated)						
Broad money	9.4	5.7	8.7	5.5	8.0	6.1
Credit to the private sector 8/	1.0	5.1	8.9	4.5	6.5	4.7
Repo rate (percent, end-period) 7/	3.5	3.8	7.0	7.2	...	...
3-month Treasury bill interest rate (percent) 7/	3.9	3.9	6.5	6.9	...	...
Balance of Payments (Annual percentage change unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	6.7	15.4	-1.9	-9.1	-10.7	-9.9
percent of GDP	2.0	3.7	-0.5	-2.3	-2.6	-2.3
Exports growth (volume)	-11.9	10.0	7.5	3.6	5.7	5.3
Imports growth (volume)	-17.4	9.5	14.2	5.9	5.3	3.6
Terms of trade	9.3	4.3	-9.4	-2.3	-0.7	-0.7
Overall balance (percent of GDP)	-1.0	1.1	1.0	-0.2	-0.4	-0.2
Gross reserves (billions of U.S. dollars)	55.5	58.1	61.0	60.2	58.6	57.6
in percent of ARA (w/o CFMs)	78.1	85.2	89.5	88.3	85.8	84.4
in percent of ARA (w/ CFMs)	86.6	94.7	99.5	98.2	95.4	93.8
Total external debt (percent of GDP)	50.5	38.3	40.6	43.3	44.4	45.5
Nominal effective exchange rate (period average) 7/	-11.6	7.6	-4.9	-8.0	...	...
Real effective exchange rate (period average) 7/	-10.1	9.7	-1.4	-10.1	...	...
Exchange rate (Rand/U.S. dollar, end-period) 7/	14.7	15.9	17.0	17.8	...	...

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

1/ Per-capita GDP figures are computed using STATS SA mid-year population estimates.
2/ Public savings are the sum of public corporations and general government gross savings, using SARB financial accounts data. This allows to obtain a private sector savings estimate that excludes SOEs (SOEs are included in the National Accounts), derived as the difference between the National Accounts gross national savings and the public savings.
3/ Inventories data are volatile and excluded from the investment breakdown to help clarify fixed capital formation developments.
4/ Consolidated government as defined in the budget unless otherwise indicated.
5/ 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 2014.
6/ Central government.
7/ Average January 1- April 19, 2023. For nominal and effective exchange rate, year on year change of average January 1–April 19.
8/ Other depository institutions' "loans and securities" in all currencies.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

May 5, 2023

KEY ISSUES

South Africa's strong economic recovery from the COVID-19 pandemic is petering out. Growth moderated from 4.9 percent in 2021 to 2.0 percent in 2022 as the country was buffeted by Russia's war in Ukraine, global monetary policy tightening, severe floods, and an unprecedented domestic energy crisis. Inflation rose above the target band though inflation expectations remained anchored. The current account moved back into a deficit after a temporary commodity-price driven surplus.

Economic and social challenges are building up, and poverty and inequality remain elevated. The limited fiscal space, long-standing rigidities in product and labor markets, governance and corruption vulnerabilities, rising policy uncertainty, and an unfavorable external environment are weighing on future growth and social outcomes. Social spending pressures add to elevated public debt vulnerabilities.

The near-term priority is to safeguard macro-financial stability in a volatile global environment. Monetary policy normalization should continue as planned, remaining data-dependent, to keep inflation expectations anchored and bring headline inflation back within the target band. In time, refinements in the central bank's inflation targeting framework would strengthen its ability to guide expectations. Stronger fiscal consolidation efforts implemented in the context of a credible medium-term framework are urgently required to put public debt on a declining path while protecting productive investment and well-targeted social spending. Supporting the consolidation by reforms to the fiscal framework, procurement system, and public investment management would enable more productive and transparent use of public resources. The financial sector has remained resilient in the face of global financial market volatility following the collapse of Silicon Valley Bank while domestic financial indicators moved in line with peers. Enhancing financial sector supervision, monitoring of banks' holdings of sovereign debt, and implementing the Financial Action Task Force action plan in a timely manner to come off the grey list will further strengthen resilience.

Far-reaching reforms are urgently needed to durably lift potential growth, create jobs, and reduce poverty and inequality. Without further such reforms, income per capita is set to continue falling, while rising public debt will leave less room to deal with shocks, including climate shocks, and meet spending needs on social safety nets, health, education, and infrastructure. This would jeopardize macroeconomic stability and threaten social cohesion. The most urgent priority is to resolve the ongoing energy crisis, which is impacting economic performance across the board. Easing the heavy regulatory burden on corporates, leveling the playing field, and forcefully tackling corruption and governance weaknesses would promote private sector investment, particularly in the network industries that are dominated by inefficient state-owned enterprises (SOEs). Reforms to enhance labor market flexibility are also needed to bolster job creation. Although the chosen course of action for structural reform will be determined by South Africa specific circumstances, experiences in other countries suggest that successful implementation of structural reform requires taking a gradual but sustained approach, well-targeted compensatory measures conditional on reform implementation and with clear sunset clauses, leveraging of independent institutions, early engagement with stakeholders, and effective communications.

Decisive action is needed to facilitate the transition to a greener economy. South Africa's energy security and green transition depend critically on the participation of the private sector, which in turn depends on a steadfast implementation of the government's energy transition plan. Ensuring a smooth green transition while maintaining social cohesion requires well-targeted fiscal support for affected communities and workers.

Approved By
Andrea Richter Hume (AFR) and Bjoern Rother (SPR)

An IMF team comprising Papa N'Diaye (head, AFR), Max Alier (resident representative), Vybhavi Balasundharam (FAD), Jana Bricco (AFR), Heiko Hesse (SPR), Haonan Qu, Alejandro Simone (AFR), and Nasha Mavee (local office) held discussions with Finance Minister Enoch Godongwana, Public Enterprises Minister Pravin Gordhan, Reserve Bank Governor Lesetja Kganyago, other senior government officials, parliamentarians, and representatives of labor unions, the business community, the banking sector, and academia during March 1–17, 2023. Vuyelwa Vumendlini and Linda Motsumi (OED) attended key discussions. Yadian Chen, Tiana Wang, (AFR), and Hermine Ilunga (local office) provided research support. Cecilia Prado (AFR) and Sandra du Plessis (local office) supported the preparation of the report.

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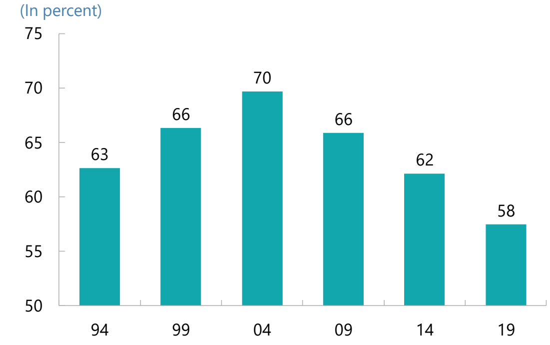
URGENT NEED FOR FAR-REACHING REFORMS

1. Elevated political uncertainty clouds the outlook for reform. Against the backdrop of a declining share in the national vote, the African National Congress (ANC) held its five-yearly national conference in December 2022 to elect the National Executive Committee and determine the party's platform. While President Ramaphosa was re-elected as the party's president, reform prospects are more uncertain in the run up to national elections that are scheduled for 2024.

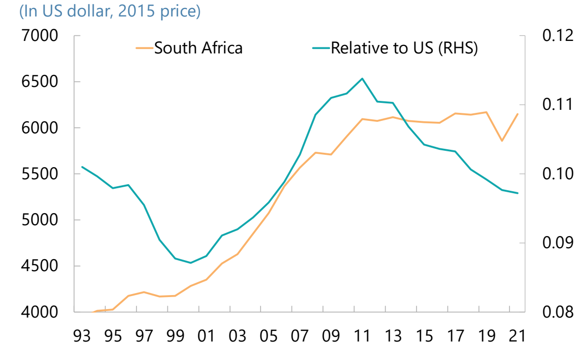
ANC Vote Share in National Elections
(In percent)



Sources: Electoral Commission of South Africa and IMF staff calculations.

2. Economic growth and job creation have been impacted by several shocks. The fifth COVID-19 wave in early-2022 was shallow, aided by herd immunity. But the country was buffeted by renewed external shocks, especially Russia's war in Ukraine and global monetary policy tightening. Domestically, on top of the recent damaging floods, the country faces an energy crisis, with unprecedented power outages. Unemployment and inequality remained elevated amid worsening logistical constraints, high inflation, and weak growth prospects. These conditions fueled labor disputes. In addition, in February 2023, South Africa was placed under enhanced monitoring by the Financial Action Task Force (FATF) (so called "grey-listing")[1], raising concerns about negative growth and financial market consequences. This comes on top of a lost decade of declining per capita income during which *state capture* weakened institutions, reduced the efficiency of public administration, including state-owned enterprises, and discouraged private investment.

Gross National Income per Capita
(In US dollar, 2015 price)



Source: World Bank.

3. South Africa has weathered the most recent shocks relatively well, thanks to its strong fundamentals, but far-reaching reforms remain essential. South Africa's large external asset position, diversified economy, flexible exchange rate, deep and resilient domestic financial system with low foreign exchange vulnerabilities, and a favorable public debt composition are sources of strength, allowing the economy to absorb external shocks (Annex I) without recourse to FX intervention or other IPF tools (Annex II). These features also provide a favorable base for growth, as

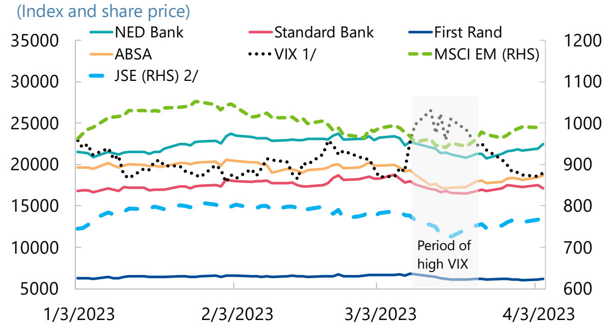
[1] This is due to the deficiencies identified in the Mutual Evaluation of South Africa's anti-money laundering and combating the financing of terrorism (AML/CFT) framework against the FATF standards.

fiscal and structural challenges continue to be tackled, including through Operation Vulindlela.[2] Output in 2022 surpassed its 2019 level but remains 2.8 percent below its pre-COVID-19 trend. Inflation expectations remained well anchored amid the South African Reserve Bank's (SARB) pro-active monetary policy. On the structural policy front, the government has made important headway on reforms (¶12). This progress is welcome and needs to be sustained. Further reforms are urgently needed to durably lift potential growth, promote good governance, create enough jobs to reduce unemployment and absorb new entrants into the labor force, and reduce poverty and inequality.[3]

CHALLENGES ARE BUILDING UP

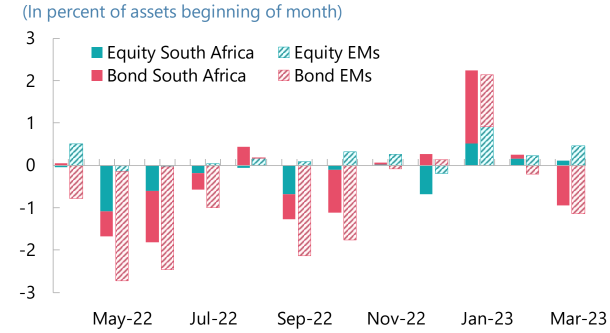
4. **After a strong rebound from the COVID-19-related recession, growth is losing momentum**. Real output growth moderated from 4.9 percent in 2021 to 2.0 percent in 2022 as floods, power cuts, and strikes dragged down manufacturing, mining, and agricultural output (Annex III). On the demand side, growth was supported by private consumption, inventory rebuilding from pandemic lows, and a modest recovery in private fixed investment that had fallen sharply during the pandemic. Business and consumer confidence remains weak (Figure 2, panel 3). The sovereign spread for South Africa remains higher than the pre-pandemic average, partly reflecting weaker investor sentiment toward the country. Even so, the impact on domestic markets from recent global financial market upheaval following the collapse of Silicon Valley Bank (SVB) was in line with global volatility. Capital outflows have also been in line with movements in other EMs, while the rand appreciated slightly (Figure 1).

South Africa Stock Market Performance in Comparison
(Index and share price)



Source: Bloomberg.
1/ For readability VIX was multiplied by 1000.
2/ For readability JSE=Johannesburg Stock Exchange index was divided by 100.

EPFR: Equity and Bond Flows (ETFs/Mutual Funds)
(In percent of assets beginning of month)



Sources: EPFR Global/Haver Analytics.
Note: Flows in March 2023 are based on the sum of weekly flows which doesn't contains flows that reportly on a monthly basis only.

5. **A weak labor market has undermined the improvement of social conditions**. While employment grew by 5.8 percent in 2022, its average level was still about 5 percent below the 2019 average. A rigid labor market and an initially lopsided recovery in favor of more capital-intensive sectors, combined with uncertainty about the growth outlook in the context of intensifying power outages, have contributed to the lackluster employment recovery despite the strong growth

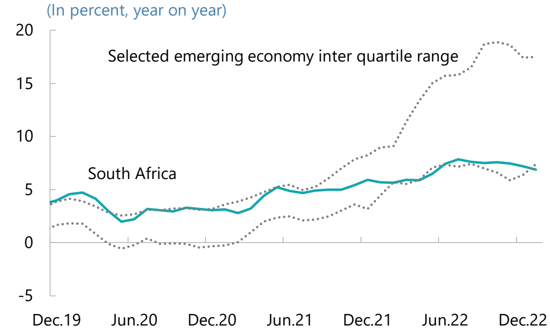
[2] Operation Vulindlela is a government initiative serving as a coordination mechanism to facilitate reform implementation.

[3] See South Africa 2019 Article IV Selected Issues Paper: Growth in South Africa: Issues and Reform Options.

rebound. Unemployment was 33.5 percent in 2022, down 0.8 percentage points from a year before. The weak labor market performance threatens social cohesion considering elevated levels of poverty and inequality in the country (Figure 2).

6. **Inflation rose above the 3–6 percent target range but compares favorably to South Africa's peers**. Headline inflation exceeded the upper end of the target range in May 2022 and peaked somewhat below 8 percent in July before coming down to average 6.9 percent in 2022. Inflation pressure stemmed from worsening logistical constraints domestically, and food and fuel price increases following the start of Russia's war in Ukraine. Core inflation increased gradually in 2022 from about 3½ percent to just under 5 percent, leveling towards the end of year (Figure 3, panel 2). Latest monthly data for March 2023 showed that headline and core inflation remain elevated at 7.1 and 5.2 percent, respectively. However, relative to other emerging economies (EMs), inflation rose less, aided by a good domestic harvest and pro-active and front-loaded monetary policy tightening. Households in lower expenditure deciles were disproportionately impacted by increasing inflation (Figure 3, panel 4), reflecting stronger reliance in their consumption basket on fuel and food items. To help mitigate the impact of rising global fuel prices, the authorities temporarily reduced the fuel levy for four months during 2022.

Inflation in Selected Emerging Economies
(In percent, year on year)



Sources: BIS and IMF staff calculations.

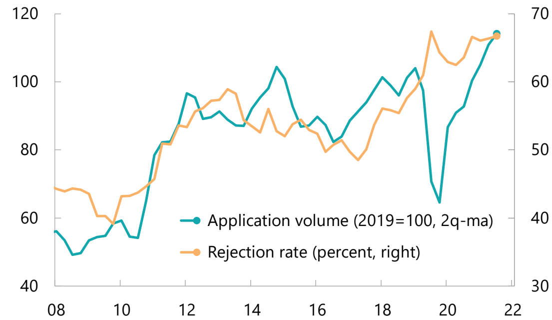
7. **Banking sector soundness remained strong.** While banks' profitability continued to improve to close to pre-pandemic levels (return-on-equity of 14.5 percent in August 2022) and pandemic-related restructured loans fell to nil, asset quality is yet to regain its pre-pandemic level and started to worsen most recently (NPL ratio of 5.0 percent). Bank capital and liquidity coverage ratios were strong (17.6 percent and 149 percent, respectively). Bank holdings of government bonds rose (to 14.6 percent of assets) in contrast to credit to households and corporates which remained weak amid subdued economic activity and private investment outlook. The sovereign and financial sector linkages strengthened as other domestic financial institutions, such as investment funds, steadily increased their sovereign bond holdings and nonresidents reduced theirs (Figure 5, panel 4).

8. **The nonfinancial sector deleveraged, compressing debt service cost to multi-decade lows**. The credit gap, estimated by SARB, remained negative and widened somewhat in 2022Q2. Household debt fell, more than unwinding the pandemic-related rise (of 1.5 percentage points), to 34 percent of GDP in 2022, but remains relatively high compared to peers.[4] Loan application volume now exceeds the pre-pandemic level by around 15 percent even though the rejection rate remains at around the pandemic peak (67 percent), likely reflecting both the higher riskiness of prospective

[4] According to IIF data in 2022Q4, median for selected 30 peer countries was 24 percent of GDP.

borrowers and banks' more conservative attitude toward risk. Compared to 2021, household debt service increased by more than one percentage point to 8.1 percent of disposable income by end 2022. Nonfinancial corporate debt fell sharply during the pandemic, by 7 percentage points, and stabilized at 33 percent of GDP. As a result, private nonfinancial debt service fell 2 percentage points to 7 percent of income. Debt service may rise as the impact of monetary policy tightening feeds through the economy, potentially straining lower-income households who tend to hold higher levels of debt relative to income. (Figure 7, panel 2, 4).[5,6] For insurers, profitability came under some pressure due partly to increased claims related to motor vehicles as mobility recovered and severe weather events damaged properties. However, solvency ratios remained appropriate. Growth in retirement funds was muted due to low investment returns.

Loan Application Volume and Rejection Rate
(Last observation 2022Q2)



Sources: National Credit Regulator and IMF staff calculations.

9. External balances worsened. After reaching a record surplus in 2021 (3.7 percent of GDP), thanks to elevated commodity prices and external demand for coal, the current account moved to a deficit of -0.5 percent of GDP in 2022, as commodity prices softened, external demand weakened, and export supply bottlenecks worsened. The rand depreciated in 2022 and during the first quarter of 2023 amid steady capital outflows on the back of faster monetary policy tightening in advanced economies as well as shifts in global investor sentiment and increased domestic political uncertainty. Gross external financing needs were around the emerging and developing economy median in 2021 in percent of GDP. Risks related to gross external liabilities are mitigated by a large external asset position and a favorable liability composition, mostly in equities, and a significant share of external debt denominated in rand (Annex IV). Staff continues to consider the external position in 2022 as moderately weaker than implied by medium-term fundamentals and desirable policies (Annex V). Foreign reserves remained below the adequate range in 2022, according to the IMF's composite adequacy metric.

10. The fiscal deficit declined on buoyant revenue and expenditure restraint, but the debt-to-GDP ratio continued to rise in the fiscal year ending in March 2023 (FY22/23). Aided by favorable mineral prices, the recovery in the services sector, and significant improvements in domestic revenue mobilization, the revenue-to-GDP ratio rose to a record of 27.9 percent of GDP in FY22/23.[7] The expenditure-to-GDP ratio declined due to wage bill containment and under-execution

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[5] Relative to other EMs, South Africa's household debt is relatively high (70th percentile in 2022Q2), similar to government debt (70th percentile). Nonfinancial corporate debt is relatively low (37th percentile).

[6] SARB: Financial Stability Review (May 2022).

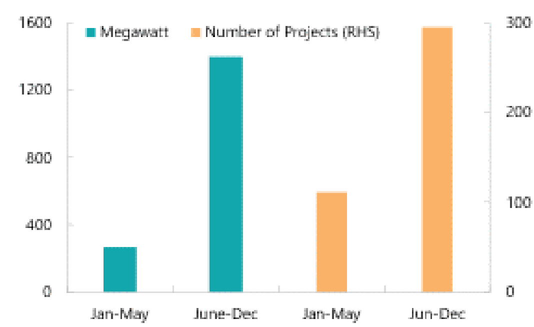
[7] There has been a notable improvement in filing among large taxpayers and international business, especially with respect to the corporate income tax (CIT). CIT filing increased from 65.7 percent in FY 19/20 to 76 percent in FY 22/23. More generally, the authorities estimate that audit weakness pre-pandemic contributed to about 1.7 percent of GDP in lost revenue of which SARS is estimated to have already collected about 0.5 percent of GDP.

of goods and services and capital expenditure outlays. As a result, the fiscal deficit is estimated to have moderated from 4.8 percent in FY21/22 to 4.2 percent in FY22/23. The debt-to-GDP ratio is estimated to have risen from 68 percent in FY21/22 to about 70 percent in FY22/23 driven by the fiscal deficit, a lower-than-anticipated cash drawdown to finance the deficit, and valuation effects of exchange rate depreciation on FX debt.

11. Pandemic-related monetary policy accommodation has been fully removed. The SARB started to withdraw monetary accommodation in November 2021 as inflation risks emerged. The policy rate has been raised by a cumulative 425 basis points to 7¾ percent since then. The pace of tightening accelerated but remained comparable to its peers, both in nominal and real terms (relative to inflation outturns). SARB transitioned to a new monetary policy implementation framework (MPIF) during June-August 2022, which entails a tiered-floor system for its repo rate transmission. Under the framework, required reserves will remain unremunerated, excess reserves within the quotas will earn the policy rate, and excess reserves above the quotas earn the standing facility rate (¶22, Annex VI). The grey listing by FATF in February 2023 had little, if any, impact on financial markets so far as it had been widely expected. The authorities continue to monitor developments, including engaging banks with concentrated correspondent banking activities. The joint IMF-World Bank Financial Sector Assessment Program, concluded in early-2022, noted that the financial sector was generally resilient and that pockets of vulnerability were being addressed.

12. Important headway was made on structural reforms. As the economy battled with the worst power shortages in history, steps were taken to ease licensing requirements and the registration process in the electricity sector. As a result, there was a significant pick-up in the registration of embedded power generation projects. Energy procurement under the Renewable Independent Power Producer Program (REIPPP) was expanded as part of the effort to alleviate the nation's energy crisis. The government also announced a three-year debt relief arrangement for Eskom to mitigate the energy crisis and help establish the company's commercial viability, the details of which were announced in the 2023 Budget Review. The debt relief arrangement envisages financial controls on the company and operational conditionalities. As part of broader efforts to restructure the electricity market in South Africa, the transmission unit of Eskom was separated as a subsidiary owned by the Eskom Holding. The Electricity Regulation Amendment Bill was published, opening ways towards a more competitive energy sector. In other reform areas, some actions have also been taken to improve third-party access to the country's ports and freight network. The long-delayed spectrum auction in the telecommunication sector was completed in March 2022. The government announced anti-graft measures in response to the recommendations of the state capture inquiry commission.

Registered Power Generation Facilities in 2022



Source: NERSA.

13. However, additional reforms are needed to address South Africa's long-standing structural impediments to growth, particularly in the energy and transportation sectors. Eskom's operational performance continues to deteriorate and its financial position remains challenging. Capacity constraints in the country's transmission lines are limiting new renewable energy supply to the grid. In the latest procurement round under the REIPPP, only about 1 gigawatt of successful preferred bidders were announced against planned 5.2 gigawatts. Thus, more needs to be done to ensure energy security, including reforms to enhance Eskom's efficiency, increase contestability, and attract private sector participation. This includes efforts to cut costs and collect arrears, a more predictable tariff-setting mechanism, as well as an enabling regulatory environment to level the playing field in the energy sector. With regard to transportation, efforts to improve third-party rail access suffered a setback recently amid limited interest from the private sector due to restrictive and unattractive terms of leasing in the contract for the auctioned slots. Structural impediments continue to hold back growth and inhibit job creation.

OUTLOOK AND RISKS

14. Economic activity is set to slow in the near term and remains weak in the medium term:

- **Growth** is expected to decelerate sharply to 0.1 percent in 2023 mainly due to a significant increase in the intensity of power cuts, as well as weaker commodity prices and external environment. Private consumption and investment are forecast to slow amid elevated inflation and interest rates, and the uncertain economic outlook. Weaker global economic activity is expected to reduce demand for South Africa's commodity and other exports. Growth is expected to pick up to 1¾ percent in 2024 as the energy crisis eases and global growth strengthens.[8] In the medium term, growth is projected to settle at around 1.4 percent, with income per capita stagnating as a result. This is because of long-standing structural impediments, such as product and labor market rigidities and human capital constraints, offsetting expected improvements in energy supply, higher private spending on energy-related infrastructure, and a more supportive external environment. This pace of growth is too slow for the economy to create enough jobs to absorb the new entrants into labor markets and materially reduce unemployment and poverty.

- **Headline inflation** is projected to fall into the upper half of the target range in 2023 and to around the midpoint of 4.5 percent by end 2024 and beyond, as supply constraints ease, food, and energy price inflation moderate, and the real policy rate increases close to its estimated neutral level.

- **Private-sector credit** growth is projected to remain sluggish (at about 4.5 percent in 2023) as relatively tight lending standards and subpar growth prospects weigh on banks' ability

[8] Several Eskom's large out-of-service power plants are expected to come back online by the year end, and additional private generation projects are expected to be connected to the grid starting 2024 which would help output pickup from a low base.

and willingness to provide credit. At the same time, financial institutions' holdings of government debt are projected to increase and the reduced credit availability also creates adverse feedback loops on growth in the medium term.

- **The current account** is projected to move to a sizable deficit of 2.3 percent of GDP in 2023 and to deteriorate further to about 2½ percent in 2024, on the back of softer commodity prices, weaker external demand, and higher energy-related capital imports. The deficit is expected to improve to around 2 percent of GDP over the medium term as these factors dissipate and logistical constraints are alleviated. Portfolio inflows are likely to stay volatile, while FDI inflows are anticipated to remain low in the coming years, hampered by slow progress in structural reform implementation and subdued private investment in the baseline projections.

15. The outlook is subject to significant downside risks related to the pace of reform domestically and the challenging external backdrop (Annex VII).

- ***Domestically,*** slower-than-expected progress and reversals of reforms, including on fiscal consolidation, would weigh on potential growth. Additional materialization of SOE contingent liabilities would intensify the pressures on debt sustainability. Slower growth would dent poverty reduction and job creation, with risks to social cohesion. Political uncertainty and a lack of resolute progress in addressing the domestic energy crisis would likely reduce investors' confidence. On the upside, faster reform implementation would boost confidence, private investment, and growth, leading to faster job creation and lower poverty. Similarly, stronger-than-expected private sector participation in the energy sector could provide some upside risk to the growth outlook. Accelerating the decarbonization transition of South Africa's electricity system could over the medium term help the economy improve energy security and sustain greener and stronger growth.

- ***Externally,*** downside risks stem from slower trading partners' growth, especially in China, further weakening of commodity prices, the impact of the FATF grey listing on capital flows, and tighter global financial conditions. More persistent high global fuel and food prices could de-anchor inflation expectations, and further raise risk premia. Systemic financial instability in advanced economies could cause adverse spillovers. Deepening geo-economic fragmentation could lower medium-term growth outlook, including through lower trade and financial flows, technology diffusion, and a fracturing of the international monetary and financial systems. On the upside, external demand for coal and precious metals could remain strong, strengthening South Africa's relative position in the EM asset class (Annex I).

16. Materialization of downside risks would significantly lower growth and entail significant macro-financial spillovers. South Africa's integration in global financial markets exposes the country to external shocks and capital flow volatility, but key economic buffers such as a flexible exchange rate, relatively low FX debt, and a large external asset position mitigate the impact of shocks. That said, a more protracted global slowdown and deterioration in the external environment and more severe power outages would lead to lower exports and domestic demand, leading to a recession in 2023.[9] This would be followed by a sluggish recovery over the medium term as structural constraints weigh on potential growth. Unemployment would rise to above 37 percent threatening social cohesion and creating additional fiscal spending pressures. Public debt would further increase relative to the staff baseline due to higher deficits resulting from lower revenue and higher expenditure and reach about 93 percent of GDP in 2028, accompanied by an increase in the sovereign risk premium reflecting eroding confidence and heightened debt sustainability challenges (Annex VIII). As a result of the recession, bank capital and profitability would weaken with worsening credit provision and asset quality. Small and medium-sized banks with relatively high NPLs would be especially impacted. Capital outflows would intensify, accompanied by currency depreciation, adding to inflationary pressures and demand for social spending and wage increases. As external financing dries out, the exchange rate would further depreciate with negative spillovers for the rest of the region (Annex II). The current account would move into a sizable positive territory in 2023, as domestic demand and imports collapse. Fiscal financing would rely increasingly on the domestic investor base, further deepening the sovereign-financial sector nexus, crowding out private investment, and weighing down growth creating an adverse feedback loop. Prompt policy interventions are warranted in case these adverse shocks materialize (Annex VII).

Downside Scenario

	2022	2023	2024	2025	2026	2027	2028	Unit
Real output growth	2.0	-1.8	0.4	1.7	1.6	1.6	1.4	(percent)
Per-capita real output growth	1.3	-3.3	-1.1	0.2	0.1	0.1	-0.1	(percent)
Unemployment	33.5	36.1	37.0	37.1	37.2	37.4	37.6	(percent)
Inflation	6.9	6.4	5.1	4.5	4.5	4.5	4.5	(percent)
Private sector credit growth	8.9	3.2	4.1	5.0	5.3	5.2	4.7	(percent)
Fiscal deficit	-4.5	-6.3	-7.1	-8.1	-8.0	-8.1	-8.7	(percent of GDP)
Public debt	71.0	74.0	77.7	81.7	85.3	88.9	93.0	(percent of GDP)
Current account balance	-0.5	1.1	-0.2	-1.6	-1.8	-1.9	-2.0	(percent of GDP)

Source: IMF staff calculations.

Note: Scenario analysis starts from 2023. Calendar year-based fiscal data for 2023 differ slightly from baseline values as the underlying fiscal year-based values are affected by 2023Q1 inflation.

17. Weak growth in South Africa would have negative spillovers to the region. The scenario outlined above would entail lower FDI and remittance flows from South Africa to the region. Import demand and financial transfers to the Southern African Customs Union (SACU) economies—SACU transfers constitute important sources of inflows for recipient countries, accounting for at least ⅓ of revenue—would be adversely impacted. Economies with currency pegs to the rand would be hurt by adverse monetary and exchange rate developments.[10]

[9] The downward scenario is calibrated based on the WEO downside scenario (April 2023) which is significantly impacting the economy in 2023 already and in 2024 before an envisaged growth rebound in 2025. A slower improvement in electricity supply than in the baseline and logistical constraints were assumed limiting the extent to which the economy can take advantage of the global recovery starting in 2025.

[10] See Arizala et al. 2018. "Regional Spillovers in Sub-Saharan Africa: Exploring Different Channels" for sub-Saharan Africa more broadly.

Authorities' Views

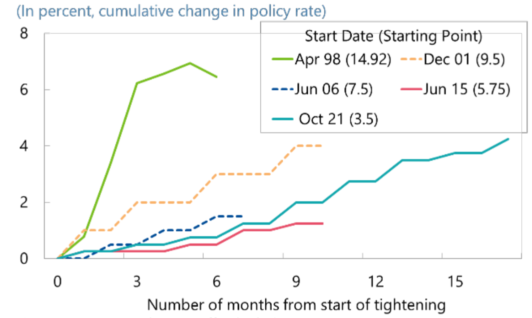
18. The authorities are somewhat more optimistic than staff on the growth outlook but agree that it is subject to significant uncertainty. In its February Budget Review, the National Treasury (NT) forecasts growth at 0.9 percent in 2023, citing weaker global growth, frequent and prolonged power cuts, elevated inflation, and higher borrowing costs as major constraints to growth. Over the medium term, the NT projects growth recovering to about 2 percent as energy and logistical challenges are gradually alleviated and the global outlook improves. Nevertheless, the NT acknowledged that a weaker than anticipated 2020Q4 GDP outcome, weaker global growth, more frequent and prolonged power cuts, and more persistent inflation will constrain growth in 2023 and that significant uncertainty remains on the evolution of energy supply and logistics going forward. On the outlook for inflation, SARB broadly agreed with the staff's projections, reiterating their commitment to bringing inflation within its target range. The authorities concurred that the current account is expected to worsen on the back of weaker commodity prices and external demand.

ENSURING MACRO-FINANCIAL STABILITY IN A VOLATILE GLOBAL ENVIRONMENT

A. Monetary Policy

19. The pace and size of monetary policy tightening have been appropriate. Like elsewhere, persistently high food and energy prices have pushed up inflation and raised inflation expectations. This has prompted the SARB to accelerate its pace of tightening, raising the repo rate by a cumulative of 425 basis points since the cycle started to 7¾ percent as of March 2023. As a result, inflation expectations have remained well anchored, with the two-year-ahead expectations within the official inflation target range.[11] The pace and extent of tightening do not stand out relative to past episodes of rate hikes in South Africa (the starting policy rate level of 3.5 percent was the lowest relative to the other 4 episodes). Pricing of money market instruments is consistent with the telegraphed path of policy action (Figure 4). In staff's view, absent further shocks, the current monetary policy stance should help bring inflation back to around the midpoint in the second half of 2024 and keep it there through the medium term. If inflation becomes more persistent than expected, further tightening would be warranted.

Episodes of Monetary Policy Tightening
(In percent, cumulative change in policy rate)



Sources: Haver and IMF staff calculations.
Note: End of period data. Average for Apr 98. Starting level in parenthesis.

[11] The inflation expectations are based on survey conducted by the Bureau for Economic Research (BER), a division of Stellenbosch University.

20. Staff recommends further enhancements to the SARB inflation targeting framework to better anchor expectations. Clear communication of monetary policy intentions would keep inflation expectations anchored and help lower inflation. The literature finds that the credibility of the inflation targeting framework in South Africa is comparable to a group of advanced and emerging economies.[12] Results from staff analysis also highlight the SARB's strong credibility (Annex IX) with an estimated inflation process that has a significant forward-looking component. A more forward-looking price formation process implies a smaller need for front-loaded monetary policy tightening to minimize the risks of inflation expectation de-anchoring.[13] Despite the SARB credibility, the 3–6 percent target band in its policy framework is interpreted as an indifference zone, with inflation expectations persistently hovering toward the upper end of the band. This contributes to keeping inflation outturns above the 4½ percent mid-point of the target band, which has been the stated inflation objective of recent monetary policy decisions. Thus, the policy framework could be improved by shifting in due course from a target band to a medium-term point target with a narrow tolerance band. Experience in other countries, such as Canada and the U.K., suggests that such a move could anchor medium-term expectations firmly.[14]

21. Staff support the SARB's plan to lower its target range at an opportune time. The authorities originally planned lowering the inflation target range to 3–5 percent by as early as 2004 and further down to 2–4 percent. The SARB stressed that doing so would improve predictability, better anchor inflation expectations, and enhance South Africa's competitiveness and economic growth. A lower inflation target would also be consistent with other large EMs and inflation in major trading partners. Staff agrees with the potential benefits of a lower target but stress the need to carefully choose the timing of such a move, taking into account inflation outturns and expectations, and the fiscal policy stance. Lowering the target when inflation is still outside the range could weaken credibility and make the disinflation process more costly in terms of output losses.

22. The new monetary policy implementation framework (MPIF) has reduced implementation costs but its effects on individual banks' liquidity positions should be closely monitored. The transition to the new MPIF, based on a tiered floor system, has helped reduce market distortions, such as the FX-implied interest rate differential to the policy rate. The transition was clearly communicated to markets and turning liquidity conditions into surplus did not affect market monetary policy expectations. Going forward, the SARB should continue closely monitoring the monetary policy transmission, and potential market distortions and associated costs. Interbank market activity and potential shifts in banks' demand curve for funds should also be closely monitored (Annex VI).

[12] E.g., Kamber et al. (2020). "Have the driving forces of inflation changed in advanced and emerging market economies?" BIS Working Paper 896.

[13] October 2022 WEO, Chapter 2.

[14] South Africa Staff Report 2018, Annex IX. How Robustly are Inflation Expectations Anchored?

Authorities' Views

23. The SARB is committed to bring consumer price inflation back within its target range. The SARB reiterated that its stance remains data dependent. It is watching closely domestic and external developments and would act to keep inflation and inflation expectations well anchored. The central bank sees merit in moving to a lower point target which would be good for the economy, the fiscal position, and ultimately the rand. However, the move will need to be carefully planned in cooperation with the NT and well communicated, and thus will take more time. The SARB expressed its satisfaction with the smooth transition to the new MPIF which has also been well received by the banking sector.

B. Fiscal Policy

24. Fiscal policy aims to restore the health of South Africa's public finances. The February 2023 Budget aims to do so by treating the windfall in mining revenue as temporary and allocating some of it to deficit reduction, while making spending composition more growth enhancing. In particular, the Budget envisages to reduce the fiscal deficit to 4 percent of GDP in FY23/24 and to 3.2 percent of GDP by FY25/26. Despite the declining fiscal deficit, debt is projected to increase from 71.4 percent of GDP in FY22/23 to 73.6 percent of GDP in FY25/26 due to the government's debt relief to Eskom.

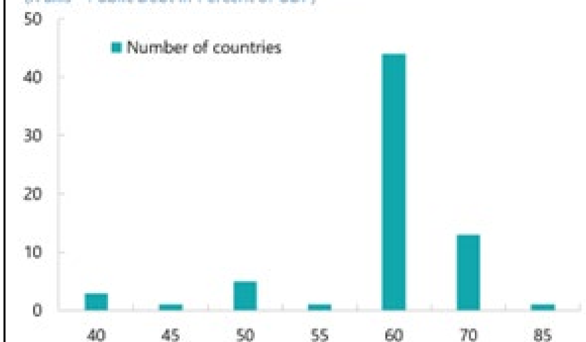
25. The authorities' fiscal consolidation in the budget hinges on revenue resilience and expenditure compression. Revenue is expected to decline somewhat in FY23/24 from the previous fiscal year as the temporary windfall from high commodity prices subsides. But commodity prices that stay above pre-pandemic levels for longer and increased tax buoyancy from tax administration reform (e.g., revamping of the large business unit and improved funding for IT and communication technology) are projected to maintain revenue significantly above pre-pandemic levels without any rate increases. Expenditure is expected to decline in the medium term as wage increases are kept below inflation, SOE transfers are cut, grants to local governments are contained, and the SRD grant is discontinued after the one-year extension until the end of FY23/24. The authorities do not consider the Eskom debt relief arrangement as part of expenditure, so it appears as a balance sheet (below the line) transaction.

26. Under staff's baseline scenario, the fiscal position is projected to deteriorate through the medium term on account of a weaker outlook for growth and higher expenditure pressures. Staff project the deficit to widen to about 6.3 percent of GDP in FY 23/24, peak at 6.9 percent of GDP in FY 25/26, and decline to 6.4 percent of GDP by FY28/29. As a result, the debt-to-GDP ratio is forecast to rise from 68 percent of GDP in FY21/22 to 85 percent of GDP in FY28/29. The forecast is predicated under lower medium-term growth assumptions (i.e., 1.5 percent versus 1.9 percent), more conservative revenue yields from tax administration reform which tend to be quite uncertain, a treatment of the SRD grant as permanent given repeated extensions, and an alignment of wage indexation and transfers to SOEs (Annex X) with recent negotiations outcomes and current policies.[15] The Eskom debt relief arrangement is considered as a capital transfer by the staff, meaning that it is included as an expenditure item in the budget (i.e., a capital transfer above the line).[16] Debt financing is set to increasingly come from domestic sources with moderately shorter maturities than in the past, deepening the financial sector-sovereign nexus, and reducing the availability of credit to fund private sector investment.

27. **Stronger fiscal consolidation efforts are urgently needed to put public debt on a declining path.** While staff welcomes the significant reduction in the fiscal deficit since 2019, the debt ratio needs to be stabilized at around 74 percent of GDP and put on a downward path thereafter in the context of a credible medium-term framework. While South Africa's deep domestic capital markets reduce the near-term fiscal funding risks, its public debt ratio is among the highest in EMs and set to continue rising on current policies (Figure 5, panel 3). This leaves limited fiscal space to mitigate future adverse shocks, including from contingent liabilities, especially from SOEs, social spending needs, and climate events. It also exposes the government to increasing borrowing costs and the financial system to increased risk, given a growing sovereign nexus (see below). Therefore, staff recommends to stabilize the debt ratio (excluding the Eskom debt relief) at current level and put it on a downward path towards a level that is in line with that of investment grade sovereigns and consistent with the most common debt ceiling levels of 60–70 percent of GDP across the world (text charts). Moreover, with investors focusing closely on macroeconomic fundamentals during episodes of heightened global uncertainty, failure to reduce debt vulnerabilities could expose South Africa to sharp capital outflows, which could result in even more aggressive tightening of fiscal policy with attendant adverse effects on growth, employment, and social cohesion.

Distribution of Public Debt Ceiling

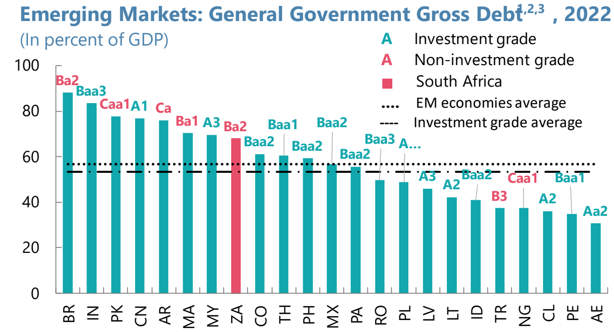
(X axis - Public Debt in Percent of GDP)



Source: IMF Fiscal Rules Database.

Emerging Markets: General Government Gross Debt[1,2,3], 2022

(In percent of GDP)



Sources: IMF World Economic Outlook, Moody's, and staff calculations.
1/ The countries listed above include (from left to right): Brazil, India, Pakistan, China, Argentina, Morocco, Malaysia, South Africa, Colombia, Thailand, Philippines, Mexico, Panama, Romania, Poland, Latvia, Lithuania, Indonesia, Turkey, Nigeria, Chile, Peru, United Arab Emirates.
2/Moody's ratings are shown given its broader coverage of EMs and to ensure comparability of the ratings methodology. Moody's ratings from EMs range from A1 to C where C reflects the highest risk. Ratings below Baa3 are below investment grade."
3/Even though some countries in the sample are not included in the IMF's WEO Emerging Market list, the analysis in Box 3 uses the definition of emerging markets that major rating agencies use, to facilitate comparability across countries.

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[15] Given recent negotiation outcomes with unions, staff expect public sector compensation to grow at CPI+1, offset in part by some attrition.

[16] Based on the Government Finance Statistics Manual 2014, pages 302–304. The manual seeks to capture the economic nature of the transaction and there are two main criteria that need to be satisfied for capital injections to be considered as balance sheet transactions (below-the-line) rather than expenses (above-the line) – 1) can the government obtain an effective financial claim, and 2) can the government expect a realistic/sufficient return on the investment. IMF Staff assess that the Eskom debt relief announced in the 2023 Budget does not satisfy either criterion for a balance sheet transaction, and hence, should be treated as capital transfer above-the-line item.

28. To achieve the debt stabilization and reduction goals outlined above, staff recommends additional consolidation measures of 3 percentage points of GDP as compared to its baseline scenario. The adjustment needs to protect productive public investment while supporting the most vulnerable and be accompanied by structural reforms (see below) given their beneficial impact on growth, fiscal deficit, and inflation.[17] The adjustment would also benefit from the following characteristics:

- *Be evenly spread over three years*. This time horizon is appropriate given current financing availability, limits the adverse short-term growth impact, and avoids credibility erosion from backloading. If financing conditions deteriorate markedly, a more front-loaded adjustment path would be warranted to maintain credibility and prevent financing costs from rising significantly. Recent cross-country experience highlighted how market sentiment could shift violently in response to fiscal policy decisions perceived as not credible.

- *Be predominantly expenditure-based while protecting productive investment and well-targeted social spending.* The widening of South Africa's fiscal imbalances over the last decade has been driven mainly by higher spending of limited efficiency, suggesting there is scope for rolling expenditure back without undue impact on growth.[18] Moreover, gains from expenditure consolidation are relatively more certain than those from revenue collection in an uncertain economic environment, enhancing the credibility of the consolidation (Annex XI). Furthermore, any decision to make the SRD grant permanent would need to find financing sources and based on staff simulations, such financing would be more beneficial if it came from improved public expenditure efficiency gains and spending cuts instead of tax increases (Annex XII).

- *Introduce some efficiency-enhancing revenue collection measures.* Given that South Africa's tax revenue to GDP ratio compares favorably with its peers, the measures could be focused on broadening the tax base, by ending tax exemptions for sectors and special economic zones that add little economic value or are poorly targeted. Efforts to strengthen tax administration should also continue. Increasing the effective carbon and excise tax rates (i.e., on alcohol and tobacco) would also support fiscal consolidation, while also helping reduce emissions to meet the nation's climate objectives (Selected Issues Paper: South Africa Carbon Pricing and Climate Mitigation Policy). Vulnerable groups affected by revenue measures could be compensated through the safety net.

- *Reduce the cost of servicing the public debt while being mindful of currency, liquidity, and refinancing risks.* While the bulk of interest savings would come from a lower fiscal deficit and country risk premium, debt and cash management measures could generate limited additional savings (Annex XIII).

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[17] See 2021 South Africa Article IV Staff Report for discussion of macroeconomic outlook under a reform scenario.

[18] Selected Issues Paper. 2018. "What Led to the Doubling of Public Debt In the Last Decade? Was Debt Good for Growth?"

29. Improving the institutional fiscal framework would support growth-friendly fiscal adjustment, create fiscal space, and improve risk management. In the current context, the following reforms are needed: i) anchoring the nominal primary expenditure ceiling with an explicit debt ceiling; ii) using the new procurement bill and accompanying regulations as an opportunity to step up implementation of the 2015 Supply Chain Management Review (SCMR); iii) strengthening the Public Financial Management (PFM) processes to enhance inclusive growth and development outcomes, including through Gender Responsive Budgeting (GRB) (Annex XIV), and iv) reducing public investment inefficiencies. See Annex XV for details.

Authorities' Views

30. The authorities reiterated that the medium-term fiscal strategy aims to narrow the budget deficit to stabilize and reduce debt and ensure fiscal sustainability. The authorities indicated that while the MTBPS and the recently tabled budget make provision for some risks and contingencies, there are a range of risks to the fiscal outlook. They have embarked on a personnel expenditure review to guide wage bill containment over the medium term and are committed to continue improving revenue administration to address the significant tax gaps and non-compliance that had grown pre-pandemic. The government has stepped up efforts to increase private participation in network industries and used Eskom's debt relief provision to increase its ability to manage fiscal risks arising from this enterprise. More generally, the authorities are seeking to extend the approach to government support used for Eskom to other SOEs and considering the possibility of rationalizing public entities, although savings will take time to materialize. The government is also considering alternative options to the COVID-19 SRD grants beyond 2024 and will seek to finance any permanent replacement grants in a deficit neutral way. On the financing front, the government will continue to lower the average domestic debt maturity while seeking to increase concessional financing from international financial institutions, including through climate finance. This will help reduce interest costs while keeping debt portfolio risks at acceptable levels.

31. The institutional fiscal framework is gradually being strengthened. The authorities have been exploring fiscal rule alternatives and noted their use of the primary balance as an implicit target in addition to the existing nominal primary expenditure ceiling. They felt that fiscal rules could bring rigidities and constrain fiscal space to address the structural challenges they are facing. The authorities are also working on standardizing the procurement procedures with a public procurement bill and expanding the use of framework agreements to aggregate public demand. They are also planning to undertake a MAPS procurement assessment to further guide reforms in this area. Efforts to improve the alignment of budget allocations with specific policy goals are also ongoing with the completion of the first climate budget tagging pilot and a pilot on GRB expected for the 2024 budget cycle.

C. Financial Sector Policy

32. The financial system remains resilient. Adequate capital buffers make the financial system resilient to shocks, including those emanating from weak growth, public finance vulnerabilities, and intensified climate events. Large banks generally have strong balance sheets. Small- and medium-sized banks tend to have higher NPLs, but also larger equity holdings, than the largest 5 banks. Financial sector interlinkages remain strong, which presents a conduit for contagion, with nonbank deposits representing an important source of bank funding. While nonbank financial institutions' (NBFIs) reliance on funding from banks is small, their exposures through assets to banks are one of the largest globally.[19] Despite the high interconnectedness, contagion risks from large banks appears relatively low owing to the strength of their balance sheets but should be monitored closely. Although banks are highly liquid (Liquidity Coverage Ratio is above 150 percent), under stress, banks could face some liquidity gaps, highlighting the importance of continued close monitoring (FSAP 2021).

33. Intensification of the financial sector-sovereign nexus exposes the financial system to sovereign risks. The 2021 FSAP warned about capital erosion under a severe stress scenario where weak debt servicing capacity of corporates and the potential intensification of the financial sector-sovereign nexus, notably the exposure of NBFIs, could threaten the resilience of the financial sector (Figure 5, panel 4). Banks' holdings of local currency government debt (bills and bonds) rose from around 11 percent of total assets in 2017 to 12½ percent in 2019, and exceeded 14 percent in late-2022, comparable to the median for EMDEs, as nonresidents investors continued to reduce their holdings. The largest 5 banks held government debt of 13 percent of assets, mainly in bonds, while other banks had more than 30 percent of assets, mainly in T-bills. At the same time, lending to SOEs is generally low.

34. Closing gaps in financial sector regulation will enhance financial stability. The 2021 FSAP assessed that financial sector regulation is generally strong, with substantial progress since the 2014 FSAP, but that several gaps remain. In particular, the implementation of the risk-based approach to AML/CFT measures should be improved. Financial safety nets should be boosted by adopting and operationalizing the new resolution and deposit insurance legislation and stepping up crisis preparedness. Financial sector competition and efficiency should be improved by, for instance, enabling the provision of payment services by nonbanks. Improving the credit information environment will help enhance access to credit by SMEs and broader financial inclusion. Finalizing the taxonomy of green economic activities and guidelines on climate-related financial disclosures will help attract much needed green finance to facilitate the decarbonization transition which entails substantial investment needs (Section D).

35. There is also a need to enhance financial sector supervision. In particular, the authorities should continue to monitor the impact of the lifting of pandemic measures amid the challenging economic environment. Vulnerability analysis should be strengthened, and its results incorporated in risk-based supervision. More broadly, efforts to improve financial sector supervision should include continuing to broaden the macroprudential toolkit, incorporating and deepening quantitative analysis of risks from the financial sector-sovereign nexus in the Prudential Authority activities, and pursuing more structured, intrusive, and comprehensive supervision, including performing more on-

[19] For more detailed discuss see 2019 South Africa Article IV Staff Report, Annex III, and Financial Stability Board (2022).

site inspections and improving risk-based supervision (Appendix II). Reducing the risks from the sovereign-financial sector nexus will primarily require fiscal adjustment and structural reforms, but carefully calibrated prudential measures (e.g., higher risk weights, capital surcharges, concentration limits) could play a complementary role. These would need to be phased-in and clearly communicated whilst being mindful of procyclicality and potential unintended negative effects on financial institutions balance sheets. [20]

36. While the impact of the recent grey listing of South Africa by the FATF on capital flows and the financial system has been small thus far, the authorities should continue their efforts towards a swift removal from the list. The FATF has placed South Africa on its list of jurisdictions under increased monitoring and has identified eight key areas with strategic deficiencies in its anti-money laundering and counter-financing of terrorism (AML/CFT) framework. FATF has recognized that South Africa has made significant progress on many of the recommended actions to improve its system including the passage of two key Acts of Parliament addressing technical compliance deficiencies, demonstrating the authorities' strong political commitment. International experience suggests that the adverse impacts of grey listing increase the longer a country remains on the list. Therefore, the authorities are encouraged to continue implementing the FATF action plan in a coordinated manner, particularly on enhancing law enforcement actions under the AML/CFT framework, and closely monitor the impact on capital flows and the financial system.

Authorities' Views

37. The South African regulatory authorities assessed the financial sector as resilient, well capitalized, liquid, and profitable. Since the financial sector doesn't have direct exposures to small US banks like SVB, they are not expecting direct spillovers but are closely monitoring developments in global markets. Domestically, while the authorities are continuing to closely monitor the financial sector's rising exposure to the sovereign, they do not see it as a threat to financial stability and thus agree with staff that the first line of defense should be fiscal sustainability. Where necessary, they prefer to address the issue on a case-by-case basis through moral suasion and Pillar II requirements. The authorities noted that many FSAP recommendations including strengthening of the supervisory and resolution framework are being implemented. They reiterated their commitment to do whatever it takes to get off the FATF's grey list as soon as possible. They noted their progress in financial inclusion by operationalizing a new instant payment system "PayShap" that allows online payments from bank accounts and phones as well as the launch of "super Apps" by mobile operators which will enable unbanked customers to access financial services.

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[20] For a detailed discussion on specific measures to address the sovereign-financial nexus, see "South Africa: Financial Sector Assessment Program-Technical Note on Systemic Risk Oversight and Macroprudential Policy".

FAR-REACHING REFORMS TO ACHIEVE JOB-RICH, INCLUSIVE, AND GREENER GROWTH

A. Policy Prioritization and Coordination for a Swift Economic Turnaround

38. A well-sequenced implementation of reforms in coordination with growth-friendly fiscal adjustment are key to boost growth in South Africa. While a comprehensive reform package requires immediate actions to tackle the longstanding structural impediments to growth, prioritization should consider both potential gains of various measures and their implementation difficulty and timeframe. The top priority is to improve South Africa's energy security. This should be supported by decisive reforms to Eskom and measures to foster competition in the energy sector and facilitate its decarbonization transition (see below). Product market reforms, particularly actions to address the inefficient SOEs in network industries, should also advance with urgency, as they could deliver substantial growth gains quickly with low costs.[21] Addressing SOE vulnerabilities in network industries would greatly enhance productivity and allocative efficiency for the whole economy and generate significant fiscal savings. These reforms would need to be implemented along with governance reforms to strengthen their impact. Early success in product market measures would help build reform momentum and support efforts in other areas such as labor market. Reform experiences in other countries suggest a variety of approaches that contribute to the successful implementation of structural reform. These include taking a gradual and sustained approach, well-targeted compensatory measures conditional on reform implementation and with clear sunset clauses, leveraging of independent institutions, early engagement with stakeholders, and effective communications (Annex XVI).

Summary of Key Structural Reform Recommendations

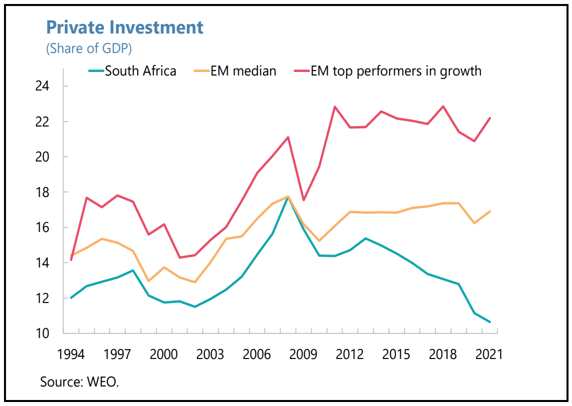
Areas of Reforms	Key Recommendations	Timeframe
Structural Fiscal		
	Introducing explicit debt ceiling.	Short to medium term
	Strengthening the Public Financial Management processes.	Short to medium term
	Improving procurement system.	Medium term
Product Market Reforms		
	Improving Eskom's operation efficiency and reducing its footprint in the energy sector.	Short term
	Making SOEs lean, efficient, and competitive, particularly for those in the network industries.	Short term
	Lowering entry barriers to make it easier for businesses to start, grow, and compete.	Short to medium term
Labor Market Reforms		
	Improving representativeness in the collective bargaining system and allowing firm-level flexibility.	Medium term
	Streamlining enforcement of employment protection legislations.	Medium term
	Activating some social grants to encourage labor force participation and job search.	Short term
	Introducing effective immigration framework.	Short to medium term
	Improving the quality of education system.	Medium term
Governance Framework		
	Strengthening criminal prosecution and enforcement of sanctions against corruption offenses.	Short term
	Equipping anti-corruption agencies with sufficient legal power, capacity, and operational autonomy.	Short to medium term
Climate Mitigation		
	Implementing South Africa's Just Energy Transition Investment Plan.	Short to medium term
	Providing targeted support to affected workers and communities.	Medium term
	Improving the effectiveness of the carbon tax to align carbon pricing with the emission reduction targets.	Medium term

Note: Short term: within 1–2 years; Medium term: within 2–5 years.

[21] In IMF 2019 South Africa Article IV Selected Issues, staff analysis shows that product market reforms have the largest impact on per-capita growth. While gains from complementary factors, such as health and education, could be equally significant, implementation could be more difficult, and the impact could take longer to materialize.

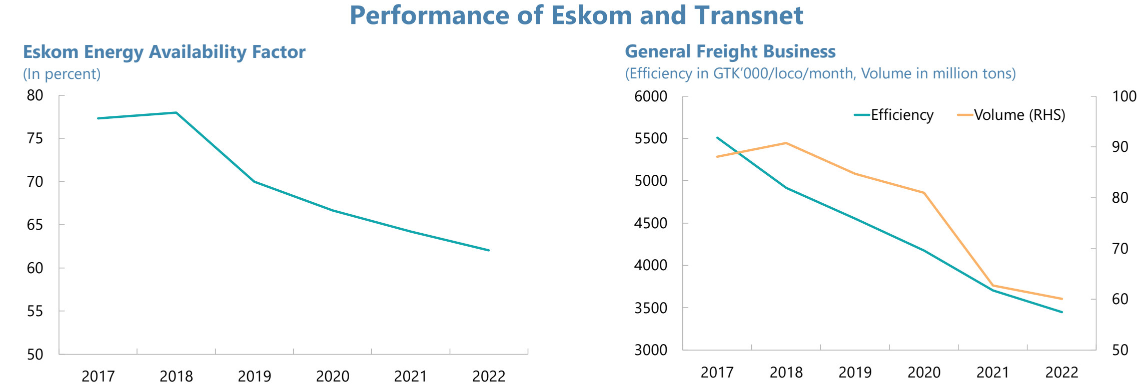
B. Promoting Private Sector Investment

39. Private investment in South Africa is too low for the country to meet its development challenges and compared with peers. Private investment in South Africa was on a decline and averaged less than 14 percent of GDP over the past decade, one of the lowest levels in EMs. Investment is particularly low in the network industries, which are dominated by large state-owned companies, such as Eskom and Transnet. Stronger private sector participation is needed in these industries for South Africa to achieve energy security, finance the green transition, create jobs, and reduce poverty and inequality. Private investment is held back by low levels of competition, high labor cost, infrastructure deficiencies, and an unfavorable business environment.[22]



40. Underperformance of large SOEs has worsened growth and the fiscal situation. Inefficient operations of SOEs and their dominance in key sectors, particularly in the network industries, have prevented the economy from realizing its full potential, and continue to drain budgetary resources, crowding out other social and development spending priorities. Eskom's persistent underperformance amid insufficient private sector participation in the power sector has resulted in severe energy shortages. Logistical constraints related to Transnet, especially in the ports and railways, have limited the capacity to export and thus benefit from high commodity prices.

Performance of Eskom and Transnet



Sources: ESKOM, and Transnet annual reports.

Note: Energy availability factor is the percentage of maximum energy generation of Eskom's power plants supplying to the electrical grid. Freight efficiency is measured as thousand gross ton-kilometers per locomotive per month (GTK'000/loco/month).

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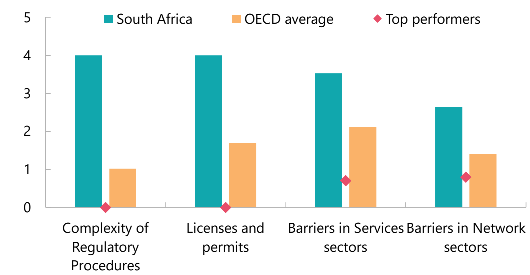
[22] E.g., IMF (2019), National Treasury (2019).

41. SOE reforms need to advance with urgency. Regarding Eskom and Transnet, decisive actions to improve their operational efficiency, reduce their footprint in respective sectors, and establish their commercial viability are crucial for safeguarding investments in key infrastructure, lifting growth, and channeling limited fiscal resources to more productive use. The conditions associated with fiscal support, including for the debt relief arrangement for Eskom, should ensure material improvement in Eskom's operation and establish its long-term viability. The conditions need to be monitored and strictly enforced. More broadly, there is need for a comprehensive approach to assess the role and viability of SOEs given the limited fiscal resources. There is room to streamline SOEs with overlapping mandates, and they all should have a clear, representative, and transparent governance structure, and operate with hard budget constraints, in competitive/contestable markets with proper autonomy and regulation.[23]

42. Broad-based actions to reduce regulatory burden and entry barriers are key to attract private investment and foster competitive product markets. Notwithstanding recent efforts to reform the energy sector, complex and burdensome regulations are pervasive in South Africa. They deter private sector investment, inhibit emergence of a dynamic micro, small, and medium-sized enterprise sector, and limit competition in the broader economy. This, in turn, prevents efficient allocation of capital and labor, and weakens productivity growth and job creation. Furthermore, inconsistent policies and delays in implementation increase economic uncertainty and further erode fragile investor confidence.

Product Market Barriers to Competition
(Scale of 0-6, 2018)



Sources: OECD 2018 PMR database and IMF staff calculations.
Notes: A higher value indicates greater regulatory barriers. Top performer = average of top 5 performing OECD countries.

43. Deeper regional trade integration would benefit South Africa. The African Continental Free Trade Area (AfCFTA) is a good opportunity for South Africa to build on its industrialized economy, exploit economies of scale, and improve productivity and growth.[24] Efforts to remove trade barriers, especially non-tariff barriers, will help boost intra-regional trade and help develop regional supply chains. Industrial policies, where desirable, should address specific market failures to promote competition and exports in concerned industries and technological advancement.[25] They should also avoid discriminatory contents that violate international trade rules or accentuate trade tensions.

44. Creating an enabling environment for the expansion of a digital economy could help lift potential growth. The telecommunication infrastructure is holding back South Africa's digitalization process, evidenced by numerous delays in allocations of the high-demand spectrum bands. With the spectrum auction having been finalized, the completion of switching analogue TV

[23] South Africa 2022 Article IV Consultation Selected Issues Paper: The Role of SOEs in South Africa.

[24] For example, see Sub-Saharan Africa Regional Economic Outlook, April 2019.

[25] See "Industrial Policy for Growth and Diversification: A Conceptual Framework".

broadcasts to digital signals would free up the spectrum for the successful bidders and facilitate deployment of the broadband infrastructure.

45. Digital technologies could enhance financial sector efficiency and financial inclusion.[26] Progress in financial inclusion and access to finance has slowed in recent years—account utilization remains limited and SMEs experience challenges in obtaining financing. Regulatory frameworks proportionate with the risk profile of new entrants would facilitate competition.[27] After conducting several Central Bank Digital Currency pilots, the SARB decided to explore the case for wholesale payments over the medium term, as it sees limited value in launching a retail CBDC in the context of a well-functioning retail payment system.

Authorities' Views

46. The most pressing issues facing South Africa include insufficient energy supply, high and persistent levels of unemployment and poverty, the rising cost of living, and crime and corruption. In the near term, the government is focusing on addressing electricity and transport challenges, including through fostering greater private sector participation in these sectors. The main actions to restore energy security involve efforts to improve the performance of Eskom's existing power plants, connect new energy supply to the grid, and fundamentally transform the electricity sector for long-term energy security. The announced debt relief plan for Eskom will enable the utility company to make necessary investments in maintenance and transmission and help achieve viability together with efforts to address the municipal arrears to Eskom and ensure cost-reflective tariffs. To improve the efficiency of the railway network, the government will implement its National Rail Policy and enable third-party access to the rail network. The authorities are developing a Transnet Roadmap to guide reform implementation for the sector. The planned private sector partnership at the Durban and Ngqura container terminals, once concluded, will enable new investment in the ports and improve their efficiency.

47. Additional reform efforts are underway to improve business environment in South Africa. The authorities have been working on reducing regulatory impediments to make it easier to do business, particularly for SMEs and informal businesses, through amendments to the Businesses Act which are being finalized. On trade integration, the authorities will focus on the implementation of AfCFTA and finalize their industrial offer, which will deepen African economic integration, boost growth, and open new markets for South African companies. Localization policies could play a complementary role if their domestic focus is shifted towards developing regional value chains. On the digital transition, the switch-off of analogue transmission will soon be completed to unlock investment for the rollout of 5G mobile networks. The ongoing work on promoting digital payment services will help broaden access to financial services in the country.

[26] For more detailed discussion, see 2022 IMF FSSA and WB FSA.

[27] See "South Africa - Financial Sector Assessment Program : Technical Note - Competition and Efficiency in the Financial System."

C. A Flexible Labor Market to Support Inclusive Growth

48. Structural rigidities in the labor market continue to hold back meaningful job creation to bring down South Africa's persistently high unemployment. Both supply and demand factors are behind the low employment levels in South Africa, including lack of job opportunities, rigidities in labor market institutions, skills mismatches, and high job search cost and reservation wages. (Selected Issues Paper: The Link Between Grants and Employment in South Africa). Advancing product market reform would help create job opportunities but they should be accompanied by the following reforms to promote inclusion:

- The collective bargaining system needs to be more representative of the bargaining parties and allow firm-level flexibility. Exemptions for SMEs from the administrative extension of bargaining council agreements to non-signatory parties could also be considered. The mechanism for setting the national minimum wage should strike the right balance between reducing in-work poverty and enhancing the job prospects of disadvantaged groups.

- Enforcement of employment protection legislation (EPL) should be streamlined to improve efficiency and predictability. Considerations could also be given to ease high protection on regular workers by introducing a gradual increase of contract protection with employment tenure, which injects flexibility and reduces duality of the labor market.

- The design of some social grants could be improved to support labor force participation and job search (Annex XVII).

- To alleviate skill shortage, an effective immigration framework that meets the rapidly evolving labor demand amid significant changes in global trade, digital technologies, and climate should be put in place in the near term (Annex XVIII), while efforts to improve the quality of education bear fruit over the medium term. The recent effort of updating the country's Critical Skill List and reviewing the work visa framework are welcome steps in this regard.

- Additional policies to durably raise employment and lower costs to job creation should support school-to-job transitions, improve the employability of the inactive population, and make job search more effective. Interventions to increase entrepreneurial capacity, lift the basic education level, and reform social housing policies would increase the participation in economic activity of people living in remote and traditional settlement areas.[28]

Authorities' Views

49. Policy interventions need to consider the underlying drivers behind the high structural unemployment. This calls for a holistic approach to reforms, including both labor market policies and product market reforms, to unlock growth and boost labor demand. Based on the review of the

[28] See Loewald, Makrelov, and Wörgötter (2021).

work visa system, the authorities plan to make the system more flexible and streamline the visa process for large investors and high-growth start-ups to attract skilled immigration. Access to quality education is most effective tool to end poverty. The government is expanding vocational education and training systems to address skill shortages. They are exploring options to link the expansion of social grants to employment, to reduce dependency and address the structural unemployment. The authorities acknowledged that reforms to the collective bargaining system and EPL will take time.

Social Partners' Views

50. Some unions have voiced concerns about the high prevalence of precarious jobs in South Africa, which resulted in a significant number of workers being laid off during past crises. They considered that in-work poverty and working conditions needed to be addressed in many instances. They felt that hard-won gains on employment protection and the collective bargaining system were not the reason behind high unemployment, which they blame on the inability of the economy to create enough job opportunities.

D. Setting the Right Climate Incentives

51. South Africa faces significant climate challenges. The economy is among the most carbon intensive EMs and is vulnerable to extreme weather events, as evidenced by the devastating flooding in Durban. Deteriorating infrastructure, including in the electricity, water, and transportation sectors, further adds to the challenges. In this context, the authorities have put forward the Just Energy Transition Investment Plan (JETIP) to decarbonize the economy and address the growing risks associated with climate change. The ongoing energy crisis provides a window of opportunity for an expedited rollout of renewable energy in South Africa. On green finance, a roadmap on Financing a Sustainable Economy was published by the National Treasury in 2020 and subsequent work has focused on providing a framework to align the financial sector with climate targets.

52. A multipronged approach is needed to achieve South Africa's climate ambition. At the COP27, South Africa's economic partners (France, Germany, UK, US, and EU) supported the JETIP by mobilizing a $8½ billion financing package consisting of grants, concessional and commercial funding over the next five years. However, this amount covers a relatively modest portion of the total transition cost, estimated at $500 billion in net present value by 2050.[29] Additional funding from governments sources is constrained by the limited fiscal space while financing through multilateral institutions will not be sufficient. Thus, South Africa needs to rely on private sector investment to achieve its green transition. Promoting private sector participation requires steadfast implementation of labor and product market reforms mentioned above. At the same time, well-targeted fiscal support, conditional on reform implementation and with clear sunset clauses, for

[29] World Bank Group, 2022, South Africa's Country Climate and Development Report.

communities and workers affected by the transition are needed.[30] The transition should also be supported by policies to change the carbon intensity of consumption and production, including through the carbon tax and other complementary measures (e.g., energy efficiency standards and renewable energy programs). This could be achieved by phasing out the generous tax-free allowances and exemptions and aligning carbon pricing with the emission reduction targets. (Selected Issues Paper: South Africa Carbon Pricing and Climate Mitigation Policy).

Authorities' Views

53. Extreme weather events such as drought, floods, and wildfires, increasingly pose a risk to the well-being of South Africans. The government remains committed to a just transition to a low carbon economy at a pace the country can afford and in a manner that ensures energy security. However, the pace of transition could be disrupted by adoption of carbon border adjustments by South Africa's trading partners. Adequate external support both in financing and affordable technology transfers is needed for achieving South Africa's climate goals. The transition will prioritize workers and communities in vulnerable industries to ensure inclusivity. A review of the carbon tax will be published later this year which will consider the treatment of tax-free allowances, exemptions, and the mitigation of any distributional impacts of the carbon tax. The authorities have developed a voluntary green finance taxonomy and governance framework to strengthen sustainable finance in South Africa. Globally, policy interventions are needed to shield South Africa against adverse spillovers from the recent trend of rising protectionism in many countries, and massive green industrial policies from the advanced economies.

E. Governance that Supports a Good Business Environment and Social Cohesion

54. There has been some progress in addressing corruption and governance deficiencies. The inquiry led by Chief Justice Zondo into State Capture revealed an extensive scale of corruption and fraud in state entities under the previous administration. State Capture disrupted the proper functioning of public infrastructure and institutions, weakened South Africa's business environment, and imposed a huge toll on the economy. In response to the recommendations of the State Capture inquiry report, the authorities have announced anti-graft measures (Annex XIX).

55. Further efforts are needed to tackle corruption and governance weaknesses. This would require strengthening criminal prosecution and enforcement of sanctions against corruption offenses and establishing credible and effective deterrence mechanisms. Anti-corruption agencies need to be equipped with sufficient legal power, capacity, and operational autonomy to prevent political interference. Exiting from the FATF grey list would entail improving AML/CFT law

[30] South Africa 2021 Article IV Consultation Selected Issues Paper: How Can Structural Reforms Support the Climate Ambition of South Africa.

enforcement, which requires strong coordination among the authorities involved.[31] The new procurement legislation and regulations under preparation are an important opportunity to address some of the deficiencies in the public procurement process. They should help centralize procurement and increase the standardization of processes and transparency requirements in line with international good practice (Selected Issues Paper: Public Procurement in South Africa: Issues and Reform Options).

Authorities' Views

56. The authorities underscored the commitment to take decisive action against crime and corruption and make clear break with the era of state capture. The government has made more resources available to law enforcement agencies and remains committed to implement the recommendations of the Commission and address deficiencies in combatting money laundering and terrorism financing identified by the FATF. The new Public Procurement Bill, once enacted, will improve efficiency and transparency of the procurement process. The National Anti-Corruption Advisory Council was established to advise on suitable mechanisms to stem corruption. The government also plans to make integrity assessments mandatory for public service recruitment and introduce entry exams.

F. Technical Collaboration

57. The technical cooperation strategy is aligned with the Fund's surveillance activities and South Africa's technical capacity is high. Priorities include rationalizing expenditures, managing contingent liabilities, and strengthening the medium-term fiscal framework to stabilize debt; strengthening tax administration; maintaining financial stability while supporting financial inclusion; and upgrading national accounts statistics. These areas relate strongly to key surveillance issues: reviving growth by implementing structural reforms, consolidating government and SOEs financial positions, and maintaining credible monetary and financial sector policies. Recent technical cooperation with the IMF relates to public-sector wage bill management, property price index development, debt management strategy, GRB, and SOE funding framework. The FSAP also provided an opportunity to discuss reforms in the financial sector area (Annex XX).

STAFF APPRAISAL

58. South Africa's wide-ranging economic and social challenges continue to build up, risking long-term stagnation. The recovery from the COVID-19-related recession encountered headwinds created by increasingly binding domestic structural constraints and a more challenging external environment. A recovery in the services sector supported jobs; however, employment remains below pre-pandemic levels and unemployment close to record highs, exacerbating poverty

[31] More specifically, this entails (i) enhancing investigation, prosecution and conviction of money laundering and terrorist financing offenses; (ii) increasing confiscation of proceeds of crime; (iii) ensuring law enforcement agencies' timely access to accurate and up to date information on beneficial ownership; and (iv) aligning the targeted financial sanction framework with the FATF standards.

and inequality. Higher food and fuel price inflation has worsened the plight of the most vulnerable. The high public debt significantly limits the fiscal space available to respond to these challenges. At the same time, South Africa is highly integrated in global financial markets and exposed to external shocks and capital flow volatility. On a preliminary basis, the external position in 2022 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. That said, South Africa's mineral wealth, large external asset position, diversified economy, sophisticated financial system, and strong track record and credibility of monetary and exchange rate policies are sources of strength.

59. Stepped-up implementation of economic reforms is needed to promote sustained and inclusive economic growth and address pressing social challenges. In the context of a volatile external environment, domestic economic activity is projected to further decelerate, credit growth to remain sluggish, the fiscal accounts to remain under pressure, and the current account deficit to further widen in 2023. The medium-term outlook will be challenging in the absence of further reforms to address the structural rigidities that prompted the subpar economic performance of the last decade. Domestically, downside risks include further intensification of the energy crisis, slower-than-expected progress or reversal in reforms and policies, including fiscal consolidation, and political uncertainty. On the upside, decisive implementation of reforms would help realize South Africa's potential by boosting private investment, employment, and growth. Similarly, stronger-than-expected private sector participation in the energy sector could improve the near-term growth outlook. External downside risks include a deeper global slowdown, further softening of commodity prices, and a shift in global investors' sentiment away from EMs.

60. Monetary policy accommodation has been withdrawn at an adequate pace with inflation expected to return to the midpoint of the target range. The decisive increases in the policy rate were consistent with the SARB's mandate of maintaining price stability. Monetary policy should remain data dependent as further tightening would be warranted if the ongoing energy crisis, tighter global financial conditions, and renewed external price pressure threaten to de-anchor inflation expectations. The credible inflation targeting framework has served South Africa well in an environment of volatile inflation. As conditions allow, the framework could be enhanced by formalizing the current focus on the midpoint for inflation (instead of targeting a range), and by reducing the inflation target. Such conditions will present themselves as fiscal consolidation and structural reform efforts start to bear fruit. Communication will be of the essence as demonstrated by the successful shift in the MPIF, which is expected to strengthen the monetary policy transmission mechanism.

61. Stronger fiscal consolidation efforts relative to staff baseline projections are urgently required to put public debt on a declining path and boost the impact of structural reforms. The recent decline in the fiscal deficit, reflecting significant improvement in domestic revenue mobilization, a commodity price-related revenue windfall, and efforts to contain public spending, is welcome. As the revenue windfall fizzles, decisive efforts to reduce public spending as a share of GDP will be needed to stabilize and eventually reverse the upward trend of the public debt ratio. Measures should focus on reducing compensation and transfers to SOEs, and better targeting subsidies, while protecting well-targeted social spending and public investment. Strengthening the fiscal framework by introducing a debt ceiling to complement the nominal primary expenditure ceiling, addressing deficiencies in public procurement, and improving public investment management would facilitate fiscal consolidation.

62. The financial sector remains resilient, but pockets of vulnerabilities need to be monitored and the financial safety net and supervision strengthened. The impact of the recent grey listing by FATF on capital flow and financial system needs to be closely monitored. Fiscal consolidation should be the main line of defense to alleviate risks from the financial sector-sovereign nexus, as it will help reduce the supply of sovereign debt. Complementary prudential measures could be considered in due course, considering risks of procyclicality and potential unintended negative effects on financial institutions' balance sheets. Financial sector oversight is already strong but could be further enhanced by continuing to implement FSAP recommendations, in particular pivoting towards a more structured and intrusive approach, with a recalibrated mix between on-site and off-site supervision and a greater focus on governance and less reliance on third party auditors; adopting and operationalizing the new bank resolution and deposit insurance legislation; and stepping up crisis preparedness. Greater financial sector competition and an improved credit information system would enhance access to credit by SMEs and promote financial inclusion more generally. Finalizing the taxonomy of green economic activities and guidelines on climate-related financial disclosures will help attract green finance.

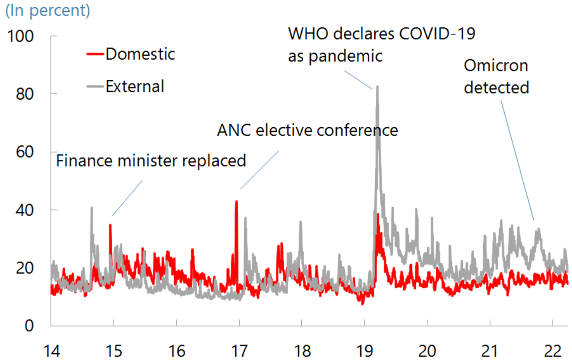
63. Promoting a sustainable, inclusive, and green economic recovery requires reforms that foster private investment, a just energy transition, and good governance. Opening key network industries to private sector participation, especially energy and transportation logistics, is crucial to overcome the obstacles to economic growth imposed by inefficient SOEs. Addressing the heavy regulatory burden and reducing entry barriers is key to foster competition and attract private investment, especially by job creating SMEs. Reforms aimed at increasing labor market flexibility are needed to tackle high structural unemployment. The energy crisis provides a window of opportunity to accelerate the rollout of renewable energy in the country. Implementation of the Just Energy Transition Investment Plan, including by increasing effective carbon taxation and supporting vulnerable households, is essential to achieve South Africa's ambitious climate goals. Corruption and governance weaknesses undermine institutions, hurt growth, perpetuate poverty and inequality, and need to be forcefully tackled. Timely implementation of the FATF action plan is needed to ensure a rapid exit from its grey list.

64. It is proposed that the next Article IV consultation with South Africa take place on the standard 12-month cycle.

Figure 1. South Africa: Financial Market Developments

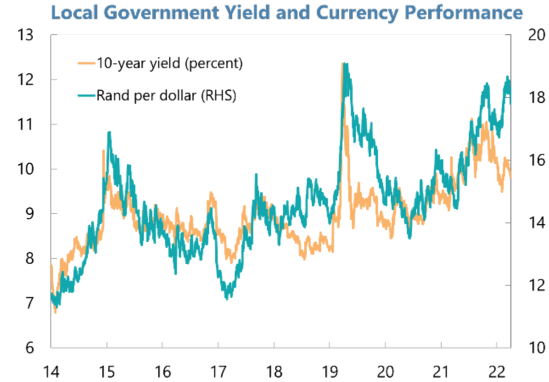
Since the pandemic external shocks gained in importance over domestic shocks.

Indicators of Domestic and External Shocks
(In percent)



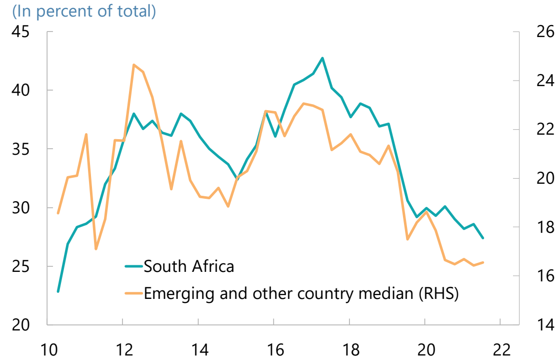
The rand continued to weaken while local-currency government yields strengthened since the MTBPS in October 2022.

Local Government Yield and Currency Performance



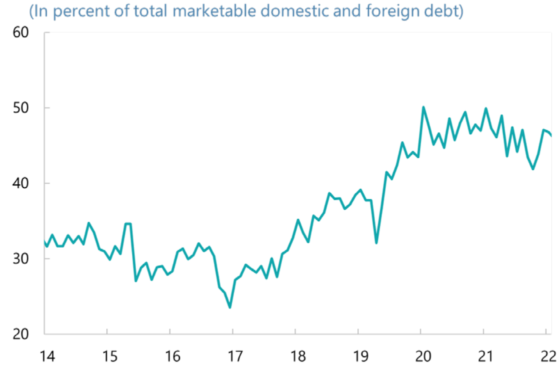
Nonresident investors shed local government bond holdings like other markets.

Nonresident Holdings of Local Currency Govt. Bonds
(In percent of total)



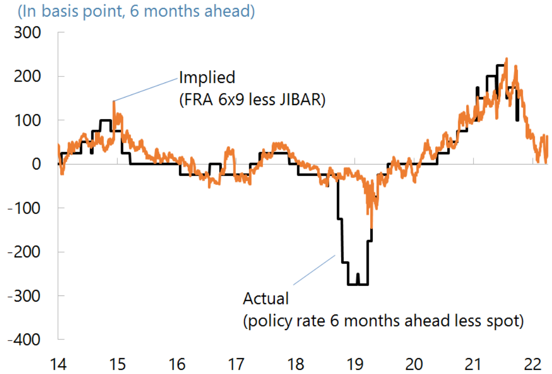
ETF and mutual funds remain important holders of government bonds.

Government Debt Held by ETF and Mutual Funds
(In percent of total marketable domestic and foreign debt)



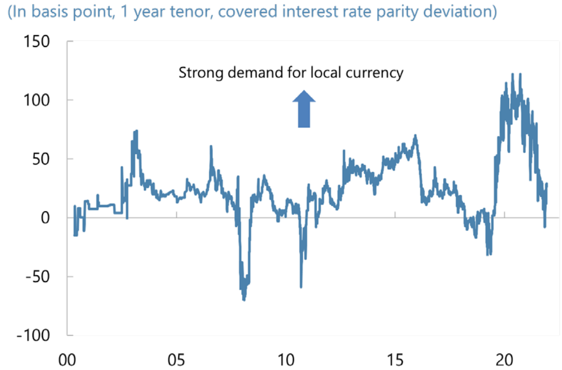
Markets expectations of monetary policy tightening recently moderated.

Actual and Market-Implied Monetary Policy Action
(In basis point, 6 months ahead)



The cross-currency basis swap spread normalized after jumping into positive territory.

Rand/US Dollar Cross-Currency Basis Swap Spread
(In basis point, 1 year tenor, covered interest rate parity deviation)



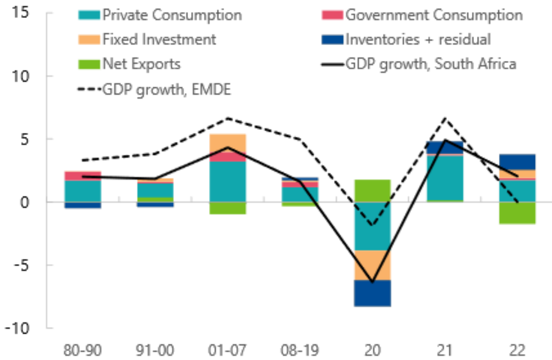
Sources: Bloomberg, EPFR, Haver, IIF, and IMF staff calculations.

Note: In panel 1, domestic shocks are implied volatility of dollar-rand exchange rate, and external shocks are implied volatility of US equity prices, or VIX, commonly used as a gauge of the global "fear factor". South Africa lost investment grade status in end-March 2020.

Figure 2. South Africa: Real Sector and Social Developments

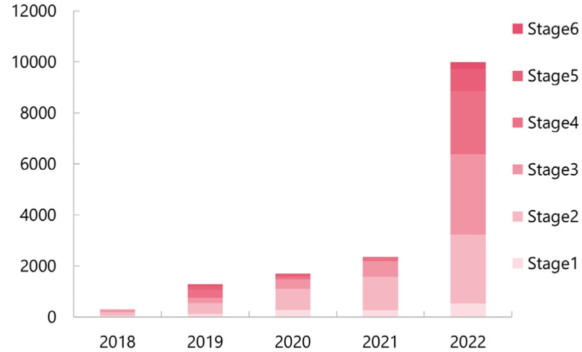
Growth recovery from the pandemic has been driven by private consumption.

Real GDP Growth Decomposition
(In percent of GDP)



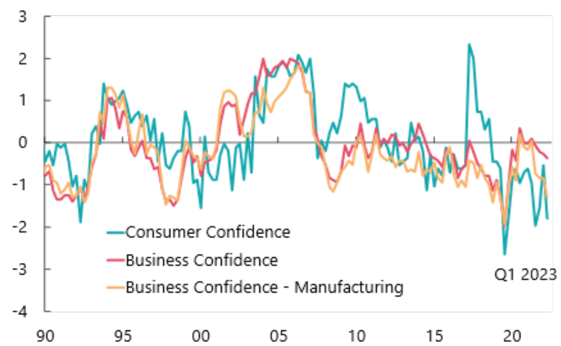
Power outages in 2022 were the worst ever.

Power Outages by Intensity
(In Gigawatt hours)



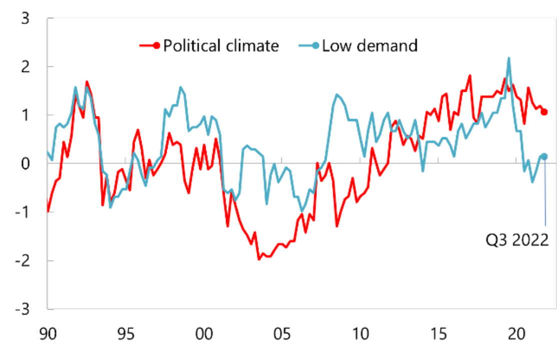
Business and consumer confidence remains persistently weak...

Confidence Index
(Net percent balance, distance from mean in number of standard deviation)



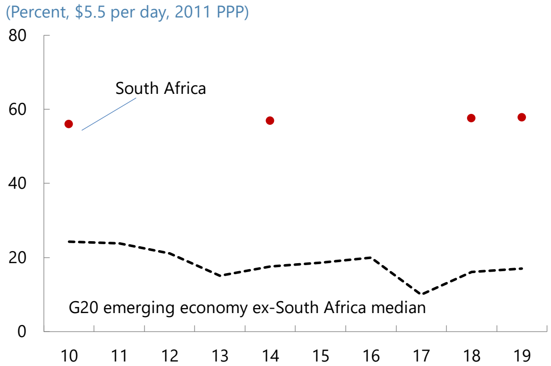
...with the political climate perceived as a key constraint.

Key Constraints to Manufacturing Activities
(Net percent balance, distance from mean in number of standard deviation)



Amid high poverty...

Poverty Headcount
(Percent, $5.5 per day, 2011 PPP)



...inequality is very high in South Africa.

Gini Coefficient Index
(In percent, Latest available data)

Sources: BER, Haver, World Bank, and IMF staff calculations.

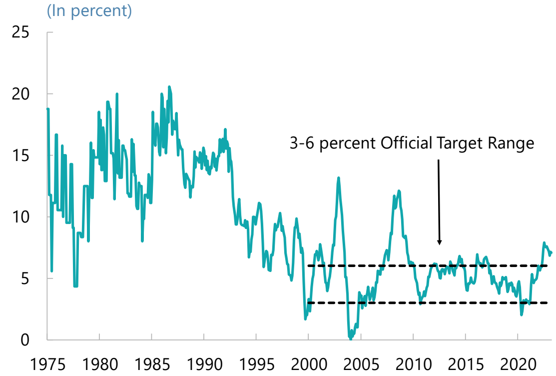
Note: EMDE = emerging markets and development economies, WEO.

Figure 3. South Africa: Inflation Developments

Inflation declined in level and volatility.

Headline Inflation and Official Target

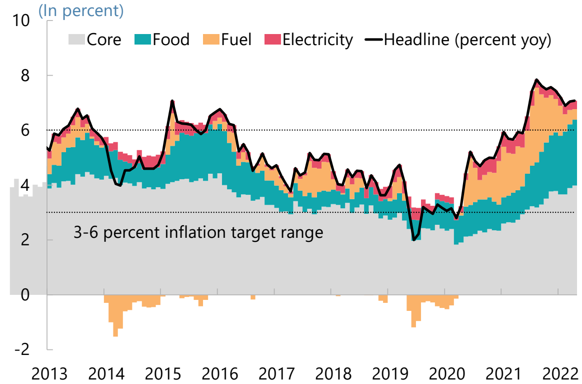
(In percent)



The recent increase was due mainly to fuel and food but core continued to edge higher.

Contributions to Headline Inflation

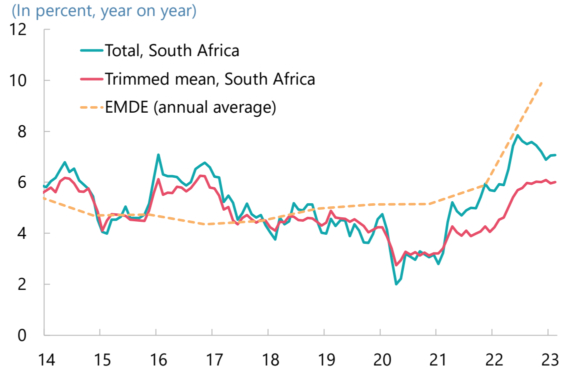
(In percent)



Inflation, excluding highly volatile items also rose.

Total and Trimmed Headline Inflation

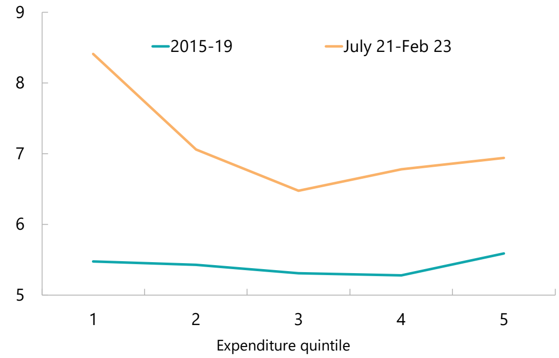
(In percent, year on year)



Inflation rose more for poorer individuals.

Average Headline Inflation by Expenditure Quintile

(In percent)



Inflation expectations also rose.

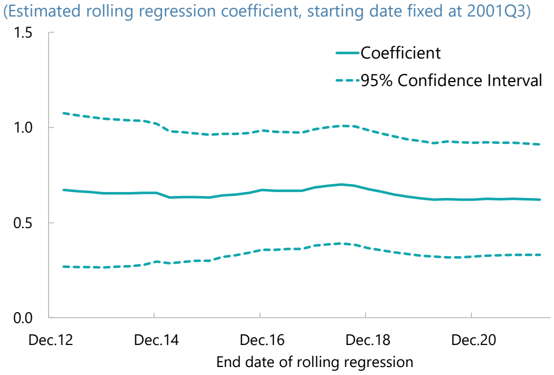
Inflation Outturn and Expectation

(In percent, year on year, one year-ahead constant horizon expectations)

Inflation expectations, 12 months ahead, have a significant predictive power on actual inflation.

Roll of Inflation Expectations in Determining Inflation

(Estimated rolling regression coefficient, starting date fixed at 2001Q3)



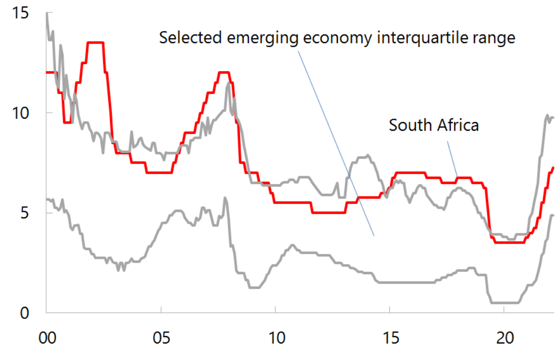
Sources: BER, Haver, National Credit Regulator, and IMF staff calculations.

Note: EMDE = emerging markets and development economies, WEO.

Figure 4. South Africa: Monetary Sector Developments

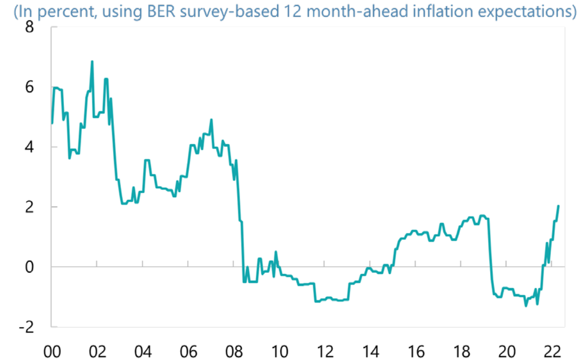
The policy rate returned to pre-pandemic levels in South Africa…

Nominal Policy Rate in Selected Emerging Economies
(In percent)



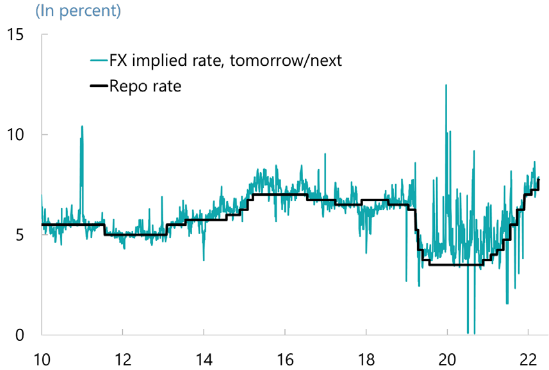
…so did the real policy rate.

Real Policy Rate
(In percent, using BER survey-based 12 month-ahead inflation expectations)



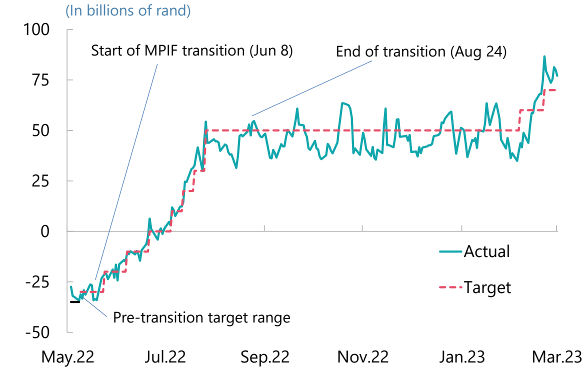
FX-implied rates are more in line with the policy rate.

Repo and FX-Implied Rates
(In percent)



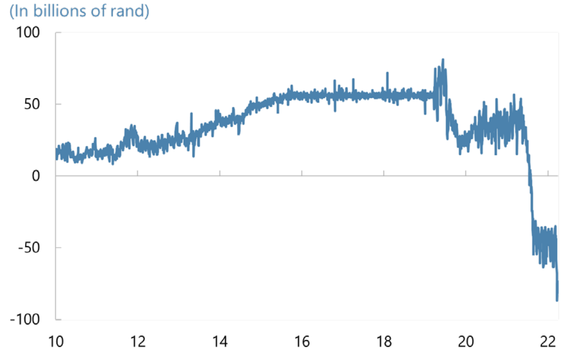
The SARB transitioned to a new monetary policy implementation framework…

Transition of liquidity target and outturn
(In billions of rand)



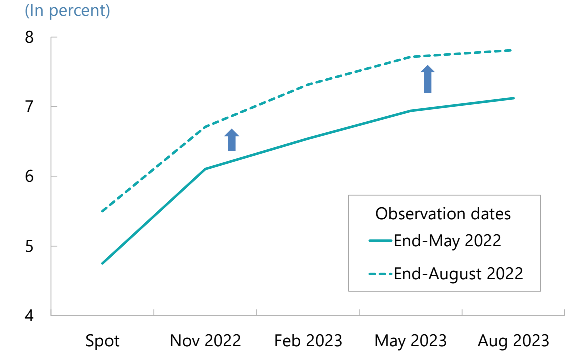
…where the money markets are cashed up…

Daily Liquidity Requirement
(In billions of rand)



The transition to the MPIF appears not to have confused markets on the future course of monetary policy.

Policy Rate Trajectory Implied by Financial Asset Pricing
(In percent)

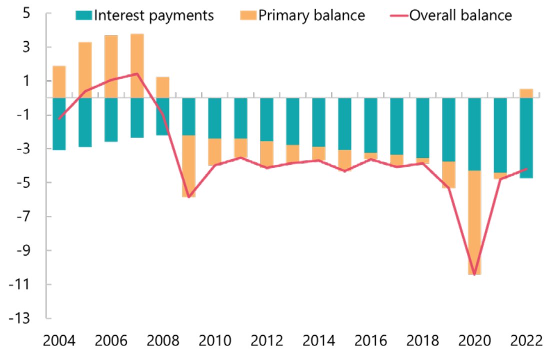


Sources: BIS, Haver, and IMF staff calculations.

Figure 5. South Africa: Fiscal Sector Developments

The overall balance improved despite rising interest payments…

Fiscal Balance
(Percent of GDP)

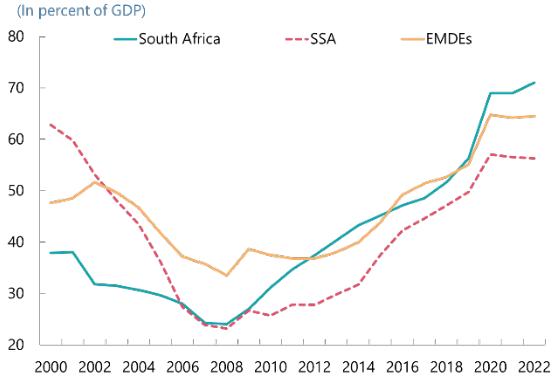


…which together with transfers are increasing in relation to total government expenditure.

Government Expenditure by Component, 2012 and 2022
(In percent of total expenditure)

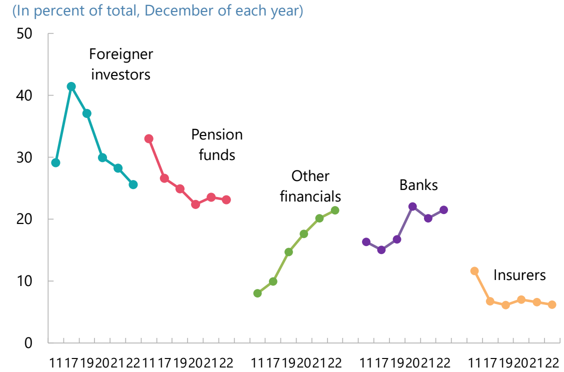
South Africa's government debt ratio exceeds peers' averages.

Government Debt
(In percent of GDP)



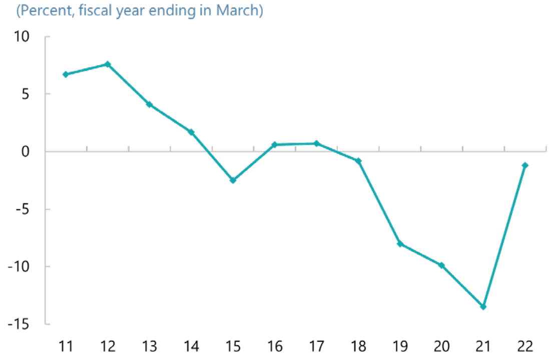
As nonresidents shed sovereign bond holdings, domestic other financials gained in importance.

Ownership of Domestic Government Bonds
(In percent of total, December of each year)



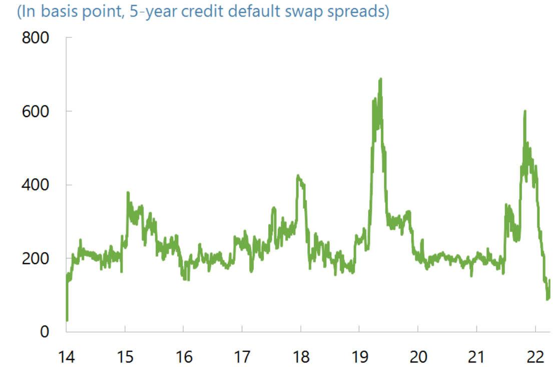
SOE financial performance has worsened over the years despite some recent recovery from the pandemic …

SOE Return on Equity
(Percent, fiscal year ending in March)



…especially for Eskom, whose risk premium over the sovereign's jumped before declining after the debt relief was announced.

Eskom Credit Risk Differential to Sovereign
(In basis point, 5-year credit default swap spreads)

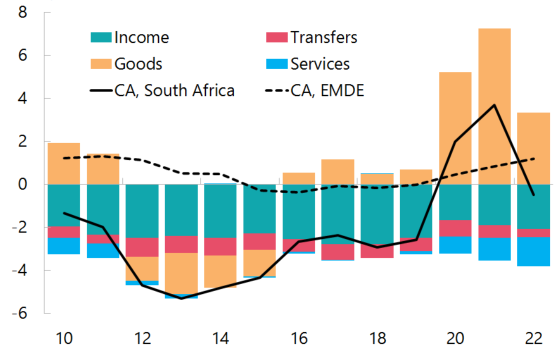


Sources: Bloomberg, Haver Analytics, IMF Fiscal Monitor, National Treasury Budget, and IMF staff calculations.

Figure 6. South Africa: External Sector Developments

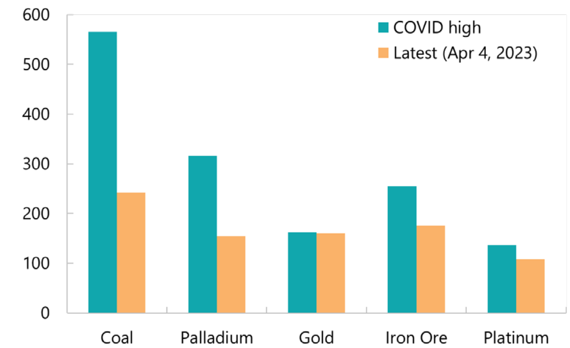
The current account (CA) surplus narrowed in 2022…

Current Account Balance Decomposition
(In percent of GDP)



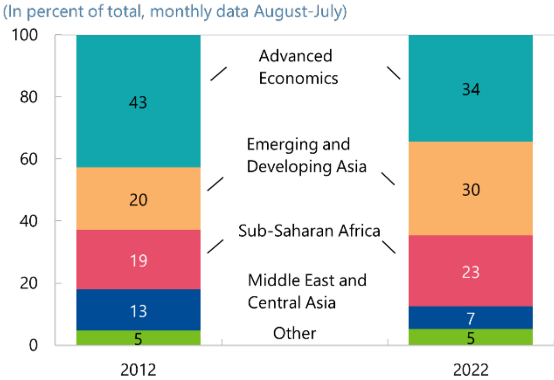
… driven by commodity price performance…

Key Commodity Export Prices
(2015-19 average =100)



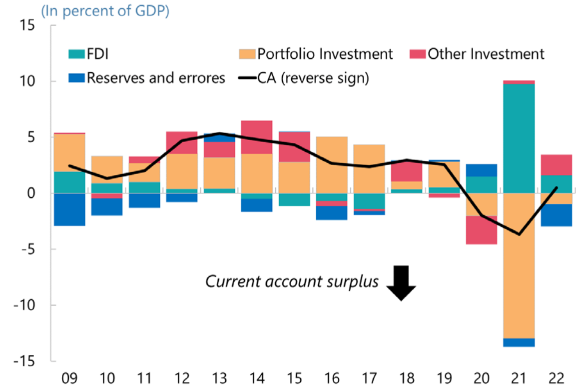
And weaker demand from advanced economies.

Export Destinations
(In percent of total, monthly data August-July)



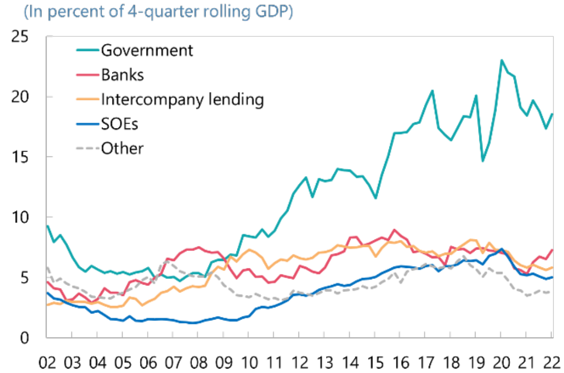
Portfolio outflows eased.

Financial Account Components and Current Account
(In percent of GDP)



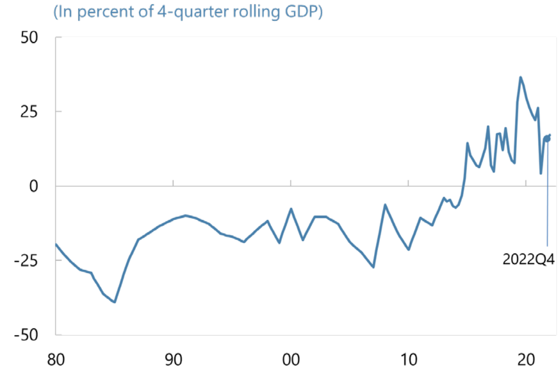
External debt continued to moderate across sectors.

External Debt
(In percent of 4-quarter rolling GDP)



NIIP remained positive in 2022.

Net International Investment Positions
(In percent of 4-quarter rolling GDP)



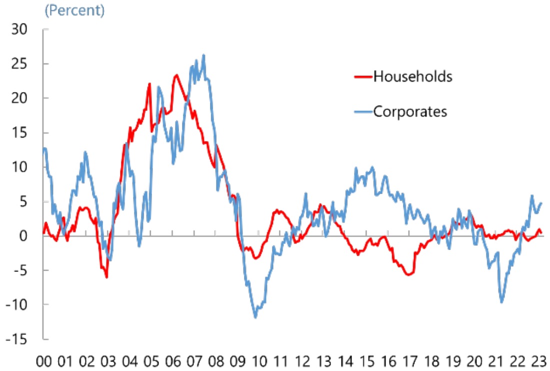
Sources: Haver Analytics, IMF WEO, and IMF staff calculations.

Note: CA = current account balance. EMDE = emerging markets and developing economies, WEO.

Figure 7. South Africa: Credit and Financial Sector Developments

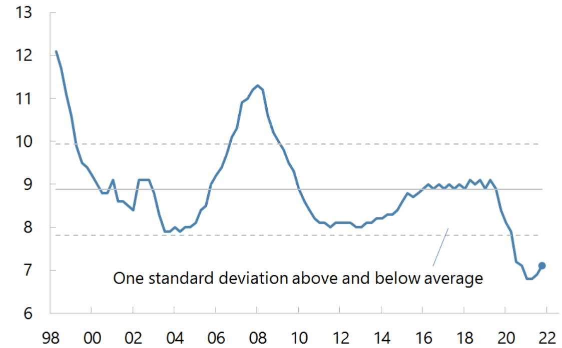
Bank lending to corporates rebounded but that to households remained subdued.

Private Sector Real Credit Growth by Borrower
(Percent)



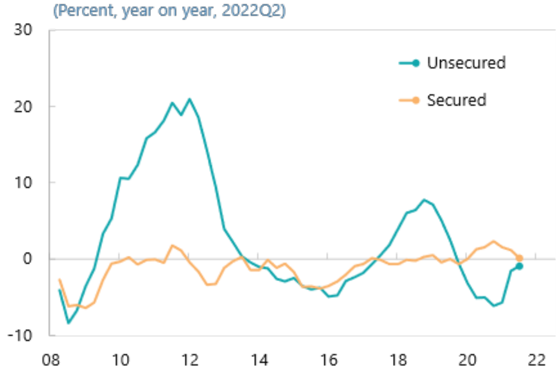
Debt service burden of nonfinancial corporates is at historical lows.

Private Nonfinancial Sector Debt Service to Income
(In percent)



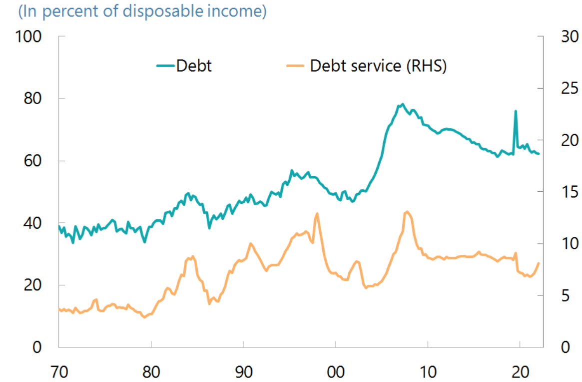
Consumer lending is weak for both secured and unsecured credit.

Real Consumer Credit Growth by Type
(Percent, year on year, 2022Q2)



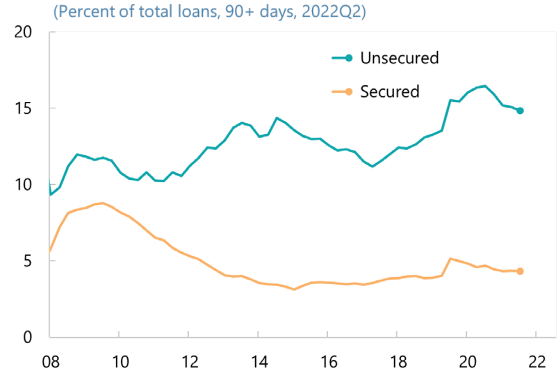
Household debt stabilized while debt service moderated, both relative to income.

Indicators of Household Indebtedness
(In percent of disposable income)



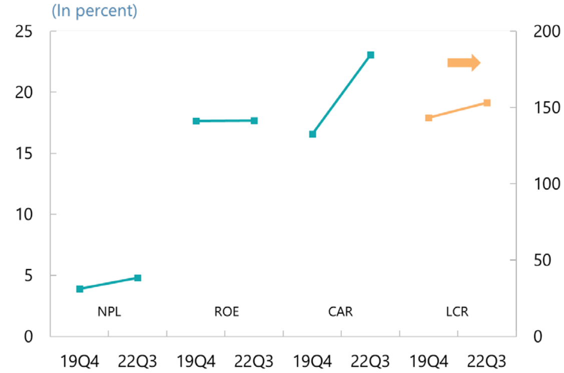
Asset quality of unsecured consumer lending started to improve somewhat.

Consumer NPL by Type
(Percent of total loans, 90+ days, 2022Q2)



Banks' regulatory capital and liquidity buffers have increased while profitability remains solid.

Indicators of Banks' Performance
(In percent)

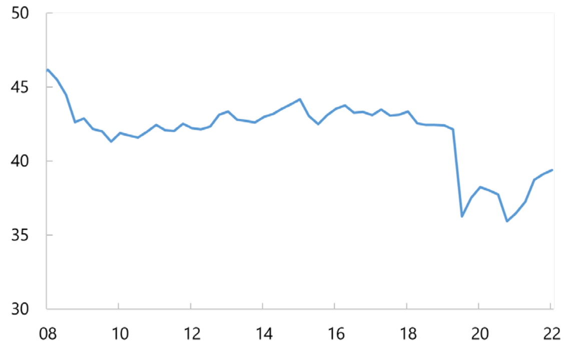


Sources: BIS, Haver Analytics, National Credit Regulator South Africa, and IMF staff calculations.

Figure 8. South Africa: Labor and Product Market Developments

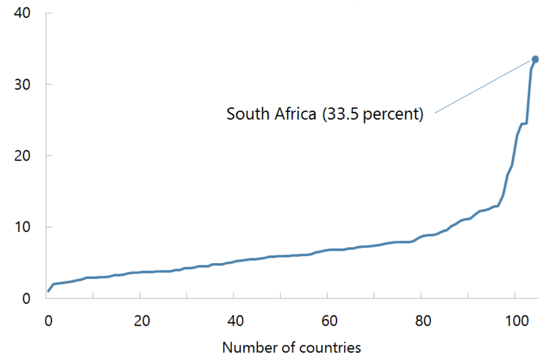
Less than 40 percent of working age population is employed.

Employment
(In percent of working age population 15-65 years)



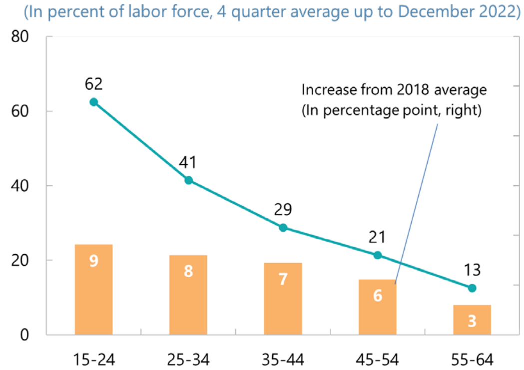
Unemployment remains high in South Africa…

Unemployment in 2022
(Percent of labor force, 110 countries, WEO April 2023)



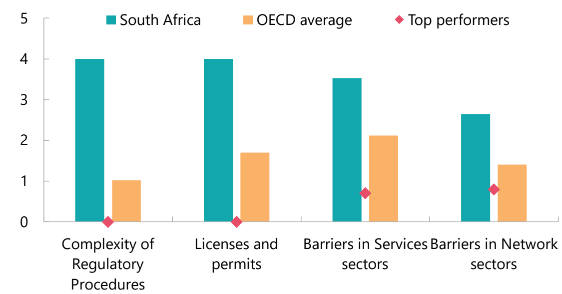
…especially among the youth.

Unemployment by Age Group
(In percent of labor force, 4 quarter average up to December 2022)



High product market barriers stifle competition.

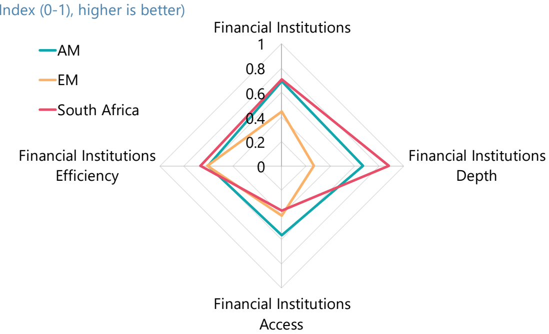
Product Market Barriers to Competition
(Scale of 0-6, 2018)



Sources: OECD 2018 PMR database and IMF staff calculations.
Notes: A higher value indicates greater regulatory barriers. Top performer = average of top 5 performing OECD countries.

Access to finance remains relatively low.

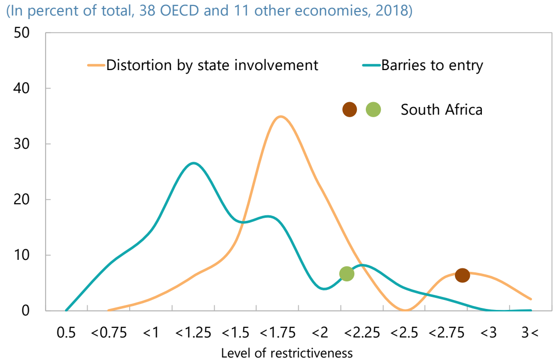
Financial Institution Development, 2020
(Index (0-1), higher is better)



Note: Financial institutions include banks, insurance companies, mutual funds, and pension funds. The dataset is maintained by the IMF SPR department .
Souce: IMF Financial Development Index.

Barriers to entry and distortions from state involvement are high.

Indicators of Product Market Regulations
(In percent of total, 38 OECD and 11 other economies, 2018)



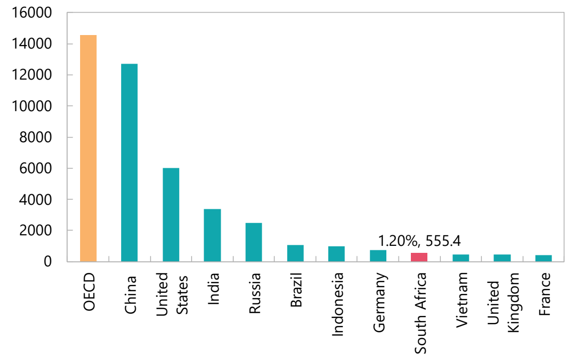
Source: OECD.

Sources: Haver, OECD, IMF Financial Development Index, and IMF staff calculations.

Figure 9. South Africa: Climate and Carbon Tax Developments

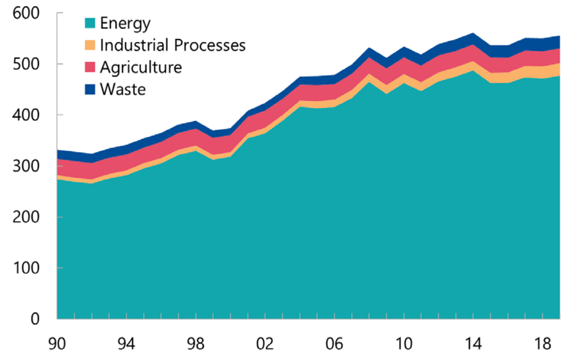
South Africa accounts for about 1 percent of global carbon emissions, the largest in Africa...

Global Distribution of CO2 Emissions
(In percent of total, 2019)



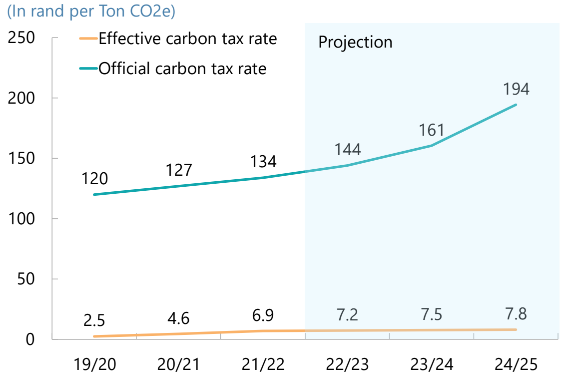
...as total emission increased nearly 70 percent in the past three decades.

Historical GHG Emissions
(In million tons of CO2e)



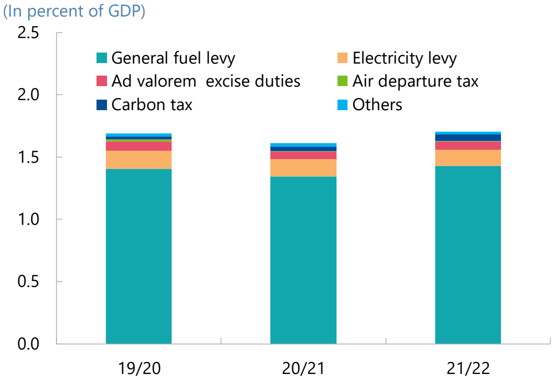
South Africa adopted a carbon tax in 2019, the first in Africa, even though effective rates are low.

Carbon Tax Rate
(In rand per Ton CO2e)



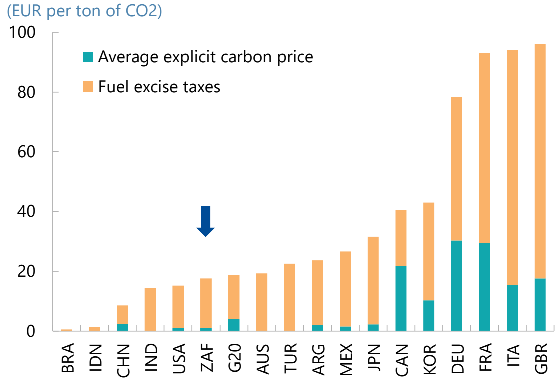
Fuel levy is the major instrument affecting carbon price.

Environment-related Tax
(In percent of GDP)



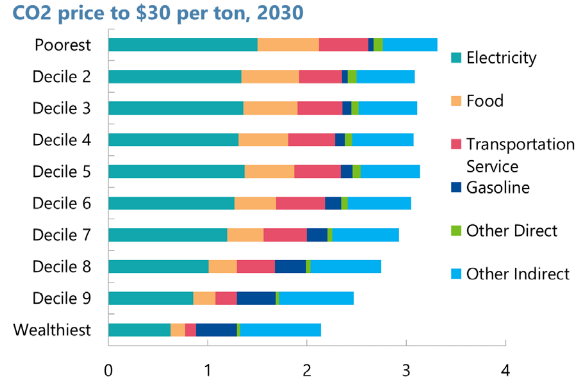
South Africa's carbon price is comparable to its emerging economy peers.

Carbon Price, 2021
(EUR per ton of CO2)



A higher carbon pricing would have a regressive impact on households.

Average Effect on Consumption Deciles from Increasing CO2 price to $30 per ton, 2030



Sources WRI Climate Watch, OECD, National Treasury Budget, and IMF staff calculations.

Table 1. South Africa: Selected Economic Indicators, 2020–25

GDP		**Poverty (percent of population)**	
Nominal GDP (2022, billions of US dollars)	406	Lower national poverty line (2015)	40
GDP per capita (2022, in US dollars)	6,694	Undernourishment (2019)	7
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2022, million)	61	Highest 10 percent of population (2015)	53
Urban population (2020, percent of total)	67	Lowest 40 percent of population (2015)	7
Life expectancy at birth (2020, number of years)	64	Gini coefficient (2015)	65

Economic Indicators

	2020	2021	2022	2023	2024	2025
			Est.	Proj.		
National Income and Prices (Annual Percentage Change Unless Otherwise Indicated)						
Real GDP	-6.3	4.9	2.0	0.1	1.8	1.6
Real GDP per capita 1/	-7.7	4.0	1.3	-1.4	0.3	0.1
Real domestic demand	-7.8	4.7	3.8	0.8	1.8	1.2
GDP deflator	5.7	6.2	5.1	5.3	4.8	4.5
CPI (annual average)	3.3	4.6	6.9	6.0	4.9	4.5
CPI (end of period)	3.2	5.4	7.4	5.3	4.6	4.5
Labor Market (Annual Percentage Change Unless Otherwise Indicated)						
Unemployment rate (percent of labor force, annual average)	29.2	34.3	33.5	34.7	34.7	34.8
Unit labor costs (formal nonagricultural)	2.8	1.5	6.9	6.0	4.9	4.5
Savings and Investment (Percent of GDP)						
Gross national saving	14.4	16.5	14.6	13.9	14.0	14.5
Public (incl. public enterprises) 2/	-6.0	-1.5	0.0	-0.9	-1.4	-1.8
Private	20.4	17.9	14.6	14.8	15.4	16.3
Investment (including inventories) 3/	12.4	12.8	15.1	16.1	16.6	16.8
Public (incl. public enterprises)	4.0	3.8	3.9	3.9	4.0	4.0
Private	9.8	9.2	10.2	10.6	11.0	11.3
Fiscal Position (Percent of GDP Unless Otherwise Indicated) 4/						
Revenue, including grants 5/	25.0	27.1	27.7	27.5	27.2	27.2
Expenditure and net lending	34.6	32.7	32.2	33.4	33.3	33.9
Overall balance	-9.6	-5.6	-4.5	-5.8	-6.1	-6.7
Primary balance	-5.4	-1.2	0.2	-0.7	-0.5	-0.6
Structural balance (percent of potential GDP)	-5.7	-5.0	-5.5	-6.3	-6.4	-6.2
Gross government debt 6/	69.0	69.0	71.0	72.2	73.8	76.9
Government bond yield (10-year and over, percent) 7/	9.7	9.9	11.3	11.1	...	...
Money and Credit (Annual Percentage Change Unless Otherwise Indicated)						
Broad money	9.4	5.7	8.7	5.5	8.0	6.1
Credit to the private sector 8/	1.0	5.1	8.9	4.5	6.5	4.7
Repo rate (percent, end-period) 7/	3.5	3.8	7.0	7.2	...	...
3-month Treasury bill interest rate (percent) 7/	3.9	3.9	6.5	6.9	...	...
Balance of Payments (Annual Percentage Change Unless Otherwise Indicated)						
Current account balance (billions of U.S. dollars)	6.7	15.4	-1.9	-9.1	-10.7	-9.9
percent of GDP	2.0	3.7	-0.5	-2.3	-2.6	-2.3
Exports growth (volume)	-11.9	10.0	7.5	3.6	5.7	5.3
Imports growth (volume)	-17.4	9.5	14.2	5.9	5.3	3.6
Terms of trade	9.3	4.3	-9.4	-2.3	-0.7	-0.7
Overall balance (percent of GDP)	-1.0	1.1	1.0	-0.2	-0.4	-0.2
Gross reserves (billions of U.S. dollars)	55.5	58.1	61.0	60.2	58.6	57.6
in percent of ARA (w/o CFMs)	78.1	85.2	89.5	88.3	85.8	84.4
in percent of ARA (w/ CFMs)	86.6	94.7	99.5	98.2	95.4	93.8
Total external debt (percent of GDP)	50.5	38.3	40.6	43.3	44.4	45.5
Nominal effective exchange rate (period average) 7/	-11.6	7.6	-4.9	-8.0	...	...
Real effective exchange rate (period average) 7/	-10.1	9.7	-1.4	-10.1	...	...
Exchange rate (Rand/U.S. dollar, end-period) 7/	14.7	15.9	17.0	17.8	...	...

Sources: South African Reserve Bank, National Treasury, Haver, Bloomberg, World Bank, and Fund staff estimates and projections.
1/ Per-capita GDP figures are computed using STATS SA mid-year population estimates.
2/ Public savings are the sum of public corporations and general government gross savings, using SARB financial accounts data. This allows to obtain a private sector savings estimate that excludes SOEs (SOEs are included in the National Accounts), derived as the difference between the National Accounts gross national savings and the public savings.
3/ Inventories data are volatile and excluded from the investment breakdown to help clarify fixed capital formation developments.
4/ Consolidated government as defined in the budget unless otherwise indicated.
5/ 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 2014.
6/ Central government.
7/ Average January 1- April 19 2023. For nominal and effective exchange rate, year on year change of average January 1-April 19.
8/ Other depository institutions' "loans and securities" in all currencies.

Table 2. South Africa: Consolidated Government Operations 1/, FY2019/20–2028/29

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
				Est.			Proj.			
				(In billions of rand)						
Total Revenue and Grants	1504	1381	1741.8	1879.2	1945.3	2063.0	2191.7	2328.4	2478.9	2638.5
Tax revenue	1305	1186	1517.8	1644.1	1697.2	1798.0	1911.3	2030.5	2161.9	2301.1
Non-tax revenue 2/	25	24	37.7	35.8	37.6	40.5	42.4	45.0	47.9	51.0
Provinces, social security, and other entities	174	171	186.2	199.3	210.6	224.5	238.0	252.8	269.0	286.3
Total Expenditure	1807	1964	2042.9	2161.1	2394.2	2516.1	2746.3	2847.2	3045.6	3257.1
Current expenditure	1602	1746	1821.7	1942.1	2111.6	2246.5	2420.4	2618.1	2801.8	2997.6
Wages and salaries	624	635	666.4	690.4	749.1	804.3	854.4	904.6	957.7	1014.0
Other goods and services	245	243	265.0	283.2	300.2	314.8	329.0	343.8	359.2	375.4
Interest	214	241	277.1	317.9	377.3	428.6	496.1	582.6	647.2	716.6
Transfers	519	627	613.2	650.5	685.0	698.9	741.0	787.2	837.7	891.5
Capital expenditure	139	128	144.8	153.9	165.0	180.7	191.6	203.5	216.5	230.5
Payment for financial assets	66	91	76.4	65.2	117.6	88.9	134.3	25.6	27.3	29.0
Contingency	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary Balance	-89	-343	-24.0	36.0	-71.6	-24.6	-58.6	63.8	80.5	98.0
Overall Balance	-303	-584	-301.2	-281.9	-448.9	-453.2	-554.6	-518.8	-566.7	-618.6
Financing	303	584	301.2	281.9	448.9	453.2	554.6	518.8	566.7	618.6
Local Currency Debt (net)	338	572	220.8	203.7	333.6	387.3	517.9	500.7	549.5	601.5
Foreign Currency Debt (net)	25	77.59	27.5	34.7	24.9	31.1	23.0	22.8	21.7	21.6
Transactions in Assets and Liabilities	16	28	8.9	15.9	14.0	6.4	1.9	2.0	2.2	2.3
Use of cash and other balances	-75	-94	44.0	13.7	101.7	62.2	11.9	-6.7	-6.7	-6.7
Structural Primary Balance	-71	-94	-20.1	-46.4	-88.6	-51.1	-23.1	62.0	86.1	111.5
Gross Government Debt	3261	3936	4277.5	4727.5	5160.8	5629.0	6246.2	6850.2	7506.0	8217.8
				(In percent of GDP)						
Total Revenue and Grants	26.4	24.6	27.7	27.9	27.3	27.2	27.3	27.3	27.3	27.3
Tax revenue	22.9	21.1	24.1	24.4	23.9	23.7	23.8	23.8	23.8	23.8
Non-tax revenue	0.4	0.4	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Provinces, social security, and other entities	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Total Expenditure	31.7	35.0	32.5	32.1	33.6	33.2	34.2	33.3	33.5	33.7
Current expenditure	28.1	31.1	29.0	28.8	29.7	29.6	30.1	30.7	30.8	31.0
Wages and salaries	10.9	11.3	10.6	10.3	10.5	10.6	10.6	10.6	10.5	10.5
Other goods and services	4.3	4.3	4.2	4.2	4.2	4.2	4.1	4.0	4.0	3.9
Interest	3.8	4.3	4.4	4.7	5.3	5.7	6.2	6.8	7.1	7.4
Transfers	9.1	11.2	9.7	9.7	9.6	9.2	9.2	9.2	9.2	9.2
Capital expenditure	2.4	2.3	2.3	2.3	2.3	2.4	2.4	2.4	2.4	2.4
Payment for financial assets	1.2	1.6	1.2	1.0	1.7	1.2	1.7	0.3	0.3	0.3
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary Balance	-1.6	-6.1	-0.4	0.5	-1.0	-0.3	-0.7	0.7	0.9	1.0
Overall Balance	-5.3	-10.4	-4.8	-4.2	-6.3	-6.0	-6.9	-6.1	-6.2	-6.4
Financing	5.3	10.4	4.8	4.2	6.3	6.0	6.9	6.1	6.2	6.4
Local Currency Debt (net)	5.9	10.2	3.5	3.0	4.7	5.1	6.4	5.9	6.0	6.2
Foreign Currency Debt (net)	0.4	1.4	0.4	0.7	0.3	0.4	0.3	0.3	0.2	0.2
Transactions in Assets and Liabilities	0.3	0.5	0.1	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Use of cash and other balances	-1.3	-1.7	0.7	0.2	1.4	0.8	0.1	-0.1	-0.1	-0.1
Structural Primary Balance (Percent Of Potential Gdp)	-1.2	-1.7	-0.3	-0.7	-1.2	-0.7	-0.3	0.7	0.9	1.2
Gross Government Debt 3/	57.2	70.1	68.0	70.2	72.5	74.2	77.7	80.2	82.6	84.9
Memorandum Items:										
National budget primary balance (percent of GDP)	-2.7	-6.2	-1.0	0.0	-1.1	-0.3	-1.0	0.4	0.6	0.7
National budget overall balance (percent of GDP)	-6.3	-10.3	-5.3	-4.5	-6.2	-5.8	-7.0	-6.2	-6.3	-6.5
Fiscal year GDP (billions of rand)	5,704	5,612	6,292	6,735	7,115	7,584	8,041	8,542	9,090	9,675
Fiscal year real GDP growth (percent)	0.3	-7.0	6.2	1.3	0.7	1.8	1.6	1.3	1.4	1.4
Fiscal year GDP Deflator growth (in percent)	5.1	5.8	5.5	5.7	4.9	4.8	4.4	4.8	4.9	5.0
Fiscal year nominal GDP growth (percent)	5.4	-1.6	12.1	7.0	5.7	6.6	6.0	6.2	6.4	6.4
Contingent Liabilities (percent of GDP) 4/	18.5	19.6	18.7	…	…	…	…	…	…	…

Sources: South African National Treasury And Fund Staff Estimates And Projections.

1/ Data are on a fiscall year basis (April 1-March 31) and factor in the 2022 Medium Term Budget Policy Statement. 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 national government.

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.

4/ Contingent Liabilities are sourced from Table 11 of the Statistical Annex of the 2023 *Budget Review* . Starting in FY 2020/21, the figures also includes disbursements of loan guarantees provided in the context of the COVID-19 fiscal support package.

Table 3. South Africa: Balance of Payments, 2019–28

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
							Proj.			
				(In billions of US dollars)						
Balance On Current Account	-10.0	6.7	15.4	-1.9	-9.1	-10.7	-9.9	-9.9	-9.7	-9.5
Balance on goods and services	2.1	14.8	25.8	8.0	2.1	1.8	3.3	4.6	5.8	6.6
Exports of goods and services	106	93	131	136	142	152	161	170	179	188
Imports of goods and services	-104	-78	-105	-128	-140	-150	-158	-166	-174	-182
Balance On Income	-9.7	-5.6	-8.0	-8.4	-8.9	-9.6	-10.3	-11.3	-12.2	-12.9
Income receipts	8.5	7.8	11.3	11.4	21.2	18.0	12.9	8.1	7.1	7.0
Income payments	-18.2	-13.5	-19.3	-19.8	-30.1	-27.6	-23.2	-19.4	-19.3	-19.9
Balance on Transfers	-2.4	-2.6	-2.4	-1.5	-2.3	-2.9	-2.9	-3.1	-3.3	-3.1
Capital Flows (Including Errors and Omissions)	11.7	-9.9	-10.9	6.1	8.3	9.1	8.9	9.7	9.7	9.5
Balance on Capital and Financial Account	9.0	-11.1	-12.0	6.6	8.3	9.1	8.9	9.7	9.7	9.5
Balance on capital account	0.0	0.0	0.0	-1.8	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	9.0	-11.1	-12.0	8.3	8.3	9.0	8.9	9.7	9.7	9.4
Direct investment	2.0	5.0	40.9	6.4	8.0	8.7	9.5	10.2	11.0	11.2
Liabilities	5.1	3.1	40.9	8.9	10.4	11.2	12.1	12.9	13.7	14.1
Assets	-3.1	2.0	0.0	-2.5	-2.4	-2.5	-2.6	-2.7	-2.8	-2.8
Portfolio investment	9.0	-6.8	-54.4	-4.0	-6.0	-5.2	-4.3	-4.4	-4.6	-4.7
Liabilities	6.1	-9.7	-27.6	2.6	-8.0	-7.3	-6.5	-6.7	-6.9	-7.0
Assets	2.9	2.8	-26.7	-6.5	2.0	2.1	2.2	2.2	2.3	2.3
Financial derivatives	-0.4	-0.7	0.2	-1.7	-1.7	-1.7	-1.8	-1.8	-1.9	-1.9
Liabilities	-11.6	-20.4	-16.6	-17.3	-17.0	-17.4	-17.8	-18.2	-18.4	-18.7
Assets	11.3	19.7	16.9	15.5	15.3	15.6	16.0	16.3	16.6	16.8
Other investment	-1.6	-8.6	1.3	7.6	8.0	7.3	5.6	5.7	5.1	4.8
Liabilities	-2.2	1.3	0.9	11.4	11.8	11.0	9.3	9.5	8.9	8.5
Assets	0.6	-9.9	0.3	-3.8	-3.8	-3.8	-3.8	-3.8	-3.8	-3.8
Errors and Omissions	2.7	1.2	1.1	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance of Payments	1.8	-3.3	4.6	4.2	-0.8	-1.7	-1.0	-0.2	0.0	0.0
IFI disbursements		5.5								
FX reserves drawdown	-1.8	-2.2	-2.6	-2.9	0.8	1.7	1.0	0.2	0.0	0.0
Gross Reserves (End of Period)	55.1	55.5	58.1	61.0	60.2	58.6	57.6	57.4	57.4	57.4
				(In percent of GDP)						
Balance on Current Account	-2.6	2.0	3.7	-0.5	-2.3	-2.6	-2.3	-2.2	-2.1	-2.0
Balance on goods and services	0.5	4.4	6.2	2.0	0.5	0.4	0.8	1.0	1.3	1.4
Balance on goods	0.7	5.2	7.2	3.3	1.5	1.1	1.3	1.3	1.4	1.4
Balance on services	-0.2	-0.8	-1.1	-1.4	-1.0	-0.7	-0.5	-0.3	-0.1	0.0
Exports of goods and services	27.3	27.6	31.2	33.4	35.4	36.5	37.5	38.3	39.2	40.1
Imports of goods and services	-26.8	-23.2	-25.0	-31.5	-34.9	-36.1	-36.7	-37.3	-37.9	-38.7
Balance on income	-2.5	-1.7	-1.9	-2.1	-2.2	-2.3	-2.4	-2.5	-2.7	-2.8
Balance on transfers	-0.6	-0.8	-0.6	-0.4	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7
Capital Flows (Including Errors and Omissions)	3.0	-2.9	-2.6	1.5	2.1	2.2	2.1	2.2	2.1	2.0
Balance on Capital and Financial Account	2.3	-3.3	-2.9	1.6	2.1	2.2	2.1	2.2	2.1	2.0
Balance on capital account	0.0	0.0	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	2.3	-3.3	-2.9	2.1	2.1	2.2	2.1	2.2	2.1	2.0
Direct investment	0.5	1.5	9.8	1.6	2.0	2.1	2.2	2.3	2.4	2.4
Portfolio investment	2.3	-2.0	-13.0	-1.0	-1.5	-1.3	-1.0	-1.0	-1.0	-1.0
Financial derivatives	-0.1	-0.2	0.1	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other investment	-0.4	-2.6	0.3	1.9	2.0	1.7	1.3	1.3	1.1	1.0
Errors and Omissions	0.7	0.3	0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance of Payments	0.5	-1.0	1.1	1.0	-0.2	-0.4	-0.2	0.0	0.0	0.0
Gross Reserves (End of Period)	14.2	16.5	13.9	15.0	15.1	14.1	13.4	12.9	12.5	12.2
in months of next year's imports	8.4	6.4	5.5	5.2	4.8	4.4	4.2	4.0	3.8	3.6
Memorandum Items:										
Total external debt	47.7	50.5	38.3	40.6	43.3	44.4	45.5	46.2	46.5	46.8
International investment position (net)	7.8	29.7	...	...	...	...	...	...	...	...
GDP at current prices (US$ billion)	388	338	419	406	400	416	431	444	458	469

Sources: South African Reserve Bank And Fund Staff Estimates And Projections.

Table 4. South Africa: Financial Corporations, 2019–28

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Est.			Proj.			
	(In billions of rand)									
Central Bank										
Net foreign assets	771	815	912	1,021	1,051	1,047	1,057	1,086	1,125	1,167
Net domestic assets	-489	-515	-597	-658	-669	-636	-619	-627	-637	-651
Domestic claims	-413	-435	-554	-626	-610	-587	-567	-574	-585	-602
Central government (net)	-517	-505	-642	-767	-750	-728	-707	-715	-725	-743
State and local government	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public nonfinancial corporations	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Private sector	1.1	0.6	1.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other depository corporations	96	65	83	136	136	136	136	136	136	136
Other financial corporations	5.0	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Other items net	-75.2	-80.5	-43.6	-32.3	-59.2	-48.2	-52.2	-52.2	-52.2	-48.2
Monetary base	282	299	312	362	382	411	438	460	488	516
Other Depository Corporations										
Net foreign assets	105	378	425	257	226	190	160	126	93	60
Net domestic assets	3,526	3,593	3,772	4,319	4,590	5,006	5,345	5,689	6,053	6,446
Domestic claims	4,749	4,904	5,146	5,714	6,036	6,486	6,857	7,237	7,640	8,077
Central government (net)	525	478	565	759	851	967	1,067	1,155	1,244	1,345
State and local government	23.0	22.8	21.4	21.6	22.7	24.3	25.7	27.3	29.1	30.9
Public nonfinancial corporations	77.1	70.3	68.5	75.7	76.2	76.7	77.2	77.7	77.7	77.7
Private sector	3,388	3,445	3,594	3,889	4,064	4,328	4,531	4,749	4,983	5,233
of which loans and securities	3,281	3,312	3,483	3,794	3,964	4,222	4,419	4,633	4,861	5,105
Central Bank	159	165	172	218	230	245	260	276	294	313
Other financial corporations	577	722	725	751	792	844	896	951	1,012	1,077
Other items net	-1,224	-1,311	-1,373	-1,395	-1,446	-1,480	-1,513	-1,548	-1,587	-1,631
Depository Corporations										
Net foreign assets	876	1,193	1,336	1,278	1,277	1,237	1,217	1,212	1,218	1,227
Net domestic assets	2,888	2,926	3,017	3,453	3,715	4,153	4,499	4,827	5,170	5,539
Domestic claims	4,081	4,239	4,337	4,736	5,062	5,519	5,896	6,252	6,627	7,027
Central government (net)	9	-27	-78	-7	101	239	360	440	519	602
State and local government	23.3	23.1	21.4	21.6	22.7	24.3	25.7	27.3	29.1	30.9
Public nonfinancial corporations	78.1	71.3	69	77	77	78	78	79	79	79
Private sector	3,389	3,446	3,596	3,891	4,065	4,330	4,532	4,751	4,985	5,235
of which loans and securities	3,281	3,312	3,483	3,794	3,964	4,222	4,419	4,633	4,861	5,105
Other financial corporations	582	725	728	754	795	848	900	955	1,016	1,081
Other items net	-1,193	-1,313	-1,320	-1,283	-1,346	-1,366	-1,397	-1,426	-1,457	-1,489
Broad money	3,764	4,119	4,354	4,731	4,992	5,390	5,716	6,039	6,388	6,765

Sources: International Financial Statistics, South African Reserve Bank, And Imf Staff Estimates.

Table 4. South Africa: Financial Corporations, 2019–28 (concluded)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Est.	Proj.					
	(In billions of rand)									
Other Financial Corporations										
Net foreign assets	1,243	1,683	3,023	2,581	2,531	2,460	2,404	2,347	2,309	2,397
Net domestic assets	5,934	5,213	5,627	6,842	7,396	8,248	8,939	9,636	10,355	11,008
Domestic daims	5,932	6,051	5,891	7,126	7,694	8,567	9,275	9,988	10,726	11,398
Central government (net)	1,084	1,242	1,335	1,468	1,636	1,836	2,115	2,406	2,718	3,063
State and local government	34.3	39.3	40.9	44.6	46.9	50.6	53.6	56.7	59.9	63.4
Public nonfinancial corporations	358	388	398	409	419	428	437	447	447	447
Private sector	3,203	2,621	2,186	3,101	3,376	3,861	4,136	4,403	4,674	4,832
of which loans and securities	948	776	647	918	999	1,143	1,224	1,303	1,303	1,303
Central Bank	6.9	6.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.8
Other Depository Corporations	1,245	1,754	1,931	2,103	2,216	2,390	2,532	2,675	2,827	2,992
Other items net	2	-838	-264	-284	-298	-318	-335	-352	-370	-390
Non-liquid liabilities	7,177	6,896	8,650	9,422	9,927	10,708	11,344	11,983	12,665	13,405
Financial Corporations										
Net foreign assets	2,119	2,875	4,359	3,859	3,807	3,697	3,621	3,559	3,527	3,624
Net domestic assets	7,672	6,546	7,395	8,961	9,694	10,854	11,786	12,706	13,656	14,555
Domestic claims	8,179	7,803	7,569	9,004	9,744	10,847	11,738	12,610	13,510	14,352
Central government (net)	1,093	1,215	1,258	1,460	1,737	2,076	2,475	2,847	3,237	3,665
State and local government	57.6	62.4	62.3	66.1	69.7	74.9	79.4	84.0	89.0	94.3
Public nonfinancial corporations	436	459	468	486	496	506	515	525	525	525
Private sector	6,592	6,066	5,781	6,991	7,441	8,191	8,668	9,154	9,658	10,067
of which loans and securities	4,229	4,088	4,129	4,711	4,964	5,365	5,644	5,936	6,164	6,408
Other items net	-507	-1,257	-174	-43	-50	8	48	95	146	203
Liabilities	9,791	9,421	11,754	12,820	13,501	14,551	15,407	16,265	17,183	18,179
Liquid	2,469	2,386	2,959	3,215	3,392	3,661	3,881	4,100	4,336	4,591
Nonliquid	7,322	7,035	8,795	9,605	10,109	10,890	11,526	12,165	12,847	13,587
Memorandum Items:										
Central Bank (billions of US dollar)										
Net foreign reserves	55.0	55.5	57.4	60.1	59.3	57.6	56.6	56.5	56.5	56.5
Central gov. FX deposits	10.1	6.7	5.7	7.3	6.5	4.8	3.8	3.6	3.6	3.6
Year-on-year growth (percent)										
Monetary base	4.9	6.1	4.5	16.0	5.3	7.7	6.5	5.0	6.1	5.9
Broad money	6.1	9.4	5.7	8.7	5.5	8.0	6.1	5.7	5.8	5.9
Claims on private sector										
Dep. Corp.	5.8	1.7	4.3	8.2	4.5	6.5	4.7	4.8	4.9	5.0
Dep. Corp., loans and securities	5.5	1.0	5.1	8.9	4.5	6.5	4.7	4.8	4.9	5.0
Fin. Corp.	3.8	-8.0	-4.7	20.9	6.4	10.1	5.8	5.6	5.5	4.2
Fin. Corp., loans and securities	5.5	-3.3	1.0	14.1	5.4	8.1	5.2	5.2	3.8	4.0
Broad money multiplier (ratio)	13.3	13.8	13.9	13.1	13.1	13.1	13.1	13.1	13.1	13.1
Claims on public sector (percent of total assets)										
Other Depository Corporations										
Central government	12.0	12.4	13.4	14.7	14.9	15.2	15.6	16.0	16.3	16.6
Public nonfinancials	1.3	1.0	1.0	1.0	1.0	0.9	0.9	0.9	0.8	0.8
Other Financial Corporations										
Central government	11.8	12.1	11.2	11.3	11.8	12.2	13.2	14.0	14.9	15.7
Public nonfinancials	3.1	3.2	2.8	2.6	2.6	2.4	2.4	2.3	2.2	2.0

Sources: International Financial Statistics, South African Reserve Bank, And Imf Staff Estimates.

Table 5. South Africa: Financial Soundness Indicators, 2019–22

	2019	2020	2021	2022 1/
		(Percent)		
Capital Adequacy				
Regulatory capital to risk weighted assets	16.6	16.6	18.1	17.5
of which Tier 1 capital	15.6	15.7	17.1	16.6
Capital to total assets	8.0	7.6	8.1	7.7
Asset Quality				
Nonperforming loans to total of loans	3.9	5.2	4.5	4.5
Nonperforming loans net of provisions to capital	18.1	25.1	18.6	19.7
Earnings, Profitability, and Efficiency				
Return on assets	1.5	0.7	1.4	1.5
Return on equity	14.0	7.4	13.2	13.5
Interest margin to gross income	53.9	54.9	54.7	54.8
Trading income to total income	5.6	6.2	6.6	7.2
Non-interest expenses to gross income	62.5	63.1	62.4	62.0
Personnel expenses to non-interest expenses	49.1	47.4	49.0	48.5
Liquidity				
Liquid assets to total assets	18.5	18.7	19.2	18.4
Liquid assets to short-term liabilities	37.1	35.2	34.6	33.4
Customer deposits to total loans	63.9	70.0	71.5	71.5
Exposure to FX Risk				
Net open FX position to capital	0.9	0.7	0.6	0.6
Foreign-currency-denominated loans to total loans	8.3	8.7	7.8	7.8
Foreign-currency-denominated liabilities total liabilities	7.8	7.1	7.0	6.8
Derivatives				
Gross asset position in financial derivatives to capital	51.1	102.1	49.5	50.4
Gross liability position in financial derivatives to capital	49.2	98.3	52.4	52.5
Real Estate Market				
Residential real estate price growth 2/	3.5	2.5	4.2	3.5
Residential real estate loans to total loans	24.2	23.6	24.3	24.3
Commercial real estate loans to total loans	8.0	8.0	7.9	7.6
Household Debt 3/				
Household debt to GDP	40.5	42.7	41.8	40.4
Household debt service to disposable income	9.4	7.7	7.2	7.5

Sources: Financial Soundness Indicators Database, Haver, and IMF staff calculations.
1/ As of July, 2022.
2/ As of December, 2022.
3/ As of June, 2022.

Table 6. South Africa: Medium-Term Macroeconomic Framework, 2019–28

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
							Proj.			
National Income and Prices (Annual Percentage Change)										
Real GDP	0.3	-6.3	4.9	2.0	0.1	1.8	1.6	1.4	1.4	1.4
CPI (annual average)	4.1	3.3	4.6	6.9	6.0	4.9	4.5	4.5	4.5	4.5
Output gap (percent of potential real GDP)	-1.0	-7.6	-3.5	-0.6	-0.4	-0.3	-0.2	-0.1	0.0	0.0
Labor Market (Annual Percentage Change)										
Unemployment rate (percent of labor force, annual average)	28.7	29.2	34.3	33.5	34.7	34.7	34.8	35.1	35.4	35.6
Savings and Investment (Percent of GDP)										
Gross national saving	13.3	14.4	16.5	14.6	13.9	14.0	14.5	14.9	15.2	15.6
Public (incl. public enterprises) 1/	0.2	-6.0	-1.5	0.0	-0.9	-1.4	-1.8	-2.3	-2.6	-2.8
Private	13.1	20.4	17.9	14.6	14.8	15.4	16.3	17.2	17.8	18.4
Investment (including inventories) 2/	15.9	12.4	12.8	15.1	16.1	16.6	16.8	17.1	17.3	17.6
Public (incl. public enterprises)	4.4	4.0	3.8	3.9	3.9	4.0	4.0	3.9	3.9	3.9
Private	11.0	9.8	9.2	10.2	10.6	11.0	11.3	11.6	11.9	12.2
Fiscal Position (Percent of GDP) 3/										
Revenue, including grants	26.8	25.0	27.1	27.7	27.5	27.2	27.2	27.3	27.3	27.3
Expenditure and net lending	31.5	34.6	32.7	32.2	33.4	33.3	33.9	33.5	33.5	33.6
Overall balance	-4.7	-9.6	-5.6	-4.5	-5.8	-6.1	-6.7	-6.3	-6.2	-6.4
Primary balance	-1.0	-5.4	-1.2	0.2	-0.7	-0.5	-0.6	0.4	0.8	1.0
Gross government debt 4/	56.2	69.0	69.0	71.0	72.2	73.8	76.9	79.6	82.0	84.4
Balance of Payments (Percent of GDP Unless Otherwise Indicated)										
Exports of Goods and Services (volume, annual percentage change)	-3.4	-11.9	10.0	7.5	3.6	5.7	5.3	4.6	3.9	3.6
Imports of Goods and Services (volume, annual percentage change)	0.4	-17.4	9.5	14.2	5.9	5.3	3.6	3.6	3.5	3.6
Current account balance (billions of U.S. dollars)	-10.0	6.7	15.4	-1.9	-9.1	-10.7	-9.9	-9.9	-9.7	-9.5
percent of GDP	-2.6	2.0	3.7	-0.5	-2.3	-2.6	-2.3	-2.2	-2.1	-2.0
Overall balance	0.5	-1.0	1.1	1.0	-0.2	-0.4	-0.2	0.0	0.0	0.0
Gross reserves (billions of U.S. dollars)	55.1	55.5	58.1	61.0	60.2	58.6	57.6	57.4	57.4	57.4
percent of short-term debt (residual maturity)	98.4	95.1	119.2	65.6	109.8	99.0	92.7	95.5	88.5	88.6
Total external debt	47.7	50.5	38.3	40.6	43.3	44.4	45.5	46.2	46.5	46.8

Sources: Haver, South African National Treasury, World Bank, And Fund Staff Estimates And Projections.
1/ Public savings are computed using SARB financial accounts data adding public corporations and general government gross savings. This allows to obtain a refined private sector savings estimate that excludes SOEs included as part of the private sector in the National Accounts. The refined private sector savings estimate is derived as the difference between the National Accounts gross national savings and the public savings.
2/ Noisy inventories data are excluded from the investment breakdown to highlight fixed capital formation developments.
3/ Consolidated government unless otherwise indicated.
4/ National government.

Table 7. South Africa: Indicators of External Vulnerability, 2018–22

	2018	2019	2020	2021	2022
Financial Indicators					
Gross government debt (percent of GDP)	51.7	56.2	69.0	69.0	71.0
Broad money (annual percentage change)	5.6	6.1	9.4	5.7	8.7
Private sector credit (annual percentage change)	5.5	5.5	1.0	5.1	4.1
91 day Treasury bill yield (percent, end-period) 1/	7.2	7.1	4.5	3.8	5.2
91 day Treasury bill yield (real, percent, end-period) 2/ 3/	2.5	2.8	1.3	-0.8	-1.8
External Indicators					
Exports (annual percentage change in U.S. dollars)	7.6	-4.5	-6.1	43.6	1.2
Export volume (goods and services, annual percentage change)	2.7	-3.4	-11.9	10.0	7.5
Imports (annual percentage change in U.S. dollars)	10.9	-5.3	-23.3	36.0	20.0
Import volume (goods and services, annual percentage change)	3.2	0.4	-17.4	9.5	14.2
Terms of trade (annual percentage change) 4/	-1.9	4.2	9.3	4.3	-9.4
Current account balance (percent of GDP)	-2.9	-2.6	2.0	3.7	-0.5
Capital and financial account, excl. financial derivatives (percent of GDP)	2.8	2.4	-3.1	-2.9	2.5
of which: Net portfolio investment (debt and equity)	0.7	2.3	-2.0	-13.0	-1.0
Other investment (loans, trade credits, etc.)	1.7	-0.4	-2.6	0.3	1.9
Net foreign direct investment	0.3	0.5	1.5	9.8	1.6
Gross international reserves (billions of U.S. dollars) 3/	51.6	55.1	55.0	57.6	60.6
in months of prospective imports of goods and services	6.0	8.4	6.3	5.4	5.2
in percent of broad money	20.9	20.5	19.6	21.0	21.8
in percent of short-term debt, residual maturity	89.2	98.4	94.2	118.2	65.1
Net international reserves (billions of U.S. dollars) 3/	43.1	44.9	52.1	55.3	53.8
Foreign currency forward position (billions of U.S. dollars) 3/	0.1	-0.1	3.8	3.4	0.6
Total external debt (percent of GDP)	42.7	47.7	50.5	38.3	40.6
percent of export earnings	154.9	174.8	182.9	122.8	121.3
External interest payments (percent of export earnings)	6.2	5.7	6.0	3.1	3.2
External amortization payments (percent of export earnings)	48.6	54.6	60.1	44.7	35.9
Exchange rate (Rand/U.S. dollar, period average) 1/	13.2	14.5	16.5	14.8	16.4
Real effective exchange rate (annual percentage change, period average	1.5	-3.2	-9.2	9.3	-2.2
Financial Market Indicators					
Stock market index (end-period) 3/	52,737	57,084	59,409	73,709	73,049
Net purchases of bonds by nonresidents (billions of U.S. dollars)	4.7	10.4	-4.5	-0.4	1.7
Net purchases of shares by nonresidents (billions of U.S. dollars)	2.4	-4.4	-5.1	-27.2	0.9

Sources: Haver and IMF staff calculations.

1/ Acutal values as of March 2023 from Haver Analytics.
2/ Nominal yield deflated by CPI inflation.
3/ Acutal values as of February 2023 from Haver Analytics.
4/ Terms of trade include gold.

Table 8. South Africa: Gross External Financing Requirement and Sources, 2019–2024

	2019	2020	2021	2022	2023	2024
			(In billions of US dollars)			
Gross External Financing Requirements	67.9	49.3	43.0	50.7	102.2	65.6
Current account deficit	10.0	-6.7	-15.4	1.9	9.1	10.7
Short-term debt at remaining maturity	57.9	56.0	58.4	48.7	93.1	54.8
Short-term debt at original maturity	47.9	44.5	37.1	36.1	43.4	47.4
MLT amortization	10.0	11.5	21.3	12.6	49.7	7.4
Sources of Financing	67.9	49.3	43.0	50.7	102.2	65.6
FX reserves drawdown	-1.8	-2.2	-2.6	-2.9	0.8	1.7
FDI (net)	2.0	5.0	40.9	6.4	8.0	8.7
New borrowing and debt rollover	67.7	41.0	4.7	47.2	93.4	55.2
Short-term debt	44.5	37.1	36.1	43.4	47.4	50.9
Long-term debt	23.2	3.9	-31.4	3.8	46.0	4.2
Other sources (including IFI)	0.0	5.5	0.0	0.0	0.0	0.0
RFI	0.0	4.2	0.0	0.0	0.0	0.0
			(In percent of GDP)			
Gross External Financing Requirements	17.5	14.6	10.3	12.5	25.5	15.8
Current account deficit	2.6	-2.0	-3.7	0.5	2.3	2.6
Short-term debt at remaining maturity	14.9	16.6	13.9	12.0	23.3	13.2
Short-term debt at original maturity	12.3	13.2	8.9	8.9	10.8	11.4
MLT amortization	2.6	3.4	5.1	3.1	12.4	1.8
Sources of Financing	17.5	14.6	10.3	12.5	25.5	15.8
FX reserves drawdown	-0.5	-0.7	-0.6	-0.7	0.2	0.4
FDI (net)	0.5	1.5	9.8	1.6	2.0	2.1
New borrowing and debt rollover	17.4	12.1	1.1	11.6	23.4	13.3
Short-term debt	11.5	11.0	8.6	10.7	11.8	12.2
Long-term debt	6.0	1.2	-7.5	0.9	11.5	1.0
Other sources (including IFI)	0.0	1.6	0.0	0.0	0.0	0.0
RFI	0.0	1.2	0.0	0.0	0.0	0.0

Source: SARB and Fund Staff Estimates.

Table 9. South Africa: Indicators of Capacity to Repay the IMF, 2020–26 1/

	2020	2021	2022	2023	2024	2025	2026
IMF Obligations Based on Existing Credit (In Millions of SDRs)							
Principal	0.0	0.0	0.0	381.4	1525.6	1144.2	0.0
SDR Charges and Assessments	0.1	0.0	33.0	33.1	22.8	6.4	0.3
IMF Obligations Based on Prospective Credit (In Millions of SDRs)							
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	24.0	0.0	0.0	0.0	0.0	0.0	0.0
Total IMF Obligations Based on Existing and Prospective Credit							
In millions of SDRs	24.1	0.0	33.0	414.5	1548.4	1150.6	0.3
In millions of U.S. dollars	17.6	0.0	24.7	317.8	1182.8	880.9	0.2
In percent of GDP	0.0	0.0	0.0	0.1	0.3	0.2	0.0
In percent of exports of goods and services	0.0	0.0	0.0	0.3	1.0	0.7	0.0
In percent of government revenue	0.0	0.0	0.0	0.3	1.0	0.7	0.0
In percent of gross international reserves	0.0	0.0	0.1	0.7	2.6	2.0	0.0
In percent of IMF quota	0.8	0.0	1.1	13.6	50.7	37.7	0.0
IMF Credit Outstanding (End of Period)							
In millions of SDRs	3,051.2	3,051.2	3,051.2	2,669.8	1,144.2	0.0	0.0
In millions of U.S. dollars	4,176.7	4,346.7	4,073.4	3,482.6	1,497.9	0.0	0.0
In percent of GDP	1.2	1.0	1.0	0.9	0.4	0.0	0.0
In percent of exports of goods and services	4.5	3.3	3.0	2.5	1.0	0.0	0.0
In percent of government revenue	5.0	3.7	3.5	3.1	1.3	0.0	0.0
In percent of gross international reserves	5.5	5.3	5.0	4.4	2.0	0.0	0.0
In percent of IMF quota	100.0	100.0	100.0	87.5	37.5	0.0	0.0
Memorandum Items (In Millions of U.S. Dollars, Unless Otherwise Noted)							
Nominal GDP	337,521	418,907	405,705	400,025	416,232	430,906	444,395
Exports of goods and services	93,157	130,673	135,683	141,782	152,096	161,462	170,335
Government revenue	83,870	117,825	114,847	111,161	114,990	119,162	123,009
Gross international reserves	55,549	58,103	61,048	60,243	58,560	57,579	57,401
IMF quota	3051.2	3051.2	3051.2	3051.2	3051.2	3051.2	3051.2
SDR exchange rate (per U.S. dollar)	0.73	0.70	0.75	0.77	0.76	0.77	0.77

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

1/ Includes RFI disbursement approved by the Board in July 2020

Annex I. External Spillovers to South Africa[1]

Like many other economies, South Africa has been hit by a series of large external shocks in the past several years. This annex revisits key transmission channels of external shocks, the amplifying (vulnerabilities) and mitigating factors in the economy, and considers a downside scenario. The annex finds that while South Africa's integration in the global financial and trade systems exposes it to shocks, the country remains quite resilient thanks to the depth and composition of the domestic capital market and strength of its economic buffers.

A. Introduction

1. **Global economic and market uncertainty has sharply risen globally, putting a premium on stronger fundamentals and policies for emerging markets** (EMs). As the intensity of the COVID-19 pandemic started to moderate, the Russian war in Ukraine sharply increased global market volatility and the prices of food and energy, leading to a widespread cost-of-living crisis in many countries. With inflation at multi-decade highs in several countries, monetary and financing conditions tightened globally, generating significant financial and real spillovers to EMs, including exchange rate depreciation and even debt distress in some countries. The extent of tightening in financing conditions varied across countries partly based on domestic fundamentals and the credibility of policy frameworks. In addition, the prolonged lockdown in China and the recent re-opening had added to economic uncertainty and severe climate events have increased in intensity and frequency.

2. **In South Africa, external shocks usually propagate through financial, and commodity and trade channels** (Figure AI.1). During the COVID-19 pandemic, similar to past episodes of market stress, sizable capital outflows by nonresident investors, who hold relatively large amounts of local portfolio assets, led to higher borrowing costs and lower equity prices. This was offset in part by a strong current account surplus amid improved terms of trade, which also boosted domestic tax mining revenues.[2] The flexible rand exchange rate, one of the nation's key economic buffers, acted as a main shock absorber and depreciated significantly.[3]

3. **How vulnerable to shocks is South Africa?** To shed light on this question, the annex revisits key transmission channels (financial, commodities, and trade), vulnerabilities, economic buffers against external shocks, and considers a downside scenario. The note finds that South Africa's integration in the global financial and trade systems exposes it to shocks, but the country

[1] Prepared by Heiko Hesse (SPR) and Ken Miyajima with assistance from Yadian Chen (AFR).

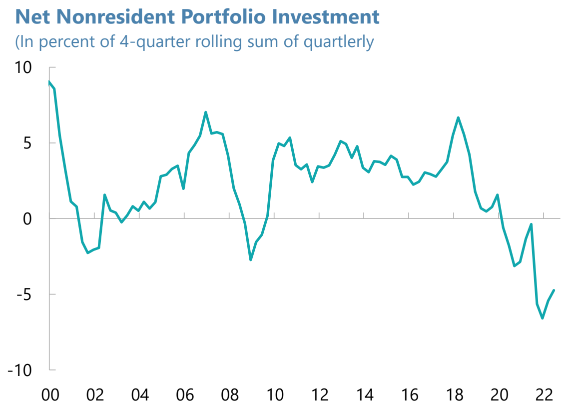
[2] The current account (CA) recorded a record surplus of 3.7 percent of GDP in 2021, with the CA falling significantly in 2022 to a deficit of -0.5 percent of GDP.

[3] The rand exchange rate depreciated during the "rand crisis" in the early 2000s, the global financial crisis (GFC) in 2008–9, the Nene gate scandal in end-2015, and the early phase of the pandemic. There is some indication that rand volatility has gradually fallen. Rand depreciation tended to be accompanied by portfolio outflows. South Africa witnessed terms of trade gains several times, including in the run up to the GFC and during the COVID-19 pandemic.

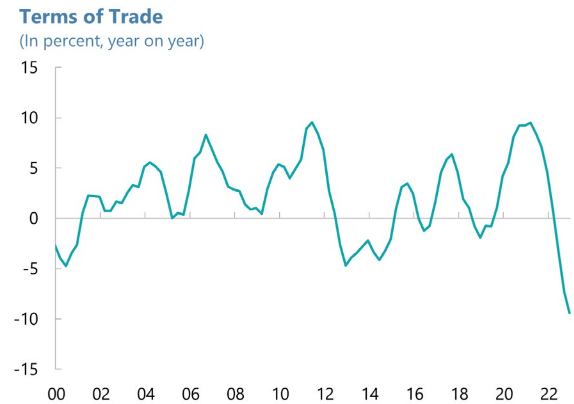
remains quite resilient thanks to its numerous buffers (e.g., flexible rand, low foreign currency debt, deep capital markets, and strong banks and economic institutions).

Figure AI.1. South Africa: Past Episodes of Market Stress

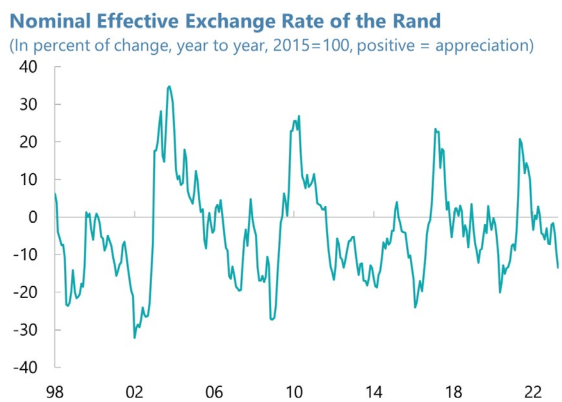
Financial channels, such as nonresident portfolio holdings, have transmitted shocks.



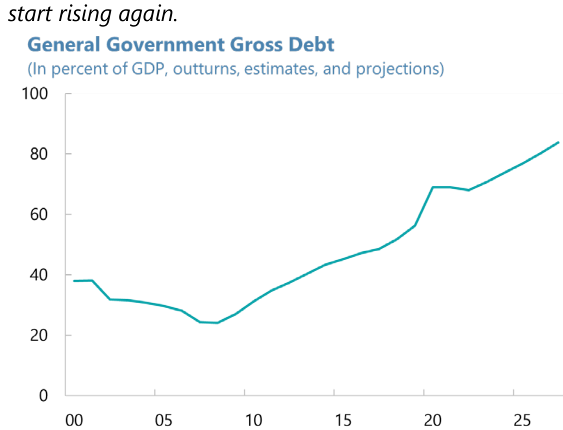
Commodity and trade channels, such as terms of trade performance, have been important.



The very flexible rand exchange rate has absorbed shocks.



Fiscal space is limited, with government debt to GDP set to start rising again.



Sources: Haver, SARB, WEO, and IMF staff calculation.

B. Financial Channels

4. South Africa's economy has become more exposed to external shocks with increased capital inflows (Figure AI.2). Net capital flows were negative during the decade prior to the transition to democracy in 1994. However, in the decade and a half following the end of apartheid, net capital flows turned positive. Portfolio investment was the largest component, while direct foreign investment (FDI) was of a comparable size, likely supporting improvements in productivity and economic growth.[4] After the Global Financial Crisis (GFC) in 2008–9, net capital inflows accelerated, supported mostly by often volatile portfolio investment (Figure AI.2, Panel 1). Other investment also increased but has remained relatively small (Figure AI.2, Panel 2). Direct investment

[4] In Figure AI.2, Panel 1, relatively large and positive FDI in 1994–2009 is offset by other components.

fell to zero, coinciding with a period of slow progress in structural reforms and weak economic activity. Among nonresident flows, the portfolio debt component is the largest and most sensitive to changes in external risk sentiment, particularly during capital flow reversals, in South Africa (Figure AI.3, Panel 3; Goel and Miyajima, 2021).[5] The risks from large external liabilities, 109.5 percent of GDP in 2022 Q3, are mitigated by several factors–the external asset position is large (125.9 percent of GDP in 2022 Q3), liabilities are mainly in equities, and external debt is mostly in rand (Figure AI.2, Panel 5).[6]

5. Several factors could amplify external shocks. The rand exchange rate is flexible and usefully absorbs shocks but also tends to strongly reflect global investors' sentiment towards risk, including for other EMs than South Africa—owing to the deep trading liquidity, the currency trades globally around the clock and as an EM proxy (Figure AI.2, panel 4). In addition, after South Africa' sovereign credit rating fell into sub-investment grade and the nation was removed from a major global bond index, the investor base shifted from those tracing global indices, thus relatively stable, to more active investors such as hedge funds with volatile trading behavior (e.g., Figure AI.2, panel 6).

C. Commodity and Trade Channels

6. South Africa has diversified commodity and export markets, which help mitigate global shocks. South Africa has diversified its export destinations, with 34 percent of its exports going to advanced economies, 30 percent to emerging and developing Asia and 23 percent to sub-Saharan Africa (Figure AI.3, Panel 4). The key export products are coal, iron, precious metals (such as gold, palladium, platinum, and rhodium), and manufacturing goods, including cars. This composition of trade has served the country well since, after Russia's invasion of Ukraine, strong demand for and high prices of coal boosted the current account despite prices for precious metals coming down from the pandemic peaks (Figure AI.3, Panel 2).

7. During times of market stress, global investors differentiate emerging economies based on fundamentals. For example, during the 2013 taper tantrum, asset price and capital flows were affected more indiscriminately across countries during the initial period of acute and systemic market volatility (Sahay et al, 2014). However, over time, investors differentiated EMs, where those with better macroeconomic fundamentals experienced less volatility. Furthermore, where vulnerabilities existed, EMs that acted early and decisively with strong policy frameworks generally fared better.

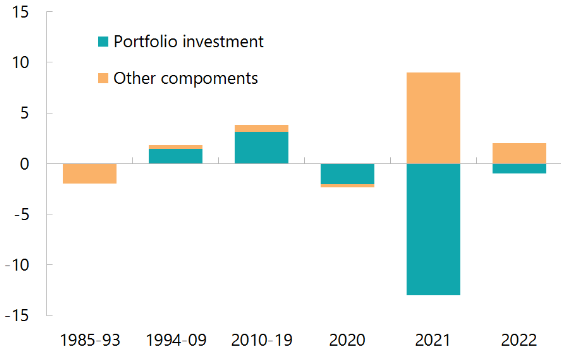
[5] Net FDI increased significantly in 2021 (from 1.5 percent of GDP in 2020 to 9.7 percent in 2021), while net portfolio investment recorded substantially larger outflows (-13 percent of GDP). These significant flows in 2021 can largely be attributed to Prosus N.V. acquiring about 45 percent of Naspers Ltd N ordinary shares from existing Naspers Ltd shareholders (direct investment inflows) and to both resident and nonresident investors exchanging Naspers Ltd N ordinary shares for Prosus N.V. ordinary shares (portfolio investment outflows).

[6] The NIIP is expected to moderate over the medium term as the CA deficit is projected to worsen in 2023 and 2024 before slightly improving to around 2 percent of GDP over the medium term.

Figure AI.2. South Africa: Financial Channels

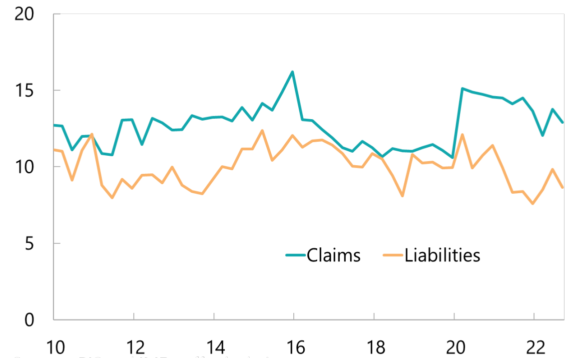
Portfolio investment has been the main element of overall net capital flows.

Financial Account and Its Composition
(In percent of GDP)



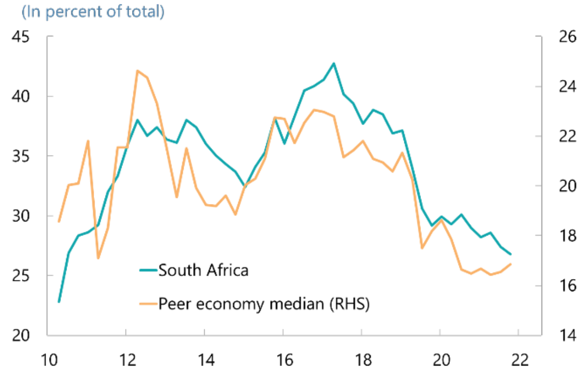
Banks' cross-border positions are not large.

External Claims and Liabilities of Banks in South Africa
(In percent of South African bank assets)



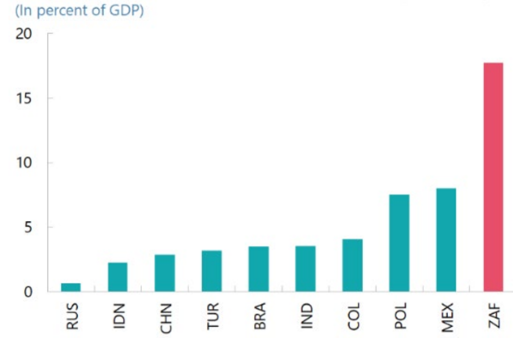
Nonresident appetite for local-currency government bonds has fallen in EMs.

Nonresident Holdings of Local Currency Govt. Bonds
(In percent of total)



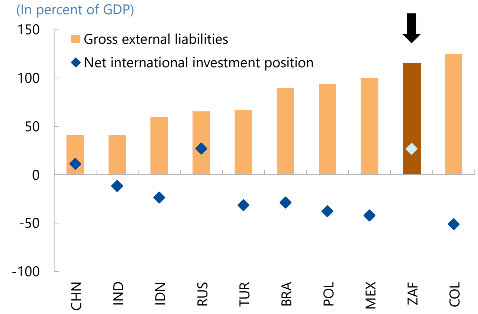
Rand trading volume exceeds those for other EM currencies, reflecting the rand's EM proxy status.

Daily Avg. Turnover of OTC FX Instruments by Currency
(In percent of GDP)



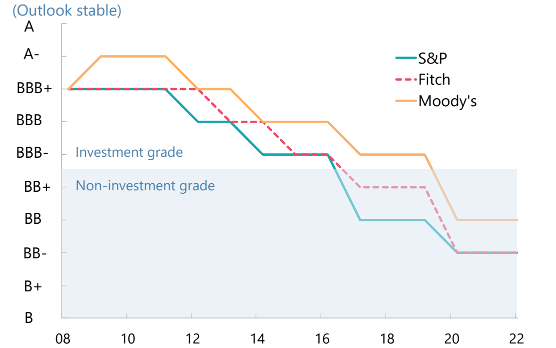
South Africa's gross external liabilities are relatively high among EMs, but the NIIP is positive.

Gross External Liabilities and NIIP, 2021
(In percent of GDP)



South Africa's sovereign credit ratings have steadily fallen.

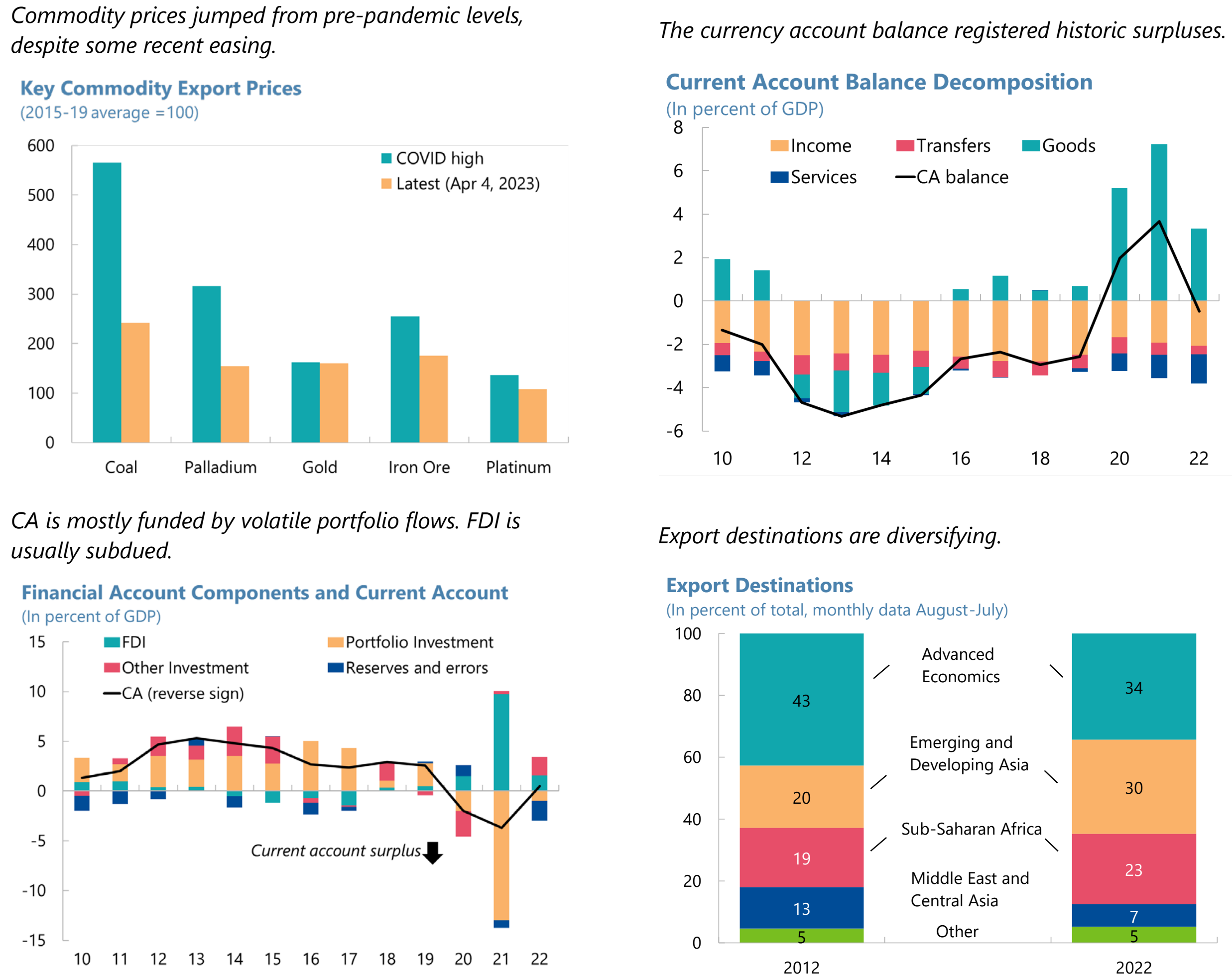
Sovereign Credit Ratings
(Outlook stable)



Sources: BIS, Haver, IIF, selected credit rating agencies (Fitch, Moody's, and S&P), and IMF staff calculations.

Note: Ratings data are shown in accordance with S&P rating scale.

Figure AI.3. South Africa: Commodity and Trade Channels



Sources: Bloomberg, SARB, and IMF staff calculations.

Note: Panel 2 = 2022 data are estimates. Panel 3 = See footnote 5 as to why FDI jumped in 2021.

D. Vulnerabilities

8. South Africa's fiscal vulnerabilities remain high. Fiscal risk is often a key determinant of country risk—one view is that government debt determines the trend level of the country risk premium, and external shocks its fluctuations, which can be large and unpredictable (Loate et al., 2021). Elevated fiscal risk could erode investors' confidence, and ultimately lead to significant increases in borrowing costs and potentially to debt distress. In South Africa, fiscal policy is constrained by relatively high government debt. Broader public debt, including SOE debt and contingent liabilities (especially from Eskom and Transnet), are even higher (Figure AI.4, Panel 2). Market-based indicators of risk suggest that investors consider that a large fraction of SOE risks are set to morph onto government balance sheet—amid the decision that the government will take over some of Eskom's debt, the "Eskom premium" in local currency government yields, which emerged in 2019, dissipated in 2022 (Figure AI.4, Panel 3).[7]

9. Elevated public debt weighs on economic activity. Government debt is denominated mostly in local currency and a large share is still held by nonresident investors by international standards (Figure AI.2, Panel 3). As the share of holdings by nonresident investors continued to decline further for a multi-year low registered recently, the large domestic investor base absorbed domestic sovereign debt, in particular banks and other financial institutions, such as mutual funds. Continued buying by domestic investors, especially banks, would strengthen the financial sector-sovereign nexus, crowd out private investment, and dampen economic activity.

10. Spending pressure remains elevated amid high poverty and inequality. Poverty is significantly higher than in other G20 EMs. Inequality, measured by the Gini coefficient, is one of the highest globally, so is unemployment (Figure AI.4, Panels 4 and 5). Like in many other countries, these social indicators worsened during the COVID-19 pandemic, raising worries about lengthy scarring effects. Indeed, per-capita income, which started to fall below the global median a decade ago, is set to remain stagnant and fall further to the bottom ¼ of global economies (Figure AI.4, Panel 6). This could threaten already fragile social stability.

11. South Africa's external vulnerabilities are less pronounced than some EM peers. Gross external financing needs (GEFNs) improved in 2021 partly as external liabilities declined amid continued selling by nonresident investors of local-currency government bonds (Figure AI.5, Panel 1). However, the stock of central bank foreign reserves remains below the level deemed as adequate based on the Assessing Reserve Adequacy (ARA) metric (Figure AI.5, Panel 2).

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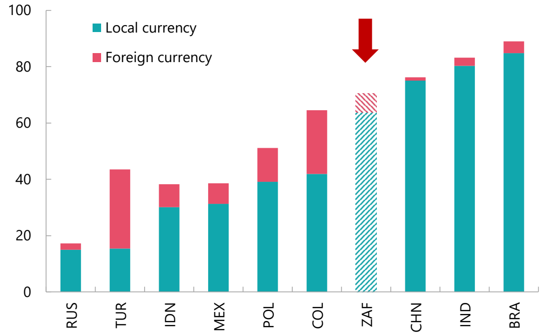
[7] The local currency 10-year government yield is compared with its implied value. The implied yield is calculated as the sum of maturity-matching US yields, South Africa's dollar credit spreads, and the difference in long-term inflation expectations between the two nations. The difference between the actual and implied was mean reverting up to 2019, that is, the implied yield was broadly comparable to the actual on average. However, the difference started to surge rapidly as Eskom's situation started to worsen significantly to the extent that the SOE required a bridge loan from a local bank to avert a default. One interpretation is that investors trading dollar-denominated credit products did not fully price in risks from Eskom to sovereign credit, while investors trading local-currency assets did, creating the large "Eskom premium." Amid the decision of Eskom debt takeover by the government, the Eskom premium dissipated in 2022. Investors in dollar credit products likely priced in Eskom risks for the sovereign to a fuller extent.

Figure AI.4. South Africa: Fiscal and Social Vulnerabilities

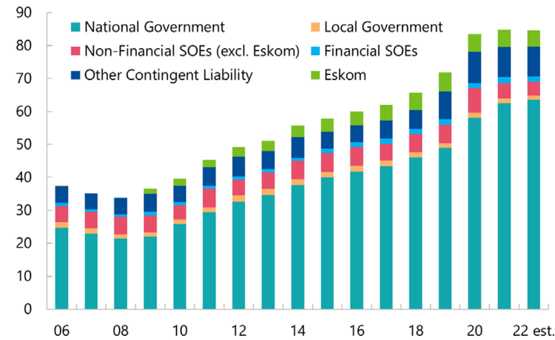
The public debt ratio is high…

Government Debt, 2022Q2
(In percent of GDP)



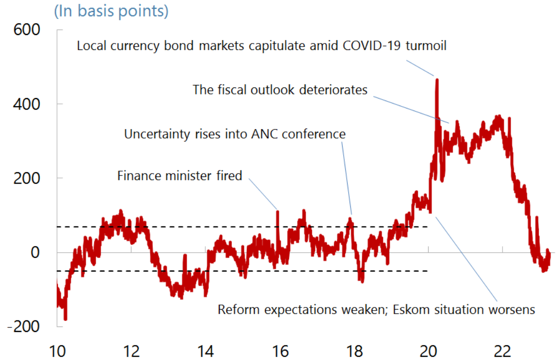
…especially with SOE debt and contingent liabilities.

Broader Public Sector Debt and Contingent Liabilities
(In percent of GDP, as of end-March of given year)



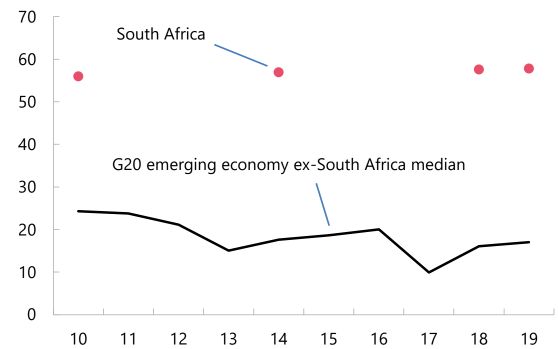
Amid talks of Eskom debt takeover, "Eskom premium" in local sovereign yields dissipated.

Local Currency Sovereign Yield Differential to Implied
(In basis points)



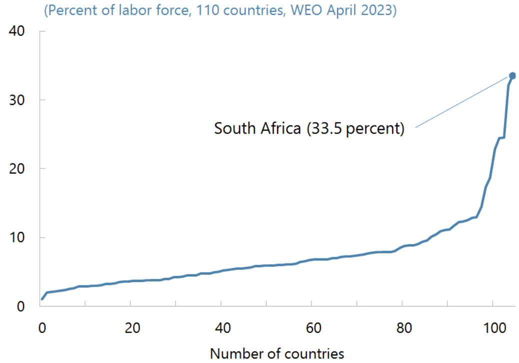
Poverty in South Africa is significantly above that in G20 emerging economies.

Poverty Index
(In percent of population under US$ 5.5 per day)



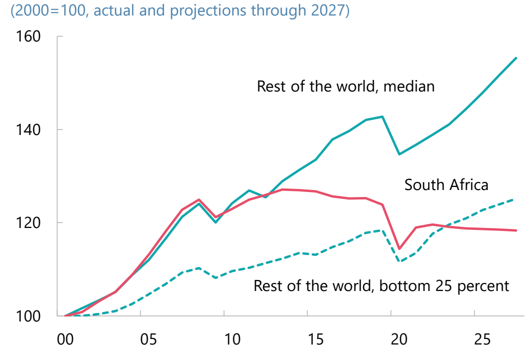
Unemployment is among the highest globally.

Unemployment in 2022
(Percent of labor force, 110 countries, WEO April 2023)



Per-capita income is set to remain stagnant, falling to the lowest quartile globally.

Per-Capita Real GDP
(2000=100, actual and projections through 2027)

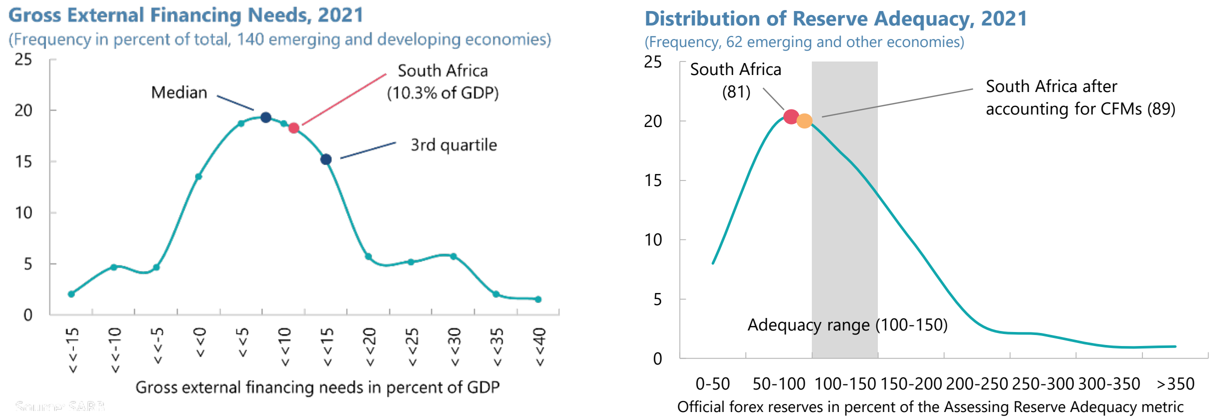


Sources: IMF World Economic Outlook, World Bank, South African authorities, IIF Global debt monitor database, Haver, JP Morgan Markets, and IMF staff calculations.

Figure AI.5. External Vulnerabilities

GEFNs, at around sample median in 2021, are set to worsen as the CA surplus dissipates.

Central bank international reserves are below the ARA metric adequacy range.



Sources: SARB, IMF Assessing Reserve Adequacy Metrics.

E. Economic Buffers

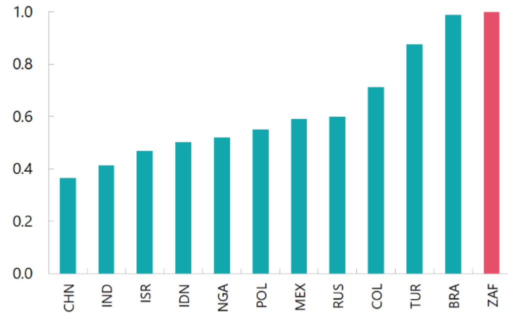
12. Key economic buffers have mitigated shocks in South Africa. The rand exchange rate, one of the most flexible in EMs, is widely understood, including by market participants, to have worked as the main shock absorber (Figure AI.6, Panel 1). The high rand volatility partly reflects the policy of letting the currency float freely with no foreign exchange interventions (FXI).[8] Moreover, foreign currency debt in the economy is relatively low (Figure AI.6, Panel 2). The country's NIIP remain positive even though NIIP surplus moderated (Figure AI.6, Panel 3). Indeed, during past episodes of large market volatility, large rand depreciation did not appear to have created adverse effects stemming from currency mismatches for several reasons. First, the size of FX liabilities is not particularly large partly as the flexible exchange rate prompts economic agents to internalize currency risk. Second, economic agents are believed to have both natural and financial hedges against currency risks. Third, the credible inflation targeting regime helps keep inflation expectations anchored. Indeed, South Africa's inflation has performed better than in many other EMs, owing partly to strong central bank credibility and decisive monetary policy tightening. Fourth, and more broadly, the strong domestic financial systems can withstand shocks. Banks have strong solvency, liquidity, and asset quality (Figure AI.6. Panel 5). The financial system is large, including non-bank financials, and has helped absorb sovereign debt when nonresident investors remained on the sidelines (Figure AI.6, Panel 6).

[8] It also reflects the rand's EM proxy status where investors widely trade the rand to express their views on the broader EM space, further increasing rand volatility, which may be a source of vulnerability.

Figure AI.6. South Africa: External and Domestic Economic Buffers

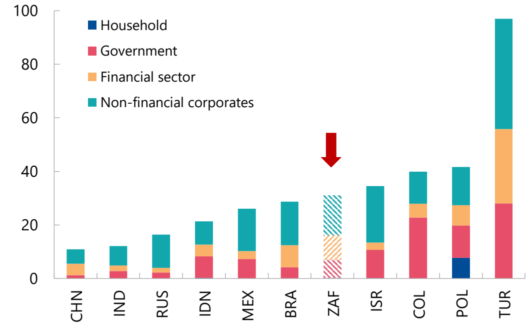
The rand exchange rate is very flexible.

Flexibility of Selected Exchange Rates
(NEER median monthly percentage change, Jan 00-Oct 22, South Africa = 1)



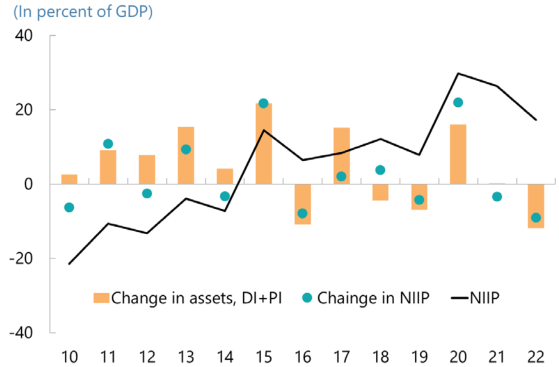
FX mismatches are relatively small.

Foreign Currency Debt
(In percent of GDP, June 2022)



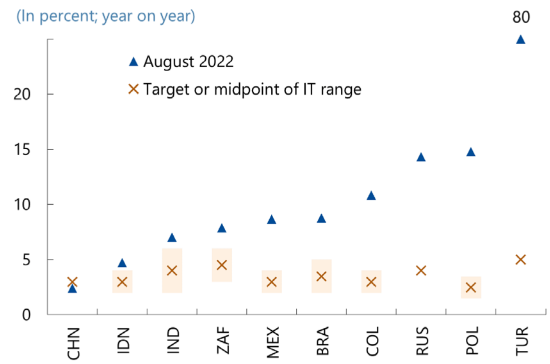
NIIP is positive.

International Investment Position
(In percent of GDP)



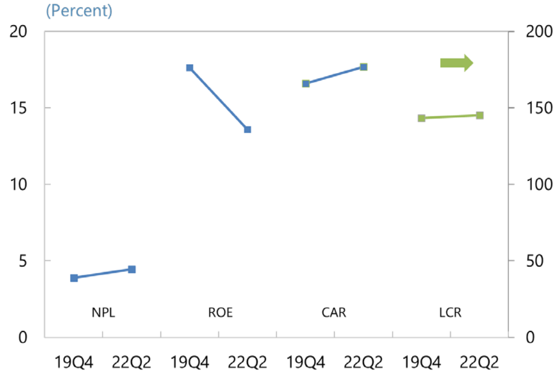
Inflation has performed relatively well.

Inflation
(In percent; year on year)



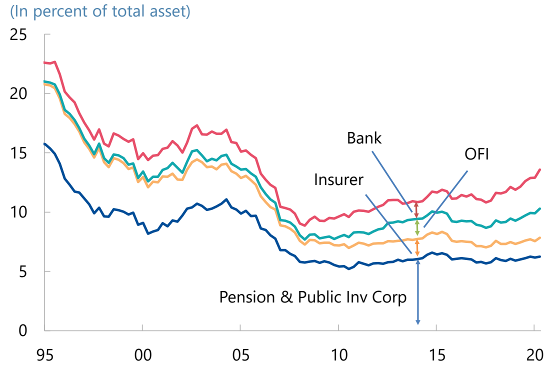
Banks have strong buffers to absorb shocks.

Indicators of Banks' Performance
(Percent)



The large financial system has helped absorb domestic government debt.

Holdings of Government Bonds by Financials
(In percent of total asset)



Sources: SARB, Haver, Bloomberg, IIF Global Dent Monitor, IMF Emerging Market Monitor, and IMF staff calculations.

F. External Shocks

13. For South Africa, external shocks may have become more prominent than domestic shocks. This can be seen from the relative importance of indicators of domestic shocks (implied volatility of dollar-rand exchange rate) and external shocks (implied volatility of US equity prices, or VIX, commonly used as a gauge of the global "fear factor").

14. South Africa faces significant external and domestic downside risks (Annex VII. Risk Assessment Matrix). Key external risks are lower global demand and commodity prices from recession in advanced economies and China, intensifying spillovers from the war in Ukraine, and attendant rise and volatility in the prices of food and energy, systemic social unrest, as well as a sharp tightening in global financial conditions to tame high inflation. According to the recent SARB Financial Stability report (November 2022), South Africa is highly vulnerable to insufficient and unreliable electricity supply (domestic risk) and a sharp repricing in government debt (both domestic and external driven risks), while global stagflation and a rapid tightening of financial conditions is seen as a high-moderate vulnerability over the near term.

G. Downside Scenario

15. Materialization of risks in a downside scenario would significantly lower growth and entail macro-financial spillovers (Table AI.1). A more protracted global growth slowdown and deterioration in global investor sentiment would lead to a recession in 2023, a recovery from which would be sluggish owing to structural constraints. Unemployment would rise above 37 percent, threatening social cohesion. Public debt would increase faster relative to the staff baseline and reach over 92 percent of GDP in 2028. The sovereign risk premium would increase as investors' confidence erodes and concerns about debt sustainability worsen (Annex VIII. Public DSA).

Table AI.1. South Africa: Downside Scenario

	2022	2023	2024	2025	2026	2027	2028	Unit
Real output growth	2.0	-1.8	0.4	1.7	1.6	1.6	1.4	(percent)
Per-capita real output growth	1.3	-3.3	-1.1	0.2	0.1	0.1	-0.1	(percent)
Unemployment	33.5	36.1	37.0	37.1	37.2	37.4	37.6	(percent)
Inflation	6.9	6.4	5.1	4.5	4.5	4.5	4.5	(percent)
Private sector credit growth	8.9	3.2	4.1	5.0	5.3	5.2	4.7	(percent)
Fiscal deficit	-4.5	-6.3	-7.1	-8.1	-7.9	-8.0	-8.4	(percent of GDP)
Public debt	71.0	74.0	77.7	81.7	85.2	88.6	92.5	(percent of GDP)
Current account balance	-0.5	1.1	-0.2	-1.6	-1.8	-1.9	-2.0	(percent of GDP)

Source: IMF staff calculations.

Note: Scenario analysis starts from 2024. Calendar year-based fiscal data for 2024 differ slightly from baseline values as the underlying fiscal year-based values are affected by 2024Q1 inflation.

16. Headline inflation is projected to decline more gradually to the 4.5 percent midpoint than in the baseline scenario. Weak domestic demand is set to be disinflationary. However, the risk premium would rise and the exchange rate would depreciate significantly in 2023–24 amid higher fiscal deficits, public debt, and capital outflows, creating inflationary pressure.

17. Capital outflows would intensify and the rand depreciate, adding to inflationary pressures and demand for social spending and wage increases in the general government and SOEs. As external financing dries out, foreign exchange reserves would be drawn down to help meet financing needs with negative spillovers for the financial system and the rest of the region. The current account would move into a sizable positive territory in 2023, as especially domestic demand and imports get depressed. Fiscal financing would rely increasingly on the domestic investor base, further crowding out private investment and weighing down growth creating an adverse feedback loop.

18. As a result of the recession, bank capital and profitability would weaken with worsening credit provision and asset quality (2021 FSAP). Small and medium-sized banks with relatively high NPLs would be especially impacted increasing contagion risks to a tightly interconnected broader financial system.

Annex II. Case for Foreign Exchange Interventions in the Integrated Policy Framework (IPF)[1]

South African does not have significant "IPF frictions" that would call for the use of foreign exchange intervention (FXI). The rand exchange rate markets are deep, currency mismatches are low in the economy, and exchange rate pass through to inflation expectations is low. Thus, allowing the exchange rate to absorb shocks is the optimal response. This view is consistent with that of the authorities.

1. **The South African rand is a relatively volatile currency for several reasons.** South Africa is subject to frequent external shocks through financial, commodity, and trade channels (Annex I). The country is highly integrated in global capital markets, and volatile portfolio flows tend to finance the current account (CA) balance. The rand trades globally around the clock as an emerging market (EM) proxy. Moreover, commodities are an important component of South Africa's exports, subjecting the nation to swings in commodity prices. In addition, the rand floats freely as a policy choice without foreign exchange intervention (FXI), increasing the currency's volatility. Rand volatility surged during past episodes of global risk aversion and large terms of trade movements.[2]

2. **The Integrated Policy Framework (IPF) helps assess the appropriate policy responses to shocks for economies vulnerable to capital flow volatility** (IMF 2020)**.** It shows that the optimal policy response depends on the nature of shocks, country characteristics, and initial conditions. When the local currency trades in deep markets and the country continues to have market access, allowing the exchange rate to adjust freely is optimal. However, some countries have "frictions", such as shallow FX markets, currency mismatches on non-bank balance sheets, and weakly-anchored inflation expectations. Here, additional policies, including pre-emptive capital flow management measures (CFMs), macroprudential measures (MPMs), and FXI, could mitigate trade-offs from the use of monetary policy—e.g., monetary policy tightening to help stem currency depreciation would raise funding cost for domestic agents and slow economic activity.

3. **South Africa does not appear to have significant frictions that would warrant the use of FXI in response to shocks.** The rand exchange rate markets are deeper than markets for other EM currencies, even though shallower than those for some advanced economy currencies, gauging from several indicators of FX market depth. The bid-ask spread for the rand against the U.S. dollar in the spot markets is lower than the EM average. The uncovered-interest-rate-parity premium—a proxy for the risk premium compensating for holding local currency debt by external investors—has been positive on average. In the past, like for many other EM currencies, the indicator remained negative during risk-off events, including the global financial crisis in 2008–09. Currency mismatches in the economy, which tend to trigger or exacerbate the feedback loop between currency depreciation and capital outflows, are low. Nonfinancial corporate FX debt is low. At least, large

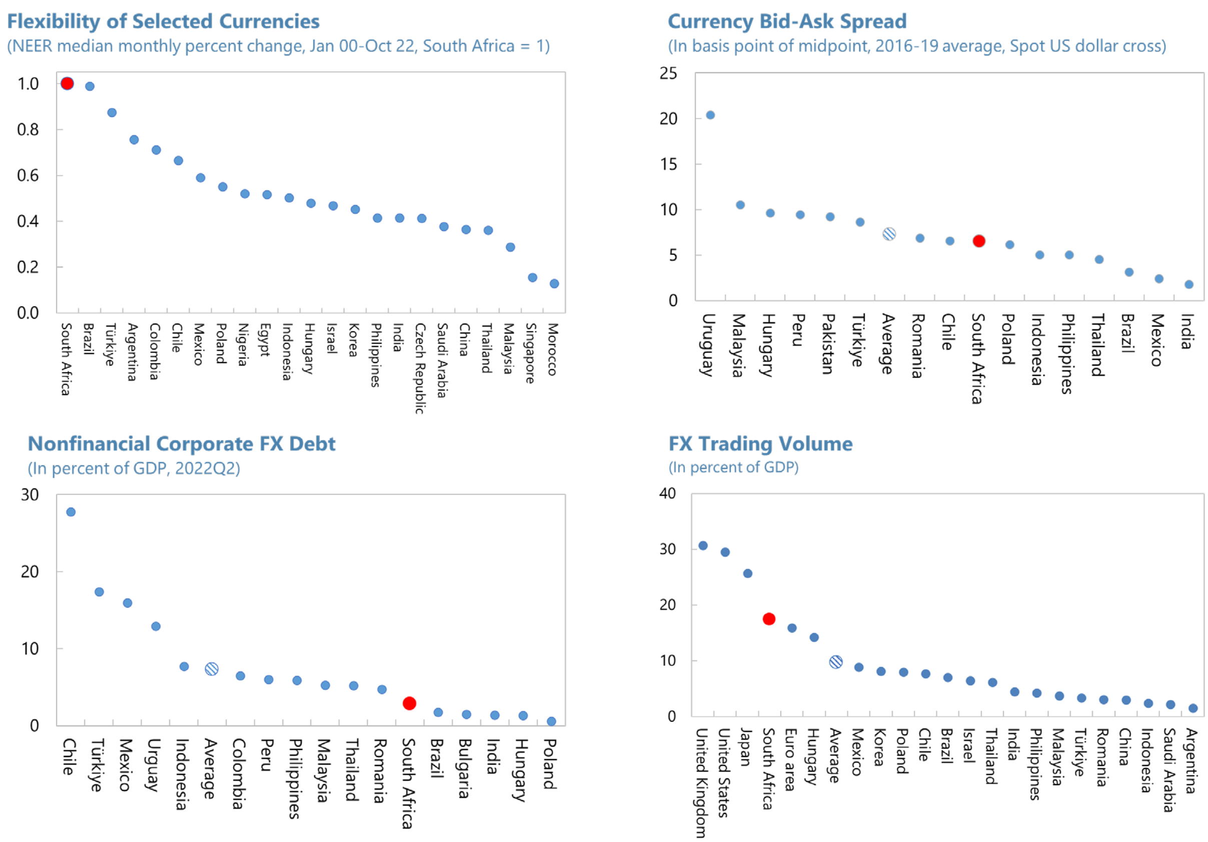
[1] Prepared by Imen Benmohamed, Heiko Hesse (both SPR) and Ken Miyajima (AFR).

[2] This includes the global financial crisis in 2008–09 and the COVID-19 market turmoil in 2020. It also rose in response to domestic shocks (the firing of the finance minister in end-2015; the December 2017 ANC elective conference).

corporates have natural hedges from FX revenue. Moreover, the net international investment position (NIIP) is positive. The large domestic financial system helped absorb local currency assets during episodes of capital outflows. Staff estimates suggest exchange rate pass-through to inflation expectations is low in South Africa.[3]

4. In the authorities' views, a flexible exchange rate, credible policy frameworks, and policy coordination are key for maintaining macroeconomic stability in South Africa ([Loewald, 2021](#))**.** Restoring external and internal imbalances requires allowing the exchange rate to float freely within a robust inflation targeting framework, supported by consistent macroeconomic policies. In particular, countercyclical fiscal policy eases monetary policy trade-offs, reducing currency and inflation risks. This, in turn, lowers the "adequate" target level of foreign currency reserves and the costs of holding them. Deep local currency capital markets and low inflation are critical elements for reducing the real costs of currency volatility.

Figure AII.1. South Africa and Selected Economies: Currency Flexibility and IPF Frictions

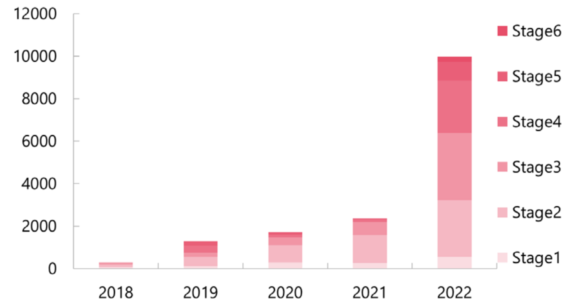


Sources: BIS, BIS Quarterly Review December 2022, Haver, and IMF staff calculations.

[3] One view is that the SARB's enhanced credibility contributed to a fall in the exchange rate pass-through. See Kabundi, A., and Mlachila, M., (2019), "The Role of Monetary Policy Credibility in Explaining the Decline in Exchange Rate Pass-Through in South Africa," *Economic Modelling*, vol. *79*, pp. 173–185.

Annex III. Recent Power Shortage in South Africa

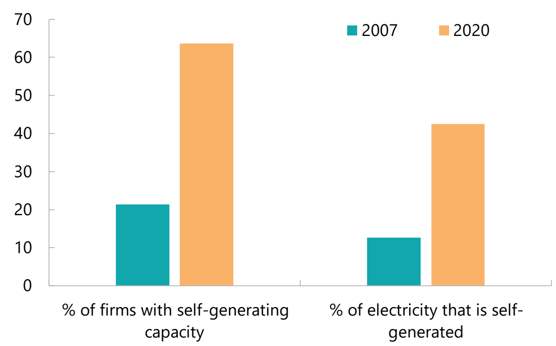
Power Outages by Intensity
(in Gigawatt hours)



Sources: Eskom, and IMF staff calculations.

1. In 2022, South Africa experienced the worst power outages in recent history and the situation is expected to worsen in 2023 before improving. The performance of Eskom's aging coal-fired power plants has deteriorated in recent years, despite the government's effort to reverse the trend. The debt-ridden state monopoly has been relying on government bailouts to stay afloat and struggling to keep old power plants running and fix deficiencies in newer units. At the same time, excessive regulatory burden, and high barriers to entry in the sector limited private sector participation and improvements in energy supply. The rolling power outages (locally known as "loadshedding") reached almost 160 days in 2022, more than triple the fewer than 50 days in 2021 (chart). The intensity of power outages is expected to worsen significantly in 2023 before improving.

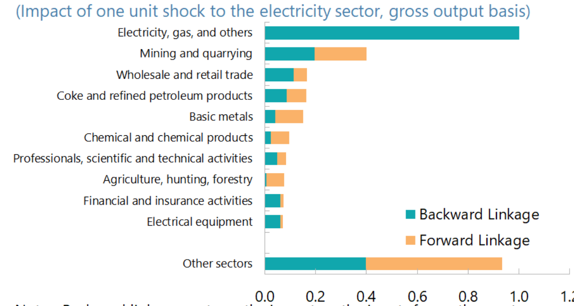
Self-Generation Amongst Firms in South Africa



Source: World Bank Enterprise Survey.

2. The economy has developed some degree of resilience against the rolling power outages since they first occurred in 2007–08. For example, the number of firms with self-generation capacity increased by nearly three-fold from 2007 to 2020, and these firms tend to face lower output and productivity losses from electricity shortages (chart). To further increase resilience, the government announced substantial incentives for businesses in the 2023 Budget to promote investment in renewables over the next two years.[1]

Linkages with Electricity Sector
(Impact of one unit shock to the electricity sector, gross output basis)



Notes: Backward linkage captures the impact on the inputs from other sectors (upstream), while forward linkage captures the impact on the supplies to other sectors (downstream).
Sources: OECD Input-Output Tables, and IMF staff calculations.

3. Nevertheless, the unprecedented intensity of loadshedding in 2022 caused material disruptions to economic activity and people's daily life. The most affected sectors based on input-output table analysis are mining, wholesale and retail trade, coke and refined

[1] From March 1, 2023, businesses can reduce their taxable income by 125 percent of the cost of renewable investments for two years. Individuals who install rooftop solar panels can claim a rebate of 25 percent of the cost of the panels, up to a maximum of R15,000 for one year. This latter rebate is not expected to have a meaningful impact given the substantially higher costs of solar panels.

petroleum products, basic metals, and chemicals sectors (chart). The rolling power outages are estimated to have lowered South Africa's growth by between 0.4 to 0.7 percentage point in 2022. These estimates are, however, subject to high uncertainty, stemming from the underlying assumptions and potential non-linearities in the effects of power outages respect to their intensity.

Annex IV. External Debt Sustainability Analysis[1]

South Africa's significant gross external financing needs (GEFNs), largely financed by non-FDI flows traditionally, are set to increase as financing costs rise and the current account balance (CA) deteriorates. External debt, at 40.6 percent of GDP in 2022, is projected to remain elevated and further increase to around 47 percent over the medium term. Staff's scenario analysis suggests that the impact of exchange rate depreciation is mitigated by a relatively large local currency-denominated component and currency hedges.

1. GEFNs declined in 2021 on account of the large CA surplus, with external debt also falling, but increased in 2022. GEFNs fell from 15 percent of GDP in 2020 to 10 percent of GDP in 2021 as the CA reached a historic surplus of 3.7 percent of GDP in 2021 (driven by booming commodity prices). The CA sharply declined in 2022 to a deficit of 0.5 percent of GDP, which, together with rand depreciation, contributed to a moderate increase in GEFNs. Short-term external debt significantly decreased in 2021 (by 2.4 percentage points of GDP) but continued to represent a large share of GEFNs (on a remaining maturity basis). External debt declined in 2021 to 38 percent of GDP (from 51 percent in 2020) amid a historic CA surplus and strong GDP growth. A Prosus/ Naspers financial transaction led to a significant reallocation of capital flows where net FDI inflows jumped to about 10 percent of GDP, while net portfolio outflows reached 13 percent of GDP, in 2021. In 2022, FDI was subdued and portfolio flows registered outflows amid tighter and volatile global financing conditions.

2. External debt is set to remain elevated and further increase over the forecast horizon. GEFNs are projected to sharply increase in 2023, as a sizable amount of external debt matures, and the current account deficit is projected to worsen to 2.3 percent of GDP. External debt under the baseline is projected to remain elevated and to steadily increase to around 47 percent of GDP over the medium term. Net FDI inflows are anticipated to remain low over the forecast horizon, hampered by slow progress in structural reform implementation and subdued private investment. Given a difficult and volatile market environment going forward, portfolio investment will remain subdued. Any reduction in nonresident holdings of local currency bonds would require more local funding from the financial system.

3. Effects of currency depreciation are mitigated by several factors. After a 30 percent depreciation in the rand per US dollar, external debt rises by around 12 percentage points of GDP to about 59 percent of GDP (from a baseline of around 47 percent of GDP), which is mitigated as half of total external debt is denominated in rand and corporates hedge against rand volatility. At the same time, other standard shocks simulated—such as a widening of the non-interest current account deficit, and a deceleration in real GDP growth—would lead to moderate increases in external debt.

[1] Prepared by Heiko Hesse (SPR).

Table AIV.1. South Africa: External Debt Sustainability Framework, 2017–2028

(In percent of GDP, unless otherwise indicated)

	Actual					Projections								
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028		**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	45.4	42.7	47.7	50.5	**38.3**	**40.6**	**43.3**	**44.4**	**45.5**	**46.2**	**46.5**	**46.8**		**-3.6**
Change in external debt	1.3	-2.7	5.0	2.8	-12.2	2.3	2.7	1.1	1.1	0.7	0.3	0.3	0.0	
Identified external debt-creating flows (4+8+9)	-2.9	-0.4	3.0	1.8	-8.9	-2.1	0.0	-0.5	-0.8	-0.9	-1.1	-1.2	0.0	
Current account deficit, excluding interest payments	1.3	1.6	1.3	-3.3	-4.5	-0.4	1.4	1.7	1.4	1.3	1.1	1.0	3.6	
Deficit in balance of goods and services	-1.1	-0.5	-0.5	-4.4	-6.2	-2.0	-0.5	-0.4	-0.8	-1.0	-1.3	-1.4		
Exports	27.3	27.6	27.3	27.6	31.2	33.4	35.4	36.5	37.5	38.3	39.2	40.1		
Imports	26.2	27.1	26.8	23.2	25.0	31.5	34.9	36.1	36.7	37.3	37.9	38.7		
Net non-debt creating capital inflows (negative)	-0.6	-0.9	0.6	0.0	-3.3	-1.8	-2.2	-2.3	-2.4	-2.5	-2.6	-2.6	-2.5	
Automatic debt dynamics 1/	-3.6	-1.0	1.1	5.1	-1.2	0.0	0.8	0.1	0.2	0.3	0.3	0.3	-1.1	
Contribution from nominal interest rate	1.0	1.4	1.3	1.3	0.8	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	
Contribution from real GDP growth	-0.4	-0.7	-0.1	3.5	-2.0	-0.8	0.0	-0.8	-0.7	-0.6	-0.6	-0.6	-0.6	
Contribution from price and exchange rate changes 2/	-4.2	-1.8	0.0	0.3	...	...	...	...	...	...	...	...	-1.4	
Residual, incl. change in gross foreign assets (2-3) 3/	4.2	-2.3	2.0	0.9	-3.2	4.4	2.7	1.6	1.9	1.6	1.5	1.5	0.0	
External debt-to-exports ratio (in percent)	166.2	154.9	174.8	182.9	122.8	121.3	122.1	121.4	121.4	120.5	118.7	116.8		
Gross External Financing Need (in billions of US dollars) 4/	49.1	66.0	67.9	49.3	43.0	50.7	102.2	65.6	69.1	72.0	69.8	73.5		
in percent of GDP	12.9	16.3	17.5	14.6	10.3	12.5	25.5	15.8	16.0	16.2	15.3	15.7		
Scenario with Key Variables at Their Historical Averages 5/					**38.3**	**41.9**	**45.4**	**49.4**	**54.0**	**58.4**	**62.7**	**67.2**		**0.0**
Key Macroeconomic Assumptions Underlying Baseline													For debt stabilization	
Real GDP growth (in percent)	1.2	1.5	0.3	-6.3	4.9	2.0	0.1	1.8	1.6	1.4	1.4	1.4	1.4	
GDP deflator in US dollars (change in percent)	16.5	4.4	-4.1	-7.2	18.3	-5.1	-1.5	2.2	1.9	1.7	1.6	1.2	1.7	
Nominal external interest rate (in percent)	2.8	3.2	2.8	2.4	1.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	
Growth of exports (US dollar terms, in percent)	14.5	6.8	-4.8	-12.1	40.3	3.8	4.5	7.3	6.2	5.5	5.3	5.0		
Growth of imports (US dollar terms, in percent)	11.5	9.5	-4.9	-24.7	33.9	21.8	9.4	7.6	5.2	4.8	4.7	4.7		
Current account balance, excluding interest payments	-1.3	-1.6	-1.3	3.3	4.5	0.4	-1.4	-1.7	-1.4	-1.3	-1.1	-1.0		
Net non-debt creating capital inflows	0.6	0.9	-0.6	0.0	3.3	1.8	2.2	2.3	2.4	2.5	2.6	2.6		

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

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

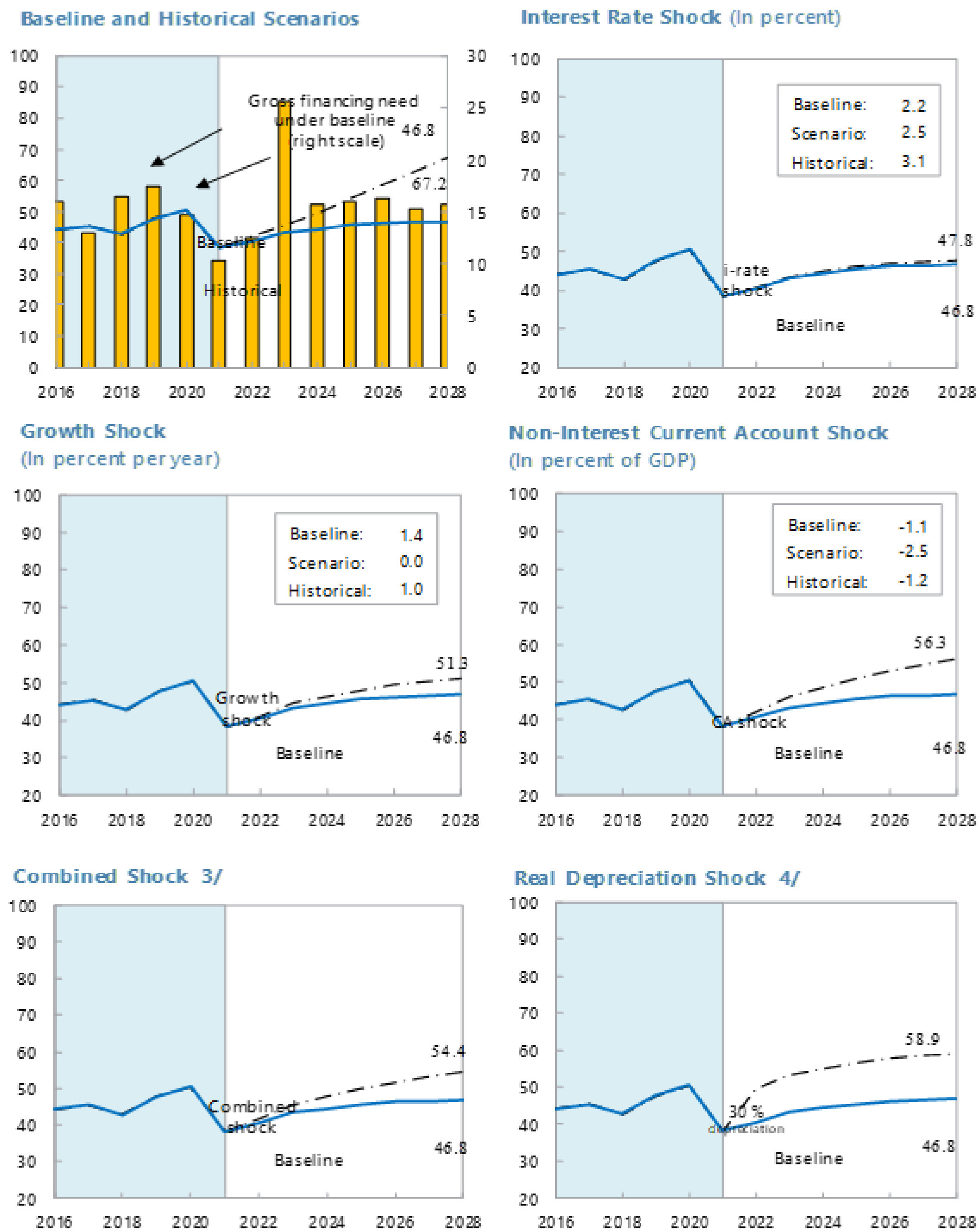
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

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



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 projectins for the respective variables in the baseline and scenatio 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 ¼ standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2022.

Annex V. External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: On a preliminary basis, the external position in 2022 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. After the exceptional CA surplus in 2021 (3.7 percent of GDP) thanks to high commodity prices and a number of temporary pandemic-related factors, the CA sharply declined to a small deficit in 2022. The CA deficit is expected to sizably worsen in 2023 on the back of softer commodity prices, weaker external demand, and higher energy-related capital imports. A complete analysis will be provided in the 2023 External Sector Report.

Potential Policy Responses: Tackling external imbalances will require a combination of bold implementation of structural reforms and gradual but substantial fiscal consolidation, while providing space for critical infrastructure investment and well-targeted social spending to help reduce poverty and inequality. Reform efforts should focus on improving governance, the efficiency of key product markets (to promote private sector participation), and the functioning of labor markets. These reforms are expected to help attract less volatile and longer-term capital inflows, such as foreign direct investment (FDI), and to further boost exports. Seizing opportunities to accumulate international reserves, should they arise, would strengthen the country's ability to deal with shocks. A flexible rand exchange rate should remain the main shock absorber.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. With large gross external assets and liabilities (131.4 and 114.2 percent of GDP, respectively, at the end of 2022), South Africa is highly integrated into international capital markets. The Net International Investment Position (NIIP) fell from 26.3 percent of GDP in 2021 to 17.2 percent of GDP in 2022, mainly due to valuation adjustments from lower share prices in foreign assets and despite nonresident capital outflows that reduce NIIP liabilities. The NIIP surplus is expected to continue falling over the medium term as the CA balance is projected to return to a deficit in 2023 and beyond. Gross external debt declined sharply from 50.5 percent of GDP in 2020 to 38.3 percent of GDP in 2021 (as GDP recovered) and the ratio increased slightly to 40.6 percent of GDP in 2022. Short-term external debt (on a residual maturity basis) rose from around 10 percent of GDP in 2021 to 12.2 percent of GDP in 2022.

Assessment. Risks from large gross external liabilities are mitigated by a large external asset position and the liability composition (mostly in equities, and a significant share of external debt in rand).</td></tr>
<tr><td>2022 (% GDP)</td><td>NIIP: 17.2</td><td colspan="2">Gross Assets: 131.4</td><td>Debt Assets: 16.4</td><td>Gross Liab.: 114.2</td><td colspan="2">Debt Liab.: 40.6</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The CA balance turned into a surplus for the first time in nearly two decades in 2020, reaching 2 percent of GDP, due to pandemic-related factors. The CA surplus then further increased to 3.7 percent of GDP in 2021, as continued buoyancy in terms of trade and commodity exports more than offset higher imports from the recovery in domestic demand. However, the CA sharply declined in 2022 to -0.5 percent of GDP, as commodity prices sizably fell from their peak (except coal prices), export supply bottlenecks worsened (domestic ports and railways), external demand softened, and import demand stayed strong. In addition, private investment remained subdued in 2022. The CA is projected to move to a sizable deficit of 2.3 percent of GDP in 2023 and to slightly deteriorate further in 2024, on the back of softer commodity prices, weaker external demand, and higher energy-related capital imports. The deficit is expected to improve to around 2 percent of GDP over the medium term as these factors dissipate and logistical constraints are alleviated.

Assessment. IMF staff estimate a CA gap in the range of –1.9 to -0.5 percent of GDP in 2022 (point estimate is –1.2 percent of GDP). IMF staff's cyclically adjusted CA is estimated at –1.4 percent of GDP in 2022. The assessment accounts for COVID-19-related adjustors of 0.2 percent of GDP, which captures the lingering impact of the pandemic on exports of precious minerals (-0.6), travel services (including tourism) (0.5), transportation (0.5), and the income balance (which remains below pre-pandemic levels) (-0.2),[1] as well as the statistical treatment of transfers and income accounts.[2] The adjusted CA norm for 2022 (1.5 percent of GDP) is obtained by subtracting 0.6 percentage point from the EBA CA norm (2.1 percent of GDP) to reflect lower life expectancy relative to other countries in the regression sample.[3]</td></tr>
<tr><td>2022 (% GDP)</td><td>CA:
-0.5</td><td>Cycl. Adj. CA:
–1.4</td><td>EBA Norm:
2.1</td><td>EBA Gap:
–3.5</td><td>COVID-19 Adj.:
0.2</td><td>Other Adj.:
2.1</td><td>Staff Gap:
–1.2</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. After depreciating during 2019–21, the CPI-REER appreciated by 3.4 percent overall during 2022, but it depreciated around 5.3 percent during the second half of 2022, mainly driven by nominal depreciation from a worsening external environment.</td></tr>
</table>

	Assessment. The IMF staff CA gap implies an overvalued REER with a midpoint of 4.8 percent for 2022 (applying an estimated elasticity of 0.25). The REER-based regressions point to a range of overvaluation of 12.8 percent to a marginal undervaluation of 3.5 percent (index approach). Based on the CA approach, IMF staff assess the REER to be overvalued by 4.8 percent, with a range of 2 and 7.6 percent.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Net FDI inflows decreased significantly in 2022 (from 9.8 percent of GDP in 2021 to 1.6 percent in 2022), while net portfolio investment recorded substantially smaller outflows in the same period (–1.0 percent of GDP compared to –13 percent in 2021).[4] Gross external financing needs stood at 12.5 percent of GDP in 2022, somewhat up from 10.3 percent in 2021. **Assessment.** In 2022, financial market volatility in emerging markets persisted due to the war in Ukraine and tighter global financial conditions. South Africa witnessed capital outflows and a rand depreciation against the US dollar of 6.4 percent. Risks from a traditionally large reliance on non-FDI inflows for external financing and still sizable nonresident holdings of local financial assets are mitigated by relatively small currency mismatches in the economy, large equity liability composition of the NIIP, and a large domestic institutional investor base. The latter tends to reduce asset price volatility during periods of market stress.
FX Intervention and International Reserves	**Background.** South Africa's exchange rate regime is classified as floating. Central bank intervention in the FX market is rare. At the end of 2022, international reserves were about 14.9 percent of GDP, 117.3 percent of gross external financing needs, and 4.9 months of imports. International reserves stand below the threshold suggested by the IMF's composite adequacy metric (89.5 percent of the metric without considering existing capital flow management measures and 99.5 percent of the metric after considering them). **Assessment.** If conditions allow, international reserve accumulation would be desirable over the medium term to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.

[1] The South Africa–specific COVID-19 adjustors for 2022 of 0.2 percent of GDP are composed of adjustments for travel services (including tourism exports) (0.5 percent of GDP), transportation (0.5 percent of GDP), and mineral exports (-0.6 percent of GDP), and an improved income balance (-0.2 percent of GDP). The mineral exports adjustor reflects the temporary surge in mineral export prices and volumes, still above pre-pandemic averages and the importance for South Africa of some mineral exports (for instance, rhodium, palladium, and platinum), which are not included in the IMF EBA model (terms-of-trade adjustment).

[2] Net current transfers related to the Southern African Customs Union (SACU) in 2022 are assessed to have a net negative impact on the CA, are not accounted for in the regression model, and warrant an adjustment to the cyclically adjusted CA by 0.7 percent of GDP. In addition, measurement issues pertaining to the income balance are likely to contribute to an underestimation of the CA by 0.8 percent of GDP in 2022 overall.

[3] Because South Africa is among the few countries with relatively high 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 -0.6 percent of GDP to the model-based CA norm for 2022. Overall, important positive contributors for the norm include demographics (even after adjusting downward to account for the aforementioned lower life expectancy), net foreign assets, and the desirable policy stance, especially reserves.

[4] These significant flows in 2021 can largely be attributed to Prosus N.V. acquiring about 45 percent of Naspers Ltd N ordinary shares from existing Naspers Ltd shareholders (direct investment inflows) and to both resident and nonresident investors exchanging Naspers Ltd N ordinary shares for Prosus N.V. N ordinary shares (portfolio investment outflows).

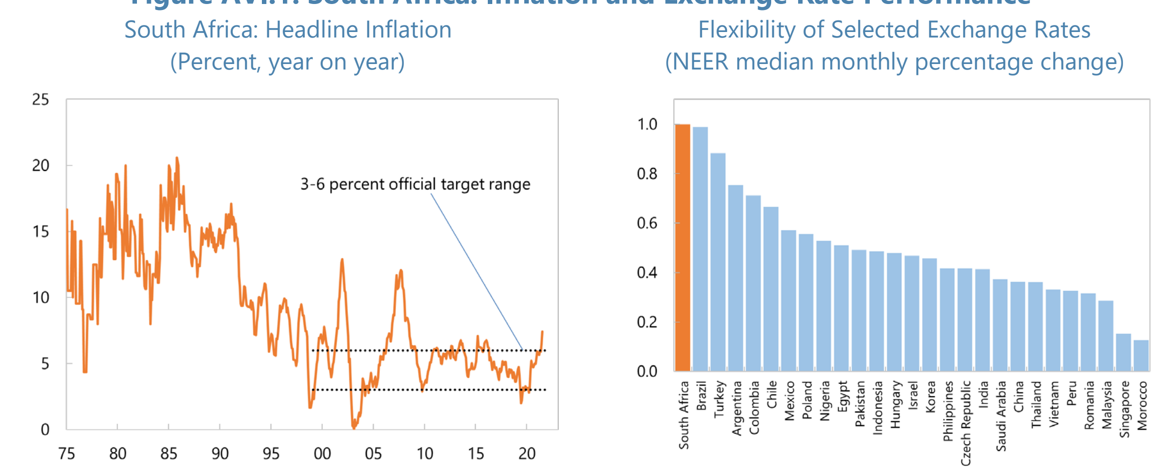
Annex VI. New Monetary Policy Implementation Framework in South Africa[1]

The SARB has introduced a new monetary policy implementation framework (MPIF). This annex discusses the motivation for the change, options considered, the main features of the chosen option, and the way forward.

Background

1. **Following the introduction of inflation targeting (IT), inflation has remained relatively low and stable in South Africa.**[2] Inflation trend-declined starting long before the introduction of IT, during which monetary policy had many guises and exchange controls were gradually abolished (Figure AVI.1, left panel). IT was introduced in 2000 with the 3–6 percent official target range, the interest rate as the operational target, and a flexible exchange rate as a crucial complement (right panel). Inflation was initially volatile but has become more stable in the past decade, generally remaining within the target range. Prior to COVID-19, the SARB started to communicate its stronger focus on the 4.5 percent midpoint and willingness to reduce the target range at the opportune time, while raising the real policy rate into positive territory. As central bank credibility strengthened, inflation expectations declined from around the ceiling to the midpoint of the target range. The central bank has also highlighted the benefits of low and stable inflation, including price competitiveness, pro-poor distributional effects, lower debt financing costs, and investor confidence. Most recently, amid rising inflationary pressure globally, headline inflation has risen above the upper end of the target range.

Figure AVI.1. South Africa: Inflation and Exchange Rate Performance



Sources: Haver and IMF staff calculations.

Note: Right panel shows nominal effective exchange rates, normalized such that South Africa =1. January 2000–June 2022.

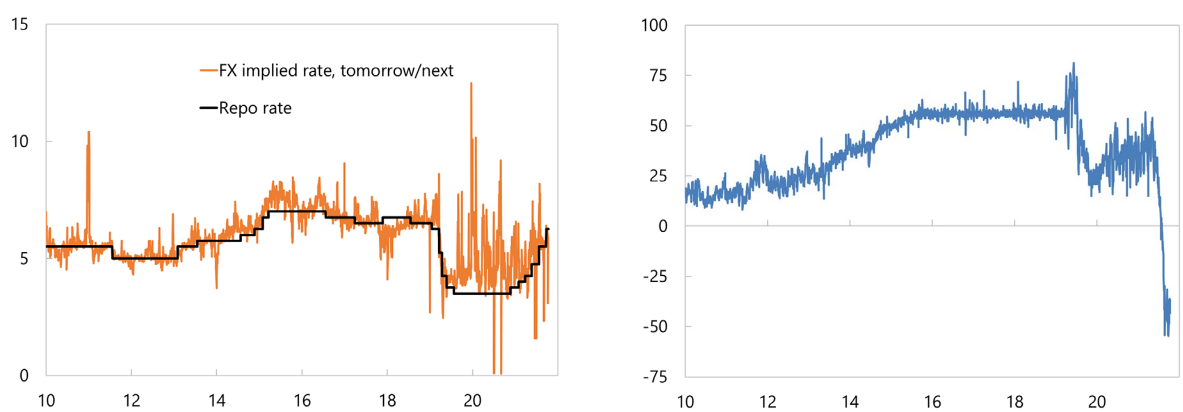
[1] Prepared by Ken Miyajima, and drawing on IMF (2018) and South African Reserve Bank (2021, 2022).

[2] See Miyajima and Yetman (2019) for more detail.

2. Despite the favorable inflation performance, reforming the MPIF was deemed necessary, particularly after the COVID-19 market turmoil. The SARB has been reviewing the MPIF for many years. Under the previous scarce reserve system, the SARB drained funds using various instruments to create a targeted daily shortage, and then lent sufficient funds at the policy rate to make up that shortage. Traditionally several central banks operated a classical cash reserve system, where this so-called structural shortage of funds was generated to gain traction on short-term interest rates.[3] This approach can be expensive and alternative frameworks can deliver the necessary control over interest rates. For an extended period, South Africa had a structural surplus of funds and the SARB has actively created scarcity to offset the effects of other policies, which were injecting funds. At the same time, the effectiveness of the SARB's toolkit to drain funds for operating a shortage system declined. The issues of the previous MPIF crystalized during COVID-19 as the amount of funds expanded significantly owing to a range of new initiatives.[4] Draining operations to maintain a shortage created distortions, including relatively persistent and large deviations of the foreign exchange (FX)-implied interest rate from the policy rate (Figure AVI.2, left panel). This prompted the SARB to operate with the shortages, or the daily requirement of funds, below the pre-COVID-19 target of around R56 billions (Figure AVI.2, right panel). As a gradual transition to a new MPIF started, liquidity requirements turned negative, suggesting a transition from shortage to excess. A consultation paper was issued for public comments in November 2021 and the final paper in May 2022, ahead of the transition in MPIF during June–August 2022.

Figure AVI.2. South Africa: Indicators of Money Market Developments

FX-Implied and Policy Rates (Percent) | Daily Liquidity Requirement (Billions of rand)



Sources: Haver and IMF staff calculations.

[3] See, for instance, this page.

[4] The amount of funds expanded due to the Bond Purchase Program, the National Treasury's permanent utilization of a portion of its sterilization deposit account at the SARB, and the Loan Guarantee Scheme, while foreign currency inflows from IFIs into South Africa's were sterilized through FX swaps.

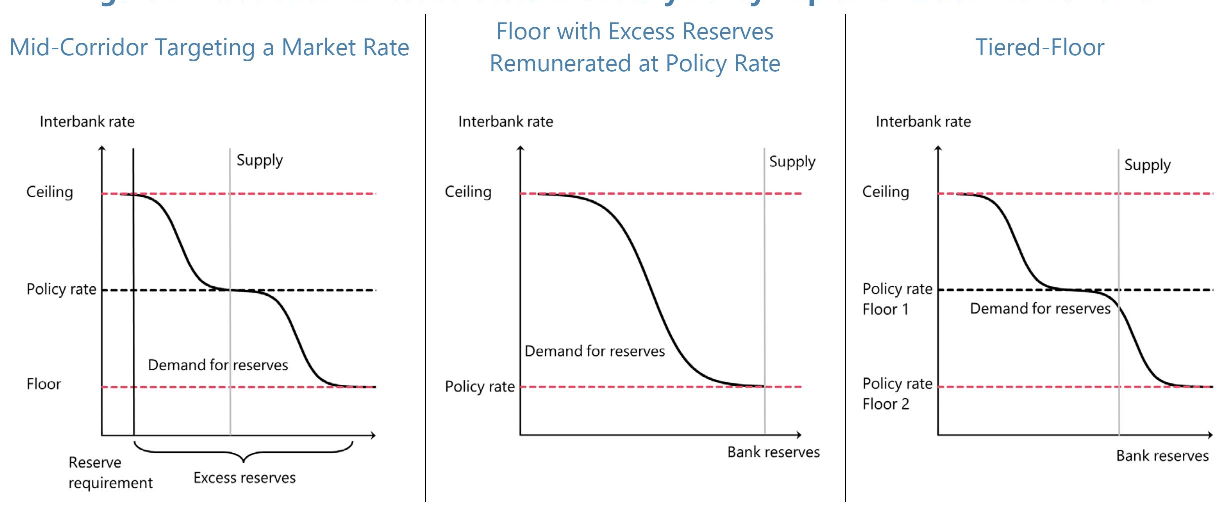
Options Considered:

3. In its consultation paper issued for public comments, the SARB considered three alternatives (Figure AVI.3):[5]

- Maintaining the scarce reserve system while providing/draining only funds that are/will be short of/excess to demand. This would still create distortions even though less than before. The framework requires accurate high frequency forecasts of the supply versus demand for funds by banks, but incentivizes banks to manage daily liquidity because being long or short incurs a penalty equal to half the width of the corridor. Interbank activity stimulates market development and monitoring, with some holding the view that transmission is strengthened. This framework is used in counties including Brazil, Chile, the Czech Republic, Mexico, and Sweden.

- Moving to a floor system where excess funds are remunerated (at the policy rate), and few or no draining operations are undertaken. Central banks can set the policy rate at the floor of the corridor and supply sufficient funds to keep rates at or close to that floor. The floor system breaks the link between the price and the quantity of funds held by bank as reserves. Ideally, the central bank would supply funds close to the point where the demand curve meets the floor in order to retain a degree of liquidity risk and thus spur some trading of funds among banks. Supply far to the right of this point (e.g., when central banks engage in quantitative easing) limits incentive to trade. Norges Bank first operated a floor system in the mid-1990s, and currently central banks including the Bank of Canada, Bank of England, ECB, and US Fed use the framework.

Figure AVI.3. South Africa: Selected Monetary Policy Implementation Frameworks



Source: IMF. 2018. "Advancing the Frontiers of Monetary Policy," edited by Tobias Adrian, Douglas Laxton, and Maurice Obstfeld.

[5] This section draws on IMF 2018.

- Moving to a variation of a floor system with a quota. Some central banks are concerned that interbank activity may decline under floor systems. The SARB, in particular, was concerned that if banks hoard reserves, rather than trading them, the central bank's balance sheet would have to expand to help maintain control over interest rates. To attenuate such effects and to incentivize banks to manage their funds more actively, some central banks remunerate funds at the policy rate up to a limit, while offering a lower rate on the balance. The framework is used in Norway. The Reserve Bank of New Zealand (RBNZ) recently moved from a floor system with quotas to one without.

Chosen Option:

4. The SARB chose a tiered-floor system after considering trade-offs between different objectives. The SARB placed a high priority on maintaining incentives for banks to transact in the short-term money markets while reducing both the distortions in the financial markets and the (sterilization) costs of implementing monetary policy. The central bank concluded that the tiered-floor system, or a floor system with bank quotas, would achieve these objectives compared to an outright floor system where a greater abundance of funds would likely dampen money market activity. Under the framework, required reserves will remain unremunerated, excess reserves within the quotas will earn the policy rate, and excess reserves above the quotas the standing facility rate (100 basis points below the policy rate). The aggregate size of quotas would be based on the liquidity target, or the underlying surplus of reserves to be placed with banks (set by the SARB initially at around R50 billion) and a buffer to cover liquidity shocks (initially at R10 billion, relatively large compared to the R50 billion liquidity target). The latter allow banks leeway to absorb liquidity shocks without being forced into the standing facility. Quotas are allocated to banks based on the size of their liabilities.[6]

5. A floor system with quotas is used, for instance, by Norges Bank in Norway and earlier by the Reserve Bank of New Zealand (RBNZ).

- Norges Bank started to use a floor system from the mid-1990s, but, as bank reserves grew and interbank trading weakened overtime, quotas were introduced in October 2011. After their introduction, demand for central bank reserves stabilized.

- The RBNZ in 2006 moved from a midpoint corridor system to a floor system to help operate a system of real-time settlements effectively while limiting credit risk to the central bank (by prompting banks to hold more funds). In 2007, a tiered system was introduced, capping banks' access to the deposit facility earning the policy rate. The policy move encouraged interbank activity but also pushed interbank rates slightly below the policy rate. In early-2020, the tiering was dropped when the RBNZ was going to implement active balance sheet policy to mitigate the large COVID-19 shock—the central bank was reluctant to push bank

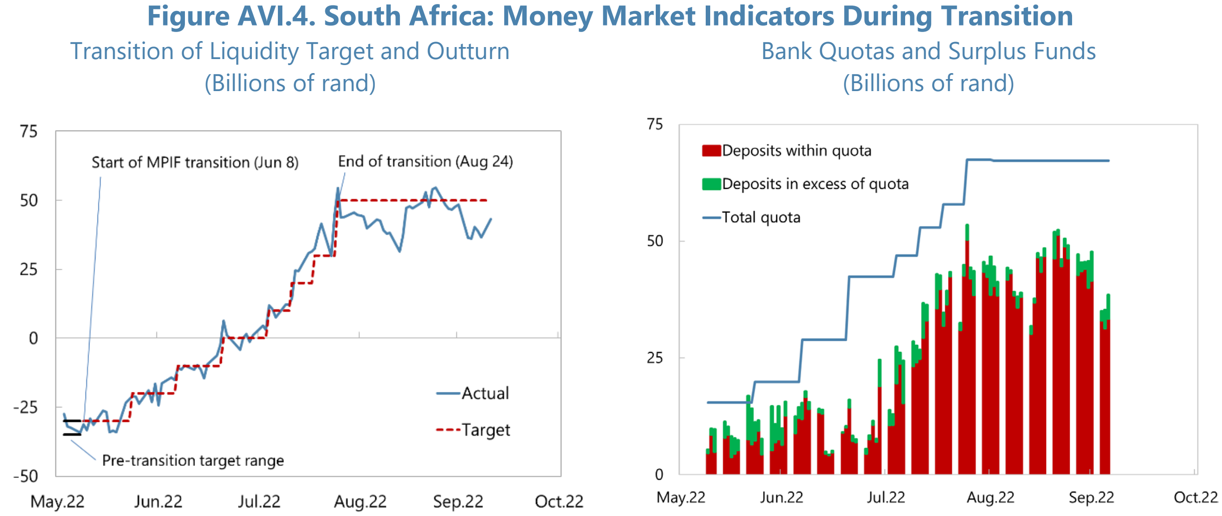
[6] Interest rate volatility would be very small under all systems, if calibrated appropriately. The key is to ensure accurate liquidity forecasting so that the supply of funds is calibrated appropriately. In the case of the tiered system, because of the quotas, interest rate volatility will likely be slightly higher since a price signal is needed for the redistribution of funds (i.e., interbank activity).

reserves beyond their quotas and market interest rates further below the policy rate. In mid-2022, to help improve the anchoring of interbank rates at the policy rate amid large excess reserves, the RBNZ introduced the Standing Repo Facility remunerated at near the policy rate which a wider range of counterparties can access.[7]

Way Forward:

6. The SARB undertook a gradual transition to the new MPIF. The transition started on June 8, 2022, and was implemented over a 12-week period through August 24, 2022. The amount of funds in the system was gradually raised from a shortage of around R30 billion at the start of the transition to a surplus of R50 billion by the end of the transition (Figure AVI.4, left panel). Quotas that allow banks to earn the policy rate on excess funds up to given limits were introduced at the start of the transition at low levels. Banks then had access to the SARB's repo lending facility to fill the shortage and populate these quotas. Quotas were progressively raised during the transition so that banks had sufficient space to absorb the surplus funds. Quotas are usually not fully utilized to the extent that they exceed the targeted level of surplus funds by the size of buffers to absorb liquidity shocks. Relatively small amounts of surplus funds are outside of quotas (Figure AVI.4, right panel).

Figure AVI.4. South Africa: Money Market Indicators During Transition



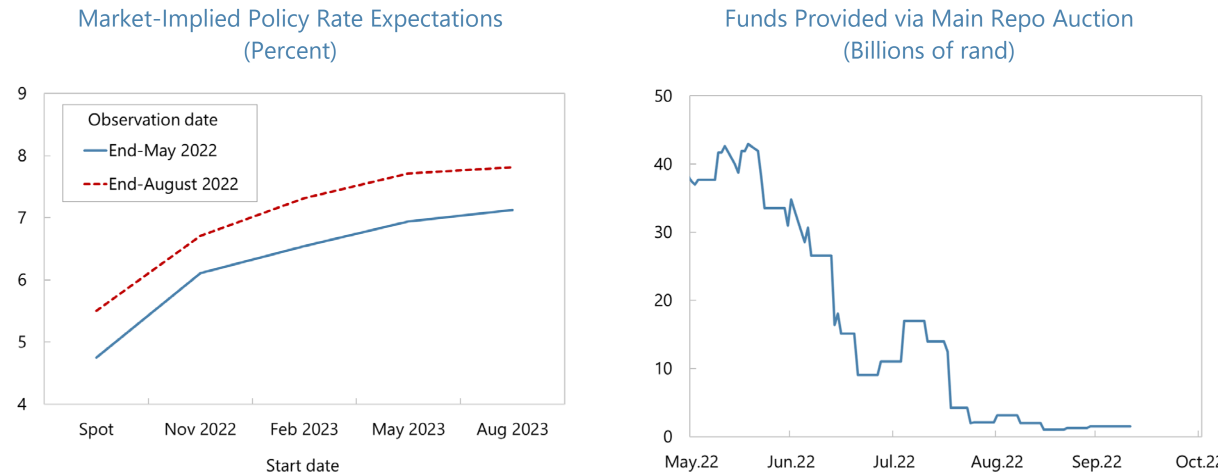
Sources: Haver and IMF staff calculations.

7. Early signs suggest the MPIF has performed well and the SARB continues to monitor interbank market activity. The level of funds in the interbank markets broadly transitioned according to the SARB's target. The MPIF reform does not seem to have affected market perception of the monetary policy outlook that the SARB will continue to withdraw accommodation. FX-implied interest rates differentials to the policy rate have moderated (Figure AVI.5). Money market surplus funds appear to have been sufficient, gauging from the low levels of funds provided via the main

[7] The facility is remunerated at the policy rate less 15 basis points to also help retain an incentive for interbank market trading.

repo auction. The marginal funds deposited at the penalty-rate facility do not seem significant enough to move interbank rates away from the policy rate. The amount of surplus funds outside of quotas will likely decline as banks continue to adopt to the new system and the SARB fine-tunes quota size and allocation. The resultant greater availability of high-quality liquid assets (HQLA) for banks would be beneficial from financial stability point of view. Looking ahead, key considerations include monetary policy transmission, market distortions (or their absence), and the costs of the new MPIF, particularly if FX reserves were to expand. Interbank market activity and potential shifts in the demand curve should be closely monitored—the amount of funds that ensures smooth functioning of the payment system and anchors market interest rates at the targeted level will change over time. It is important to note that, as the SARB has discussed extensively, QE is not its intention (see, for instance, Kganyago, 2020; and Fowkes, 2022).

Figure AVI.5. South Africa: Money Market Indicators During Transition



Sources: Haver and IMF staff calculations.

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Annex VII. Risk Assessment Matrix[1]

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Global Risks				
Intensification of Regional Conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	***High***	*ST*	***H/M***. Increasing spillovers from the war in Ukraine could lead to persistently high global fuel and food prices, lifting core inflation and de-anchoring inflation expectation. Domestic financing conditions could abruptly tighten with capital outflows and rand depreciation. On the other hand, the country's coal and precious metal exports might provide an external offset to the adverse effects.	Tighten monetary policy further if large currency depreciation and a surge in general uncertainty de-anchor inflation expectations. Proceed with a gradual, credible, and growth-friendly fiscal consolidation, while preserving well targeted social spending. Implement bold structural reforms, including that boost exports, to facilitate private sector-led employment creation.
Social Discontent. Supply shocks, high inflation, real wage drops, and spillovers from crises in other countries worsen inequality, trigger social unrest, and give rise to financing pressures and damaging populist policies with possible spillovers to other EMDEs. This exacerbates imbalances, slows growth, and triggers market repricing.	***High***	*ST-MT*	***H/M***. Social tensions would disrupt key infrastructure and supply channels, and weaken confidence generally, dampening economic growth. Employment would deteriorate, fiscal deficits worsen, risk premia surge, and domestic financing conditions tighten.	Enact support measures targeted to the poor while continuing gradual and credible fiscal consolidation to ensure debt stabilization. Implement bold structural measures that allow the private sector to invest and create jobs and promote inclusive growth. Tighten monetary policy further in case of external financing shortfalls and/or higher inflation.
Systemic Financial Instability. Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	***Medium***	*ST-MT*	***M/L***. South Africa's asset markets and financial system could be adversely impacted from systemic financial instability in advanced economies due to sudden shifts in investor sentiment to EMs. That said, the country's large external asset position, diversified economy, sophisticated financial system, and flexible exchange rate regime are sources of strength.	Adopt and operationalize the new bank resolution and deposit insurance legislation; and step up crisis preparedness. Provide temporary liquidity support to the financial system if domestic financing conditions tighten acutely and threaten financial stability. Consider reinstating swap lines with major central banks. Frontload the envisaged fiscal tightening if budget financing becomes problematic.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood 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. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Global Risks				
Abrupt Global Slowdown or Recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation. EMDEs: A new bout of global financial tightening, possibly combined with volatile commodity prices, leads to spiking risk premia, debt distress, widening of external imbalances, fiscal pressures, and sudden stops.	***Medium***	*ST*	***H/M***. A worsening external environment would plunge the country into a recession with an adverse impact on financing conditions, capital flows, the exchange rate, poverty reduction, job creation and social stability. In contrast, weaker demand could reduce inflation pressures, but any exchange rate depreciation would counteract this. Increasingly costly fiscal financing would rely increasingly on domestic sources amid a deepening bank-sovereign nexus, further crowding out private investment. Terms of trade would worsen, and exports of precious metals and coal would decline.	Frontload the envisaged fiscal tightening if budget financing becomes problematic. Focus more on expenditure-based consolidation that protects productive investment and well-targeted social spending. Implement bold structural reforms, including to alleviate export bottlenecks, boost market confidence and increase private investment supporting private sector-led growth and employment creation. Tighten monetary policy further if large currency depreciation and a surge in general uncertainty de-anchor inflation expectations.
Monetary Policy Miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	***Medium***	*ST-MT*	***H/M***. Capital flow reversals would cause a sharp tightening of financial conditions, rand depreciation, and an increase in risk premia across asset classes, and weakening the external and fiscal positions.	Tighten monetary policy further if large currency depreciation and a surge in general uncertainty de-anchor inflation expectations. Frontload the envisaged fiscal tightening to boost market confidence if budget financing becomes problematic. If market conditions turn disorderly, consider measures to stem capital flow reversals among a package of measures to restore orderly conditions.
Commodity Price Volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	***Medium***	*ST-MT*	***H/M***. Commodity price volatility is a main driver for the country's current account (CA) performance in the coming period given the importance of mining exports. Terms of trade would worsen from lower commodity prices and external demand, and exports of precious metals and coal would decline, as well as tax mining revenues. In contrast, higher commodity prices could temporarily and significantly improve the CA.	Frontload the envisaged fiscal tightening if budget financing becomes problematic. Tighten monetary policy further if large currency depreciation and a surge in general uncertainty de-anchor inflation expectations. Alleviate export bottlenecks in the network industries (i.e., ports and rail). Attract private sector participation in the energy sector through reforms to streamline complex and burdensome regulations to boost electricity supply.
Deepening Geo-Economic Fragmentation. Broader and deeper conflict(s) and weakened international cooperation lead to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	***High***	*MT-LT*	***H***. Reconfiguration of trade and financial flows could have a sizable impact on South Africa, although the direction and the magnitude of the potential effect also depend on the degree of fragmentation, as the country is a major exporter of precious metals that are highly sought after.	Build resilience and mitigate the risks associated with geo-economic fragmentation, including: Implement bold structural reforms to improve the business environment and benefit from trade and capital flow diversion. Strengthening the ongoing regional trade integration under the African Continental Free Trade Area. Restore policy space through a gradual, credible, and growth-friendly fiscal consolidation, while preserving well targeted social spending.

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Cyberthreats. Cyberattacks on critical domestic and/or international physical or digital infrastructure (including digital currency and crypto ecosystems) trigger financial and economic instability.	***Medium***	*ST-MT*	***H/M***. Disruptions could severely impact the financial market infrastructure and related economic activity, the widespread usage of cash could cushion the impact on the supply of essential goods but would still affect large parts of the population.	There is scope to strengthen cybersecurity supervision and oversight and a need for additional dedicated resources. Detailed recommendations can be found in the FSAP Technical Note on Cybersecurity Risk Supervision and Oversight (2021).
Extreme Climate Events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth.	***Medium***	*MT-LT*	***H***. The economy is among the most carbon intensive EMs and is vulnerable to extreme weather events, as evidenced by the devastating flooding in Durban. Deteriorating infrastructure, including in the electricity, water, and transportation sectors, further adds to the challenges.	Improve capacity for monitoring and assessing climate policies and strengthen early warning systems. Ensure well-targeted fiscal support for post-disaster assistance. Proceed with implementation of Just Transition plan. Promote green and resilient public investment to build low-carbon and climate-resilient infrastructure. Steadfast implementation of labor and product market reforms to facilitate adoption of climate change technology.
Domestic Risks				
Delays in Implementing Structural and Governance Reforms amid Political Uncertainty. Difficulties to attain consensus delay the implementation of the envisaged reforms.	***High***	*ST-MT*	***H***. Structural constraints to growth would continue to erode confidence, trigger capital outflows, and raise financing costs amid further sovereign rating downgrades. Poverty, inequality, and unemployment would worsen, and dissatisfaction would become widespread. Lingering political uncertainty would amplify the impact.	To address eroding market confidence, swiftly implement reforms to strengthen governance and tackle corruption, notably in SOEs, enhance competition in product markets, and increase labor market flexibility. Advance anti-corruption and anti-money laundering measures to boost confidence.
Continued Large-Scale Energy Shortages and Loadshedding Reflecting Eskom's Worsening Operational and Financial Problems.	***High***	*ST-MT*	***H/M***. The electricity shortages have significant economic consequences. Medium-term growth potential will remain subdued, with persistent high poverty and inequality. Failure to address the state utility monopoly Eskom's vulnerabilities would also have major adverse consequences for the fiscus.	Attract private sector participation in the energy sector through reforms to streamline complex and burdensome regulations to boost electricity supply. Improve Eskom's operational efficiency, reduce its footprint in the sector, and establish its commercial viability. Fiscal support needs to be conditional on measurable reform progress.
Higher-than-expected Budget Deficits and Ballooning Debt. The fiscal deficit is already high and threatened by continuous SOE bailouts, compensation policy challenges, and high current expenditures.	***High***	*ST-MT*	***H***. Perception that public debt is unsustainable would lead to capital outflows, amid deteriorating confidence, and challenging BOP financing. Financial sector vulnerability would increase with entrenched bank-sovereign nexus and loss of appetite for sovereign credit.	Adopt revenue and expenditure measures to credibly reduce the fiscal deficit (while protecting social outlays) by adhering to the announced compensation policy, conditioning transfers to SOEs to meeting performance indicators, and eliminating inefficient subsidies. Support fiscal consolidation by decisively implementing long-standing structural reforms to boost market confidence.

Annex VIII. Public Debt Sustainability Analysis

A. Sovereign Risk and Debt Sustainability Analysis

Figure AVIII.1. South Africa: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	…	**Moderate**	The overall risk of sovereign stress is moderate, as the authorities still have time to address unfavorable medium term debt dynamics arising from persistent weak growth, elevated fiscal deficits, and the materialization of contingent liabilities from SOEs. Mitigating factors include the depth of the domestic investor pool, and low FX and short-term debt exposure. A credible medium-term fiscal consolidation and growth enhancing structural reforms are key to put debt on a downward path and contain medium term sovereign stress risks.
Near Term 1/			
Medium Term	**High**	**High**	Medium-term risks are assessed as high, given the probability of debt not stabilizing, and the high terminal debt level. The stress tests for commodity and contingent liabilities further confirm the high risk. GFN analysis indicates that financing needs will be broadly stable. Global financial tightening, additional spending pressures, and large SOE liabilities exacerbate the medium-term risks.
Fanchart	**High**	…	
GFN	**Moderate**	…	
Stress test	…	…	
Long Term	…	**High**	In the absence of policy changes, the persistence of medium-term factors which imply a non-stabilizing medium term debt path would also cloud the long-term outlook.
Sustainability Assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt Stabilization in the Baseline		No	

DSA Summary Assessment

Commentary: South Africa is at a moderate overall risk of sovereign stress. Debt is not expected to stabilize in the baseline during the extended time horizon. However, medium-term liquidity risks as analyzed by the GFN Financeability Module are moderate, with the currency and maturity composition of debt mitigating these risks. The deep domestic capital markets further help mitigate the risks. Advancing fiscal consolidation as part of a credible medium-term framework and structural reforms to boost growth are needed to contain medium term risks of sovereign stress.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure AVIII.2. South Africa: Debt Coverage and Disclosure

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					Yes	
2. Subsectors included in the chosen coverage in (1) above:						

Coverage		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	No	
CPS / NFPS / GG: expected	4	State governments	No	
CPS / NFPS / GG: expected	5	Local governments	No	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on intra-government debt holdings

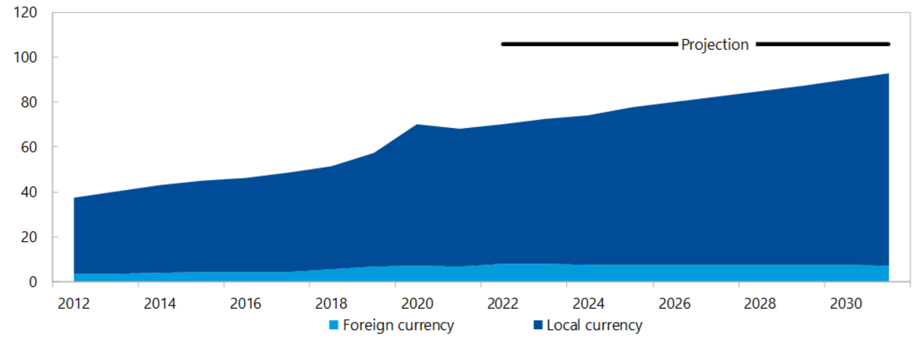
Coverage		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Consistent with the debt coverage available from the authorities, calculations are based on the national government's budget (central government). Consolidated general government debt figures are not available due to difficulties in identifying cross debt holdings across institutional sectors. 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 borrow, most provincial and municipal expenditure is funded through transfers from the national government and is thus already captured to a considerable extent. However, the DSA also excludes SOEs, whose indebtedness has increased rapidly in recent years.

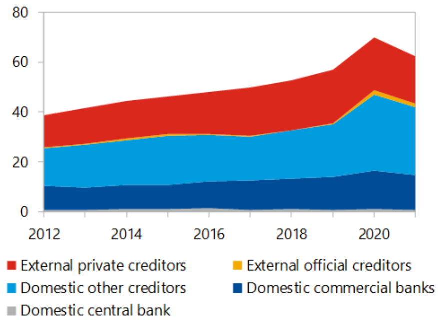
Figure AVIII.3. South Africa: Public Debt Indicators

Debt by Currency (Percent of GDP)



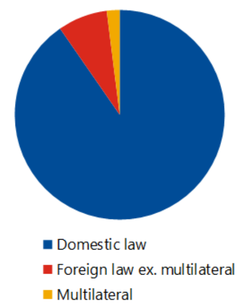
Note: The perimeter shown is central government.

Public Debt by Holder (Percent of GDP)



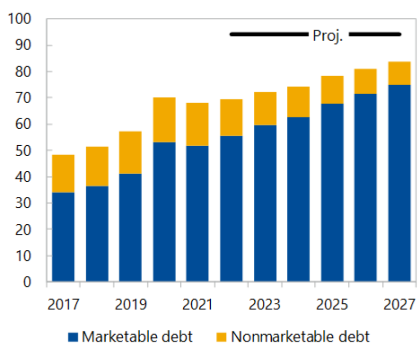
Note: The perimeter shown is central government.

Public Debt by Governing Law, 2021 (Percent)



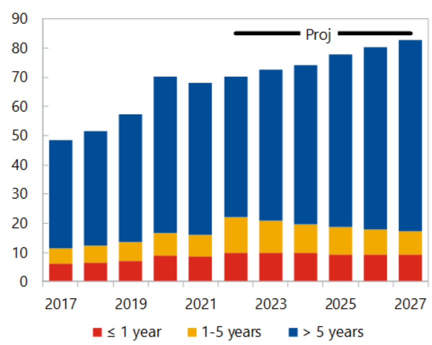
Note: The perimeter shown is central government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is central government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is central government.

Commentary: The debt-to-GDP ratio is projected to rise in the projection period, driven by the anticipated fiscal deficit dynamics. Domestic financing sources are expected to play a more significant role, as nonresident local currency bond purchases continue to decline following the sovereign downgrade to below investment grade by all three ratings agencies in 2020 and a deteriorating external environment. The charts also show the relatively favorable debt composition with relatively long maturities and low foreign currency denominated debt.

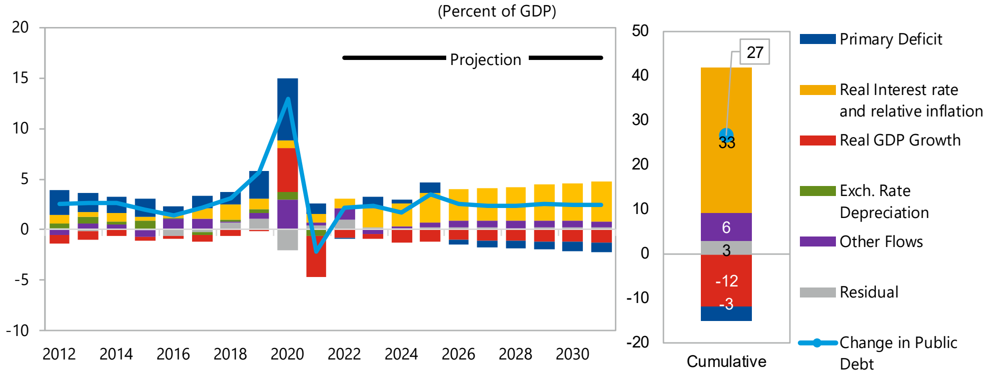
Figure AVIII.4. South Africa: Baseline Scenario

(Percent of GDP unless otherwise indicated)

	Actual	Medium-term projection						Extended projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	68.0	70.2	72.5	74.2	77.7	80.2	82.6	84.9	87.5	89.9	92.4
Change in public debt	-2.1	2.2	2.3	1.7	3.5	2.5	2.4	2.4	2.5	2.4	2.5
Contribution of identified flows	-2.6	1.2	2.1	1.5	3.2	2.3	2.2	2.2	2.3	2.3	2.3
Primary deficit	1.0	0.0	1.1	0.3	1.0	-0.4	-0.6	-0.7	-0.8	-0.9	-1.0
Noninterest revenues	24.7	24.9	24.4	24.2	24.3	24.3	24.3	24.3	24.3	24.3	24.3
Noninterest expenditures	25.7	24.9	25.4	24.6	25.3	23.9	23.7	23.6	23.5	23.4	23.3
Automatic debt dynamics	-3.9	0.1	1.4	1.0	1.7	2.0	2.0	2.2	2.4	2.5	2.6
Real interest rate and relative inflatio	0.8	1.0	1.9	2.3	2.9	3.1	3.2	3.3	3.6	3.7	3.9
Real interest rate	0.8	0.9	1.9	2.2	2.9	3.1	3.2	3.3	3.6	3.7	3.9
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-4.1	-0.8	-0.5	-1.2	-1.2	-1.0	-1.1	-1.1	-1.2	-1.2	-1.2
Real exchange rate	-0.6	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.3	1.1	-0.4	0.2	0.5	0.7	0.7	0.7	0.7	0.7	0.6
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.3	1.1	-0.4	0.2	0.5	0.7	0.7	0.7	0.7	0.7	0.6
Contribution of residual	0.5	1.0	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Gross financing needs	13.6	12.5	15.5	15.1	16.2	14.9	14.9	15.2	15.3	15.3	16.1
of which: debt service	12.5	12.5	14.4	14.8	15.2	15.4	15.5	15.9	16.1	16.2	17.1
Local currency	12.1	12.0	13.3	13.8	14.0	14.4	14.7	14.9	15.1	15.3	16.0
Foreign currency	0.5	0.6	1.1	1.0	1.2	1.0	0.8	1.0	1.0	0.9	0.9
Memo:											
Real GDP growth (percent)	6.2	1.3	0.7	1.8	1.6	1.3	1.4	1.4	1.4	1.4	1.4
Inflation (GDP deflator; percent)	5.5	5.7	4.9	4.8	4.4	4.8	4.9	5.0	4.8	5.0	4.9
Nominal GDP growth (percent)	12.1	7.0	5.7	6.6	6.0	6.2	6.4	6.4	6.3	6.4	6.4
Effective interest rate (percent)	6.8	7.2	7.7	8.0	8.5	9.0	9.1	9.2	9.3	9.4	9.5

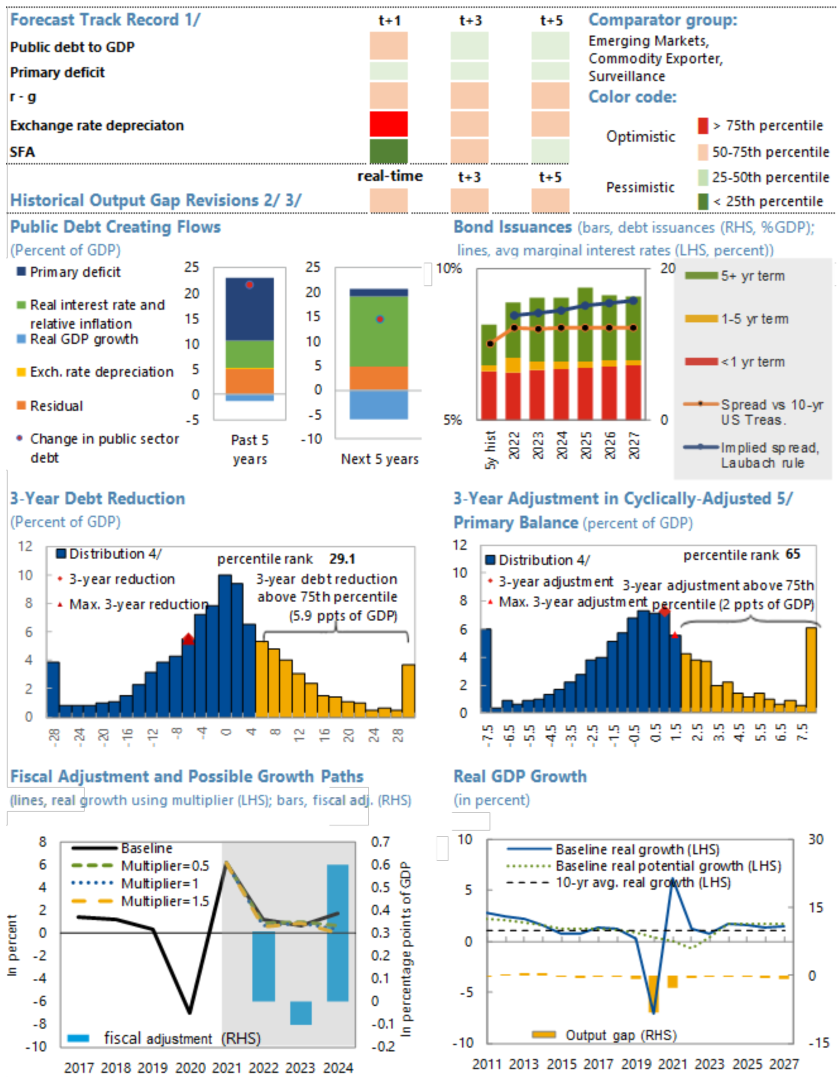
Contribution to Change in Public Debt

(Percent of GDP)



Commentary: Public debt will continue to rise, driven by the r-g dynamics which reflects persistent weak growth, in real terms and a relatively high average interest rate on public debt. While the real GDP growth is expected to offset some of the unfavorable automatic debt dynamics in the longer-term, it will be insufficient to lower the public debt ratio. GFNs are projected to exceed 15 percent of GDP during most of the projection period, despite the still-favorable maturity and currency structure of the debt. The Eskom debt relief arrangement is included as a capital transfer, resulting in higher noninterest expenditures between FY23/24 and FY25/26.

Figure AVIII.5. South Africa: Realism of Baseline Assumptions



Source: IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

3/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

4/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

5/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the

Commentary: The forecast track record is generally within bounds for optimism, except for exchange rate depreciation projections. Debt creating flows are compositionally different between the last and next 5 years, driven by the inclusion of data from the COVID-19 pandemic which biases GDP growth's contribution downwards and primary balance's contributions upward in the former. Spreads reflect heightened risks and uncertainty during the projection period. The three-year debt and CAPB adjustments are around the median of the distribution of comparator countries' experience. The effect of fiscal adjustment on growth is broadly within the bounds of standard multiplier assumptions.

Figure AVIII.6. South Africa: Medium-Term Risk Analysis

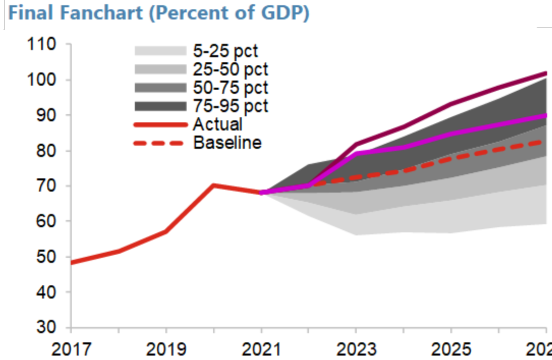
Debt fanchart and GFN financeability

(percent of GDP unless otherwise indicated)

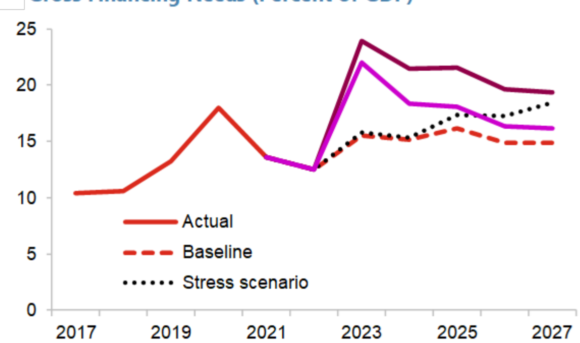
Module	Indicator	Value	Risk index	Risk signal	Emerging Mkt., Com. Exp, Surveillance (0 / 25 / 50 / 75 / 100)
Debt fanchart module	Fanchart width	41.1	0.6	...	
	Probability of debt not stabilizing (pct)	100.0	0.8	...	
	Terminal debt level x institutions index	47.6	1.0	...	
	Debt fanchart index	**...**	**2.5**	**High**	
GFN finance-ability module	Average GFN in baseline	14.9	5.1	...	
	Bank claims on government (pct bank assets)	13.9	4.5	...	
	Chg. in claims on govt. in stress (pct bank assets)	12.8	4.3	...	
	GFN financeability index	**...**	**13.9**	**Moderate**	

Legend: Interquartile range; South Africa

Final Fanchart (Percent of GDP)



Gross Financing Needs (Percent of GDP)

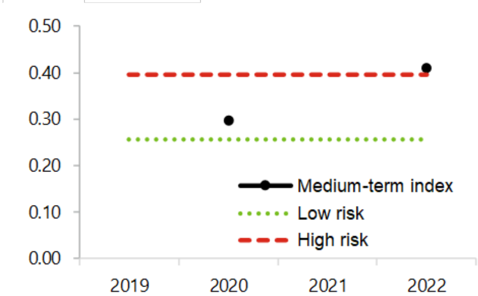


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index

(index number)



Medium-Term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.5
GFN finaceability index	7.6	17.9	0.5	0.3
Medium-term index (MTI)	0.3	0.4	...	0.4, High

Prob. of missed crisis, 2022-2027 (if stress not predicted): 54.5 pct.

Prob. of false alarm, 2022-2027 (if stress predicted): 9.1 pct.

Commentary: The medium-term analysis suggests a high risk of sovereign stress over that time horizon. The main issue suggested by the analysis is the possibility of substantial increases in the public debt ratio under low-probability downside scenarios. The increase in gross financing needs under a stress scenario is moderate. The commodity price and the contingent liability stress scenario were triggered. The materialization of these contingent liability risks significantly increases both the fanchart and GFN Financeability risks.

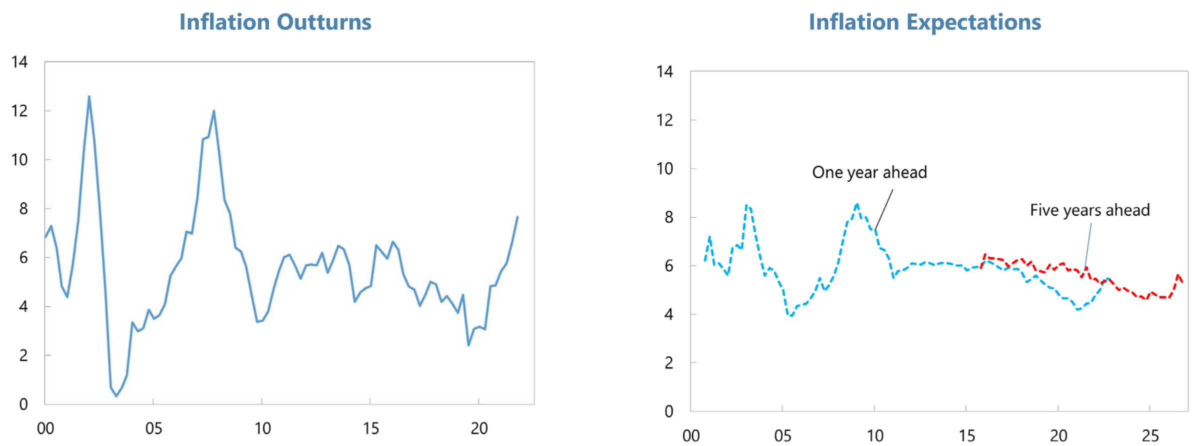
Annex IX. How Well do Inflation Expectations Predict Outturns in South Africa?[1]

Amid rising inflationary pressure, inflation expectations have started to increase, raising concerns about the future path of inflation in South Africa. At the same time, some took comfort from the relative stability of long-term inflation expectations. In this context, the predictive power of inflation expectations is estimated using a regression approach drawing on Kamber et al (2020) and Randal and Zaman (2021). Inflation expectations one year-ahead are a reasonable predictor of outturns, and their predictive power may have strengthened over the past decade. Tentative evidence that long-term inflation expectations have reasonable predictive power needs revisiting as sufficient data become available. The results support the SARB's monetary policy action to keep inflation expectations anchored.

1. **Inflation volatility increased in the past few years and inflation expectations have risen most recently, prompting monetary policy tightening in South Africa** (Figure AIX.1). Amid the COVID-19 pandemic and initially stringent lockdowns, inflation declined, falling even below the lower end of the 3–6 percent target range for several months. As the pandemic waned, commodity prices surged, amplified by the war in Ukraine, and inflation rose precipitously to above the upper end of the target range. Inflation expectations progressively rose, with the one year-ahead index increasing from close to 4 percent in 2020H2 21Q1 to above 7 percent in 2022Q3. As inflation risk emerged and started to intensify, the SARB has continued to remove monetary accommodation since November 2021 to keep inflation expectations anchored.

Figure AIX.1. South Africa: Headline Inflation Outturns and Expectations

(Percent, year on year)



Source: Author's estimations.

Note: Inflation expectations for all agents (unweighted average) or "total." One year-ahead index with a fixed horizon is calculated from next year (called "one year-ahead") and following year ("two year-ahead") expectations surveyed and plotted 4 quarters ahead. Five year-ahead index is over the next five years net of next year and following year, and are plotted 20 quarters ahead.

[1] Prepared by Ken Miyajima

2. Against this backdrop, the capacity of inflation expectations to predict outturns is assessed. The extent to which inflation expectations predict (or affect) outruns importantly informs monetary policy decisions. We start from a version of the open economy hybrid Phillips curve model of inflation in Kamber et al (2020):

$$\pi_t = \beta_0 + \beta_1 \pi_{t-4} + \beta_2 E_{t-4}[\pi_{t+4}] + \beta_3 \tilde{y}_t + \beta_4 \Delta p(oil)_t + \beta_5 \Delta e_t + \epsilon_t \quad (1)$$

Similar to Randal and Zaman (2021), 4 quarter-ahead inflation expectations surveyed 4 quarters earlier, *E_(t-4) [π_(t+4)]*, are used. With perfect foresight and no unexpected shocks, such inflation expectations should be close to outturns. The autoregressive term is lagged by 4 quarters, *π_(t-4)*, to capture backward looking expectations formed at the same timing. Shocks between the time of survey and inflation realization are represented by output gap, *y˜_t*, oil price inflation, *Δp(oil)_t*, and the rate of nominal effective exchange rate (NEER) appreciation, *Δe_t*, and are included contemporaneously. A residual inflation shock is represented by *ϵ_t*. We consider a restricted version of equation (1) by imposing *β_1 + β_2* = 1:

$$\pi_t - \pi_{t-4} = \beta_0 + \beta_2 (E_{t-4}[\pi_{t+4}] - \pi_{t-4}) + \beta_3 \tilde{y}_t + \beta_4 \Delta p(oil)_t + \beta_5 \Delta e_t + \epsilon_t \quad (2)$$

This restriction helps reduce the number of estimated independent parameters, gives the parameters β_1 and β_2 direct interpretation as respective weights on backward and forward-looking expectations, and reduces the chance of having stationarity issues (Kamber et al, 2020). Equation (2) is estimated using OLS. A Newey-West estimator is used to adjusted for potential heteroskedasticity and autocorrelation in standard errors.

3. Quarterly data spanning 2000Q3–22Q1 are used. The dependent variable is headline inflation, in percent year on year, or from quarter t to t+4. Headline inflation consists of four subcomponents—core, fuel, energy, and food. The SARB targets headline inflation. Headline inflation expectations are surveyed by the BER South Africa starting from 2000Q3 for three agents—analysts, businesses, and trade unions. BER calculates the total as the equally weighted average. For the regression analysis, we calculate 4 quarter constant forecast horizon inflation expectations using next year (called "1 year ahead") and following year ("2 years ahead") expectations, similar to Miyajima and Yetman (2019). Quarterly real GDP level is HP filtered to estimate the output gap, expressed in percent of the HP trend. Brent crude oil prices and NEER are included in year-on-year percent changes.

4. Regression results suggest inflation expectations one year ahead have reasonable predictive power (Figure AIX.2, Table AIX.1). The estimated coefficient on forward-looking expectations is 0.62.[2] This is larger than what Kamber et al. (2020) find—a little over 0.4 for a panel of 47 advanced and emerging economies and around 0.3 for South Africa, both for the period of 1996–2018.[3] Our estimates imply greater central bank credibility than suggested by Kamber et al.

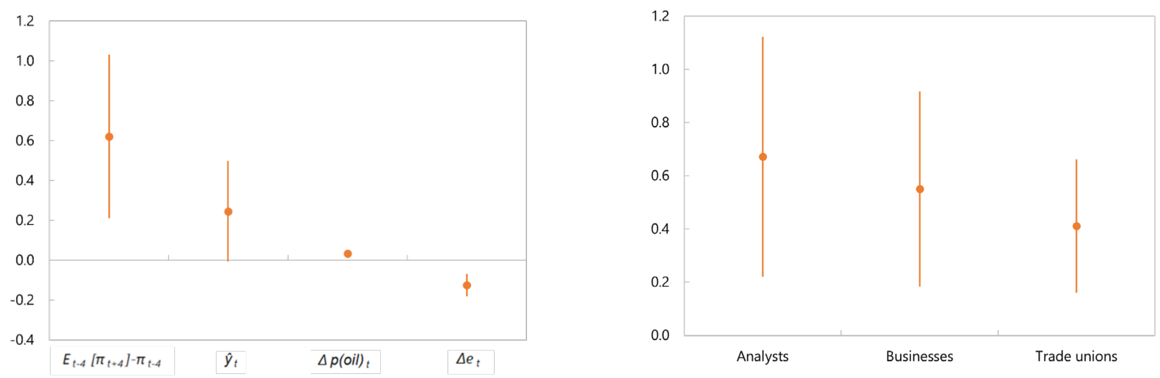
[2] This implies that the weight on lagged inflation, or backward-looking expectations, is 0.38.

[3] Kamber et al. (2020) use professional forecasts from Consensus Economics, and different lags than ours, including for the autoregressive term and inflation expectations.

(2020). The coefficients on the controls in our results are reasonable. The coefficient on the output gap, through statistically significant only at the 10 percent level, implies the sacrifice ratio (change in the output gap associated with a one-unit change in inflation) of around 1.5, which falls in the range of empirical estimates.[4] The coefficients on oil price inflation and NEER appreciation are small, but, since the data are much more volatile, their "overall effects", or the estimated coefficient multiplied by the standard deviation of the data, are larger than those of inflation expectations and of the output gap.

Figure AIX.2. South Africa: Determinants of Headline Inflation

Estimated Coefficients | Coefficients on Et-4 [πt+4] - πt-4



Source: Author's estimations.

Note: Left panel is from a model with "total" inflation expectations, or unweighted average for analysts, businesses, and trade unions. The vertical lines represent 95 percent confidence intervals. See Table A6.1 for more detail.

Table AIX.1. South Africa: Determinants of Headline Inflation in South Africa

Variable	Coeff.	*Total*	*Analysts*	*Businesses*	*Trade unions*
$E_{t-4}\,[\pi_{t+4}]-\pi_{t-4}$	β_2	0.621***	0.672***	0.550***	0.411***
$\hat{y}_t$	β_3	0.246*	0.210**	0.258*	0.239*
$\Delta p[oil]_t$	β_4	0.033***	0.031***	0.035***	0.039***
Δe_t	β_5	-0.125***	-0.114***	-0.131***	-0.137***
Constant	β_0	-1.046***	-0.628*	-1.269***	-1.139***
N	...	83	83	83	83
Adj. R^2	...	0.548	0.602	0.532	0.490

Source: IMF staff calculations.

Note: Newey-West standard errors. The model is:

$$\pi_t - \pi_{t-4} = \beta_0 + \beta_2(E_{t-4}[\pi_{t+4}] - \pi_{t-4}) + \beta_3\tilde{y}_t + \beta_4\Delta p(oil)_t + \beta_5\Delta e_t + \epsilon_t$$

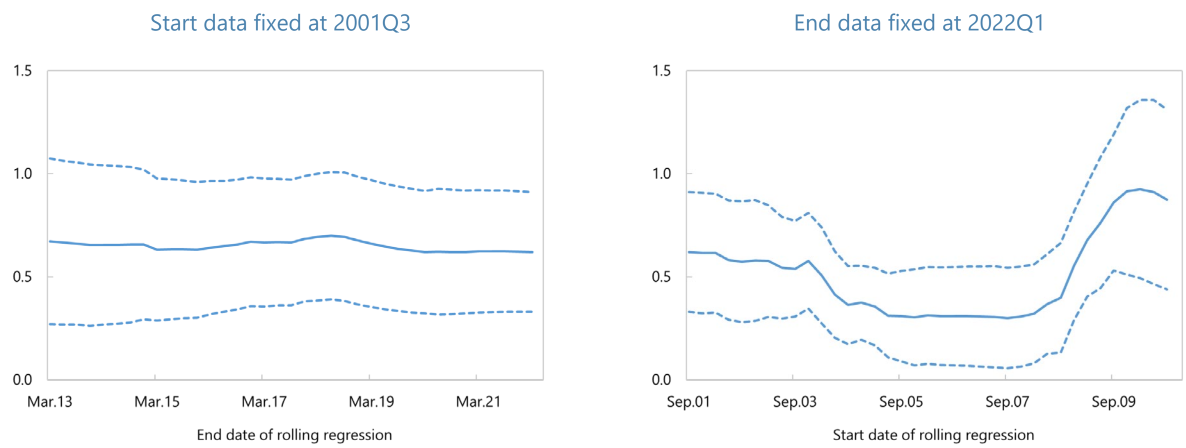
5. The expectations of professional forecasters have greater predictive power than those of businesses and trade unions (Figure AIX.2, Table AIX.1). The model is estimated for the subcomponents of "total" inflation expectations, that is, analysts (comparable to professional forecasters from Consensus Economics), businesses, and trade unions. The estimated weight on

[4] $(1-\beta_2)/\beta_3$.

inflation expectations is larger for analysts (0.68) than for businesses (0.55) or trade unions (0.41), so is the amount of variability explained by the model (the adjusted R squared). Analysts, for whom following inflation may be a relatively more important part of their job, may update their inflation expectations more efficiently than other agents in response to changes in the economy. By contrast, trade unions and to some extent businesses may be influenced more strongly by inflation outturns to the extent that, for instance, wage setting aims at compensating for past inflation (Miyajima and Yetman, 2019).

6. **The predictive power of inflation expectations may have improved in the past decade, but the small sample calls for cautious interpretation** (Figure AIX.3). The model is recursively estimated such that the shortest sample is equivalent to about ½ of the whole sample. The recursive rolling regression, where the start date is fixed at 2001Q3 and the end date is progressively extended from 2013Q3 to the end of the whole sample of 2022Q1, produces stable estimates of around 0.6. In other words, adding the last decade worth of data does not alter the estimated weight on inflation expectations. However, when the model is reverse-recursively estimated—that is, when the start date is progressively shortened from 2001Q3 to 2010Q3 (immediately after the global financial crisis of 2008–09, when headline inflation troughed) and the end date is fixed at 2022Q1—estimates are more volatile. The weight on inflation expectations drops initially to around 0.4 and, as observations during the global financial crisis drop out, rises up to around 0.9. The confidence band widens toward the end as the sample shortens.

Figure AIX.3. South Africa: Weight on Inflation Expectations from Rolling Regressions



Source: Author's estimations.

7. **Tentative evidence based on limited data suggests long-term inflation expectations also have reasonable predictive power** (Table AIX.2). Long-term inflation expectations are represented by the "over the next five year" index net of shorter-term expectations (both one year and two year-ahead indices), in other words, over three years two years ahead. Accordingly, equation (2) is adjusted by extending the lag length from 4 to 20 quarters. The estimated β_2 coefficient is 0.9 for total at the 1 percent significant level, suggesting that the role of long-term inflation expectations is stronger than that of shorter-term inflation expectations. The role of other control variables become smaller (Table AIX.2). The associated sacrifice ratio of 1.2 is smaller than

1.6 based on one year-ahead inflation expectations. Importantly, these estimates are based on relatively short time series data starting from 2011. In particular, estimated coefficients for one year-ahead inflation expectations using comparable samples were less stable and rose to similarly high levels (Figure AIX.3). Thus, further analysis is warranted as more data for long-term inflation expectations become available.

Table AIX.2. South Africa: Determinants of Headline Inflation in South Africa

Variable	Coeff.	*Total*	*Analysts*	*Businesses*	*Trade unions*
$E_{t-20}[\pi_{t+20}]-\pi_{t-20}$	β_2	0.912***	0.964***	0.869**	0.609*
$\hat{y}_t$	β_3	0.073***	0.075***	0.051**	0.065**
$\Delta p[oil]_t$	β_4	0.004	0.002	0.003	0.002
Δe_t	β_5	0.037**	0.035*	0.048**	0.044**
Constant	β_0	-1.458***	-0.891***	-1.829***	-1.398***
N	...	23	23	23	23
Adj. R^2	...	0.279	0.280	0.262	0.190

Source: IMF staff calculations.

Note: Newey-West standard errors. The model is:

$\pi_t - \pi_{t-20} = \beta_0 + \beta_2(E_{t-20}[\pi_{t+20}] - \pi_{t-20}) + \beta_3\tilde{y}_t + \beta_4\Delta p(oil)_t + \beta_5\Delta e_t + \epsilon_t$.

8. Looking ahead, both continued removal of monetary policy accommodation and clear communication should help keep inflation expectations anchored. The stability of long-term inflation expectations likely owes to the credibility that the SARB will take necessary action to bring inflation back to around the mid-point of the target range. Without monetary policy tightening, the recent rise in inflation expectations is likely to translate into higher inflation outturns down the road, prompting interest rates to remain high, and generating higher growth cost in the medium term.

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Annex X. Transfers to Key SOEs

1. Eskom. The electricity SOE's cost to the budget exceeded 8 percent of GDP cumulatively between FY08/09 and FY18/19, reflecting direct transfers (5 percent of GDP) and interest costs. Since FY19/20, direct annual transfers rose to an average of about 0.8 percent of GDP per year to ensure it remains as a going concern and to support its restructuring plan. The company also benefitted from a government loan guarantee facility equivalent to about 6 percent of GDP. Despite the support, the company continued to register net losses which averaged 0.4 percent of GDP per year between FY19/20 and FY21/22. Moreover, power outages have increased in frequency and severity driven by unplanned outages in its ageing plants. To mitigate the impact on the economy, Eskom has consistently relied on expensive diesel turbines. Tariff increases have also not kept up with the rise in the company's costs. In the 2023 Budget, the government announced a debt relief arrangement of R254 billion (4 percent of GDP) over the next three years, with strict conditions to safeguard public money and achieve operational and financial improvement.[1] Strict enforcement of these conditions combined with containment of municipal arrears and cost reflective tariffs would help Eskom achieve financial viability and eliminate the need for additional transfers beyond FY25/26.

2. Transnet. Unlike Eskom, the second largest SOE operating in the logistics business did not receive significant budget support in the past. It received budget transfers in FY22/23 (0.1 percent of GDP) after a more costly than anticipated three-year wage agreement, flooding of the Durban port, and theft of key inputs by criminal syndicates took a toll on its finances. Given the weak cash flow and financing needs to address logistical issues (e.g., repair non-working locomotives and improve infrastructure maintenance), additional transfers in FY23/24 and beyond may be needed.

[1] Debt relief to Eskom is provided through convertible subordinated loans of R78 billion in FY23/24, R66 billion in FY24/25 and R40 billion in FY25/26, which are to finance Eskom's debt service costs. According to the agreement, the loans would be converted to equity if Eskom complies with NT's loan conditions. Moreover, in FY25/26, government intends to take over up to R70 billion of Eskom's debt portfolio. The debt relief conditions include restrictions on new borrowing, capital investments in greenfield generation projects, and remuneration adjustments.

Annex XI. Proposed Options to Reduce Expenditure

1. **Wage bill rationalization.** The increase of the wage bill of the consolidated government as a percent of GDP has been mainly driven by the rise in employee compensation rather than by the headcount since FY07/08, and the headcount does not stand out compared to South Africa's peers (National Treasury, 2022; IMF South Africa Staff Report. 2022. Annex IV. South Africa's Wage Bill and Cross-Country Experience). Therefore, staff advised to focus on containing employee compensation by applying below-inflation cost-of-living adjustments, reducing allowances and pay progression, and introducing an evidence-based approach to pay-setting.[1] These measures combined could save 2 percent of GDP.

2. **SOE reform.** Options include divestment, liquidation, or restructuring to ensure financial viability (IMF, 2022). Such measures would support a permanent and sizable reduction of budget support. Support to SOEs that will not be liquidated or divested should be subjected to achieving measurable milestones in their restructuring plan, such as procurement costs and wage bill reduction targets. Cost savings in this area could amount up to 1.5 percent of GDP in line with current support to major SOEs and other state entities.

3. **Procurement and tertiary education subsidy reforms.** Potential savings from more efficient procurement processes could be equivalent to up to 1.3 percent of GDP or 20 percent of consolidated government spending on goods, services, and public works as estimated in a procurement review carried out by the authorities (see below). Limiting tertiary education subsidies to only vulnerable households could save about another ½ percent of GDP in line with National Treasury's fiscal impact estimates of past relaxation of income eligibility criteria.

4. **Implementation timeframe.** While all the options require immediate actions for the savings to materialize, the wage bill measures, and tertiary education subsidy reforms can lead to savings earlier. In contrast, SOE and procurement reforms need more time for the impact to materialize as measures to improve financial situation of the SOEs and make the public procurement system more efficient take longer to implement.

[1] An evidence-based approach requires monitoring compensation trends and patterns of recruitment and retention for different occupations on an annual basis and using this as a core input during wage negotiations. For a more detailed discussion see Annex IX of the 2021 Article IV consultation report.

Annex XII. Macroeconomic and Distributional Effects of Financing a Permanent SRD Grant[1]

The Social Relief Distress (SRD) Grant is set to expire in March 2024. Permanently extending the SRD would require an explicit outline of how the grant will be financed. Model simulations suggest that financing the permanent SRD through increased revenues via tax reforms would lower poverty and inequality at the cost of lower output growth and employment, regardless of the tax instrument employed. Alternatively, reducing expenditure through greater efficiency of public service sector, would achieve somewhat better macroeconomic outcomes than tax reforms with comparable effects on poverty and inequality. Our analysis of financing tradeoffs suggests that focusing on programs with work conditionality could alleviate the adverse macro effects and thus ease the trade-offs while preserving the poverty and inequality alleviation goals.

1. As part of the responses to the COVID-19 crisis, in May 2020 the government extended an SRD grant for its working-age population. The current SRD consists of a monthly lump-sum payment of R350 paid to working-age persons with formal income below a means-testing threshold, which is set at the food poverty line (FPL) of R624 per month.[2] The temporary grant is set to expire in March 2024. The SRD grant is estimated to cost around R29 billion in FY22/23 (0.4 percent of GDP) and has been financed primarily via mineral revenues. The Budget 2023 has included R36 billion (0.5 percent of GDP) for SRD Grants.

2. A sustainable extension of the SRD grant must be financed in a deficit-neutral manner. South Africa has limited fiscal space with elevated fiscal risks and unfavorable debt dynamics. In fact, the National Treasury finds a sustained and profound negative impact on GDP over the medium- to long-term if the permanent SRD grants result in a widening budget deficit and increasing sovereign debt (National Treasury, 2022). Thus, any permanent increases in spending should be accommodated with matching permanent increases in revenue or expenditure rationalization.

3. Using the IMF Multisector Incomplete Markets Macro Inequality (MIMMI) Model, we simulate potential financing options for the SRD grant in the long run.[3] Specifically, we assess the impact of the different financing options for a grant extension against the baseline of allowing the grant to expire at the originally planned horizon. We find that the following four basic options would be sufficient to finance the SRD grant:

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[1] Prepared by Alejandro Badel and Vybhavi Balasundharam

[2] The grant is completely withdrawn as soon as the threshold is breached. See Annex XVII for suggestions to improve the design of the SRD grant, including the tapering of benefits.

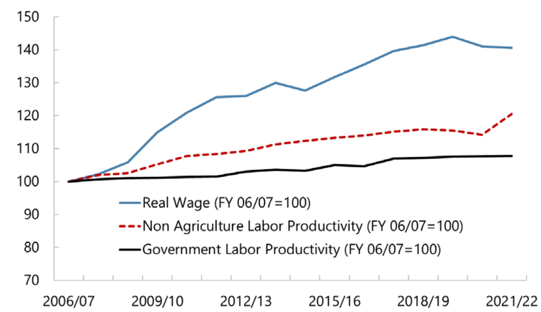
[3] The MIMMI model includes rural and urban areas, informal and formal work, multiple production, and consumption sectors as well as imports of food and a government enterprise sector. The model is calibrated to match South African demographics, national accounts, income, and wealth distribution indicators as well as the South African tax system and the profitability of its government enterprise sector. See Badel and Lyngaas (forthcoming) for details on the model. Replication materials, the model and training are available upon request from the SPR Department of the IMF. Contact abadel@imf.org for questions on this process.

- Increase of 6% in the productivity of the public service sector (i.e., greater spending efficiency), motivated by partially closing the gap between real wage and government labor productivity (Figure AXII.1) and improving the return on assets of SOEs.

- Increase of 4.5 percentage points in the statutory VAT rate.[4]

- Increase of 2 percentage points to the current CIT rate.

Figure AXII.1. South Africa: Consolidated Government Real Wage Growth and Productivity



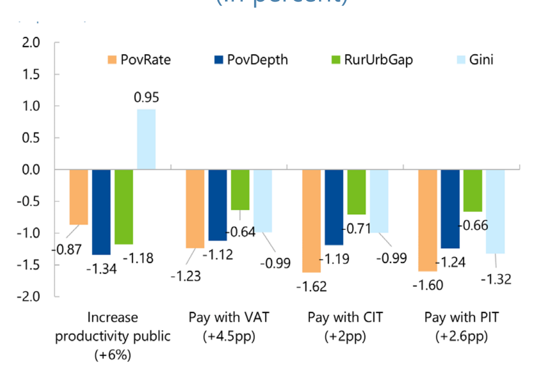
Source: IMF Staff estimates based on the Budget documents.

- Increase of 2.6 percentage-point to all marginal rates in the progressive PIT system.

While a hybrid financing scheme with a mix of tax and expenditure measures may also be constructed and analyzed, we focus on each instrument separately to clearly highlight the specific impact of each instrument in the policy discussion. It should also be noted that South Africa may have limited scope to increase tax rates, and revenue reforms that focus on broadening the tax base, increasing compliance, and reducing tax expenditures (from paring back investment incentives and breaks given to special economic zones) might be more feasible and efficient.[5]

4. **Maintaining the SRD grant could play a significant role in poverty alleviation.** Figure AXII.2 displays the impact of extending the program indefinitely under different financing options, relative to allowing the program to expire. Our baseline specification maintains the grant value at R350 per months and features a poverty rate of 25 percent, which induces the food poverty line that, when used as the eligibility threshold for the SRD grant, implies a fiscal burden of the program between 0.4 and 0.6 percent of GDP (consistent with the estimated budget for the SRD grants). The results across all considered financing schemes,

Figure AXII.2. South Africa: Inequality Indicators: Change with Respect to Baseline of no Grant
(In percent)



[4] According to the National Treasury, only a 2 percentage points increase in the VAT rate would be needed to raise around R50 billion. The differences possibly arise from variations in the modelling assumptions about the Laffer Curve and leakages. We assume that only 50 percent of the expected revenue from higher VAT rates materializes.

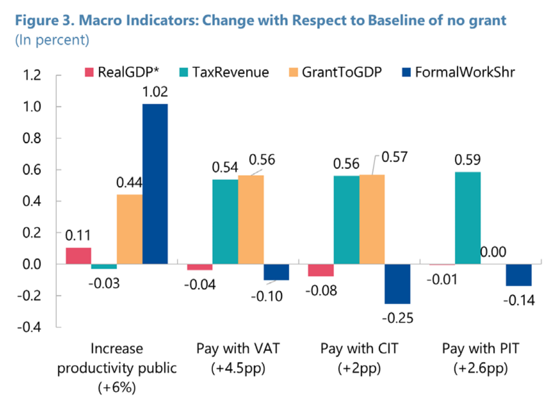
[5] The CIT was recently reduced from 28 to 27 percent, effective from F23/24, and so increasing it again so soon could generate business uncertainty. Excise rates were already increased on alcohol and tobacco, and the appetite for VAT increases may be low, especially given that it is a regressive tax. Concentrating the PIT rate increases on only the

(continued)

indicate that the grant would imply lower poverty rates and lower poverty depth, the latter defined as the average distance of poor households from the poverty line, as a percentage of the poverty line.[6] Inequality, as measured by the Gini Index, would generally improve as well, except for a mild increase observed in the case of the increased productivity of public sector to finance the grant.[7] The Rural-urban income gap would also improve due to the increase in food demand induced by the grant. Higher relative food demand benefits formal and informal food producers of the rural area, inducing higher relative prices and gains for rural area dwellers. If a higher poverty rate threshold is used for the means-testing (such as the upper-bound poverty line), the grant has larger impact on poverty but also a larger financing burden.

5. Labor supply distortions could be managed when the SRD grant generosity is modest and the means-testing (eligibility) threshold is large relative to the value of the grant. Our baseline simulations show that extending the current program would lead to losses in the share of formal employment (up to 0.25 percent - equivalent to about 25,000 formal jobs) (Figure AXIII.3). The grant value of R350 per month is below the upper-bound poverty line of R1,417 per person per month and well below the National Minimum Wage which amounts to roughly R4,500 per month.[8] At this low level, the program might not significantly impact the incentives for formal work and hence, does not significantly distort labor supply decisions.[9] Nonetheless, incorporating job search conditionality and complementing the SRD grant with active labor market policies could help mitigate these output and employment costs of the program (See Annex XVII). Also, additional

Figure AXIII.3. South Africa: Macro Indicators: Change with Respect to Baseline of no Grant
(In percent)



highest tax brackets would likely not generate the revenue required given the skewness in the income distribution toward low incomes. On the other hand, extending the rate hikes to low-income earners may meet social resistance.

[6] These effects are lower than the partial equilibrium effects identified by Kohler and Bhorat (2021) who estimate that in the grant's absence, poverty would have been over 5 percent higher among the poorest households, and household income inequality 1.3 to 6.3 percent higher using actual data. We find similar poverty and inequality reduction estimates if we assume that the grant can be fully financed with no costs (e.g., external grants). Therefore, financing costs of the SRD grant reduce the impact of grant on poverty and inequality.

[7] In this case, the increase in formality caused by the stronger public sector benefits upper tail of the income distribution, leading to a slight increase in the Gini Coefficient notwithstanding the improvement in poverty depth and poverty rate that is also generated at the lower end of the distribution.

[8] The upper bound non-food poverty line is estimated by calculating the mean non-food expenditures of those individuals whose total food expenditure is close to the food poverty line and adding this mean amount to the food poverty line.

[9] We take a cautious view on the impact of the Grant. On one hand, our analysis abstracts from some mechanisms that have been proposed whereby the grant could increase job search effort. For example, Kohler and Bhorat (2021) estimate that receiving the SRD grant increases the probability of job search by more than 25 percentage points

(continued)

simulations show that, for unconditional grants, substantial distortions to formal employment can arise if the grant amount increases relative to value of the eligibility threshold, exacerbating the macro losses from the Grant program.

6. **Extending the duration of the SRD requires additional fiscal space which carries macroeconomic costs.** If the grant is to be extended, it should be accompanied by adequate tax rate adjustments and an important boost to the efficiency of the public sector. In Figure AXIII.3, improving public sector productivity that creates savings for the government which would then be recycled to finance the grant has a positive impact on real GDP equivalent to an additional 11 basis points of annual growth over 10 years as well as contributing to strong formal employment gains. In contrast, increasing the CIT rate to finance the program would have the most detrimental economic impact in terms of GDP growth and formal employment. These results indicate that improving public sector productivity would result in lower tradeoffs between growth and employment generation relative to poverty alleviation in comparison to increasing taxes to finance the SRD grant.

relative to comparable non-recipient. On the other hand, we consider a standard model for the elasticity of informality to changes in incentives to formal work. We view our results as consistent with the view that informality in South Africa is very stiff and would not increase under most policies, since we do not find overwhelmingly large impacts.

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Annex XIII. Recalibrating the Cash and Debt Management Strategies: Options to Reduce Borrowing Costs[1]

Sizable fiscal deficits and high and growing debt have steepened South Africa's yield curve increasing medium-and-long-term borrowing costs. Moreover, the tightening of monetary policy internationally may create additional borrowing cost pressures. This raises the question on whether there is a need and how to recalibrate the existing cash and debt management strategies to reduce borrowing costs while minimizing rollover, interest rate, and currency risks. This annex discusses options to achieve this objective while highlighting the relevant tradeoffs and drawing on cross-country experiences. The analysis finds little opportunities for South Africa to optimize its cash and debt management strategies while maintaining risk at acceptable levels. More sizable interest bill savings while minimizing risks can only be achieved by implementing fiscal consolidation and reducing the borrowing requirement.

A. Background

1. **South Africa's prudent cash and debt management strategies have been a source of resilience limiting the impact of market volatility on its financing operations.** The focus on financing the budget with debt denominated in local currency, at fixed interest rates, and issued at a long-maturities have kept refinancing, currency, and interest rates risks low helping weather market volatility, especially in the context of the COVID-19 pandemic. Moreover, the drawdown of sizable cash balances and prudent foreign currency borrowing from international financial institutions (IFIs) more recently have helped reduce borrowing costs.

2. **This annex explores possibilities to recalibrate the debt and cash management strategies to adapt to more challenging global conditions and reduce interest costs.** Debt levels are significantly higher than in the past making the budget more sensitive to borrowing cost changes. The weakening fiscal position over the years and the corresponding downgrade of the sovereign debt rating to below investment grade has resulted in a steepening of both local and foreign currency yield curves and higher borrowing costs. Borrowing at long maturities can therefore be expensive raising the question of whether increasing lower cost shorter maturities borrowing would be beneficial. Similarly, issuing in local currency keeps the currency risk low but at expense of higher borrowing costs, given the sizable currency risk premium due to the volatility of the Rand. Finally, the opportunity cost of holding cash buffers has increased, raising the question of what the appropriate size of the cash buffer is.

B. Finetuning the Debt Management Strategy

Adjusting the maturity structure and currency composition of the government's debt portfolio can help reduce debt service costs, but at the expense of increasing rollover and currency risks. Against this background, the analysis finds that reducing the average maturity of the debt portfolio by adjusting the

[1] Prepared by Vybhavi Balasundharam, Jacob Ejsing, Arindam Roy, Alejandro Simone, and Sebastien Walker.

distribution of domestic debt issuance across maturity segments could help lower the interest bill by 0.2 percent of GDP annually while keeping the debt portfolio risks at acceptable level as per the strategic benchmarks of the debt management strategy.

3. The current borrowing strategy in South Africa relies heavily on long term local currency (LC) bond issuance. The bulk of the LC bond issuance takes place in long dated maturities (e.g., the average maturity of fixed-rate instruments issued in FY 2021/22 amounted to 15 years).[2] In fact, the average term to maturity of around 12 years is one of longest globally while other advanced and emerging market economies (EMs) usually have debt maturities of around 6 to 7 years. Foreign currency (FC) debt is comparatively modest at around 12 percent of total debt and mostly denominated in US dollars. External borrowings in the form of concessional loans have been increasing but only account for a small share of the debt stock.

4. The portfolio risk indicators confirm the overall favorable profile of the existing debt portfolio. The shares of debt to be refinanced and refixed in the near term are modest, and the average term to maturity is high on both the fixed-rate and inflation-linked domestic bond portfolios (Table AXIII.1). However, the weighted average cost of overall debt portfolio at 6.4 percent is at moderate level, reflecting the higher cost from longer maturity debt.

Table AXIII.1. South Africa: Portfolio Risk Indicators

		end-Oct. 2022
Nominal gross debt as percent of GDP		71.8
Interest payment as percent of GDP		4.6
Implied interest rate		6.4
Refinancing risk	Debt maturing in 1yr (percent of total)	10.9
	Debt maturing in 1yr (percent of GDP)	7.8
	ATM External portfolio (years)	12.0
	ATM Domestic portfolio (years)	12.1
	ATM Total portfolio (years)	12.1
Interest rate risk	Debt refixing in 1yr (percent of total)	11.9
	T-bills (percent of total)	9.3

5. South Africa manages its debt portfolio according to a set of strategic benchmarks. For FY22/23, all estimated indicators were within the targeted ranges/limits (Table AXIII.2), implying potential to reduce the average maturity of issuance. In particular, the indicator measuring the share of long-term debt maturing within 5 years (as a percentage of fixed-rate bonds and inflation-linked bonds) is estimated at 16 percent, well below the stipulated limit of 25 percent. Although the share of foreign currency debt – at 11.7 percent - was below the limit of 15 percent, further depreciation of the Rand could bring this indicator closer to the limit. Moreover, with the recent revision in the strategic benchmarks for the weighted average maturity of local currency debt, there appears to be limited scope – within the ranges/limits currently in place – for gradually reducing the maturity of the domestic bond portfolio through the issuance strategy.[3]

[2] As of end October 2022, long-term bonds consisting of fixed-rate bonds (FRBs) and inflation-linked bonds (ILBs) accounted for close to 80 percent of total debt, and debt linked to short-term interest rates (T-bills and floating-rate instruments) amounted to around 9 percent.

[3] As longer maturities for fixed-rate and inflation-indexed bonds have been issued, the strategic benchmarks on weighted term-to-maturity for fixed-rate bonds and T-bills were revised upwards: lower bounds of weighted term-to-maturity for fixed-rate bonds and T-bills was revised up from 9.5 to 10 years; and for inflation-linked bonds from 12.5 to 14 years. The increase in the strategic benchmarks in effect implies very limited scope to reduce maturities on local currency bonds.

Table AXIII.2. South Africa: Strategic Benchmark Indicators and Ranges/Limits

	Limit / range	FY22/23	FY23/24
Share of short-term debt maturing in 12 months (Treasury bills) as a percentage of total domestic debt	15	9.9	10.4
Share of long-term debt maturing in 5 years as a percentage of fixed-rate bonds and inflation-linked bonds	25	16.0	16.1
Share of inflation-linked bonds as a percentage of total domestic debt	20-25	23.9	22.0
Share of foreign debt as a percentage of total government debt	15	11.7	11.2
Weighted term-to-maturity (fixed-rate bonds and Treasury bills in years)	10-14	11.2	10.6
Weighted term-to-maturity (inflation-linked bonds in years)	14-17	12.8	13.6

Source: National Treasury, 2023 Budget Review, p. 82 (benchmark limits and target ranges).

6. To quantify the cost and risk implications of adjustments to the baseline debt management strategy, a number of specific variations are considered (Table AXIII.3). The cost/risk analysis is based on a stochastic simulation of key risk drivers of the portfolio, and – in turn – of the evolution of the entire debt portfolio.[4] The baseline strategy assumes that the projected borrowing requirement in local currency will be covered by issuance of T-bills, FRBs and ILBs in the same proportions observed for actual issuance in FY21/22 and 22/23 (until end-Oct. 22).[5] In line with South Africa's practice in the recent past, FRBs are assumed to be issued in the maturity segments 5, 7, 10, 15, 20, and 25 years while ILBs have maturity segments of 7, 10, 15, and 25 years. The new foreign currency debt issuance is assumed to exactly cover interest payments and redemptions on the existing foreign debt.

7. The strategy variations result in modest cost savings over the medium term. Although the strategy variations lead to some shifts in the sub-portfolios' relative shares of the total portfolio, the impact on the overall debt levels are rather modest, reaching a maximum reduction in the debt level of about 0.9 percent of projected GDP by 2028 for Strategy D (Chart 1).[6] Strategy "A" involving more reliance on T-bills does not achieve a meaningful reduction of expected interest costs without relevant increases in rollover risks.[7] While Strategy "B" reduces expected costs, it increases the currency risk given the volatility of the Rand. Strategy C achieves a reduction in expected costs

[4] The stochastic simulation models seven risk drivers- three factors governing the dynamics of the domestic nominal yield curve (level, slope, and curvature), three exchange rates (ZAR via-à-vis USD, SDR, and EUR), as well as a single risk driver capturing the evolution of the South African USD-issuance yield on international bonds. The nominal domestic yield curve is modeled using the Dynamic Nelson-Siegel (DNS) model (Diebold & Li, 2006), Each of the bilateral exchange rates is modeled based on a geometric Brownian motion (GBM), implying that the monthly changes to natural logarithm of the changes to the exchange rates follow a random walk with drift. A joint distribution mirroring the correlations between risk factors in the historical data has been estimated and 1000 scenarios have been generated.

[5] Although the alternative strategies considered do not explicitly consider floating rate notes (FRNs), the cost-risk trade-offs associated with an increase in issuance of FRNs would be similar to the strategy for increased T-bills issuance (strategy variation A) since FRNs are linked to average yields on T-bills.

[6] These calculations were completed before the Budget 2023 announcement of the Eskom Debt Relief.

[7] Also, compared to increasing T-bill issuance in Strategy 'A", issuance of more bonds in the 3–5 year segments, for example in Strategy "C", would have a less severe impact on roll-over risk.

without relevant increases in risk. More significant cost reductions are only possible for higher levels of risk appetite than what is currently expressed in the strategic benchmarks.

Table AXIII.3. South Africa: Variations of the Borrowing Strategy

Strategy Variation	Description of Variation
A) Increased issuance of T-bills	The annual net domestic-currency funding contribution from increased T-bill issuance is assumed to be 40 bn. ZAR higher than in the baseline. The issuance of domestic long-term bonds is reduced accordingly.
B) USD-denominated issuance is increased	30 bn. ZAR of the funding needs in domestic currency is assumed to be covered by increased issuance of USD-denominated foreign-currency issuance comprising international bonds and external loans from multilaterals. The issuance of domestic long-term bonds is reduced accordingly.
C) Reduce average maturity of long-term domestic bond issuance 1/	The distribution across maturity segments for FRBs and ILBs is adjusted so as to reduce the average maturity of the issuance mix on FRBs and ILB issuance by 2.5 and 2 years respectively.
D) All of the above	Simultaneous application of the strategy adjustments A, B and C described above. In this case the borrowing requirement in domestic long-term bonds is reduced by a total of 70 bn. ZAR, reflecting the combined contributions from increased T-bill and foreign bond issuance.

1/ The strategic benchmark on the share of LC bonds (for FRBs and ILBs) maturing within 5 years (Table 2) is breached under strategy variation C. The other strategy variations would keep debt within the set of strategic benchmark indicators adopted by the National Treasury.

8. **Strategy "C" - involving issuance of larger shares of domestic bonds in shorter maturities – provides the most cost savings for a given risk impact but depends on investor demand.** This suggests that implementing adjustments to the domestic issuance mix could be the best option for reducing expected costs with relatively modest deviations from the current debt management strategic benchmarks. However, implementing such a strategy requires sufficient interest among institutional investors for these shorter-maturity instruments through proactive investor consultations.[8] At the same time, the possibility of increased issuance of non-marketable bonds for retail investors in 1–3 maturity buckets could be considered as they provide a stable source of demand and are normally not subjected to rollover risks.

Finetuning the Cash Management Strategy[9]

Maintaining cash buffers is an important risk mitigation tool to address timing mismatches between liquidity inflows and outflows, cash flow forecast errors, and refinancing risks during market stress

[8] At the end of 2022, institutional investors held about one-quarter of fixed-rate bonds above 10 years and two-third of inflation-indexed bonds above 10 years.

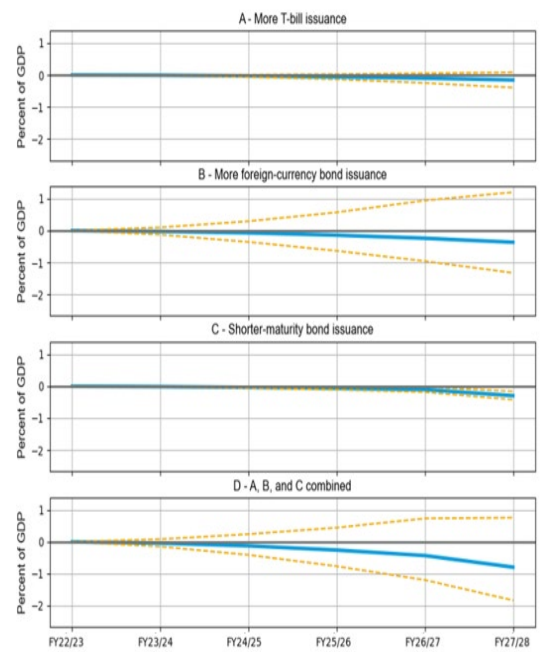
[9] Draws from Hürcan, Fatoş Koç, and Balıbek (2020) but focuses on gross financing needs instead of the debt service.

periods.[10] *However, there is a tradeoff between the risk-mitigation objective and the carry cost of the buffer. The analysis indicates that South Africa has limited scope to draw down some of the existing cash reserves to meet its gross financing needs in the near term if it were to insulate itself from a more protracted market stress period (e.g., 12 months). The annual cost of carry estimated at 0.2 percent of GDP for these cash balances seems reasonable in the context of the more challenging global environment ahead.*

9. Cash buffer targets are an integral part of the cash and debt management strategies. From a cash management perspective, holding an appropriate level of cash balance serves to address cash flow volatility and timing mismatches between revenue collections, expenditures, borrowing, and debt service as well as to ensure availability of liquidity in government accounts. From a debt management perspective, a cash buffer serves to mitigate funding risks. Many countries held cash balances in their central bank accounts averaging 3 percent of GDP as of end-2018. Some countries have explicitly identified and publicly disclosed the minimum amount of cash reserves needed on a consistent basis (Table AXIII.4). Advanced economies tend to hold cash balances mostly consistent with addressing short period of markets stress than EMs. In the case of South Africa, deposit levels were about 5 percent of GDP as of end September 2022 (Quarterly Bulletin, December 2022), suggesting some room for optimization.

10. The appropriate level of the cash balance target depends on a combination of factors. These include cash flow forecasting capacity, the debt repayment profile, the availability of other risk-mitigation mechanisms (such as overdraft lines), the cost of carry (see below), and external factors, such as local and global market conditions. The cash buffer target can be set on a rolling-horizon basis, as a moving target, or at a fixed level. There is no one-size-fits-all methodology in determining the target as it depends on the government's perception of risks, its ability to manage cash balances actively, and its priorities in managing cash and debt. Cash buffer targets should therefore be updated based on the changes in these factors. In fact, several countries revised their cash balance levels upwards as part of the policy responses to the COVID-19 pandemic and the associated more uncertain financing environment.

Changes in Debt Levels vis-à-vis Baseline Strategy
(Average values and 95 percent confidence intervals)



[10] Cash buffers are the funds in the SARB held by the national government as reported in the SARB's government deposits table.

Table AXIII.4. South Africa: Country Examples for Cash Buffer Targets

	Country	Cash Buffer Target to Cover
Advanced Economy	Canada (2019/20)	One month of net projected cash flows, including coupon payments and debt refinancing needs.
	Denmark (2020)	Comparable to the annual refinancing requirement of government bonds.
	Greece (2019)	Next four years of debt service, excluding treasury bills.
	Hungary (2020)	Total of six weeks of financing needs.
	Portugal (2018)	Forty percent of the next 12 months of financing need.
	US (2015)	Total of one week of cash outflows.
Emerging Market	Brazil (2020)	Six months of federal public debt service in the market in domestic currency. Although there is no official target, the government also maintains an additional foreign currency reserve to service the annual foreign currency debt.
	Romania (2018)	Four months of gross borrowing needs in foreign currency.
	Turkey (2014)	An undisclosed percentage of annual debt service.
	Uruguay (2014)	More than the annual debt service.

Note: Years in parentheses reflect the year of public disclosure for the target.

Source: Hürcan, Fatoş Koç, and Balıbek (2020)

11. **Assessing the cost of carry associated with different target levels relative to the potential benefits is an important step to determine a cash balance target.** While a larger cash buffer helps absorb unexpected variations in funding and cash flows, there are opportunity costs. The cash buffer often generates a return linked to the very short end of the yield curve—either the policy or the short-term market rate (around 6 percent for local currency cash buffer in South Africa). The borrowing or the opportunity cost of holding the cash buffer is generally determined by the rates for longer-term borrowing (around 12 percent for South Africa). Hence, the cost of carry can be calculated by comparing the cost of funding with the rate of return on the cash buffer.[11] Nevertheless, a fully quantitative cost-benefit analysis is usually challenging as the risk-mitigation benefits of cash buffers are difficult to quantify.

12. **A unified cash buffer target should address both cash and debt management considerations to avoid over-borrowing and to minimize the cost of carry**. A two-tiered structure could be developed where the unified targeted cash buffer is the total of two components:

- Tier-1 would be used to meet financing gaps arising from regular daily cash flow volatility and forecast errors (i.e., address cash management considerations). The cash buffer target can be estimated using the following formula:

  $$Target\ CB_{CM} = [max_j \sum_{i=1}^{m_j}(Net\ Outflows\ in\ day\ i)\ ] * (1 + x\%) - OD \ (1)$$

  where m_j is duration of stress period *j* in days, *OD* is the level of cash available through existing risk mitigation mechanisms (such as an overdraft), and *x* is the historical daily

[11]For example, Denmark compares the future short-term rates with the current longer-dated financing cost (i.e., the term premium) to estimate of the cost over the medium term, while Canada uses treasury bill rates to estimate the cost. Portugal has different cost of carry measures: 1) the implicit interest rate on the overall debt stock, which is implied by the rates on current outstanding debt; (2) the marginal cost of new funding in the year of consideration; and (3) the marginal cost of funding only using treasury bills.

forecast error if forecasts are used.[12] Alternatively, under a less conservative approach, the target could be based on the average level of net outflows in stress periods. The fluctuations within a given stress period would be managed with issuance of treasury bills or other short-term borrowing.

Using the daily cashflow from the "Tax and Loan Balances before Tax Revenues" combined with the monthly cashflow in the FX account, we estimate the Tier 1 *Target CB* for cash management purposes. In the absence of a reliable historical forecast error information, we assume *x* is a scaling factor of 5%, which is around the average medium-term inflation. Parameter *OD* is set at R50 billion (including the CPD account[13] plus some T-bill issuance).[14] The stress period is assumed to be for 5 days, based on the observed volatility of net outflows (i.e., the periods of continuous net cash outflows are around 5 days). Under these assumptions, the Tier 1 *Target* CB_{CM} would be zero using average net outflows, primarily because the CPD account and T-bill issuance would be sufficient to cover both the stress periods and errors in cash forecasting, and R70 billion using maximum net outflows.

- Tier-2 would be a "safety" buffer to address less frequent risks, such as meeting gross financing needs in periods of market stress, thus reducing the need to borrow when market conditions are unfavorable (i.e., addresses debt management considerations). The safety buffer can be invested in longer-term instruments if options exist to reduce the cost of carry and could thus cover a portion of the gross financing needs for a given period ahead:

$$Target\ CB_{DM,t} = GFN_{t,t+n} * (1 - C\%) \quad (2)$$

Where $GFN_{t,t+n} = \sum_{i=t}^{t+n} GFN_i$ is the projected level of GFN within the timeframe (*t*, +*n*), *n* is duration of potential stress period in months, and *C* is the ratio of debt service that can be rolled over/covered by primary dealers and other funding resources. Parameters *n* and *C* can be determined using historical data or forward-looking analysis.[15] The $CB_{DM,t}$ from (2) will be a moving target on a rolling horizon basis and can fluctuate significantly based on the GFN in a given period. GFN volatility is significant in South Africa with a standard deviation of around R40 billion (0.6 percent of GDP) between months (Figure AXIII.1). The target safety cash buffer can be smoothed by replacing with the average or maximum level of GFN, computed over rolling horizons.

[13] The CPD account has R50-80 billion that the government can draw down in abnormal circumstances to manage liquidity shortages. Around 60 percent of the drawdowns have to be settled within 3 months, while the rest has a longer maturity of around 12 months. In extreme circumstances, the government could borrow for longer periods.

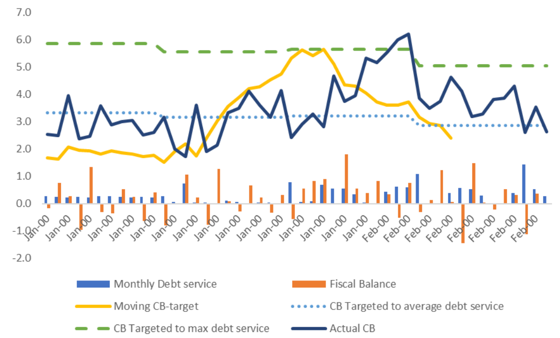
[14] The National Treasury issues T-bills worth between R40 and 60 billion rand per month and the auctions are oversubscribed by at least of a factor of 2 or more indicating that the government may have space to secure more financing through T-bill issuance in the near-term.

[15] Primary dealers are banks or other financial institutions that are contracted by the government for distribution of their bonds/bills and/or that commit to purchase a portion of these bonds themselves in return for special access to bond auctions and exclusive meetings.

Using the monthly GFN from 2018–2022, we estimate the safety $Target\ CB_t$ for South Africa (Figure AXIII.1) assuming an intention to cover potential financing gaps over a stress period of twelve months (n=12), and that 50 percent of needs can be covered through available resources (such as the CPD account , and short-term t bill issuance) (C=0.5).[16]

Figure AXIII.1. South Africa: Cash Buffer Targets for Debt Repayment

(In percent of GDP)



Source: IMF staff estimates based on data provided by the authorities.

With these assumptions, *$Target\ CB_t$ based on the average GFN* is around R120 billion (2.7 percent of GDP) and the *$Target\ CB_t$ based on the maximum GFN* is around R200 billion (4.5 percent of GDP). These calculations adjust for the 2020 pandemic outlier GFN to avoid this extreme episode to lead to an overestimation of the cash needs.[17]

13. The above calculations point to a unified cash buffer target between R120 to 270 billion depending on whether the average or maximum level of GFN is used. This would imply annual cost of carry between 0.1 and 0.3 percent of GDP.[18] These figures seem broadly in line with the actual average cash balance of around R200 billion which is on the more prudent side of this range (Figure AXIII.1). This suggests South Africa would have limited scope to draw down some of the existing cash reserves in the context of the more challenging global environment ahead. The annual cost of carry of the average 200 billion balance estimated at 0.2 percent of GDP seems a reasonable risk mitigation cost.

[16] Stress periods under normal market conditions can be up to 2–4 months long in developing and emerging markets. In more challenging periods internationally, stress periods may extend to 12 months and above. Given the more challenging global conditions ahead, planning for a more extended period of market pressures such as 12 months of cash buffer for debt management would be prudent.

[17] The COVID pandemic generated outlier financing pressures due to additional spending needs and a significant revenue shortfall. To illustrate, Including the 2020 pandemic needs would lead to a *$Target\ CB_t$ based on the average GFN* of R180 billion (4 percent of GDP) and a $Target\ CB_t\ based\ on\ the\ maximum\ GFN$ of R317 billion (7 percent of GDP).

[18] The cost of carry is estimated as the difference between the cost of long-term borrowing (i.e., interest rate for bonds with maturity 10 years and above) and the short-term interest received on the cash balances at SARB (i.e., the treasury bill interest rate) which yields a cost of carry of around 6%. Applying this to the range of targeted cash balances and dividing by GDP yields the 0.1 to 0.3 percent of GDP cost.

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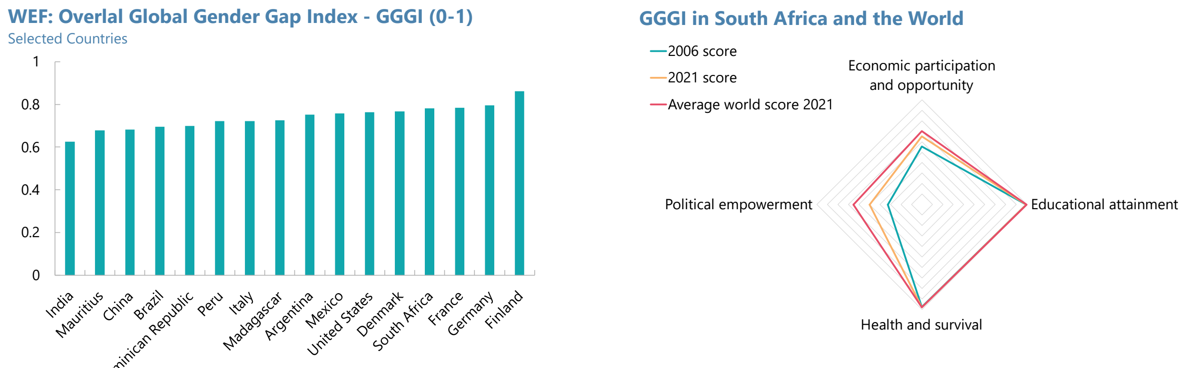
Annex XIV. Gender-Pay-Gap in South Africa[1,2]

South Africa has made significant strides in addressing gender disparities since 1994; however, the persistent median non-adjusted gender-pay-gap (GPG), remains an important social challenge with women earning over 20-percent less than men.[3] The median non-adjusted GPG is largely the result of occupational differences, with women overrepresented in low paying jobs. The GPG perpetuates low female labor force participation, inequality, and poverty. Eliminating gender pay disparities would foster inclusive and sustainable economic growth and help in reducing poverty and income inequality. Policies that encourage focused investment in female human capital development as well as female labor force participation in productive employment are key to reducing gender inequality.

1. **Headline measures of gender equality show that on average, South Africa fares well compared to other countries.** The Global Gender Gap Index ranks South Africa 18th out of 149 countries in 2021,[4] mainly boosted by exceptionally high scores in gender educational attainment—proxied by enrolment rather than access to quality education and grade completion; and health and survival indexes—proxied by life expectancy and birth sex ratios. Nonetheless, South Africa still lags in terms of economic participation and political empowerment (Figure AXIV.1).

Figure AXIV.1. South Africa: Global Gender Gap Index



Source: World Bank, Global Gender Index, 2021.

Source: World Bank, Global Gender Index, 2021.

2. **South Africa's constitution enshrines gender equality rights in the workplace.** Extensive legislation has been passed to extend legal rights and benefits to women since 1994; in particular, the South African constitution of 1996 enshrines the prohibition of unfair gender-pay discrimination in the workplace. (Box AXIV.1).

[1] Prepared by Max Alier and Nasha Mavee.

[2] Conclusions in this annex are based on a descriptive analysis of available data and review of the current literature.

[3] The GPG is the average difference between the remuneration for men and women who are working. There are two distinct measures of pay gap, 1) non-adjusted, which is the raw difference between woman's and man's salaries, and 2) Adjusted, which takes into account differences in hours worked, occupations chosen, education, job experience.

[4] World Economic Forum (2021).

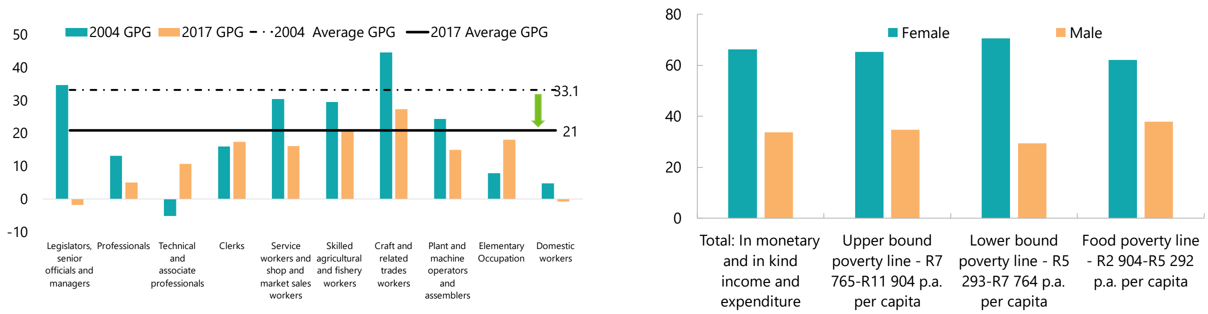
3. Nonetheless, income inequality between male and female counterparts as measured by median remuneration remains a reality. Recent studies of Gender-Pay-Gaps (GPGs) in post-Apartheid South Africa show a persistent, albeit narrowing, non-adjusted GPG across occupations (Figure AXIV.2).[5]

4. The GPG plays an important role in perpetuating poverty and inequality (Figure AXIV.2). Women head over 40 percent of households (higher as the number of dependents increase) but receive less that 30 percent of total households' income. Estimates indicate that members of female-headed households are up to 10 percent more likely to slip into poverty and 2 percent less likely to escape poverty than members of male-headed households.[6]

Figure AXIV.2. South Africa: Gender Pay Gap and Percent of Households in Poverty by Gender of Household Head

Africa's Gender Pay Gap by Occupation*
(100 - Median Female Earnings per hour as a Percent of Median Male Earnings per hour)

Percent of Male and Female Headed Households in Poverty Count Based on Monetary and in Kind per Capita Income and Expenditure



Sources: Stats SA, Labor Market Dynamics Survey 2020, Palms Data - Latest, Staff Calculations
*The Gender Pay Gap is unadjusted for level of education, age, firm, industry, or province.

Source: Stats SA: Living Consitions Survey 2015: Income and Expenditure by Household.

5. There are important social and economic gains from addressing GPG. The GPG directly and indirectly impacts female labor force participation, productivity, and financial inclusion, and thus overall economic activity. Recent estimates, show that gender equality would enrich the global economy by an estimated USD160 trillion if women were earning as much as men in the workplace.[7]

6. Occupational differences and overrepresentation of women in low paying jobs account for a large part of the GPG.[8] Women are overrepresented in low-skill low-paying jobs (Figure AXIV.3.), in part due to differences in level of education – with GPG declining with higher level of education and years of experience.[9] High school drop-out rate among girls compared to boys (particularly following teenage pregnancies), under-representation of girls and women in technical

[5] Mosomi (2019) and National Business Initiative (2021).

[6] World Bank (2018).

[7] World Bank (2018).

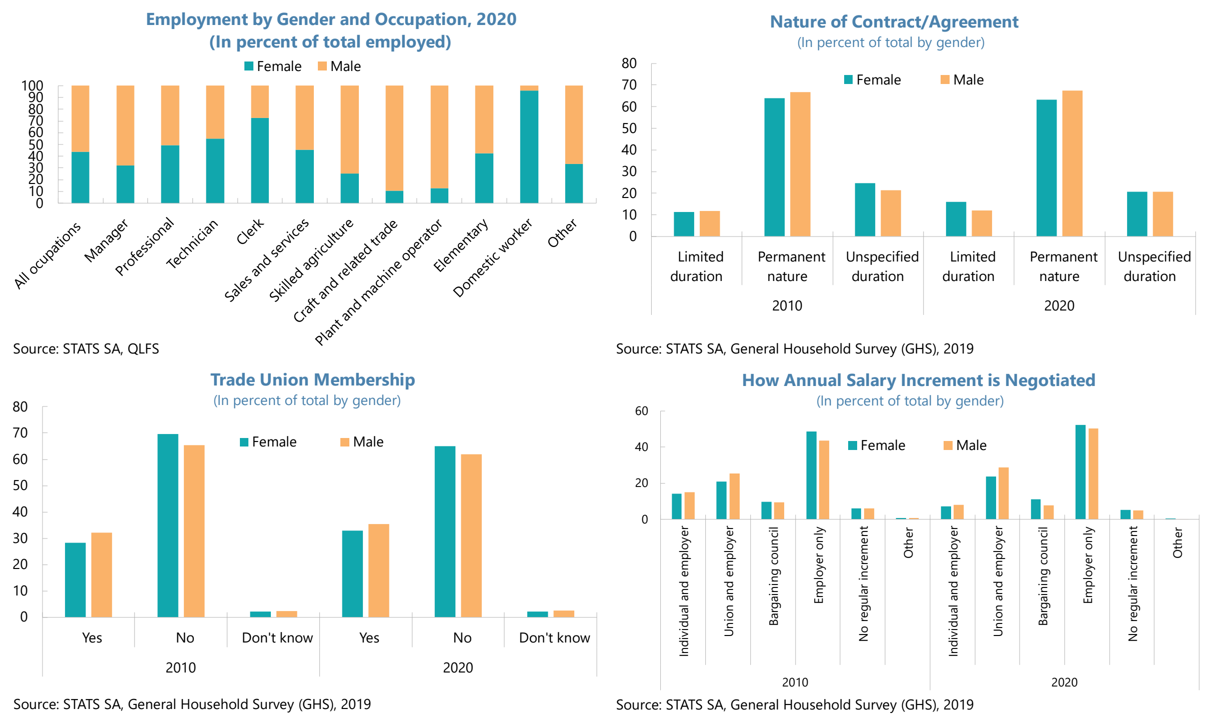
[8] Smout and Samaneh (2022).

[9] Casale and Posel (2005); Mosomi (2019); NBI (2021).

science studies (such as science, technology, engineering, and mathematics - STEMS) are factors binding women to low-skill low-paying jobs.

7. Women's limited participation in wage negotiation processes has also been identified as a reason for the GPG in South Africa. Upon entering the labor market, earnings disparities could be traced back to low membership in trade unions and a lesser active role of women in the wage negotiation process.[10] Women's salaries are more likely to be decided by employer with little input from them or negotiation (Figure AXIV.3).

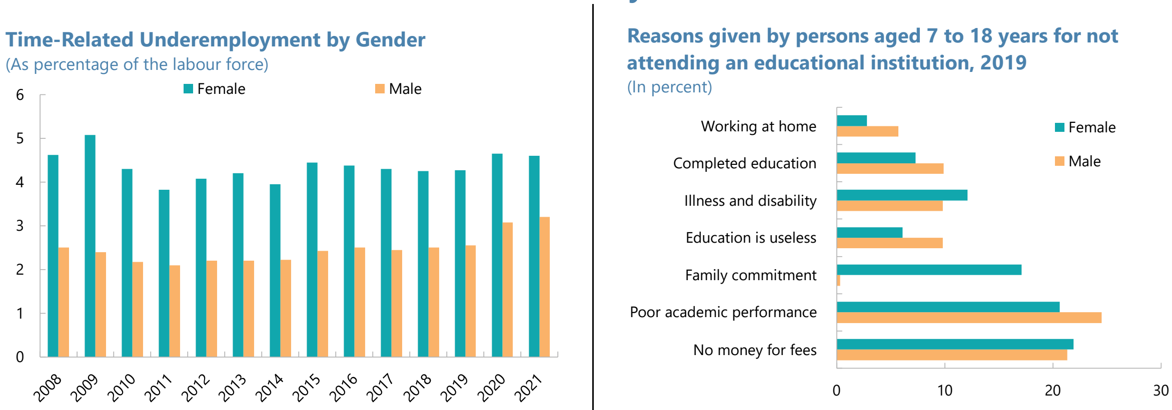
Figure AXIV.3. South Africa: Conditions of Employment by Gender



8. Reduction in job tenure or years of experience due to female's social roles as child-bearers and caretakers, hamper their labor force participation, and earnings capacity. Similar to most countries, females hold the bulk of the home making responsibilities including unpaid domestic chores and childcare. This often comes at a cost of reduced opportunities for women to access education and participate in paid labor. When in the labor force, domestic responsibility can result in reduction in job hours, time related underemployment and tenure which contribute to longer gaps in work experience reducing women's wages overall. (Figure AXIV.4)

[10] Mosomi (2019).

Figure AXIV.4. South Africa: Underemployment by Gender and Reasons for Non-Economic Activity



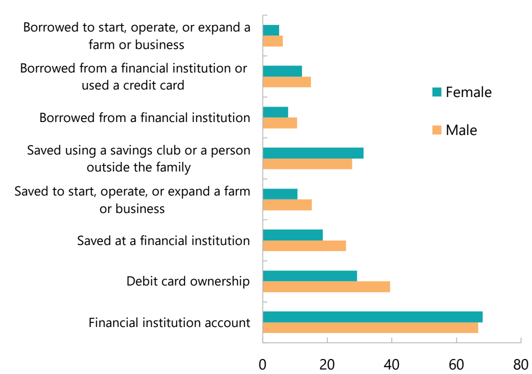
Source: STATS SA, General Household Survey (GHS), 2019

Source: STATS SA, General Household Survey (GHS), 2019

9. **Firms' voluntary compliance with legislation has helped to reduce the non-adjusted GPG.** Voluntary compliance with legislation such as the Employment Equity Act (EEA), Black Economic Empowerment (BEE), and national minimum wages (NMW) or the enforcement of such legislation; as well as firms' proactivity in tracking pay gap differentials across a variety of characteristics including gender has contributed to the downward trend in gender pay gaps.[11] Improvement with compliance of legislation on gender pay disparities can be enhanced by incorporating comprehensive pay reporting standards and pay audits to increase availability of pay information by gender; and the implementation of standardized penalties in case of non-compliance.

10. **GPGs perpetuate low female labor force participation, productivity, and overall economic activity.** Wide GPGs reduce the opportunity cost of women staying outside the labor market. The productivity lost by women staying out of the labor market due to wage differentials compared to their male counterparts are large. A recent Fund staff study suggests that closing the gender gap could increase GDP by an average of 35 percent (globally) - eighty percent of these gains come from adding workers to the labor force and the remaining twenty percent of the gains are due to the gender diversity effect on productivity.[12]

Figure AXIV.6. South Africa: Financial Inclusion and Borrowings by Gender, Findex Data 2017



Source: Findex Data, 2017.

[11] Mosomi (2019); National Business Initiative (2021).

[12] Ostry et al. (2018).

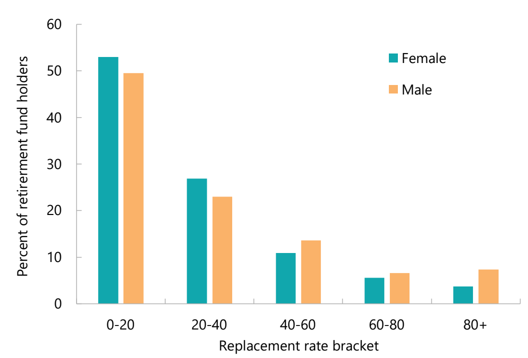
11. While there is not a large difference in financial inclusion indicators across gender, reducing the GPG could further enhance women's financial inclusion (Figure AXIV.6). A reduction in the GPG can enhance women's access to financial services beyond owning a bank account, such as investments and formal credit markets both for personal and entrepreneurship purposes, improving their welfare. Financial inclusion is positively related to welfare as measured by wealth and well-being - where financially included women have higher welfare scores than their excluded female counterparts, primarily accounted for by income, in addition to education and demographic factors such as race and marital status.[13]

12. The GPG has a direct implication on pension benefits. Due to longer contribution periods over a lifetime, South African men retire with an average replacement rate – pension as a proportion of final salary – of 35 percent, compared to 26 percent for women where most females retire with a replacement rate of less than 20 percent (Figure AXIV.7).[14] The impact of the lower replacement rate on pension benefits is compounded by women's lower end-of-work life earnings compared to men.

13. Public policies that aim at boosting women's income and bridge the GPG should combine measures focusing on:

(1) Focused investment in female human capital by promoting women participation upskills education programs and encouraging girl's enrollment in STEMS subjects.

Figure AXIV.7. South Africa: Replacement Ratio



Source: Alexander Forbes - Market Insights, 2021.

(2) Creating incentives for full-time female labor force participation, and work retention particularly in the formal sector; by increasing access to quality and affordable (or subsidized) childcare centers – which would not only be beneficial for working mothers but also in keeping school girls in school or preventing school dropout following pregnancies; promoting shared parental leave through higher or equal paternity and maternity leave benefits;[15] and broader measures to improve work-life balance – such as more flexible working environment; by incentivizing flexible working hours and/or days.

(3) Monitoring and enforcing of gender pay transparency mechanisms, by eliminating limitations in identifying non-compliance with legislation on pay-parity, especially by

[13] Nanziri (2016).

[14] Alexander Forbes (2021).

[15] In South Africa, fathers are entitled to 10 days parental leave upon the birth of the employee's child in terms of the Labor Laws Amendment Act. Mothers are entitled to four months unpaid maternity leave.

strengthening pay reporting requirements and pay audits at the level of the employer, as well as enforcing standardized penalties that are sufficient to act as a deterrent to non-compliance.

14. In the long run, it is key to address all gender related issues holistically integrated and mainstream them into policymaking. While government has been on the front-run of gender inclusion initiatives, more can be done. To this end government's commitment to gender responsive budgeting will be a strong building block to address gender disparities, including the GPG and its effects; and signal to all stakeholders that protecting women's rights in the economy is the right thing to do for strong and sustainable growth.

Box AXIV.1. Mechanisms Implemented to Promote Gender Equality Since 1994

Post-apartheid South African law and legislation took significant steps in rectifying a system of discrimination against women in the economic environment. South Africa scores 88.1 out of 100 in the Women, Business, and the Law 2022 (WBL2022) survey; up from 38.8 in 1990.[1] The overall score for South Africa is higher than the regional average observed across Sub-Saharan Africa (71.5). Relative Strengths come from zero constraints on freedom of movement, laws affecting women's decisions to work, laws affecting women's pay, women starting and running a business, and gender differences in property and inheritance. However, when it comes to laws affecting women's work after having children, and laws affecting the size of a woman's pension with significant wealth implications, South Africa could consider reforms to improve legal equality for women.

The prohibition of gender-pay discrimination is enshrined in South Africa's Constitution of 1996. Consistent with this mandate, extensive legislation has been passed to extend legal rights and benefits aimed at promoting and protecting women's equal rights and reverse the history of women's discrimination and marginalization (chart 9).

In 1995, government introduced a number of further measures to eliminate discrimination against women taxpayers. These included: (1) a single income tax rate structure applicable to all individuals irrespective of gender or marital status, replacing the system of three categories of taxpayers.
(2) a single primary rebate for all taxpayers, replacing the different primary rebates for married persons, unmarried persons, and married women; and (3) same deduction for tax purposes in respect of contributions to retirement annuity funds, regardless of the taxpayer's gender or marital status.

The new tax system, in which men and women are taxed at the same rate, has removed the formal discrimination, but has not solved the equity problem as substantive discrimination against households with one income earner has got worse.

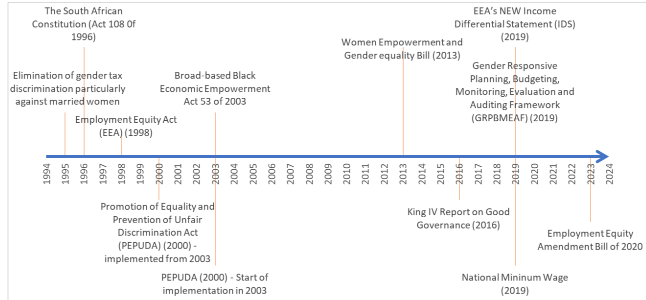
The 1998 Employment Equity Act (EEA) places a legal duty on employers to give men and women equal remuneration for the same or similar work. The act is supported by the Promotion of Equality and Prevention of Unfair Discrimination Act (PEPUDA) of 2000 which identifies the duty and responsibility of all persons to eliminate gender discrimination and to promote equality. The Department of Employment and Labor is responsible for the implementation on the EEA, including the monitoring, evaluation, and enforcement of compliance with gender pay equality; however, its role has been limited due to limited pay reporting standards and availability of gender pay gap information to identifying non-compliance with anti-gender pay discrimination laws.

[1] The survey presents an index covering 190 economies and structured around the life cycle of a working woman. In total, 35 questions are scored across eight indicators. Overall scores are then calculated by taking the average of each indicator, with 100 representing the highest possible score. Data refers to the laws and regulations that are applicable to the main business city (Johannesburg) - generally observed across the country given the constitutional law.

Box AXIV.1. Mechanisms Implemented to Promote Gender Equality Since 1994 (concluded)

The task of identifying pay discrimination is left to the employee, who would be responsible to go through a lengthy process of gathering evidence of the discrimination and making the employer accountable to the law on justifiable grounds. The penalties are derived on a case-by-case basis.

Timeline of Mechanisms Implemented to Promote Gender Pay Equality since 1994



Source: Review of The Women's Charter - Challenges to effective equality: Overview of Legislation, Programmes and Challenges Related to the Articles in the Women's Charter for Effective Equality.

The Employment Equity Amendment Bill, 2020 signed into law in April 2023, seeks to amend the Employment Equity Act, 1998. The amendments include inter alia, empowering the Minister of Labor to determine sectoral numerical targets for the purpose of ensuring the equitable representation of suitably qualified people from designated groups (blacks, women, and persons with disabilities) at all occupational levels in the workforce. In the area of remuneration, the law requires employers to pay workers equal pay for equal work. The Bill provides clear definitions of discrimination and sets out what workers can do when facing such discrimination - including lodging grievances with the Commission for Conciliation, Mediation and Arbitration, or the Labor Courts.

The Broad Based Black Economic Empowerment (B-BBEE) Act of 2003 aims at placing black women at the center of opportunities in education and employment. The act is clear on the need for women to be equal beneficiaries of black economic empowerment. The B-BBEE Act recognizes programs that promote enterprise creation in respect of cooperatives that are (1) more than fifty percent owned by black people; or (2) more than 30 percent owned by black women; or (3) more than 50 owned by members of black designated groups. The 2014 amendments to the act make provision for offences and penalties.

The National Minimum Wage Act 9 of 2018 (NMWA) helped reduce the GPG as it targeted mostly low paying jobs, which are mainly taken by women. Under the NMWA, an employer cannot pay wages that are below the minimum wage.

The Gender Responsive Planning, Budgeting, Monitoring, Evaluation and Auditing Framework (GRPBMEAF) adopted by the Cabinet in 2019 formalized South Africa's Gender responsive strategy. This framework calls for further development of Gender Responsive Budgeting (GRB) to mainstream gender equality objectives in the public financial management system (PFM) and gives the National Treasury the mandate to lead in this area. GRB promotes the application of programmatic gender impacts assessment, as well as other tools at different stages of the PFM cycle including budget preparation, execution, accounting, reporting, control, and audit. The National Treasury plans to gradually adopt GRB with peripatetic technical assistance from IMF. The initial reform primarily focuses on spending decisions and budgetary allocations to promote gender equality by translating gender policy objectives as stipulated in the National Development Plan 2030 and the Medium-Term Strategic Framework 2019–2024 into budget programs within the Medium-term Expenditure Framework. The adoption of GRB will encourage more civil society participation in budgetary oversight and facilitate South Africa's attainment of national and international gender equality commitments.

In addition to legislation, codes of good conduct aim at ensuring that South Africa's labor market is free from discrimination, including gender related discrimination. The King IV Report on Good Governance establishes that a company's board must approve reports on and the implementation of its remuneration policy, which should reflect that 'the organization remunerates fairly, responsibly and transparently'. The King Report is only mandatory for JSE-listed companies.

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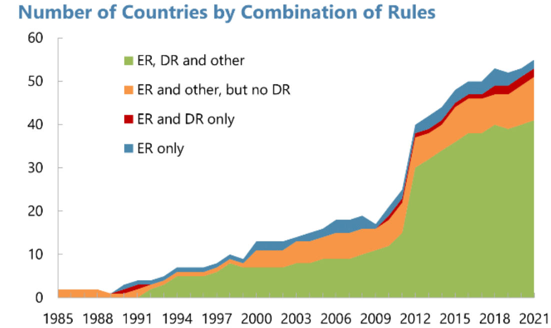
Annex XV. Reforms to Strengthen Fiscal Institutions

1. Anchoring the nominal primary expenditure ceiling with an explicit debt ceiling. South Africa is one of the few countries to adopt an expenditure rule (ER) without a debt rule (DR) or other rules. While the primary expenditure ceiling has helped reduce pro-cyclicality, it has not facilitated expenditure adjustment to revenue underperformance and growth shortfalls since the global financial crisis in 2008–09, contributing to a rapid increase in the debt-to-GDP ratio. Under a two-pillar framework, the expenditure ceiling—including tax expenditures—would automatically adjust based on well-defined rules so that the debt-to-GDP ratio stabilizes below an established debt ceiling.[1] This would result in a more risk-based fiscal policy framework that aims for a more ambitious fiscal consolidation path when risks to debt sustainability are higher. Calibration of the ceilings should be guided by economic fundamentals and be consistent with a buildup of sufficient buffers over time while allowing for deviations under emergency circumstances, and a correction mechanism for ex post deviations. Equally important is to minimize exclusions from the expenditure ceiling, include potential contingent liabilities into the debt ceiling, and strengthen the medium-term fiscal framework to balance flexibility and credibility. Staff encouraged the National Treasury to promptly complete its review of fiscal rules and make progress towards implementation.

Number of Countries by Combination of Rules



Source: IMF Fiscal Rules Dataset, 1985-2021.
Notes: DR = Debt rule; ER = Expenditure rule; Other rules include budget balance rule and revenue rule.

2. Using the new procurement bill and accompanying regulations as an opportunity to step up implementation of the 2015 Supply Chain Management Review (SCMR). The SCMR lays out a sound reform agenda to modernize and strengthen the integrity of the procurement system. Key priorities include standardizing procurement procedures and transparency requirements in line with international best practice, introducing an e-procurement system well integrated with other government and private information systems (e.g., IFMIS, creditworthiness of potential suppliers) to efficiently automate such procedures and requirements, ensuring that preferential procurement is carried out in a cost-effective and goal-oriented way, and increasing procurement capacity. In this relation, Staff advised centralizing public procurement in fewer institutions and expanding the use of framework agreements to more effectively aggregate public demand for goods, services, and public works to reduce their cost and better leverage limited procurement resources. Undertaking a Methodology for Assessing Public Procurement Initiative (MAPS) assessment could further support the authorities' procurement system reform efforts (Selected Issues Paper: Public Procurement in South Africa: Issues and Reform Options).

[1] For instance, through mandatory measures that reflect the severity of the breach or by a ratio of the difference between the actual and targeted debt level depending on the desired pace of adjustment. The required adjustment could be capped (e.g., at 0.5 percent of GDP annually) to avoid unfeasible and abrupt adjustments.

3. Strengthening the Public Financial Management (PFM) processes to enhance inclusive growth and development outcomes. The National Treasury should gradually advance the implementation of Gender Responsive Budgeting (GRB) and Climate Budget Tagging (CBT) to strengthen the linkages between government's strategic plans and the allocation of resources, increase public investment efficiency, and improve service delivery outcomes (Annex XIV). Undertaking a Fiscal Transparency Evaluation could support efforts to increase transparency and accountability of fiscal operations.

4. Reducing Public Investment inefficiencies. Specific measures include improving the selection process for large projects by systematically subjecting them to rigorous technical, economic, and financial analysis, and integrating the Public Investment Management (PIM) information systems with other government financial information systems to improve the efficiency and transparency of the process. More generally, all public investment projects should be fully integrated into the budget process and contingent liabilities arising from such projects, including private-public partnerships carried out by provinces and SOEs, need to be reported to the central government to ensure proper fiscal risk management. Undertaking a Public Investment Management Assessment (PIMA) could help identify reform priorities and devise practical steps for their implementation.[2]

[2] As South Africa scales up its green investments, the Climate-PIMA (C-PIMA), which adds a climate-responsive dimension into the PIMA framework, could help identify potential improvements in public investment institutions and processes to build climate-related infrastructure.

Annex XVI. Making Structural Reforms Happen: Country Experiences[1]

South Africa urgently needs structural reforms to address its persistent, weak medium-term growth and limited fiscal space. Making reforms happen requires bargaining and building consensus among stakeholders. And although the chosen course of action is determined by South Africa specific circumstances, reform experiences and processes in other countries can provide helpful insights for South Africa to foster its structural policy reform agenda. Notable features for achieving consensus include a gradual and sustained approach, well-targeted compensatory measures tied to reform implementation and with clear sunset clauses, leveraging of independent institutions, early engagement with stakeholders, and effective communications.

1. **While there is broad agreement on the economic benefits of structural reforms, implementing the reforms can be politically challenging**. This is partly because reforms tend to generate gains in the longer term diffused across the wider society, while distributional costs may be sizable and concentrated in the short run. Governments may lack political capital to confront vocal interest groups or there might be a political gridlock. Most reforming economies have had to overcome such obstacles to undertake difficult reforms. Although the chosen course of action is determined by country-specific circumstances, including the political and institutional settings, there is scope for cross-national learning to address number of common challenges.

2. **A gradual, sustained approach works well for some countries where memories of crisis or near-crisis are still vivid, but where the situation has stabilized.** Examples include:

- *Australia* - The "big bang" tariff reduction of the 1970s backfired and had to be reversed. Instead, the gradual pace of reforms in the 1980s–90s made them more sustainable. Step by step, international trade, the public utility sector, and labor markets were liberalized. As input costs declined, support grew for the next stage of reforms. In the public utility sectors, the first step was to introduce greater competition. Privatization came later, gradually.

- *Mexico* also took a sequenced and slow approach in reforming its SOEs, by allowing market entry for private companies in the oil, gas, and electricity sectors; SOEs were also given greater independence—a choice some policymakers considered as fostering accountability.

- *Malaysia's* SOE reform package to address weak performance, partly stemming from structural distortions, inefficient management, inadequate institutional supervision, and high indebtedness, encompassed measures to restructure or liquidate certain enterprises and to develop a privatization program. In a first stage, the government appointed private sector managers, in most cases executives of foreign joint-venture partners, to replace the incumbent government bureaucrats (Athukorala, 2010). When firms were privatized,

[1] Prepared by Vybhavi Balasundharam.

regulatory safeguards ensured that prices would not rise excessively in case of insufficient competition. Privatization proceeds were used to retire government debt.

3. **Compensating those whose livelihood is placed at risk by the reforms can reduce resistance towards reforms.** Common compensation strategies include "grandfathering" rents and long transition periods (OECD, 2010). For example, in *Malaysia*, employment after privatization of SOEs was protected for a transitional period and pension rights of staff remained guaranteed. *India's* reform introducing a nationwide Goods and Services Tax (GST) to replace a patchwork of state taxes compensated states that experienced major revenue losses. *Australia* compensated displaced workers via retraining and assistance and made direct payments to sensitive sectors. For instance, automotive tariff reductions were accompanied by assistance equivalent to 0.3 percent of annual GDP. Liberalization of the dairy market and elimination of federal and state support to the dairy industry in 2000 was accompanied by transitional assistance. Financing came in part from a levy on retail sales of liquid milk, which was not opposed by consumers because they benefited from the decline in prices stemming from deregulation. For SOEs, compensation was also targeted toward maintenance and upgrading, combined with better governance and accountability to ensure that fresh funds would be directed to those purposes. In most cases above, compensation appropriately included sunset clauses. Overall, compensation strategies need to be carefully considered as excessive compensation can blunt the gains from reforms.

4. **Appropriate independent institutions that can support reform from design to implementation could enhance the credibility of reforms and reduce the influence of interest groups.** For example, *Australia* formed an independent Industry Commission to assess costs versus benefits of lifting industrial protection. In *India*, the GST council—not independent, but representative of all states—has been tasked with setting the details of compensation schemes. In *France*, the task of deciding on the number of new public notaries to be allowed entry into the market was given to the independent competition commission rather than to the responsible arms of the government, which might have been subject to greater lobbying.

5. **Early and proactive engagement with stakeholders and the public at large can reduce opposition for reforms.** Such an approach worked for *Canada's* impressive structural fiscal adjustment and associated measures in the labor market, unemployment compensation, pensions, and transfers to the regions. The finance minister and other government representatives conducted extensive public outreach through meetings with stakeholders and the media. Breaking with tradition, the government held meetings mixing interest groups from different backgrounds, rather than separately with each interest group. The goal was to emphasize that the burden of adjustment would be shared broadly. In *Australia*, tariff reductions were pre-announced in the 1980s, avoiding the backlash that followed the sudden policy announcement of the 1970s. In *France*, religious organizations were consulted prior to legalizing Sunday shop openings; the national railway was given a couple of years' notice that it would lose its monopoly over all intercity travel, reducing opposition and allowing it to prepare.

6. **Consistent and clear communication to persuade stakeholders of the need for reform and the costs of non-reform usually complement successful reforms.** For example, the

Australian press promoted the Industry Commission's findings to a wider audience, raising public awareness of the challenges requiring reform, and prompting the governments to implement its recommendations. The *Canadian* government carried out active public education campaigns to raise awareness of the fiscal challenges. It published a key report and shared its key messages through an intensive communication strategy, including national and regional conferences organized by the Ministry of Finance and substantive public debates across the country. The public was made aware of the opportunity costs and intergenerational equity implications of carrying high debt levels. The Mexican peso crisis in late 1994 was also leveraged to sensitize the public to the risks associated with high debt. The campaigns were successful: public polls revealed that reducing the fiscal situation had become a top economic concern for Canadians.

7. When market-friendly reforms are not possible, some countries adopt second-best approaches to enhance the efficiency of incumbent firms. *Korea* in the 1960s–70s preserved favorable credit allocation and tax exemptions for well-connected firms on the condition that they met measurable export (value-added) targets (Song, 1990). *India's* reforms in the 1980s focused on raising the profitability of established industrial and commercial establishments, by easing restrictions on capacity expansion for incumbents, removing price controls, and reducing corporate taxes. These "pro-business" reforms spurred economic growth ahead of the later wave of "pro-market reforms" that opened up trade and allowed greater entry by new firms, which India undertook in the 1990s in response to its balance of payments crisis (Rodrik and Subramanian, 2004).

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Annex XVII. Jobseekers' Grant: Lessons from Other Countries[1]

South Africa has been exploring a jobseekers' grant to alleviate the high levels of poverty and address unemployment. These programs invariably include activation policies aimed at getting able-bodied working-age population off benefits and into work. Other country experiences on such programs provides some useful insights for South Africa to consider in its design, including strengthening work incentives, effectively integrating with other Active Labor Market Policies (ALMPs) to improve employability, and complementing with structural reforms to boost labor demand.

1. **South Africa has high poverty, inequality, and unemployment rates.** Nearly half the adult population lives below the upper bound poverty line (R1,417 per person per month in 2022). Measured by the income share of the richest/poorest and the Gini coefficient, South Africa is one of the most unequal in the world. The aggregate employment rate is extremely low, reflecting both low labor force participation and very high unemployment (at over 30 percent).[2]

2. **Limited direct coverage of the able-bodied working-age population is a key weakness in the extensive social protection system**. Approximately one in three South Africans is a direct beneficiary of a social grant, primarily through three grant programs: older persons', child support, and disability that together account for around 95 percent of grant spending and reach 18 million beneficiaries.[3] Until the introduction of the Social Relief of Distress (SRD) grant during the COVID-19 pandemic, the only social assistance directly accessible to able-bodied working-age adults were some Public Works Programs with limited coverage. The government is currently exploring options, including the jobseekers' grant, to replace the SRD grant following its expiration in March 2024.

3. **A permanent jobseekers' grant targeting the working-age population would need to strike the right balance between providing an adequate safety net and maintaining strong work incentives.** The SRD grant at R350 per month for individuals living below the Food Poverty Line (FPL) income threshold (R624 per month) has low generosity and high benefit withdrawal rates (BWRs).[4] This restricted generosity already provides strong incentives to take up employment. Given that the poor employment outcomes for beneficiaries reflects weak demand for their labor rather than their strong preference for leisure, the jobseekers' grant could also consider reducing the high BWRs to strengthen work incentives (Coady et al. 2021). Examples of tapering policies include:

- Reducing entitlements gradually as income rises. Ireland disregards €20 of earnings per day of permitted work from employment income when calculating Jobseekers' Allowance (JSA)

[1] Prepared by Vybhavi Balasundharam.

[2] This structural employment problem is the result of a mismatch between labor supply and demand at the prevailing market wages. See Shah (2022), Loewald et al. (2021), and Duval et al. (2021) for a discussion on the labor market issues in South Africa.

[3] Another one-third of the adult population is estimated to be indirect beneficiaries of grants by virtue of living in the same household as a direct beneficiary.

[4] BWR refers to the share of additional household income from moving into employment that is lost due to reductions in benefits and income taxation.

entitlement and deductions are calculated as 60 percent of earnings less this income disregard.

- Disregarding a fixed amount or proportion of earned income from the standard means test - Italy disregards 20 percent of the beneficiaries' earnings in the means test for the eligibility when they find a job. Romania's Minimum Inclusion Income program intends to disregard 50 percent of the incomes from formal sources (salaries, self-employed activities, agricultural incomes) with a maximum of RON 400 per family to stimulate the participation of beneficiaries on the labor market.

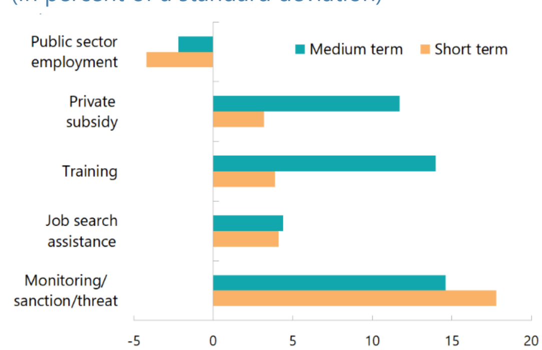
- Reducing benefits over fixed durations irrespective of income earned - Malta has a fixed-duration payment incentive to move into work where payments are tapered in proportion to time elapsed since finding employment (payments are reduced by 35 percent for the first year of employment, 55 percent for the second year, 75 percent for the third year, and 100 percent thereafter).

4. **The employment incentives could be further strengthened by requiring beneficiaries to participate in effective job-search activities.** Evidence in the literature suggests that cash transfers like the SRD grant without an explicit employment focus generally have little to no impact on adult labor market outcomes (with grants for older persons being an exception), whereas transfers made for job search assistance tend to increase adult labor supply and earnings (Baird, McKenzie, and Ozler, 2018). The complementary activation policies envisaged in a jobseekers' grant, whereby receipt of benefit is conditional on the beneficiary being available and searching for work and participating in the ALMPs, would help improve the employability of the inactive population.

5. **Strengthening ALMPs would be key to improving the labor market outcomes for beneficiaries.** ALMPs include the availability of social integration services, job search aid, vocational training, expansion of public works programs, and support for micro-entrepreneurs or self-employed people. Meta studies find that subsidized public sector employment programs are the least effective and could even be detrimental in the short to medium-term. Monitoring/sanctions for failing to search tend to be the most effective in the short-term. Job search assistance, training and subsidized private sector employment also yield modest gains in the short-term (Card et al. 2010). In the longer-term, training tends to become more effective at increasing employment than job search assistance and monitoring (Marinescu, 2017). For example, Mexico's demand-led approach to its ALMPs, particularly the Bécate job training program, has become a point of reference for other countries

Employment Impact of ALMPs in the Short and Medium-Term

(In percent of a standard deviation)



Source: Based on Table 3a from Card et al. (2015)

Note: Impact of x percent of a SD = employment rate in treatment group roughly x percent higher than in control group.

looking to develop and implement an effective activation program (ILO, 2018).[5] South Africa already has many prominent ALMP programs such as the Sector Education and Training Authority (SETA), Small Enterprise Development Agency (SEDA), and Youth Employment Service (YES). However, evidence on the effectiveness of ALMPs is mixed with many existing programs not passing the cost-benefit analysis (Duval, Yi, and Shibata, 2021).

6. **Developing "one-stop shops" that combine benefits provision with job search support and monitoring could be an effective solution.** In the case of Ireland, the positive labor market impacts of its JSA were only observed in the context of an integrated activation system offered through 'one-stop-shop'- Intreo Centre that integrates both income maintenance and employment support with stricter conditionality starting from 2009 (McGuiness et al., 2021). Similarly, studies on Germany's Hartz reform, under which beneficiaries are required to regularly attend meetings with a job-center advisor and show they are actively looking for work or enrolled in approved work-preparatory skills-training programs, find declines in the number of unemployed and long-term unemployed people (Hochmuth et al., 2021). It is important that these centers are staffed with sufficient and qualified case managers to have a meaningful impact (Rosholm, 2014). In South Africa, this could entail the expansion of its Public Employment Services (PES), which are under-resourced and do not have the quantity and quality of counsellors necessary to provide effective services for millions of job seekers (Loewald et al., 2021).

7. **In the context of South Africa with structural unemployment and high inequality, job search requirements should be designed to avoid the pitfalls of a heavy-handed monitoring program.** Job search monitoring reduces efficiency costs associated with an unconditional grant system like the SRD and is more cost-effective than other ALMPs such as job training (mainly due to lower staffing requirements). Literature consistently finds that job search monitoring and benefit sanctions reduce unemployment duration and increase job entry in the short term. However, increased job search monitoring can cause workers to give up on job search altogether and sanctions for insufficient job search can push the unemployed to take lower quality jobs with lower life-time earnings (Marinescu, 2017). For example, in Switzerland, benefit sanctions lead to a 10 percent reduction in unemployment duration, but also resulted in a 6 percent earnings reduction over the two years after the warning for a benefit sanction (Arni et al., 2013). Furthermore, stringent requirements on employment conditionality could increase social discontent amongst the poor and unemployed and negatively impact the long-term labor force participation rates (McVicar, 2020). An example is the British JSA, where reinforced job search requirements and monitoring resulted in a 5 percent decrease in the probability of working up to four years after the start of unemployment and increased the likelihood of receiving disability benefits by about 3 percent (Petrongolo, 2009). Finally, job search monitoring increases the competition for the limited local labor market opportunities and could create displacement effects, with a lower job finding rate for those who do

[5] Under Bécate, employers offer training in the specific skills they need such as air conditioning repair and lathe operation. The associated costs are shared between the government which covers the cost of training through Bécate and the employer who bears the costs of hiring the instructors, providing training materials and the training site for classroom teaching and in-work training.

not participate in the program. Hence, stricter monitoring and enforcement might not result in an increase in job finding or reduce unemployment in the economy as a whole.

8. Complementary policies such as transportation subsidies and housing support could help support the job-search activities but need to be carefully designed.[6] A study on subsidies to cover the costs of traveling into the main city center to look for work in Ethiopia finds that jobseekers moved into more formal, permanent jobs (Franklin, 2015; Abebe et al., 2016). A study based in South Arica finds that transport subsidies can intensify the search period, but if there are scarce opportunities, job seekers become discouraged and settle too soon for jobs with lower wage gradients in the townships (Banerjee and Sequeira, 2022). Hence, in low-income settings characterized by significant spatial asymmetries of information, transport subsidies need to be accompanied by de-biasing interventions that can better manage jobseekers' expectations, thereby reducing mistargeting of job search. Similarly, the United States Department of Housing and Urban Development's Jobs Plus program, which provides employment services, financial incentives, and community supports to able-bodied, working-age residents of subsidized public housing has been associated with increased annual earnings for its beneficiaries (Evidence Matters, 2018). In contrast, the housing subsidy program in South Africa has had little impact on poverty reduction despite its scale and generous funding, partly because it was developed in locations far from livelihoods and services (Bradlow et al., 2011). Enhancing collaboration with institutions that help identify and develop effective ALMPs could be valuable in scaling up complementary policies as part of the jobseekers' grant.

9. Policies that promote self-employment and "informal hustle economy" as an alternative to formal employment need to be prudently designed and delivered. A steady stream of income from a grant could alleviate the liquidity and risk constraints and lead to better labor supply and earnings outcomes for the self-employed (Baird, McKenzie, and Ozler, 2018).[7] For example, a study on the impact of unconditional and perpetual guaranteed income on small landowning farmer entrepreneurs in India finds that this increases entrepreneurs' risk-bearing ability and significantly improves their credit demand and production activity (Vats and Ghosh, 2022). For the extremely poor households, one-off asset transfers, in addition to monthly stipends and skills training, could be more beneficial with evidence pointing to higher livestock revenue, agricultural and microenterprise income and modest gains in employment in many developing countries (Banerjee et al., 2015, with evidence from six countries: Ethiopia, Ghana, Honduras, India, Pakistan, and Peru). Self-employment could also equip these beneficiaries to better integrate into the labor market and help enhance employment prospects in the longer run. However, enterprises established through policies that promote self-employment as a means to create opportunities for the

[6] Given that transportation costs can take up to a quarter of a typical low-skilled worker's wage (Ngarachu, Schimmelpfennig and Schöer, 2014), maintaining public investment in transport infrastructure and ensuring its affordability would be critical.

[7] Liquidity effect allows households to make investments in agricultural and non-farm businesses that they would otherwise not be able to do, increasing the returns to work and causing individuals to work more. Risk effect allows poor individuals who may not attempt to undertake risky activities with high potential rewards (like self-employment or migration) because of the risk of failure to do so.

extremely poor have generally failed because of lack of entrepreneurial skills and social capital, limited access to financial services and products, an adverse business environment, underdeveloped markets for inputs and outputs, and other impeding cultural factors (Weller, 2009 and Cho, Robalino and Watson, 2016). Hence, the policy mix should focus on raising the returns to self-employment, including by building skills and business know-how, and improving access to finance (Fields, 2019). Finally, while South Africa has low levels of informality compared to other developing countries, explicitly promoting informality might not be first-best as the informal sector is generally less productive and yields lower returns compared to the formal sector. In addition, many of the barriers to informal work, such as transportation costs and urban land regulation, are barriers to labor market participation in general (Shah, 2022). Thus, improving access to formal employment should be the priority.

10. Fostering labor demand would be ultimately required to address the unemployment challenges in South Africa. The jobseekers' program primarily supports labor supply and helps to improve matching with labor demand. However, one of the major constraints in South Africa is the scarcity of local job opportunities. Complementary wage subsidy programs like the Employment Tax Incentive (ETI) can support job creation but could be limited in scope given the fiscal constraints and have been found to be generally ineffective when other labor market frictions are present (Aflagah, 2020). Product and labor market reforms are needed to lift growth and create jobs, including greater representation and firm-level flexibility in the collective bargaining process, streamlined employment protection, energy security, lower transportation costs, and continued efforts to tackle corruption and governance weakness.

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Annex XVIII. Migration and its Implications for South Africa[1]

South Africa has long been a net receiver of migrants who are well-integrated into the labor market and their contribution to the economy increased over time. Immigrant workers have lower income than native-born workers with similar characteristics. The presence of immigrant workers generally complements labor market outcomes of South African workers. Immigrant workers contribute positively to public finances and are less reliant on welfare programs than native. While much lower in numbers, emigration from South Africa exacerbates domestic skills shortages. Thus, a flexible and efficient migration framework is key to alleviating skill constraints and unlocking South Africa's growth potential.

Recent Migration Trends

1. **South Africa has long been a net receiver of migrants reflecting its status of a regional economic powerhouse.**[2] South Africa is a main destination for intraregional migration driven by geographic proximity, income differences, wars in the home country, political stability in host countries, network effects, and environmental factors.[3] The number of immigrants steadily increased from less than 1.2 million in 1990 to over 4.2 million by 2019 (Figure AXVIII.1).[4] Aside from those with unidentified country of origin, the growth has been mostly driven by immigrants from the rest of the Africa continent, while a pickup of immigrants from Europe occurred more recently. In contrast, the number of emigrants leaving South Africa is much smaller, estimated at over 0.9 million by 2020 according to the UN data (Figure AXVIII.2). Top destination countries for South African emigrants are Australia, New Zealand, Canada, UK, and US, attracting ¾ of South Africa emigrants. Gonzalez-Garcia et al. (2016) found that the difference in per capital income, network of diasporas, provision of health services, and common language are important pull factors for migration flows out of the region. Nevertheless, there are signs of an increase in migration flows in both directions in recent years.

2. **Distribution of migration flows across geographic locations and ethnic groups remained stable in recent years.** Immigration flows were concentrated in three provinces since 2006 (Figure AXVIII.3). Gauteng was the main destination of immigrants to the country, accounted for about 48 percent of total net immigration flows between 2016 and 2021. Western Cape and Limpopo attracted another 22 percent of the total net flow over the same period. The disparity in the migration pattern across ethnic groups has been consistent over the years, with net immigration dominated by the African group (Figure AXVIII.4).

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[1] Prepared by Haonan Qu.

[2] International migrants in this annex are defined as individuals who are living in a country other than their country of birth. This definition is not based on the citizenship, legal status, category of migration, or tax residency of people.

[3] Ruyssen and Rayp (2014).

[4] The 2020 UN migration data for South Africa used a 2016 survey published by Stats SA which underestimated the country's international immigration. The analysis therefore opted using the 2019 immigration data instead.

Figure AXVIII.1. South Africa: Immigration Stock Trend by Geography
(Thousands of people)

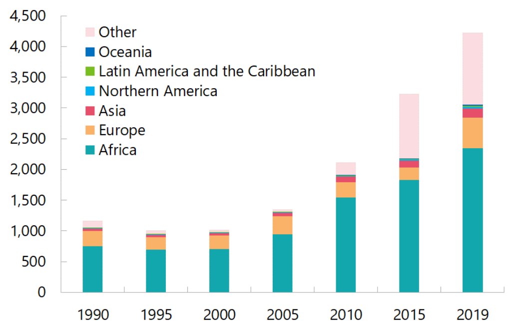
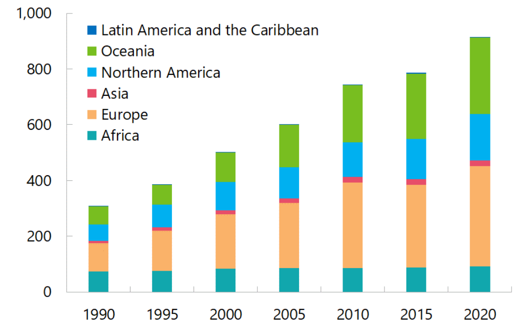


Figure AXVIII.2. South Africa: Emigration Stock Trend by Geography
(Thousands of people)



Source: United Nations Department of Economic and Social Affairs.

Figure AXVIII.3. South Africa: Net Foreign Immigration Flows by Province
(In thousands of people)

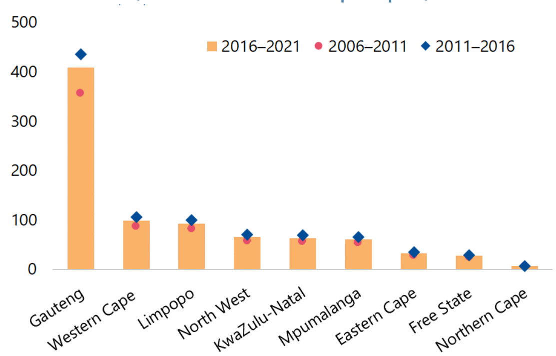
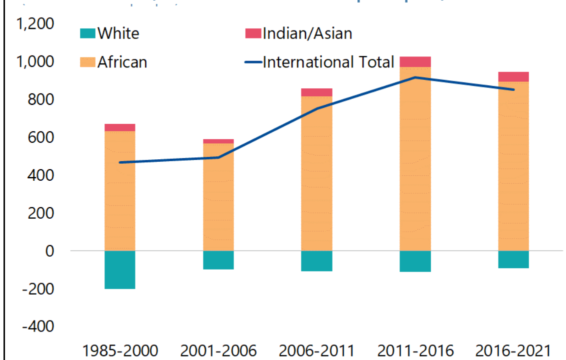


Figure AXVIII.4. South Africa: Net Immigration by Ethnicity
(In thousands of people)



Source: Department of Statistics Mid-year population estimate (MYPE).

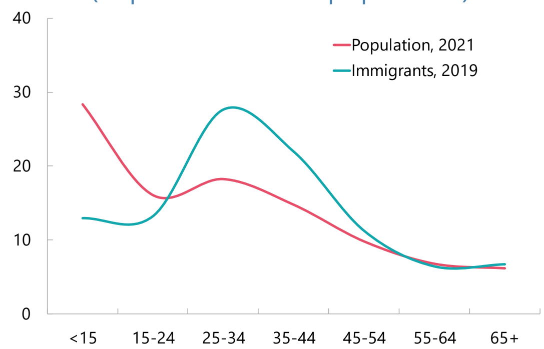
Labor Market Performance

3. **Steady inflow of immigrants gave a boost to South Africa's labor supply.** The share of "prime-age" individuals, those aged between 24 and 54, was over 60 percent according to the 2019 UN data (Figure AXVIII.5). In contrast, the share of the same age group among the South African population was less than 43 percent in 2021.

4. **Immigrants to South Africa appear to be well-integrated into the labor market** (Figure AXVIII.6). The unemployment rate of immigrant workers in South Africa was relatively stable, averaging less than 18 percent over the period between 2000 and 2017, which was substantially lower than that of native-born workers (more than 32 percent). The labor force participation rate was also noticeably higher for the immigrant workers, at 71 percent on average during the same period in contrast to less than 52 percent for the native-born workers.

Figure AXVIII.5. South Africa: Population Density Across Age Groups

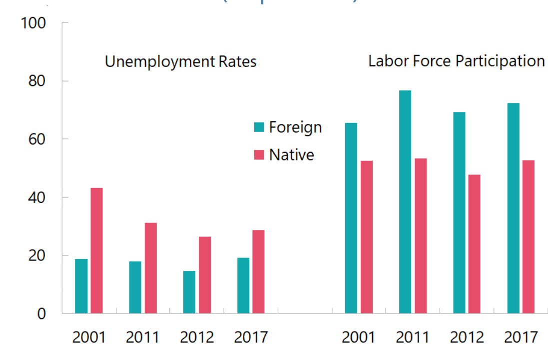
(In percent of total population)



Sources: MYPE 2021, UN 2019.

Figure AXVIII.6. South Africa: Labor Market Performance

(In percent)



Sources: Stats SA and IMF staff calculations.

5. As the number of immigrants continued to grow, their contribution to South Africa's economy also increased. Immigrants accounted for about 5 percent of employment and contributed to closed to 7 percent of South Africa GDP in 2001 (Figure AXVIII.7).[5] The estimated contribution of immigrants almost doubled by 2019 to about 12 percent of total employment, while the contribution to GDP became more aligned with their employment share.[6] The decline of GDP contribution of immigrants relative to their employment share since 2011 was driven by continued migration inflow on the back of subdued economic growth in the past decade, which possibly reflect those immigrants became more active in low-productivity sectors such as agriculture, personal services, construction, and trade.[7]

6. Relative income levels of immigrant and native-born workers changed significantly over time.[8] There was significant income disparity between the two groups of workers in 2001 (Figure AXVIII.8). The immigrant workers on average had about twice as much the income as those born in South Africa. However, compared to the 2001 levels, the average income of immigrant workers dropped substantially by nearly 31 percent in 2011, while that of the native-born workers rose by more than 32 percent. As a result, the gap between the average incomes of the two groups was largely closed based on the 2011 census data.

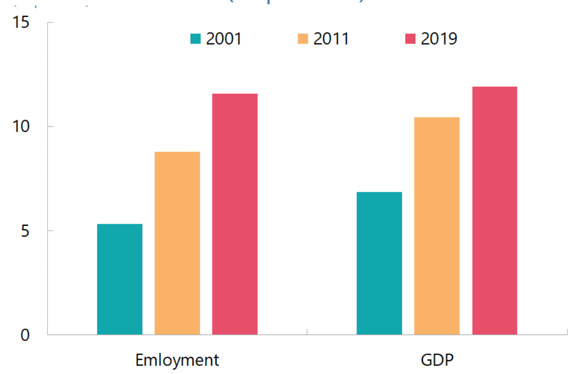
[5] The estimation of immigrants' contribution to GDP is based on the sectoral employment distribution of immigrant workers and average sectoral labor productivity based on the sectoral employment and gross value-added.

[6] The sectoral employment distribution of foreign-born workers in 2019 is estimated using the 2011 census data and the estimated growth of immigrants using the UN migration data 2019. Due to data limitation, the growth of foreign-born workers is assumed the same across all sectors.

[7] OECD/ILO (2018).

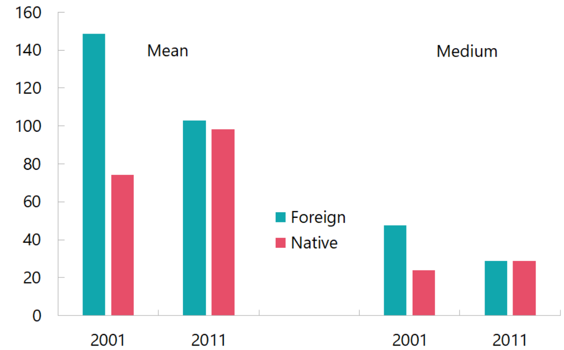
[8] It is worth noting that the income data include labor income and income from other sources. In addition, the income data are collected in broad categories, and the midpoints of the income brackets are used for the analysis. The lowest possible values of the highest income categories are taken, which generates downward bias in the results. There are also concerns about high share of "no income" response in the census data (e.g., Yu, 2009).

Figure AXVIII.7. South Africa: Immigrants Contribution to Employment and GDP
(In percent)



Source: IMF staff calculations.

Figure AXVIII.8. South Africa: Workers' Annual Income
(In thousands 2011 rand)



Sources: Stats SA and IMF staff calculations.

7. **Immigrant workers appeared to have lower income than the native-born workers with similar personal characteristics.** A significant portion of the average income gap between immigrant and native-born workers in 2001 can be attributed to personal characteristics such as education level, age, and gender (Table AXVIII.1, column 1). The income premium of immigrant workers is further reduced once controlling for economic sector, geographic location, and race (column 2, 3), and even became negative (column 4). Based on the 2011 census data, the immigrant workers earned about 4 percent less income comparing to native-born workers conditional on education level, age, and gender (column 5). The estimated negative income premium persists when controlling for additional characteristics (column 6-8), and can be as large as 10 percent.

Table AXVIII.1. South Africa: Log Income Regression Results

VARIABLES	(1) 2001 Census log_inc	(2) 2001 Census log_inc	(3) 2001 Census log_inc	(4) 2001 Census log_inc	(5) 2011 Census log_inc	(6) 2011 Census log_inc	(7) 2011 Census log_inc	(8) 2011 Census log_inc
foreign	0.221***	0.194***	0.147***	-0.018***	-0.038***	-0.022***	-0.079***	-0.099***
	(0.006)	(0.006)	(0.005)	(0.005)	(0.004)	(0.004)	(0.004)	(0.004)
educ	0.757***	0.624***	0.596***	0.441***	0.786***	0.753***	0.731***	0.615***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
age	0.026***	0.025***	0.025***	0.020***	0.028***	0.028***	0.028***	0.023***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
gender	-0.410***	-0.277***	-0.279***	-0.309***	-0.335***	-0.303***	-0.300***	-0.303***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Constant	7.696***	7.279***	7.537***	7.608***	8.024***	7.912***	8.098***	8.124***
	(0.006)	(0.006)	(0.011)	(0.011)	(0.006)	(0.007)	(0.011)	(0.011)
Observations	751,247	751,247	751,247	751,247	937,473	937,392	937,392	937,392
R-squared	0.378	0.439	0.466	0.536	0.347	0.356	0.371	0.428
Sector	No	Yes	Yes	Yes	No	Yes	Yes	Yes
District	No	No	Yes	Yes	No	No	Yes	Yes
Race	No	No	No	Yes	No	No	No	Yes

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: IMF staff calculation.

Economic Impact of Migration

8. The share of immigrant workers was positively associated with the income of native-born workers. For both the 2001 and 2011 sample, the regression results show a positive relationship between the share of immigrants in the labor force and the average income of native-born employed workers. A 1 percentage point increase in the share of immigrants in the labor force is associated with about 1.4 percent and 1.9 percent higher income of native-born employed workers in 2001 and 2011 respectively (Table AXVIII.2, column 1, 3). This could reflect a number of factors, including multiplier effects that immigrant workers bring through increased growth in business activity as well as productivity effects from knowledge transfer and possible increased specialization in the presence of more immigrant workers.[9] As part of the robustness check, the results hold when excluding the agriculture sector (column 2, 4).

Table AXVIII.2. South Africa: Regression Results on Native-Born Income

	(1)	(2)	(3)	(4)
	2001 Census	2001 Census	2011 Census	2011 Census
VARIABLES	log_inc_n	log_inc_n	log_inc_n	log_inc_n
foreign_share	1.406**	1.742***	1.879**	1.823**
	(0.607)	(0.585)	(0.809)	(0.743)
Constant	8.658***	8.786***	9.106***	9.136***
	(0.051)	(0.054)	(0.125)	(0.120)
Observations	32	32	32	32
R-squared	0.995	0.994	0.991	0.992
Education	Yes	Yes	Yes	Yes
Work Experience	Yes	Yes	Yes	Yes
Agriculture sector included	Yes	No	Yes	No

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: IMF staff calculation.

Note: Following the approach of Borjas (2003) and Facchini et al. (2013), the estimation uses a "skill-cell approach" in which observations are grouped into 32 skills cells based on workers education and experience level. Dependent variables are the average of native-born workers labor market outcomes (i.e., employment rate, unemployment rate, and log of income) for each skill cell, and the key variable of interest is immigrant workers share. Education and experience fixed effects are included, and regressions are weighted by the sample size of the skill cell.

9. The empirical evidence on possible displacement effect from immigrant workers is mixed. There is no robust relationship between the share of immigrant workers and the (un)employment rate of native-born workers. The coefficient estimates of immigrant worker share for native-born employment rate are statistically insignificant except for the 2012Q3 labor force survey sample (Table AXVIII.3, column 1–4).[10] For the native-born unemployment rate, the estimates

[9] Peri (2014).

[10] The employment rate of native-born workers is computed as the ratio of employed native-born workers over total native-born working-age population (15–64).

do not have consistent sign or robust statistical significance across different samples (column 5–8).[11] The estimate using the 2011 census data suggests that a 1 percentage point increase in the share of immigrant workers was associated with about 0.5 percentage point increase in the unemployment rate of native-born workers. The results are broadly consistent with the findings of OECD/ILO (2018). Facchini et al. (2013) finds a negative impact of immigration on income using a different sample. Based on industry-province level data and an instrumental variable approach, Hovhannisyan et al. (2018) finds positive impact of immigrants on local employment and wage.

Table AXVIII.3. South Africa: Regression Results on Native-Born Labor Market Outcomes

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
VARIABLES	Employment Rate of Native-Born				Unemployment Rate of Native-Born			
	2001 Census	2011 Census	2012Q3 QLFS	2017Q3 QLFS	2001 Census	2011 Census	2012Q3 QLFS	2017Q3 QLFS
foreign_share	-0.387	-0.215	-1.151***	-0.646	-0.040	0.490**	0.742*	0.389**
	(0.632)	(0.247)	(0.393)	(0.382)	(0.326)	(0.218)	(0.370)	(0.176)
Constant	0.009	0.019	0.060	0.099*	0.808***	0.597***	0.554***	0.540***
	(0.033)	(0.027)	(0.043)	(0.052)	(0.023)	(0.034)	(0.036)	(0.035)
Observations	32	32	32	32	32	32	32	32
R-squared	0.975	0.991	0.989	0.984	0.988	0.988	0.987	0.986
Education	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Work Experience	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: IMF staff calculation.

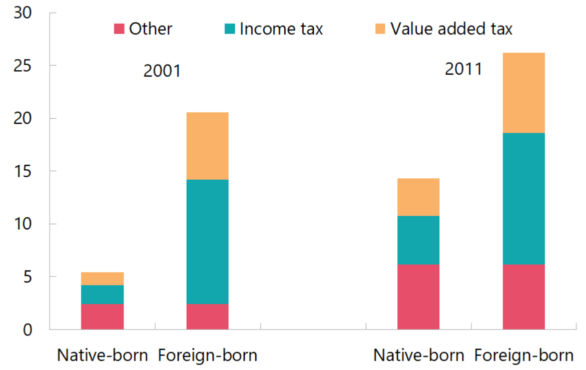
Note: Following the approach of Borjas (2003) and Facchini et al. (2013), the estimation uses a "skill-cell approach" in which observations are grouped into 32 skills cells based on workers education and experience level. Dependent variables are the average of native-born workers labor market outcomes (i.e., employment rate, unemployment rate, and log of income) for each skill cell, and the key variable of interest is immigrant workers share. Education and experience fixed effects are included, and regressions are weighted by the sample size of the skill cell.

10. There is evidence suggesting that immigrants had net positive contribution to South Africa's public finances. OECD (2018) finds that immigrants paid relatively more income and value-added taxes, while the per-capita cost estimates were lower mainly reflecting education expenditure. Per capita revenue from income and value-added taxes from immigrants is estimated more than six times than that from the native-born in 2001, which reduced substantially to about 2.5 times in 2011 (Figure AXVIII.9).[12] In contrast, the difference in estimated per capita expenditure is much smaller between immigrants and the native-born (Figure AXVIII.10).

[11] The results do not change in any material way when the agriculture sector is excluded from the samples.

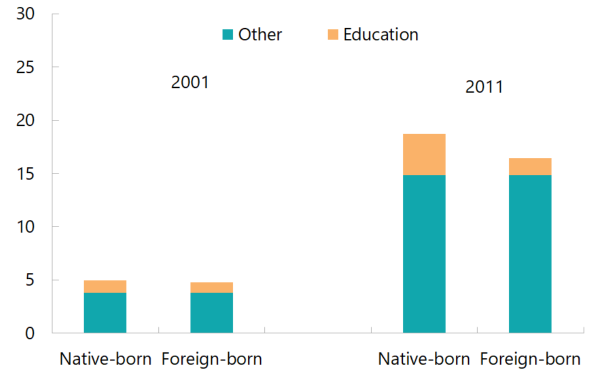
[12] It is worth noting that the estimates do not take into account any tax treaties between South Africa and immigrants' home countries, which could dampen per capita tax revenue from the immigrants.

Figure AXVIII.9. South Africa: Estimated Revenue Per Capita
(In rand)



Source: OECD (2018).

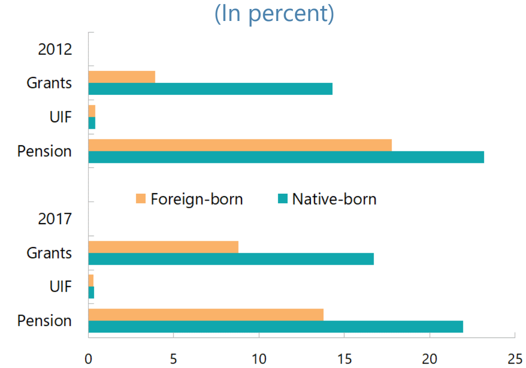
Figure AXVIII.10. South Africa: Estimated Expenditure Per Capita
(In thousands of rand)



Source: OECD (2018).

11. **Immigrants have lower likelihood of receiving welfare benefits.** Based on the quarterly labor force survey data for 2012 and 2017, shares of population receiving grants, unemployment benefits, or pension payments are generally lower among the immigrants than the native-born (Figure AXVIII.11).[13] The share of immigrants receiving grants increased between 2012 and 2017, narrowing the gap with that of the native-born, while the share of immigrants receiving pension payments declined during the same period, widening the gap with that of the native-born. The share of unemployment benefit recipients for both immigrants and the native-born were low in comparison, and the difference between the two was negligible. Controlling for other personal characteristics, such as age, gender, education level, and geographic location, the regression results suggest lower welfare program take-up rates of the immigrants than that of the native-born (Table AXVIII.4). Access to these welfare benefits in South Africa for immigrants may have contributed to their low take-up rates.

Figure AXVIII.11. South Africa: Share of Population Receiving Welfare Benefits
(In percent)



Sources: Stats SA, and IMF staff calculations.

[13] Population is defined as people 15 years and older who were unemployed or not economically active in the seven days prior to the interview was conducted. Grants include only child support grant and welfare grants. Unemployment benefits refer to payments from the Unemployment Insurance Fund.

Table AXVIII.4. South Africa: Probit Regression Result on Welfare Programs Take-Up

VARIABLES	(1) 2012 grant	(2) 2012 uif	(3) 2012 pension	(4) 2017 grant	(5) 2017 uif	(6) 2017 pension
foreign	-0.706***	-0.247	-0.618***	-0.405***	-0.128	-0.401***
	(0.100)	(0.215)	(0.083)	(0.066)	(0.208)	(0.085)
age	-0.008***	0.010***	0.066***	-0.010***	0.008***	0.068***
	(0.000)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
female	1.309***	-0.377***	-0.193***	1.392***	-0.450***	-0.197***
	(0.026)	(0.058)	(0.022)	(0.027)	(0.071)	(0.026)
Constant	-2.160***	-2.896***	-3.416***	-1.851***	-3.029***	-3.545***
	(0.053)	(0.137)	(0.063)	(0.060)	(0.184)	(0.079)
Observations	37,840	37,840	37,840	29,052	29,052	29,052
Education	Yes	Yes	Yes	Yes	Yes	Yes
Province	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo-R2	0.166	0.0820	0.563	0.177	0.0787	0.580

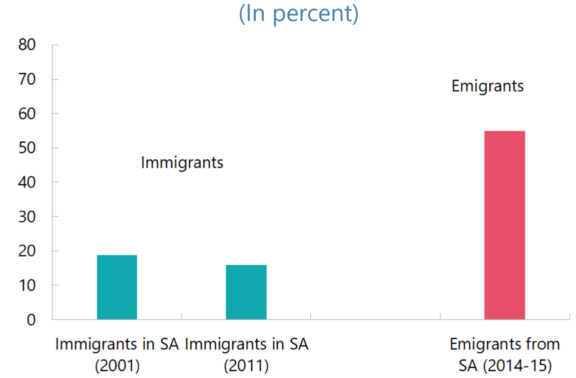
Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: IMF staff calculation.

12. Despite its relatively small size compared to the migration inflow, emigration out of South Africa has material economic consequences. While the number of immigrants in South Africa was more than three times the number of emigrants out of the country in 2019, there has been a recent pick-up in emigration flow since 2015. There is also significant difference in the characteristics between South African immigrants and emigrants. For example, the share of immigrants with tertiary education was less than 20 percent and declining between 2001 and 2011 (Figure AXVIII.12). In contrast, OECD (2019) estimated the share of highly educated among South African emigrants in OCED countries was at about 55 percent in 2014–15.[14] The loss of skills due to emigration added to the pressing shortage in human capital faced by the country. Foko (2015) estimated that South Africa needed as much as 25 percent more of highly educated workers during the period between 2005–14. While well-managed emigration could benefit the source country through knowledge transfer, remittances, investments, and repatriation,[15] Halstein (2021) showed that skilled emigration could cost South Africa about 1.2 percent in long-term growth in the absence of offsetting measures.

Figure AXVIII.12. South Africa: Share of Highly-Educated

(In percent)



Sources: Stats SA, OECD (2019).

[14] The difference in the skill profile between the immigrants and emigrants was present since 1990s. Department of Home Affairs (2017) documented that for every professional immigrating to South Africa, eight professionals left the country between 1989 and 2003.

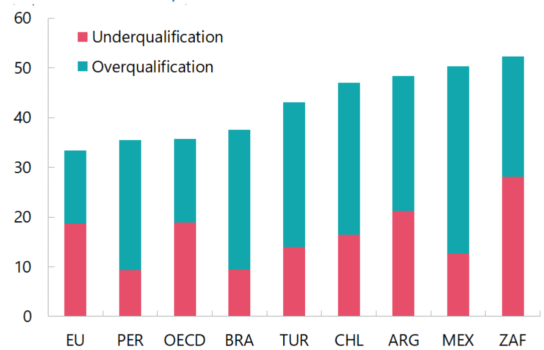
[15] For example, Bharte (2014).

Policy Discussion

13. Migration policy plays a key role in South Africa's development. Skill shortage has long been an important growth impediment and resulting in high structural unemployment in South Africa (Figure AXVIII.13).[16] The shortage of skills not only adds to the high unemployment rate, it also exacerbates inequality through lifting wage premium of skilled workers. Addressing the skills constraints could therefore significantly boost the country's potential growth, and reduce inequality.[17] While a comprehensive course of actions including labor market reforms and improvement of the education system and training programs will be needed to tackle the issue, migration policy, particularly an enabling framework to attract skilled workers, is key in alleviating skills shortages in the near term.

Figure AXVIII.13. South Africa: Qualification Mismatch in Employment

(In percent of total workers)



Source: OECD (2017).

14. The government has taken steps to help bring skills and expertise necessary for the country's development. The labor market faces rapidly evolving demand for skills amid significant changes in global trade, digital technologies, and climate. Meanwhile, the number of work permits issued in the areas of scarce and critical skills is relatively low.[18] And the country's skills immigration policy has been too restrictive to have a meaningful impact on the skills shortages. In 2014, Department of Home Affairs introduced a Critical Skills List (CSL) which formed the basis for the issuance of critical skills visas to facilitate foreign nationals who possess skills in areas where the domestic labor is in short supply. In support of an inclusive recovery from the pandemic and job creation, the government has recently revised the CSL and undertook a comprehensive review of the immigration framework for the critical skills and general work visas in order to improve the efficiency of the framework and processes.

15. The government should continue its efforts of improving the effectiveness of the country's migration framework. Skilled immigration could help alleviate the perennial skill shortages faced by the country. However, minimizing social tensions in recipient communities require policies to strengthen labor market assimilation, enhancing access to education and improving skill recognition, and housing policies to facilitate immigrants' social inclusion and integration.[19] On emigration, as recognized in Department of Home Affairs (2017), developing

[16] For example, Republic of South Africa (2020), Duval et al. (2021)

[17] National Treasury (2019).

[18] Rasool et al. (2012).

[19] Staff Background Paper for G20 Surveillance Note "International Migration: Recent Trends, Economic Impacts, and Policy Implications", 2015.

policies to harness various forms of diaspora capital is a key pillar in South Africa's migration strategy. Useful measures could include developing diaspora networks, relaxing investment barriers and restrictions faced by diasporas, and facilitating remittance inflows.[20] More broadly, sound macroeconomic economic policies in combination with steady reform actions to improve growth potential will help retain South Africans from leaving the country and attract skilled foreigners to fill South Africa's gap in human capital.

[20] Mitra et al. (2017).

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Annex XIX. State Capture Commission[1]

1. The State Capture Commission, also known as the Zondo Commission, was established in 2018 and spanned over four years.[2,3,4] In June 2022, the last out of six parts of the commission's report was handed by Chief Justice Raymond Zondo to President Ramaphosa. Investigations focused on irregular public appointments, improper conduct by the national executive and public officials, parliamentary oversight, as well as concerted efforts and activities of enterprises owned by a well-connected Indian-born family (i.e., the Guptas) as well as other interest groups in gaining control of governance and procurement in state-owned enterprises (SOEs).

2. The commission found evidence of widespread fraud, money laundering, racketeering and various other illegal activities. The commission found that multiple dimensions of state capture took place affecting South African public institutions, including ministries, accountability, and legal enforcement institutions as well as critically important SOEs like Eskom (electricity), Transnet (freight railways and ports), Prasa (passenger railways), SABC (media), and SAA (airline) during the presidency of Jacob Zuma (Table AXIX.1). Evidence revealed how ANC leaders, including former and current government officials, allegedly participated in, or encouraged corruption at an estimated cost of R57 billion, about 1.2 percent of 2018 GDP (Figure AXIX.1). More than 97 percent of this amount occurred in Transnet and Eskom. The Zondo commission report provides a set of recommendations to prompt concrete actions in both the public and private sectors.

3. President Cyril Ramaphosa made public his response to the recommendations of the commission in October 2022. A commitment was made towards reforms in the areas of whistle-blower protection and incentivization, procurement, the capacitation and strengthening of law enforcement and other accountability institutions, the professionalization of the public administration, and the protection of public institutions from abuse (Figure AXIX.2). Commitments were also made to depoliticize the appointment processes for the heads and commanding levels of law enforcement agencies and SOEs by making them transparent and independent. The ANC stated that it has provided a list of "persons implicated" in the Zondo Commission's report to the ANC Integrity Commission.

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[1] Prepared by Max Alier and Hermine Ilunga.

[2] The exact name of the commission is "Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in the Public Sector including Organs of State".

[3] The Zondo commission is one of four commissions established in 2018 to investigate the nature and extent of corruption in the awards of contracts by state entities and government departments. A discussion on the findings, recommendations, and actions of the other three commissions can be found in the 2019 Article IV consultation staff report (Annex VIII SM 20/13) and the 2021 Article IV consultation staff report (Annex XIII SM 22/8).

[4] State capture refers to the way formal procedures (such as laws and social norms) and government bureaucracy are manipulated by government officials, state-backed companies, private companies, or private individuals, so as to influence state policies and laws in their favor.

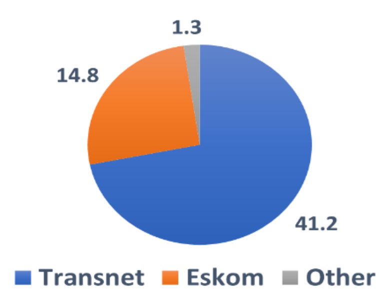
Table AXIX.1. South Africa: Key Findings of the Zondo Commission

Part 1: South African Airways (SAA) and related companies, Gupta-owned New Age newspaper, and the South African Revenue Service (SARS).	Former President Zuma was implicated for the first time in an enquiry commission report. Several high-profile allies of Mr. Zuma were named in the report. The investigation revealed that there was a steady decline in the quality and effectiveness of the governance of SAA from 2012 onwards. Lack of accountability and transparency at SAA and SAA Technical enabled state capture and corruption. Numerous public entities were used to siphon public funds to the Gupta media company and its owners. Evidence revealed that the capture of SARS took place as the private sector colluded with the Executive to weaken SARS systemically and deliberately. This was mainly achieved through a problematic restructuring of SARS, strategic appointments and dismissals of key individuals, and a pervasive culture of fear and bullying.
Part 2: Transnet and Denel.	High-level public enterprise and government officials allegedly participated in state capture at Denel and Transnet by using their positions to appoint allies in strategic positions who would facilitate the Gupta's state capture scheme. State capture at Transnet involved a systematic scheme of securing illicit and corrupt influence or control over decision making.
Part 3: Corruption allegations at Bosasa, later renamed African Global Operations.	Bosasa was a company specializing in providing services to government, most notably prison services. The company's executives were found to have used their connections with politicians to score lucrative government contracts for years.
Part 4: Attempted Capture of the National Treasury, Free State province asbestos removal and public housing project, and the capture of the state electricity utility company Eskom.	Various attempts were made to get the National Treasury to approve certain transactions that were not in the interests of the country. Mr. Zuma, the Guptas and the ANC featured prominently in the report. Evidence proves a scheme by the Guptas to capture Eskom by installing officials in strategic positions within Eskom and as board members so that they take decisions to their financial advantage. The report called on the government to seek legal advice on how to recover R255 million wasted on a Free State province housing project.
Parts 5 and 6: State Security Agency (SSA), the SABC, the ANC, Parliament oversight, Final Recommendations	Regarding the SABC, Mr. Zuma flouted the Constitution and the Executive Members' Ethics Act.

4. **Parliament adopted a plan to implement the commission's findings in November 2022.** The plan proposes that the Zondo recommendations to parliament be referred to the National Assembly's relevant portfolio committees and the National Council of Provinces' relevant standing committees. The proposed constitutional amendments will be referred to the Joint Constitutional Review Committee. The implementation plan suggests that the identified structures, mostly parliamentary committees, report to both Houses' Chairpersons for Committees each quarter. Progress reports on matters that relate directly to the mandates of the respective Rules Committees will be submitted to these committees on a bi-annual basis. A six month-deadline to implement the plan was agreed.

Figure AXIX.1: South Africa: Public Funds Spent on State Capture-Related Contracts.

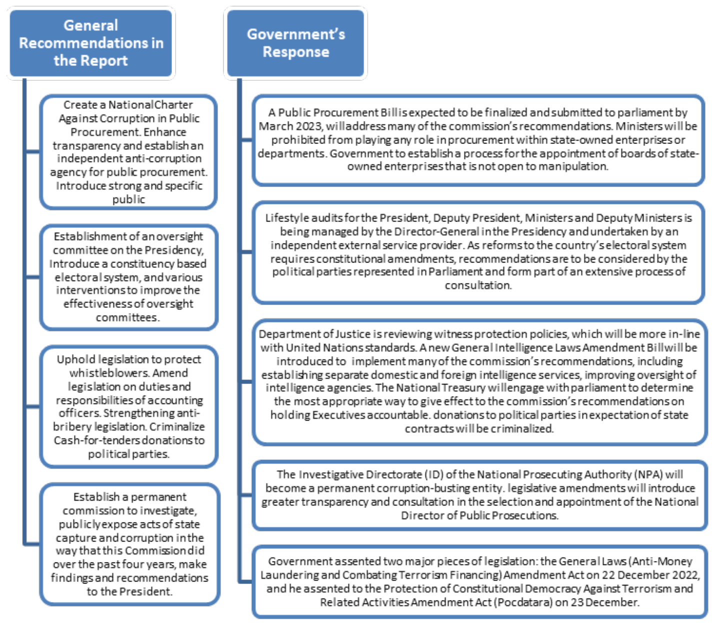
(In rand billion)



*Other includes Denel, SAA, SA Express, SABC, SAFCOL, IDC, Provincial Governments and Municipalities.
Source: Zondo Commission Report.

5. Slow progress has been made in prosecuting some of the corruption cases since 2018. Legal action has been launched by the National Prosecuting Authority (NPA) against Mr. Zuma for violating the Prevention and Combating of Corrupt Activities Act 12 of 2004. Although investigations are ongoing, the NPA has arrested several individuals in connection with state capture charges including former Transnet CEOs Siyabonga Gama and Brian Molefe, former CFO Anoj Singh, former Eskom chief executive Matshela Koko. Former ANC secretary general Ace Magashule was charged and suspended from the party for his role in the Free State province asbestos project. Fugitives Rajesh and Atul Gupta were arrested by Interpol and law enforcement authorities in the United Arab Emirates (UAE) at the request of the South African government. The government has also applied for Gupta brothers' extradition. Meanwhile, the NPA first state capture trial kicked off in late January 2023 - where former provincial officials and Gupta associates are being tried in connection with alleged fraud amounting to R24.9 million. The overall progress remains slow in the prosecution of the individuals that have been identified in the Zondo Commission's report as having possibly participated in State Capture.

Figure AXIX.2. South Africa: Recommendations and Way Forward



6. Progress is also being made in implementing the commission's recommendations to review contracts and overhaul various government processes and institutions. A new leadership was appointed at the South African Police Services' Directorate for Priority Crime Investigation (also known as "the Hawks") and there have been about 4,500 convictions for corruption and other priority crimes. The Special Investigative Unit (SIU), a special tribunal, was created to expedite the recovery of stolen funds and has since recovered over R7 billion to the state and frozen R12.9 billion of funds and assets. New leadership at the SARS has been appointed. Measures were undertaken to end corruption and politicization at the SSA. A new National Director of Public Prosecutions at the NPA was appointed. The Investigating Directorate within the NPA has to date enrolled 32 cases, declared 89 investigations and 187 accused persons have appeared in court for alleged state capture-related offences. Government is also working to capacitate the Witness Protection Unit and will introduce amendments to the Protected Disclosures Act and Witness Protection Act to strengthen protections for whistleblowers. Work is underway to improve access to the witness protection programme for public servants that expose maladministration, corruption, and unethical conduct.

7. There are numerous challenges to the implementation of the Zondo commission recommendations. The commission made over 350 recommendations, 95 of which would require constitutional, legislative, regulatory, or operational changes. Departments may also face challenges in implementing the commission recommendations due to insufficient programs, human capital, and financial resources. of financial resources has been identified for the NPA and SIU. The NPA estimates that it will need an additional R2.25 billion over the next three years if it is to successfully prosecute state capture cases; this is against the 2023 budget R1.3 billion extension to the NPA to support the implementation of the recommendations of the Zondo commission of inquiry into state capture, and to implement recommendations from the pending evaluation of the Financial Action Task Force (FATF) on South Africa's legal framework for fighting money-laundering and terror financing.[1] While the commission pushed for reforms that make it easier for directors and board members implicated in wrongdoing to be criminally prosecuted or face monetary fines, SOE industry players argue that it requires strong political will to be implemented. The commission's recommendations are not binding and ultimately, their implementation depends on the will and capacity of the relevant institutions.

8. The commission's recommendation to revamp the ANC's cadre deployment policy have not been addressed. The commission identified the ANC cadre deployment policy as illegal, unconstitutional, and a driver of state capture. While Cabinet proposed adopting a merit-based recruitment and selection system by approving the National Framework towards the Professionalization of the Public Sector, the announcement by President Ramaphosa didn't include any proposal to deal with the ANC cadre deployment policy. Nonetheless a legal battle is ahead, as the main opposition party, the Democratic Alliance (DA), has gone to court to have the policy declared illegal and against the constitution.

Annex XX. Technical Cooperation

The technical cooperation strategy is aligned with the Fund's surveillance activities. South Africa's technical capacity is high and the authorities appreciated Fund support and anticipate further engagement.

1. The technical cooperation strategy is aligned with the Fund's surveillance activities. Priorities include rationalizing expenditures, managing contingent liability, and strengthening the medium-term fiscal framework to stabilize and reduce debt; strengthening tax administration; maintaining financial stability while supporting financial inclusion; and upgrading national accounts statistics. These areas relate strongly to key surveillance issues: reviving growth by implementing structural reforms, consolidating government and SOEs positions, and maintaining credible monetary and financial sector policies. The World Bank assists with financial inclusion issues.

2. South Africa's technical capacity is high. Ensuring support from the authorities requires it to be demand-driven and prioritized. Recent cooperation by the Fund relates to public-sector wage bill management, property price index development, debt management strategy, SOE funding framework, gender-responsive budgeting (GRB), and transfer pricing. The FSAP also provided an opportunity to discuss reforms in the financial sector area.

Overall Priorities for Further Technical Cooperation:

Priorities	Objectives
Fiscal Risk Management	Support further enhancements to the budgetary framework including in the areas of zero-based budgeting, gender-responsive budgeting, climate budget tagging, and SOE risk management. Support the potential introduction of a public debt ceiling as a fiscal anchor to complement the expenditure ceiling.
Tax Administration	Improve the integrity of the registration database, strengthen the compliance risk management approach, and eliminate fragmentation of organizational roles and responsibilities by type of tax. Reduce tax base erosion and profit shifting, especially by multinational companies. Update customs legislation.
Public Investment Management	Undertake a Public Investment Management Assessment (PIMA).
Financial Stability and Inclusion	Assist the authorities in implementing FSAP recommendations to help enhance the financial stability framework. Explore opportunities for greater financial inclusion.
Statistics	Continue to improve the seasonal adjustment of quarterly national accounts statistics and assisting in developing a residential property price index (RPPI).

Authorities' Views

3. The authorities acknowledged the support provided by the Fund and expect to continue the cooperation in the future. There has been significant progress in developing an official RPPI with the assistant from the Fund. Support in the areas of transfer pricing and implementation of GRB provided by the Fund is also greatly appreciated. Future cooperation priorities include enhancing the budgetary framework; further strengthening tax administration; conducting a PIMA; assisting in the implementation of FSAP recommendations and supporting financial inclusion; and continuing the work on transfer pricing and RPPI.

Appendix I. Status of Key Recommendations from the 2021 Article IV Consultation

	Recommendation	Status
Fiscal Policy	Target medium-term debt stabilization.	The 2023 Budget presents increasing debt to GDP ratios over the medium term due to the Eskom debt relief and despite the resilient revenue and expenditure compression This debt trajectory is unlikely to materialize given elevated fiscal risks arising from spending pressures on the wage bill, social grants, and transfers to SOEs.
	Pursue growth-friendly and largely expenditure-based consolidation measures.	The government has sought to limit unaffordable wage increases by noting that overruns would be offset through headcount reductions. Significant scope remains to rein in the wage bill over the medium-term, reduce SOE transfers, ensure the affordability of social grants, and improve expenditure efficiency.
	Limit tax expenditures to mobilize revenue.	Exemptions related to selected sectors and special economic zones have not been removed.
	Introduce a debt ceiling as a fiscal anchor to complement the expenditure ceiling.	The authorities are still analyzing fiscal rules options such as a debt ceiling, to help anchor the fiscal consolidation while accounting for economic volatility and the country's large development needs.
	Strengthen tax administration (SARS).	Good progress has been made in undoing the damage inflicted by state capture. Additional budgetary resources have been granted to SARS to improve ICT capacity and revenue collection capabilities, but more is needed. There remains scope to limit base erosion and profit shifting as well as to strengthen compliance, reduce tax gaps, and enhance dispute resolution.
	Undertake a Public Investment Management Assessment (PIMA).	The authorities have not requested a PIMA.
State-Owned Enterprises	Carry out an inventory of SOEs to decide those that should be divested or liquidated and those that should remain as such.	National Ports Authority was established as an independent subsidiary of Transnet. The government has appointed a new Eskom board to improve leadership and expertise, and Eskom's transmission unit was separated as a wholly-owned subsidiary. The eventual acquisition of a majority stake in the national airline South African Airways by a domestic consortium is waiting for approval from the country's competition regulator. However, an inventory of SOEs and decisions about their future (i.e., divestment, liquidation, convert into budgetary institution, retain as SOE) remain to be undertaken.

	Recommendation	Status
Monetary and Financial Policy	The SARB needs to remain vigilant about rising inflation risks.	The SARB kicked off its tightening cycle in November 2021, rising its repo rate by a total 425 basis points (bps) since then to bring inflation within its target range.
	Reduce the inflation target range when circumstances allow in the future.	The SARB has been exploring a shift to a narrow/point inflation target but the current circumstances are not appropriate given the surge in global commodity prices.
	The planned revision of MPIF should focus on strengthening monetary policy transmission and the SARB's ability to support market functioning.	The new MPIF has been implemented. The transition was smooth, and it is too early to assess the impact.
	Strengthen oversight of fintech used to enhance financial inclusion.	South Africa has adopted an activity-based approach to fintech. Consequently, the focus has been on better understanding and assessing novel innovations and bringing those into existing regulatory frameworks through a variety of instruments including notices and amendments to legislation. Regulators continue to monitor developments/innovations in their respective sectors. Several initiatives have been implemented that aim to enhance financial inclusion (see FSAP Recommendation Table Appendix II)
	The flexibility of the rand should be maintained.	The government has maintained the ER regime.
	Increase foreign exchange reserves as opportunities arise.	Economic conditions presented very limited opportunities to increase reserves.
	Accelerate the implementation of Financial Sector Laws Amendment Bill (FSLAB).	Implementation of FSLAB is ongoing.
	Make sufficient progress to avoid being subject to the Financial Action Task Force's (FATF) enhanced monitoring process ("gray listing").	The Treasury's attempts to pass through Parliament the needed legislative changes failed as the bill had to first go through public consultation and grey listing was not avoided.
Structural Reforms	Reduce the influence of SOEs while lowering entry barriers and abolishing regulatory constraints to expand access to new players.	Some progress. The licensing rules for embedded electricity generation projects have been removed and the registration process for these projects has been streamlined. Spectrum auction has been completed.
	Reduce regulatory barriers that impede competition.	Industrial policy remains substantially the same, with strong emphasis on localization and protection.
	Accelerate governance reforms on anti-corruption, procurement and SOEs.	The full report of the Zondo Commission of Inquiry into State Capture was released and President Ramaphosa announced anti-graft measures to implement the recommendations, including the establishment of a

	Recommendation	Status
Structural Reforms		permanent Investigating Directorate in the National Prosecuting Authority, strengthening oversight of SOE boards, and finalizing of the Public Procurement Bill. The Department of Public Enterprises has increased its monitoring of SOE financials, although there is limited clarity on scope for corrective measures in case of underperformance.
	Improve labor market flexibility, the quality of education, and ALMPs to address skills mismatches.	Reforms in the labor market and education are still pending. The Public Employment Services and Department of Social Development are implementing ALMPs to improve employability of the labor force but are capacity constrained to meet the large needs.
Social	Well-targeted social spending must be protected, but any increases must be fully offset with credible cuts in other budget areas.	The temporary SRD grant introduced during the pandemic to support low-income working-age population has been extended to March 2024, helped by favorable mineral revenue developments. The authorities remain committed to deficit-neutral increases in social spending.
	Limiting tertiary education subsidies to vulnerable households only.	The government is not accepting new students into the tertiary education subsidy program.

Appendix II. Implementation of 2021 FSAP Key Recommendations

Recommendations	Progress
Vulnerability Analysis	
Further strengthen analytical tools, including for solvency and liquidity stress tests and climate risk analysis, and incorporate results in risk-based supervision.	Further strengthening of stress testing frameworks and models continues on an ongoing basis. Climate risk stress test planned for 2024. Common scenario stress test for the insurance sector to be conducted late 2023.
Financial Sector Oversight	
Continue to broaden the macroprudential toolkit and close data gaps.	Work continues around borrower-based tools and the neutral level for the CCyB.
Consider carefully calibrated measures to alleviate the financial sector-sovereign nexus.	Various policy options under consideration by the FSC. PA/SARB working on closing data gaps to better inform the policy menu.
Continue safeguarding the supervisory agencies' operational independence, further strengthen resourcing, and enhance coordination.	FCI received substantially more resources in the context of the 2023 budget.
Pursue more structured, intrusive, and comprehensive supervision, with greater focus on governance and risk management.	Work in progress.
Develop a rigorous framework for early intervention in banks.	Not implemented.
For insurers, scrutinize capital calculations, review products with high lapse and surrender rates, conduct industry-wide stress tests, and analyze IFRS 17 impact.	Not implemented.
Enact the COFI bill. Develop and implement conduct supervision framework.	The COFI Bill has been revised in response to comments from stakeholders. The Bill is expected to be tabled in Parliament in 2023.
Expedite NPS Act adoption. Buttress Fintech supervision.	Amendments to the National Payment System Act, 78 of 1998 (NPS Act) seeking to promote the transformation of the NPS to enhance access, competition, financial inclusion, and the efficiency of the NPS are to be effected through the COFI Bill.
Implement a consistent multi-sectoral regulatory framework that articulates supervisory and oversight expectations for cyber resiliency.	Not implemented.
Improve climate risk oversight.	SARB/PA is planning a comprehensive climate risk vulnerability assessment (including a stress test of the banking sector in 2024).
Improve the implementation of the risk-based approach to AML/CFT and bring all sectors covered by the FATF standards under the AML/CFT framework.	The PA has implemented the risk-based approach to supervision and has to address a remaining action which pertains to ensuring that the administrative sanctions issued are proportionate, dissuasive, and effective.

Recommendations	Progress
Financial Safety Nets	
Adopt and operationalize the new resolution and deposit insurance legislation.	Work in progress. The President signed the FSLAA into law during January 2021. The Minister will publish a commencement schedule that will bring the resolution and deposit insurance provisions into operation. Estimated for Q2/Q3 2023.
After adopting the new legal framework, step up crisis preparedness through resolvability assessments, resolution planning, and recurrent simulations.	Work on developing resolution plans have begun.
Systemic Liquidity	
Extend SARB's ELA guidance into temporary liquidity support for solvent banks.	
Improve the repo market (establish collateral interoperability, harmonize regulatory treatments of collaterals and repos, and promote repos under GMRA).	Not implemented.
Competition and Efficiency, Financial Inclusion, Green and MSME Finance	
Enable the provision of payment services by nonbanks.	The COFI Bill has been revised in response to comments from stakeholders. The Bill is expected to be tabled in Parliament in 2023. In the meantime, following initiatives are being implemented: • PayShap, one of the solutions under the Rapid Payments Programme (a collaboration between the banks, clearing houses, regulators, and other market players), was launched in 2023 to enable instant payment. Payments will be made to a bank account or a proxy (such as a mobile phone number) that has been linked to an account or wallet at any bank. • South African mobile network operators launched super Apps and offering mobile money with a suite of services including wallet, payments, and lending which will enable unbanked customers to access financial services. • Tap on Phone solution from large payment schemes and big tech firms enable MSMEs to turn their mobile phones into POS devises. • Payment service providers are offering online payment methods that reach small businesses and enable them to participate in e-commerce. • Open banking solutions from fintechs being launched to enable consumers to make instant payments without logging into their bank accounts. • Banks seeking to tap into the informal sector by digitizing payments in the public transport sector.
Foster retail payment instrument interoperability and open banking standards.	Not implemented
Improve credit information environment.	Discussions are still at elementary phase between IFC, NCR and DSBD.
Strengthen secure transaction framework.	Not implemented.

Recommendations	Progress
Competition and Efficiency, Financial Inclusion, Green and MSME Finance	
Finalize the taxonomy of 'green' economic activities and start monitoring flows.	The South African Green Finance Taxonomy (GFT) was launched on 1 April 2022 following a two-year consultation and developmental processes. The SA GFT is a voluntary tool. Our approach has thus been to introduce voluntary market tools for green finance to allow the market time to develop capacity, to adjust and reassess where necessary. Monitoring and adherence mechanisms are still underway. Developments will `be reviewed by National Treasury, in conjunction with the financial sector regulators, DFFE and SARS through the Intergovernmental Sustainable Finance Working Group.
Finalize guidelines on climate-related financial disclosures.	Voluntary guidelines and information tools have been issued. The regulators, Prudential Authority and Financial Sector Conduct Authority, will provide regulatory guidance on disclosures and taxonomy in 2023/24. The JSE Sustainability and Climate Disclosure Guidelines was published in June 2022 and includes an extensive range of frameworks aligned to international best practices i.e., Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

May 5, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The African Department in collaboration with other Departments and the World Bank

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RELATIONS WITH THE IMF

As of April 30, 2023

Membership Status

Joined: December 27, 1945

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

General Resources Account	**SDR Million**	**%Quota**
Quota	3,051.20	100.00
IMF holdings of currency	5,450.08	178.62
Reserve tranche position	652.45	21.38
Lending to the Fund		
New arrangements to borrow	1.98	

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	4,709.85	100.00
Holdings	4,426.17	93.98

Outstanding Purchases and Loans	**SDR Million**	**%Quota**
Emergency Assistance 1/	3,051.20	100.00

1/ Emergency Assistance may include ENDA, EPCA, and RFI.

Latest Financial Commitments:

Arrangements:

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

Outright Loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR million)	Amount Drawn (SDR million)
RFI	Jul 27, 2020	Jul 29, 2020	3,051.20	3,051.20

Projected Payments to the IMF

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

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	381.40	1,525.60	1,144.20		
Charges/interest	113.84	109.76	37.36	10.69	10.69
Total	495.24	1,635.36	1,181.56	10.69	10.69

Exchange Arrangements

The currency of South Africa is the South African rand (ZAR). The exchange rate of the rand is determined by market forces in the foreign exchange market. South Africa's de-jure exchange rate arrangement is free floating, and the de-facto arrangement is floating. South Africa has accepted the obligations under Article VIII, Sections 2(a), 3, and 4 and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions. South Africa has continued to gradually liberalize the system of exchange controls in place since the apartheid regime.

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

Exchange controls on capital transactions by residents have been gradually relaxed. The authorities' main objective has been to move toward a system based on prudential limits and supervision, and away from a rigid system of quantitative controls. The National Treasury and the SARB will continue to develop the legislative framework for the new capital flow management system.

Article IV Consultation

The 2021 Article IV consultation was concluded by the Executive Board on February 7, 2022. South Africa is on the standard 12-month Article IV consultation cycle.

Safeguards Assessment

A first-time safeguards assessment of the SARB, conducted in connection with the Rapid Financing Instrument (RFI) approved by the Executive Board on July 27, 2020, was completed in January 2022. The assessment found solid safeguards in place in all assessed areas, including audit mechanisms and financial reporting practices, which adhere to international standards. Governance arrangements are strong; the SARB Board and its Audit Committee are actively engaged in oversight, and a collegial executive management team is in place. The central bank has a strong control and risk culture, which is supported by a well-developed risk management function. As recommended by the assessment, the SARB enhanced internal audit reports and has recently taken steps to strengthen the analysis of the contingency reserve for risks carried by its balance sheet. The assessment also found that the SARB's involvement in, and the business model of, the Corporation for Public Deposits need to be revisited to better safeguard the central bank's autonomy. The SARB Act's provisions on autonomy could also be further strengthened to align with leading practices.

Technical Support

Fiscal Affairs Department (FAD)

Technical missions to support the authorities in the establishment of a new Parliamentary Budget Office (PBO), discuss options for the National Treasury to strengthen its performance management systems, and conduct a joint workshop with the National Treasury took place in 2013. Missions provided advice on expenditure reviews and options for further strengthening the PBO and developed a pilot of the Tax Administration Diagnostic Assessment Tool (TADAT) in 2014. Another TADAT assessment was completed in 2020. A series of expert visits in 2017–19 provided advice and training on transfer pricing. As part of the technical support for the Davis Tax Committee, an FAD mission on VAT gaps visited in late-2014 and early-2015, and missions on natural resource taxation took place in early-2015 and 2016.

Missions on public sector balance sheets, wage bill management, and PBO analysis took place in 2015. Missions followed up on the review of mining and petroleum fiscal regimes in 2016 and assessed SARS capacity in the administration of transfer pricing programs in 2017. An FAD mission supported the National Treasury in developing a fiscal stress testing framework in June 2018. Subsequent support and training have been provided via AFRITAC South (AFS) in 2018 and 2019. A FAD mission on wage bill management was completed in April 2021. A resident advisor on SOE financial oversight, hired in December 2021, provides support to the South African and regional country authorities. A workshop on Funding State Owned Enterprises was organized in December 2022 and further technical cooperation on SOE risk management is ongoing.

Both a zero-based budgeting workshop to share OECD experience and a gender-responsible budgeting mission took place in 2021, with continued cooperation on the latter.

Monetary and Capital Markets Department (MCM)

An MCM mission supported the South African Reserve Bank (SARB) on banking sector stress tests in May 2014, and AFS on modernization of monetary frameworks in 2014. Other missions worked with the SARB in enhancing its stress testing framework in 2017 and 2018. AFS held a National PFMI workshop in late-2017 and early-2019. East AFRITAC (AFE) held a joint workshop on FX spot & swap market simulation for regional central banks in June 2018. AFS convened a national workshop on risk-focused supervision of cross-border transactions in July 2018 and delivered seminars on risk-focused approach to supervision of cross-border transactions in July 2019 and March 2021 (webinar).

In August–October 2020, MCM undertook the first part of the work on Banking Regulation and Supervision–Basel III to assist the South African Prudential Authority (PA) in revising and updating its prudential regulations for traded market risk to align with Basel III. The second part of the work is expected to be held in-country when feasible. In addition, AFS and MCM have collaborated on several webinars in 2020 and 2021 to deliver information to AFS member countries, including South Africa, on regulatory and supervisory responses to the COVID-19 pandemic. AFS also continues to explore ways in which it can collaborate with the SARB Academy, to deliver technical support to the region. The IMF-World Bank join FSAP concluded in the summer of 2021.

MCM worked with the South African authorities in developing a plan for further capital flow liberalization that is adequately sequenced and considers country-specific macroeconomic, financial, and institutional conditions. A related workshop in November 2019 shared peer countries' experience, thereby facilitating the authorities' design of a plan for liberalizing capital flows, while managing the associated risks. A related mission designed with the authorities a roadmap to judiciously liberalize financial flows considering South Africa's intention to join the OECD Codes of Liberalization. The assistance was completed.

In July 2020, MCM carried out a desk review of the SARB's new monetary policy operational framework. The transition took place during the summer of 2022.

Technical cooperation on the debt management strategy is ongoing.

Legal Department (LEG)

In 2015, a LEG mission supported the authorities on fiscal law of the extractive industries in conjunction with FAD's mission on national taxation.

Statistics Department (STA)

An STA mission collaborated with Statistics South Africa (STATS SA) in assessing the potential for developing an official residential property price index (RPPI) in 2018. An AFS mission focused on the development of an experimental RPPI series for Pretoria in February 2021. The data were first published in March 2023 in the form of experimental statistics for the purposes of stakeholder evaluation and feedback.

A series of AFS missions in 2019-21 cooperated with STATS SA's efforts to derive seasonally-adjusted national accounts estimates; and improve the alignment between the quarterly national accounts estimates and short-term indicators, particularly for household final consumption expenditure and monthly retail sales. Other series reviewed included the import and export price series, and the monthly mining series. The mission reviewed, in detail, the approach taken by STATS SA for the parameters set as part of the seasonal adjustment for those series.

Jointly with the SARB Academy and the South African Development Community (SADC) Committee of Central Bank Governors (GCCB), STA conducted an introductory course on monetary and financial statistics (MFS) in October 2019. The course familiarized participants with the recommended methodology for compiling MFS and promoted the use of standardized report forms (SRFs) as an input to monetary policy formulation and analysis. An STA mission supported the SARB's work on compiling a set of integrated national accounts by institutional sector in June 2020.

THE JMAP WORLD BANK IMF MATRIX

The IMF South Africa team led by Mr. Papa N'Diaye met with the World Bank South Africa team led by Ms. Marie-Françoise Marie-Nelly in March 2023 to discuss macro-critical structural issues.

The teams agreed that South Africa's challenges include maintaining macroeconomic stability while boosting growth and making it more inclusive to promote job creation and social cohesion.

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

- The IMF team asks to exchange information on progress in macro-critical structural reforms under the World Bank's purview (product and labor markets and governance). Timing: when milestones are reached or in the context of missions (and at least semiannually).

- The World Bank team asks to exchange information on progress in the areas of macroeconomic stability (fiscal, monetary, and financial sector policies) and macro-critical structural reforms. Timing: when milestones are reached (and at least semiannually).

Table 1 lists the teams' separate and joint work programs during May 2022–April 2023.

Table 1. South Africa: World Bank and IMF Planned Activities in Macro-Critical Reform Areas, May 2022–April 2023

Title	Products
1. World Bank Work Program[1]	• Development Policy Operation. • Country Climate Development Report • Disaster Risk Finance Diagnostic • Strengthened Governance (PPP and Procurement) • South Africa Economic update • Analytical work on leveraging trade for inclusive growth and resilience • Eskom Just Energy Transition Project • Government debt and risk management • Inclusive economic development at city, regional, and national levels • Climate Financing • Country Economic Memorandum
2. IMF Analytical Work Program	The IMF will continue to conduct analytical work on topics related to: • Monetary policy implementation framework • Predictive power of inflation expectations • External spillovers to South Africa • Government's asset and liability management strategy • Grants and employment • The role of migrant workers • Gender inequality • Procurement reform • Carbon tax
3. Joint Products in the Next 12 Months	• Coordination on structural reform advice • Assist with the implementation of FSAP recommendations

[1] Missions are ad hoc, but generally occur twice a year.

STATISTICAL ISSUES

(As of May 5, 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provided to the IMF are adequate for surveillance.
National Accounts: Statistics South Africa (STATS SA) is responsible for compiling GDP data by production, expenditure, and income approaches according to the *System of National Accounts 2008 (SNA 2008)*. STATS SA now publishes benchmarked real GDP measured at constant 2015 prices, which replaces the previous GDP measured at constant 2010 prices. STATS SA revised GDP series in August 2021, raising nominal GDP level by around 10 percent. Double deflation is used to derive the volume estimates of output and intermediate consumption, as recommended by the *SNA 2008*. Quarterly labor market statistics are published two months after the end of the quarter. Given high unemployment, labor market analysis and policy design would benefit from better and more frequent labor market data. The Quarterly Labour Force Survey uses an Master Sample framework that is designed to be representative at the provincial level.
Price Statistics: The consumer price index (CPI) covers all households in South Africa. New CPI weights, effective from January 2022, were derived from changes in the detail of the household final consumption expenditure (HFCE) component of the national accounts from 2017 and 2019. STATS SA has opted to use estimates of household final consumption expenditure from the national accounts to update CPI weights, complemented by sales data, administrative sources, and survey data. It would be important for the authorities to allocate funding for a new household expenditure survey. Supported by Africa Regional Technical Assistance Center South (AFS), STATS SA is in the process of developing an official residential property price index (RPPI). The data were first published in March 2023 in the form of experimental statistics for the purposes of stakeholder evaluation and feedback.
Government Finance Statistics: To move toward fiscal analysis based on the Government Finance Statistics (GFS) framework in compliance with the *GFS Manual 2014*, fiscal data provided for surveillance by the National Treasury and data reported to the IMF's Statistics Department (STA) for the GFS database need to be fully reconciled. The National Treasury's fiscal data covers a part of the general government and does not include the corresponding balance sheet data. Data compiled for the GFS database, compiled by the SARB, cover all the general government subsectors and include the balance sheet data.
Monetary and Financial Statistics: Monetary statistics compiled by the SARB are consistent with the methodology of the 2016 *Monetary and Financial Statistics Manual and Compilation Guide*. South Africa disseminates regular and good quality monetary statistics for the central bank, other depository corporations, and other financial corporations.

<table>
<tr><td colspan="2">South Africa reports several data series and indicators of the Financial Access Survey (FAS), including mobile money and the two indicators (commercial bank branches and ATMs, both per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals. South Africa does not report gender dis-aggregated FAS data.</td></tr>
<tr><td colspan="2">Financial Sector Surveillance: South Africa compiles and disseminates Financial Soundness Indicators (FSIs), which are published on the IMF's FSI website. Thirteen core and nine additional FSIs for deposit takers and two additional FSIs for real estate markets are compiled on a monthly basis. However, the Residential Real Estate Price Index, which is a core FSI, which had been based on data compiled by a commercial bank, ceased to be used as official data in 2016. The authorities are currently developing an officially compiled residential price index. South Africa additionally compiles quarterly FSIs for the household sector and for other financial corporations' sector, including for insurance corporations and money market funds.</td></tr>
<tr><td colspan="2">External Sector Statistics: Balance of payments and international investment position data are compiled quarterly and are broadly consistent with the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). Work is needed to improve the reliability and accuracy of balance of payments data with the aim of reducing errors and omissions. Data on the international reserves position are compiled in line with the requirements of the IMF's Data Template on International Reserves and Foreign Currency Liquidity. South Africa also participates in the IMF's Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS).</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>A subscriber to the IMF's Special Data Dissemination Standard (SDDS) since 1996, South Africa met SDDS specifications on September 18, 2000. South Africa's latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board.</td><td>A Report on Observance of Standards and Codes—Data Module; Response by the Authorities, and Detailed Assessments Using the Data Quality Assessment Framework was published on October 16, 2001.</td></tr>
</table>

Table 2. South Africa: Table of Common Indicators Required for Surveillance
(As of May 5, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates	5/4/2023	5/4/2023	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	3/31/2023	4/11/2023	M	M	M
Reserve/base money	3/31/2023	4/11/2023	M	M	M
Broad money	3/31/2023	4/28/2023	M	M	M
Central Bank balance sheet	3/31/2023	4/11/2023	M	M	M
Consolidated balance sheet of the banking system	1/31/2023	5/3/2023	M	M	M
Interest rates[2]	5/4/2023	5/4/2023	D	D	D
Consumer Price Index	3/31/2023	4/19/2023	M	M	M
Revenue, expenditure, balance, and composition of financing[3] – general government[4]	Q3 2022	12/31/2022	Q	Q	Q
Revenue, expenditure, balance, and composition of financing[3]–central government	3/31/2023	4/28/2023	M	M	M
Stocks of central government debt[5]	3/31/2023	4/28/2023	M	M	M
Stock of central government guaranteed debt	3/31/2022	4/28/2023	A	A	A
External current account balance	Q4 2022	3/9/2023	Q	Q	Q
Exports and imports of goods and services [6]	3/31/2023	4/28/2023	M	M	M
GDP/GNP	Q4 2022	3/07/2023	Q	Q	Q
Gross external debt	Q4 2022	3/31/2023	Q	Q	Q
International investment position	Q4 2022	3/31/2023	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined. Includes discount rates, money market rates, and yields on treasury bills, notes, and bonds.

[3] Foreign and domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Monthly data for goods. Goods and services are published quarterly on the same schedule as the rest of the balance of payments.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by Ms. Vuyelwa Vumendlini, Alternate Executive Director and Ms. Linda Motsumi, Senior Advisor to the Executive Director for South Africa
May 22, 2023

Introduction

The authorities appreciate the productive engagement with the mission chief, Mr Papa N'Diaye and his team during the 2023 Article IV consultation. They acknowledge the Staff Report for South Africa's 2023 Article IV and Selected Issues Paper as presented.

The South African economy successfully weathered the overlapping shocks from the COVID-19 pandemic, adverse weather events, and conflict spillovers. The resilience to multiple shocks benefitted from the strong fundamentals and buffers, including a large external asset position, diversified economy, flexible exchange rate, deep and resilient domestic capital markets, and a favourable public debt composition. Nevertheless, renewed external shocks emanating from, tightened global monetary conditions, volatile capital flows, as well as domestic challenges, including from high and persistent inflation, the energy supply constraints and impediments in the logistics sector, continue to cloud the outlook. Against this backdrop, the authorities are making determined efforts to strengthen the macroeconomic framework and implement the much-needed structural reforms, consistent with the objectives of Operation Vulindlela. This initiative is designed to restore long-term growth, improve the resilience of the economy, promote good governance, and reduce poverty and inequality.

Economic Developments, Outlook, and Risks

South Africa's real output growth moderated to 2.0% in 2022, following economic growth of 4.9% in 2021. Authorities expect growth to slow further to 0.9% in 2023, before rising gradually to 1.8% over the medium term, due to weaker external demand, elevated inflation, higher borrowing costs and escalated constraints in electricity supply. The SARB is of the view that loadshedding alone has shaved-off 0.7% from real output in 2022 and is expected to deduct approximately 2.0% in 2023 and 0.8% and 0.4% in 2024 and 2025, respectively. The reduced impact of load shedding in the later years reflects the anticipated improvement in the energy supply and increased investment in alternative sources of energy. Higher and sustained growth depends on rapid progress in implementing reforms and a capable state to provide public goods and services. In the near term, government is focused on addressing growth-limiting electricity and transport challenges.

The current account surplus of 3.7 percent of GDP recorded in 2021 reversed to a small deficit of 0.5 percent of GDP in 2022, driven by slowing net trade gains. In the near term, weaker external demand, the easing of export commodity prices, and electricity and logistical constraints will limit export volume growth. A slowdown in domestic activity will constrain import volume growth in 2023, while demand for imports will gradually improve over the medium term.

Headline inflation, which had averaged around 4.0% for the three-year period 2019-2021, well within the target rage of the SARB, rose to 6.9% in 2022, on account of surges in food and energy prices. Throughout 2022, global crude oil and food prices placed significant pressure on non-core inflation. Although the pace of fuel price increases has in recent quarters moderated, fuel prices remain elevated. Food inflation has increased anew at the start of 2023 and electricity prices remain elevated. The gradual broadening of price pressures in the economy is evident in core inflation.

Overall, the authorities expect headline inflation to ease in 2023 and over the medium term. The SARB projects inflation to average 6.0% in 2023 and moderate further to 4.9% and 4.5% in 2024 and 2025, respectively. Authorities concur with Staff on the assessment of risks to the inflation outlook and remain committed to keeping inflation around the midpoint of the target range in the medium term and keeping inflation expectations anchored.

The labour market has not recovered to pre-COVID 19 levels, even though employment has increased by 5.8% in 2022. The gloomy economic outlook, together with labour market rigidities, has not supported employment growth, specifically for new entrants and the youth. The unemployment rate in 2022 was 33.5%, according to the narrow definition which excludes discouraged job seekers, an improvement from 35,3% recorded in 2021.

Fiscal Policy

The authorities agree that the macro-fiscal outlook has worsened, and that prudent fiscal management remains essential, bolstered by further measures to place public finances on a sustainable footing. The IMF staff has, however, developed an alternative fiscal framework, which projects higher spending and lower revenues than the authorities' baseline assumptions. In addition, the IMF staff are relatively more bearish on growth than the authorities and as a result, provide advice that is against the backdrop of a weaker baseline assumption. If the authorities were to implement staff's advice, there is a possibility that the measures proposed may exacerbate the weaknesses in the macro-fiscal conditions, rather than aid them, if the more negative outlook does not materialize to the extent assumed.

The authorities have, however, been embarking on a multi-year fiscal consolidation programme. Since the 2021/22 fiscal year, this programme has been undertaken in a manner consistent with the IMF's advice, including by placing greater weight on reducing current expenditure, and protecting investment spending and programmes targeted at the most vulnerable. In this regard, the 2020 Medium-Term Budget Policy Statement projected debt as a percentage of GDP to stabilize at 95.3% and a primary surplus to be achieved in the same year.

Since then, the authorities have consistently exceeded these targets. In the 2023 Budget, the debt-to-GDP ratio is projected to stabilize at 73.6%, which is slightly better than the 74% proposed by staff in paragraph 27 of the staff report. In addition, the authorities have come closer to closing the primary fiscal gap compared to previous budgets since the COVID-19 pandemic. A primary surplus was narrowly missed (by 0.02% of GDP in 2022/23) and the authorities' spending plans over the medium term includes considerable room within the spending enveloped, to enable this target to be achieved. In the 2023/24 fiscal year, a primary budget surplus of 0.9% of GDP is projected.

The authorities note the advice of staff to implement further fiscal consolidation of 3% of GDP, and further note IMF staff's assumption that the debt-to-GDP does not stabilize. However, as noted above, this outlook and the recommendation from which it arises, are significantly worse than the authorities' fiscal plans. For instance, staff assumes that unprecedented fiscal injections for state-owned companies will be made in the near future, with no consideration of alternatives for managing the fiscal risks (such as asset sales, debt management measures and other initiatives). Therefore, the authorities consider that maintaining the current path strikes an appropriate balance between the imperatives of fiscal consolidation and maintaining the appropriate support to the economy.

Monetary Policy and Financial Sector

The management of monetary policy by the SARB has been proactive. Against high and persistent inflation, tightening global financial markets and rising adverse risks to the outlook, the Monetary Policy Committee has increased the repurchase rate by a cumulative 450 basis points since November 2021, bringing the nominal repo rate to 7.75% as at March 2023. The authorities expect that the full impact of the cumulative rate hikes will bring inflation close to the midpoint of the target range by 2025. The transition to the new Monetary Policy Implementation Framework, implemented in mid-2022, is expected to strengthen the monetary policy transmission mechanism.

The financial sector is resilient, albeit with vulnerabilities in certain areas. Authorities concur that the banking sector has remained sound, reflecting improved profitability, near-closure of pandemic-related restructured loans, and adequate capital, as well as liquidity coverage ratios. Authorities continue to rely on the flexible exchange rate to manage capital flow volatility. The authorities are satisfied with the progress on implementation of the Financial Sector Assessment Program recommendations.

Structural reforms

Authorities acknowledge that the implementation of the much-needed structural reforms is central to changing the growth trajectory of South Africa. Addressing high and persistent levels of unemployment, poverty and inequality are critical, as this threatens the stability of social cohesion, particularly given the rising cost of living and financial crime and illicit activities. Operation Vulindlela was established to monitor and support the reform progress. The most binding constraint on growth is the inadequate energy supply, followed by logistical constraints at Transnet. Reduced capacity at ports has compromised South Africa's ability to take full advantage of the commodity price boom, including through higher tax revenues.

Energy sector

The authorities are working towards closing the current energy shortfall through the generation of new capacity at a rapid pace and significant scale, as well as adding capacity that is under maintenance, such as the Kusile and Koeberg power plants, which is expected to come on stream by the end of 2023. Further, the authorities will embark on the following:

- Improve Eskom's plant performance, efficiency, and availability of existing supply through proper maintenance of power plants;
- Implement cost-reflective tariffs to boost revenue and balance sheet of Eskom, though engagements with NERSA, the regulator, that the tariff structure of Eskom should not include the debt relief from the National Treasury, but the actual cost of generating electricity to enable capex investment by Eskom;
- Address the municipal debt program through directives from National Treasury that aim to incentivize servicing utility debt by local authorities;
- Support roll-out of roof top solar for household and business through tax incentives to ease the burden on the grid;
- Replenishing skills on the generation side of the business and consider implementing remuneration adjustments that do not impact negatively on the business;
- Clear regulatory obstacles for Independent Power Producers;
- Implement grid capacity rules that provide assurance to private producers; and

- The new Eskom Transmission company has been established, which will have its independent governance structure. This will ensure that the capacity generated through independent producers is connected to the grid.

Climate change

The Just Energy Transition Investment Plan (JETIP) was launched to harness investments in new energy technologies, energy-efficient appliances, and significantly lower emissions of greenhouse gases. The JETIP will be supported by a coherent industrial policy to enable innovation and economic diversification, while ensuring that communities dependent on high-emitting energy industries are provided with new skills and new economic and employment opportunities. The repurposing of retired Eskom plants, specifically the Majuba plant, has transformed the former coal power plant into a renewable energy plant, bringing in approximately 300MW of energy to the national grid.

While authorities are committed towards transitioning the economy towards a green economy through the Just Energy Transition, this transition will be at the pace and scale of what the country can afford. The review of the carbon tax is on course and efforts towards a carbon neutral economy will be enhanced.

Logistics sector

The freight transport system has been confronted with disruptions caused by the pandemic, civil unrest, increasing cable theft and vandalism of the rail network, loadshedding and extreme weather patterns. Historical underinvestment in ports and rail infrastructure, mismanagement of Transnet over the past decade, as well as an anti-competitive market structure have perpetuated poor performance of Transnet and elevated supply chain bottlenecks.

The following reforms have been put into action to address these challenges:

- Economic Regulation of Transport Bill, which is aimed at establishing the Transport Economic Regulator, is before the National Council of Provinces;
- Software upgrades have been effected to increase efficiency through better signaling;
- Steps have been taken to prevent theft and vandalism and to resolve the challenges in locomotive procurement;
- Implementation of the National Rail Policy, including granting third-party access to the rail network, is underway; and
- Modernizing rail network to allow for fair competition and improvement in pricing and operations and infrastructure functions of Transnet freight.

Labor market

South Africa's unemployment problem is structural by nature. For over a decade, the economy's ability to create jobs has been lackluster, with the youth adversely affected. Authorities concur that the underlying drivers behind the high structural unemployment in the country, exacerbated by low economic growth in recent years, call for a holistic approach to reforms. These matters require a greater social compact with all the relevant stakeholders to ensure uniformity on key challenges and effective resolution.

The challenge of requisite skills and skills mismatch has been identified. In this regard, through Operational Vulindlela, the review of the visa system was done with a view to make the system more flexible to enable the ease of attracting the skilled immigration needed to unlock growth in a less onerous way and address the skills shortages in the economy. Some key milestones in these reforms have been achieved and include the publishing of a revised Critical Skills List, reviewing of policy framework and processes that facilitate skilled immigration, and implementing an e-Visa system. Government has also been embarking on improving quality education to address the skills shortage. This includes increasing vocational education and training systems opportunities, particularly for the youth that have not been absorbed by the formal tertiary education institutions.

Financial crime and illicit activities

The coordinated action plan to get off the Financial Action Task Force (FAFT) grey list, as soon as possible is well underway, with two major pieces of legislation, related to Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) already enacted since October 2021. These have addressed 15 of the 20 legislative deficiencies identified by FATF, while the remaining 5 will be addressed through regulations and practices that do not require legislation.

Conclusion

The authorities are committed to continue to provide a stable macroeconomic policy framework, underpinned by a flexible exchange rate, inflation targeting and sustainable fiscal policy, to encourage investment, improve employment and attain long-term inclusive growth.