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South Africa: 2004 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

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 2004 Article IV consultation with South Africa, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **June 1, 2004,** 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 August 12, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **September 3, 2004,** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its September 3, 2004 discussion** of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the
2004 Consultation with South Africa

Approved by Juan Carlos Di Tata and Carlos Muñiz

August 12, 2004

- The 2004 Article IV consultation discussions were held in Pretoria and Cape Town during May 19–June 1, 2004. The staff team met with the Minister of Finance; the Deputy Governors of the South African Reserve Bank (SARB); senior officials in the Ministries of Agriculture, Trade and Industry, Public Services Administration, Education, Public Enterprise, Health, and Labor; parliamentary committee members; and representatives of the business, labor, diplomatic, and academic communities.

- The staff team comprised Messrs. Nowak (head), Ahmed, Funke, Harjes (all AFR), Mr. Horton (FAD), and Mr. Hviding (PDR). Mr. Arora, the Fund's Resident Representative in Pretoria, participated in the discussions.

- At the time of the 2003 Article IV consultation, Directors considered that the primary policy challenges facing South Africa were to achieve higher rates of growth, substantially reduce unemployment and poverty, and decisively address the HIV/AIDS epidemic. They commended the authorities for their sound macroeconomic management and implementation of structural reforms, which had helped increase the economy's efficiency and resilience to shocks.

- South Africa accepted the obligations of Article VIII in 1973 and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

- South Africa's relations with the Fund, including recent technical assistance, are summarized in Appendix I and its relations with the World Bank Group in Appendix II. Statistical issues are discussed in Section III and Appendix III. The quality and timeliness of South Africa's reporting of economic and financial data are generally satisfactory for surveillance purposes, but weaknesses remain in the reporting of key labor market statistics. The medium-term outlook is discussed in Appendix IV.

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Appendices

Executive Summary

The South African economy appears poised for a recovery in activity. Monetary easing last year, a moderately expansionary fiscal stance, increases in investment, and a pickup in external demand should provide a boost to the economy. As a result, growth is expected to rise from under 2 percent in 2003 to more than 2½ percent in 2004 and to over 3 percent in 2005.

The South African Reserve Bank (SARB) eased monetary conditions in 2003 in response to a major improvement in the inflation outlook. CPIX inflation has been within the official target range of 3-6 percent since September 2003, and short-term interest rates were cut by 550 basis points between June and December 2003, and by another 50 basis points in mid-August. However, there is evidence of a modest buildup in inflationary pressures, and an adjustment in interest rates may be required during the next 12 months.

South Africa's external position has generally strengthened over the past year. The rand has strengthened further, largely reflecting increases in commodity prices. A major milestone was reached with the closure of the SARB's forward book in the foreign exchange market in February 2004, and the SARB has since replenished its net international reserves. Nonetheless, some further increase in reserves would be desirable in order to help reduce currency volatility and keep long-term interest rates low. In response to strong domestic demand and the currency appreciation, the external current account position turned around from a surplus of 0.6 percent of GDP in 2002 to a deficit of 0.8 percent of GDP in 2003; the external debt situation, however, remains very comfortable.

The fiscal stance has been relaxed to provide countercyclical support and help address South Africa's pressing social problems. The deficit for 2004/05 is targeted at 3.1 percent of GDP, compared with outturns of 2.4 percent of GDP in 2003/04 and 1.1 percent 2002/03. The authorities agree that a deficit in the region of 3 percent of GDP should be considered the upper limit of what is desirable to maintain macroeconomic stability and to keep indebtedness under control. An important spending initiative that has been adopted is the universal provision of antiretroviral HIV/AIDS drugs through the public health system.

Key prudential indicators suggest that the banking and corporate sectors are generally sound. Real estate prices have risen strongly in recent years, but the banks appear to be well protected against the consequences of a possible drop in property prices.

Rigidities, skill deficiencies, and relatively high costs in the labor market continue to impede efforts to achieve a significant reduction in unemployment. The staff recommends that steps be considered to decentralize the collective bargaining system so as to allow small and medium-sized enterprises more autonomy in setting wages. It is, moreover, concerned that increases in minimum wages have aggravated the unemployment problem, particularly in the agricultural sector. The government's skills development program could be strengthened by relying less on labor levies as a source of funding and by focusing more on training those presently unemployed.

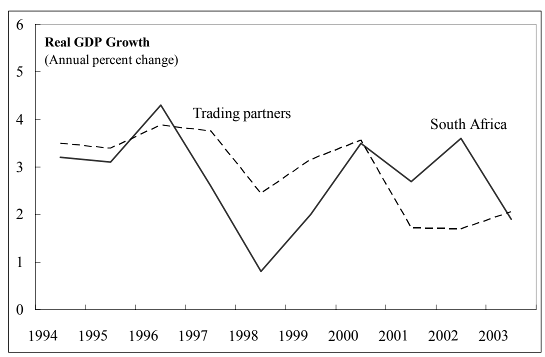
Policies in the areas of trade reform and public enterprise restructuring are being reviewed by the government. The staff urges that further liberalization of the tariff regime be undertaken and that implementation of the privatization program, which has come to a halt, be stepped up. These actions would help raise productivity and enhance South Africa's international competitiveness.

The implementation of initiatives that reduce income and wealth disparities is necessary and desirable for maintaining social cohesion. Initiatives being undertaken to implement a black economic empowerment program and accelerate land reform are, therefore, welcome.

I. RECENT ECONOMIC DEVELOPMENTS

- *After picking up in 2002, the pace of economic activity slowed in 2003, with real GDP growth slipping from 3.6 percent to 1.9 percent. More recently, however, growth appears to be regaining momentum as a result of supportive monetary and fiscal policies and stronger global economic conditions.*
- *Strong domestic demand growth and a currency appreciation have led to a deterioration in the external current account position. But much progress has been made in strengthening the central bank's international reserve position.*
- *Short-term interest rates were lowered by 550 basis points in 2003. Inflation remains well within the SARB's 3-6 percent target range, but there are indications that modest inflationary pressure may be building.*
- *The budget is set on a mildly expansionary track, due mainly to higher social and infrastructure expenditures.*
- *Despite a drop in the official rate of unemployment, limited progress has been made in job creation.*

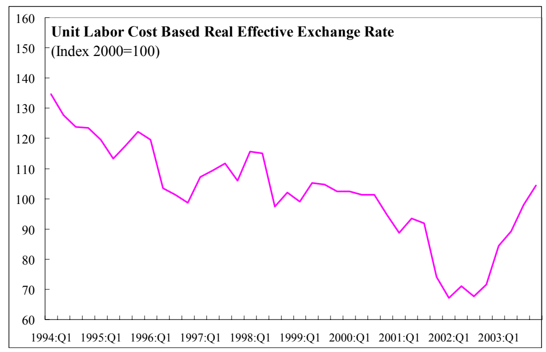
1. **Growth slowed in 2003 to 1.9 percent from 3.6 percent in 2002, despite strong domestic demand.** Fueled by low interest rates, a more expansionary fiscal stance, and the wealth effects from strong commodity and property price increases, domestic expenditures rose strongly in 2003. But the increase in aggregate demand did not translate into higher growth, largely because of a strong currency appreciation and weakening current account performance (Figures 1-6).



2. **Developments so far in 2004 point to a rebound in growth.** Real GDP grew by 3.1 percent in the first quarter of 2004 (quarter-on-quarter, annualized), and a range of indicators, such as retail sales, and consumer and business confidence indices, point to an acceleration in activity. The recovery, moreover, appears to be broadly based; following a year of contraction, the primary and secondary sectors are expanding, while services, which have been the backbone of growth in South Africa in recent years, continue to perform well.

3. **Job growth has remained weak.** Increases in wage rates during 2003 were well in excess of productivity gains and inflation, and thereby dampened labor demand. There has, however, been a sharp drop in the number of people looking for work, and, as a consequence, the official rate of unemployment fell to 28.2 percent in September 2003 from 31.2 percent in March 2003.[1]

4. **The rand has continued to strengthen in value.** The currency has now appreciated by over 50 percent in real effective terms since the end of the large currency depreciation in December 2001. This strength primarily reflects an unwinding of the overshooting in 2001, the impact of strong rises in commodity prices, and an increase in global appetite for emerging market investments (Box 1). Together, the appreciation of the rand and the increase in labor costs have served to weaken South Africa's international competitiveness. Moreover, overseas demand, particularly for manufactured products has also been weak, and, as a result, the external current account position turned around from a surplus of 0.6 percent of GDP in 2002 to a deficit of 0.8 percent in 2003. These factors put a brake on the overall pace of activity in 2003, despite an expansion in fixed capital formation of over 8 percent.



5. **Inflation has subsided over the past 18 months**. The strength of the rand, monetary tightening in 2002, and falling food prices contributed to a decline in inflation from a peak of over 10 percent in October 2002 to 4.4 percent in May 2004; this is well within the SARB's target range of 3–6 percent.[2] In response to the improved inflation outlook, the SARB eased credit conditions and reduced the repurchase rate by 550 basis points to 8.0 percent during the course of 2003 and by another 50 basis points in mid-August.

6. **Foreign exchange inflows have also helped the SARB continue to build up its net international reserve position.** The SARB has purchased foreign exchange in the market, which, together with the proceeds from external borrowing by the government, enabled it to close its open position in the forward market in February 2004. This exposure had represented a major source of external vulnerability and macroeconomic instability. The

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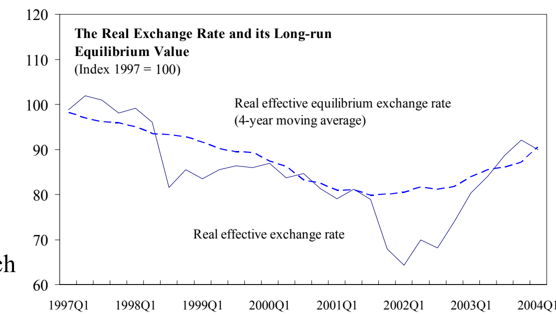
[1] The official rate of unemployment excludes "discouraged" workers; when these workers are included, the unemployment rate remained above 40 percent.

[2] These are CPIX inflation rates. CPIX is the CPI less interest payments on mortgage bonds and is the measure targeted by the SARB under its inflation-targeting framework.

increase in net international reserves contributed to a substantial decline in sovereign risk spreads in recent years (Box 2).[3]

Box 1. South Africa—The Sources of Rand Strength

Between the first quarter of 2002 and the first quarter of 2004, the rand appreciated in real effective terms by 37 percent. This reflected a number of factors. Staff analysis suggests that the exchange rate considerably overshot in value during the large currency depreciation toward the end of 2001, and that around 25 percent of the subsequent recovery in value of the rand reflects a reversion to long-run equilibrium.[1] In addition, fundamentals have served to significantly raise the equilibrium rate. Most notably, gold and platinum prices, which account for one-fifth of total exports, are now around 50 percent and 70 percent higher, respectively, than at the end of 2001. These price increases account for around 7 percent of the real currency appreciation. Similar developments have occurred with respect to other commodity currencies, such as the Australian, New Zealand, and Canadian dollars.



The impact of commodity price increases on the exchange rate appears to have taken place primarily through wealth and terms of trade effects that have boosted aggregate demand and imports. As a consequence, the increase in commodity prices, combined with weak overseas demand for manufactured products, has been associated with a weakening of the current account and a crowding out of the traded goods sector. The impact on the current account, and growth more generally, has been characterized by a relatively weak supply response of precious metal exports, particularly gold, to the price increases. Part of this weak response corresponds to a secular decline in gold production, but it also reflects a fall in prices in rand terms.

The rand has also strengthened as a result of an increase in global appetite for emerging market debt. The expansionary stance of fiscal policy has contributed to the real appreciation by raising aggregate demand and propping up long-term interest rates; however, the exchange rate impact of this stance has been offset by successive cuts in short-term interest rates.

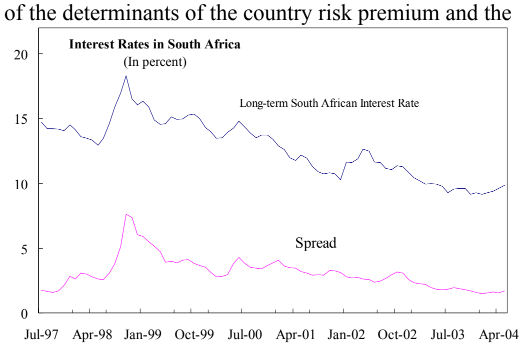
In sum, it is the staff's view that the level of the rand is broadly in line with long-run equilibrium values indicated by macroeconomic fundamentals. This assessment is, however, based on a continuation of the current high level of commodity prices, particularly for platinum and gold.

[1] This observation and the figure is based upon empirical work undertaken by the staff (R. Macdonald and L. Ricci, 2003, "Estimation of the Equilibrium Exchange Rate for South Africa," International Monetary Fund WP 03/44).

[3] The sovereign risk spread on South African debt has shrunk by 550 basis points since October 1998, when the SARB's open position in the forward market peaked at US$23 billion. An empirical study undertaken by the staff estimates that 230 points of this reduction was attributable to the reduction and closure of the forward book. Increased global appetite for risk, as captured by movements in the EMBI+, accounted for 310 points of the reduction. A reduction in domestic public debt contributed to a reduction in spread of over 100 basis points but was partly offset by the impact of an increase in the foreign debt stock.

Box 2. Long-Term Interest Rates in South Africa: Country Risk and Currency Premiums

Long-term interest rates in South Africa have been declining in recent years from historically high levels (see figure below). While sentiment in emerging markets has generally improved, an analysis of the determinants of the country risk premium and the currency premium suggests that the improvement in macroeconomic performance has contributed significantly to the decline in long-term interest rates.[1] Empirical results suggest that a further increase in reserves, a sustained reduction in inflation expectations, and a reduction in the stock of debt may further help ease pressures on long-term interest rates.



For a small open economy, such as South Africa, with a large and well-developed financial sector and a relatively open capital account (at least for nonresidents), arbitrage conditions imply that the long-term domestic interest rate will be determined by, in addition to foreign interest rates, the country risk premium and the currency premium.[2]

Determinants of the country risk premium (spread)

An econometric study, consistent with the domestic fundamentals used by rating agencies and, based on monthly data for the period 1997-2003, indicates that emerging-market lending conditions, foreign exchange reserves, growth, and exchange rate changes significantly affect the country risk premium:

- **Spreads in other emerging markets affect South African spreads, although less than proportionally.** The elasticity of the South African spread with respect to the EMBI spread is approximately 0.8, implying that a reduction in emerging market spreads by 10 percent will tend to be accompanied by a narrowing of the South African spread of 8 percent. This nonproportional effect suggests that the potential for contagion in South Africa may be somewhat less than for other emerging-market economies.

- **Higher foreign exchange reserves, or lower short-term external liabilities, will lead to a reduction in the spread**. For example, a 10 percent increase in the stock of gross foreign reserves, or in the ratio of gross foreign reserves to short-term debt (including the SARB's forward book), narrows the spread by around 5 percent.

- **An increase in real GDP growth by 1 percentage point will result in a reduction in spreads of 7-12 percent.**

- **An appreciation of the exchange rate of 1 percent is associated with a 1 percent decline in spreads**.

Determinants of the currency premium

The currency premium is strongly influenced by the inflation differential and the stock of domestic debt

- **The expected inflation differential, measured as the difference between break-even inflation rates in South Africa and the United States, is a key driver of the currency premium**. The elasticity of the premium with respect to inflation expectations is around 1. Thus, a further improvement in inflation performance in South Africa should lead to a corresponding reduction in the currency premium and long-term interest rates.

- **A decline in the domestic debt stock reduces the currency premium**. A larger stock of domestic debt may increase the incentive for inflationary financing and raise the currency premium. The study finds that an increase in the ratio of domestic debt to GDP of 1 percentage point raises the currency premium by 2-3 percent.

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[1] Currency premium refers to the difference between the domestic currency and foreign currency borrowing costs. It reflects the compensation for expected exchange rate depreciation and exchange rate risk.
[2] Long-term domestic interest rates are from South African government bonds with a maturity of ten years or longer. The country risk premium (spread) is computed as the difference between yields from South African dollar-denominated and U.S. bonds maturing in 2017.

7. **Fiscal policy was eased in 2003/04 (April-March) to provide countercyclical support and to increase outlays on social services.** The budget deficit increased to 2.4 percent of GDP from 1.1 percent in 2002/03, reflecting an increase in social spending (mainly in the form of targeted grants) of 1.3 percent of GDP. A higher-than-expected civil service pay settlement, reflecting the backward-looking nature of wage demands by trade unions, was offset by the impact of lower interest rates on debt-service payments.

Recent Political Developments

The ANC has dominated the political scene since winning the 1994 general election. In April 2004, it achieved a landslide victory with nearly 70 percent of the vote in South Africa's third democratic elections. President Mbeki was inaugurated for a second term. Most ministerial positions remained unchanged. The ANC now has a sufficient majority in the national parliament to amend the constitution with the exception of certain sections that define the values upon which South Africa is a sovereign democratic state. The ANC has, however, indicated that it does not intend to make any constitutional amendment. It has also taken control of all nine provincial legislatures for the first time, either singly or as the majority coalition partner. The ANC continues to participate in a formal coalition with the Congress of South African Trade Unions (COSATU) and the South African Communist Party.

II. Policy Discussions

A. Background and Outlook

8. **The government has overcome major political hurdles in making the transition from apartheid and has resisted pressure to use the budget primarily for redistributing income.** In the process, South Africa has made considerable progress in stabilizing the economy and laying the foundation for higher growth. The public finances have been strengthened significantly, inflation has been brought firmly under control, real interest rates have been lowered, and the external position has improved. In addition, the economy has been exposed to greater competition through trade liberalization and deregulation. As a result, the average rate of economic growth has more than doubled to just under 3 percent since the end of apartheid in 1994. There have been corresponding improvements in many of the social indicators, although performance in some areas has been impeded by the severity of the HIV/AIDS epidemic. Progress in meeting the Millennium Development Goals has been mixed (Table 8).

South Africa: Sources of Growth, 1980-2003[1/]
(Annual averages, in percentage points)

	1980-94	1995-2003	1980-2003
Annual real GDP growth (percent)	1.2	2.7	1.8
Labor (including informal sector)	0.7	0.9	0.8
Capital	0.9	0.6	0.8
Total factor productivity	-0.5	1.2	0.2

1/ Breakdowns based on a growth-accounting exercise.

9. **Near-term prospects for the South African economy are encouraging.**[4] A pickup in global economic activity, low interest rates, and a mildly expansionary budget for 2004/05 underlie a projected rise in growth to 2.6 percent for 2004 and 3.3 percent in 2005.[5] This outlook is supported by positive developments in indicators such as retail sales, consumer and business confidence, and manufacturing production. The main risk to the outlook relates to a continuation of the high pace of pay settlements, which have been running at around 8–9 percent. A continuation of settlements at these levels, while not likely beyond the end of this year, could undermine the recovery and the inflation-targeting strategy. Higher oil prices or further currency appreciation could also put a brake on the recovery.[6]

10. **The stabilization effort is now largely complete, but South Africa faces formidable long-term challenges in the form of high unemployment and widespread poverty.** Much of the task of raising growth and employment must rely on initiatives that boost labor demand and factor productivity, such as labor market reforms, the enhancement of job skills, and further steps in the areas of trade liberalization and privatization. At the same time, the incidence of HIV/AIDS has raised the cost of doing business in South Africa, and concerted action will be needed to contain the social and economic repercussions of the disease. South Africa's acute income and wealth inequalities are a potential source of social strain, and visible progress in pushing forward with land redistribution and black economic empowerment will help address these inequalities.

11. **The Fund's advice to South Africa in recent years has focused on the central policy challenge of achieving higher growth and lowering unemployment.** The authorities have generally taken an open and responsive approach to macroeconomic issues, particularly in the areas of inflation targeting, the management of international reserves, and fiscal policy. In other areas, however, notably the labor market, the need to build a consensus with social stakeholders and other partners in the governing coalition has constrained the speed at which difficult economic reforms can be undertaken.

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[4] For a discussion of the medium-term outlook, see Appendix IV.

[5] Statistics South Africa is rebasing and benchmarking the national accounts. For example, manufacturing production, which accounts for 18 percent of GDP, is now based on a new, expanded business register, and this will likely result in an upward revision of GDP. Revised data will be released at the end of November 2004.

[6] Staff and SARB estimates suggest that the direct impact of an increase of US$10 per barrel in crude oil prices could lead to an increase of CPIX inflation of some 0.7 percentage point and a reduction in growth of 0.2 percentage point.

B. Macroeconomic Policies

Inflation targeting and interest rate policy

12. **Low and predictable inflation is necessary for financial stability and sustained economic growth; it also provides protection for the more vulnerable in society**. The progress made in bringing down inflation to well around the midpoint of the SARB's target range of 3–6 percent is commendable and has paved the way for a significant reduction in short-term interest rates. Sustained success in inflation targeting will very much depend on the central bank's further bolstering its credibility. **The mission, therefore, endorsed various changes that have been made over the past year to the inflation-targeting regime**:

- The inflation objective was changed from an annual average target to a rolling monthly target in November 2003. In addition, the "escape" clause was removed;[7] instead, the SARB is now governed by an "explanation" clause, whereby it must explain deviations from the inflation target and indicate how it intends to bring inflation back on track. These innovations make it easier for the public to understand the inflation-targeting process and subject the SARB to continuous and more stringent accountability.

- The frequency of Monetary Policy Committee meetings was increased from four to six per year. This will allow for a more continuous flow of information to the public, reduce the risk of surprises, and enable the central bank to make smaller and more frequent adjustments in interest rates.

13. **The mission noted that inflation pressures appeared to be building from a number of sources,** although **these pressures were at present limited in intensity; some increase in interest rates may be needed over the forthcoming 12 months.** Aggregate demand growth is outstripping supply, and monetary expansion has been somewhat in excess of nominal income growth.[8] Moreover, the deflationary impact of the appreciation of the rand will likely dissipate before the end of the year, and import prices at the wholesale level are likely to rise in line with international inflation, after falling by 4 percent over the past year. The relatively high level of pay settlements is also likely to add to price pressures, as could the second-round effects of oil price increases.

14. **Because of the inherent volatility of inflation and credibility considerations, the mission suggested that the SARB aim to keep projected inflation at a rate closer to the**

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[7] The escape clause could be invoked when inflation exceeded the target because of spurts in oil and food prices and currency changes "unrelated to domestic economic fundamentals and domestic monetary policy."

[8] Empirical work undertaken by the staff indicates that the income elasticity of money demand is in the region of unity.

midpoint of the band. This would increase the likelihood of meeting the inflation target. The long-term benefits of fully establishing central bank credibility and bringing price and wage-setting behavior onto a more forward-looking basis probably outweigh any potential short-term output costs that may arise from lowering inflation.

15. **The real estate market has been extremely buoyant in recent years**. Property prices rose by approximately 35 percent between January 2003 and June 2004. This increase hides substantial regional disparities (Box 3).[9] Stress tests conducted by the SARB suggest that the banks are resilient to potentially adverse developments in the real estate market. In particular, SARB officials noted that mortgage debt had fallen relative to the value of collateral. Vulnerability would, however, rise if increases in interest rates were to accompany a fall in property prices.

External vulnerability and exchange rate policy

16. **The mission commended the authorities on the considerable progress made in strengthening South Africa's international reserve position.** The SARB's open position in the forward market had been closed and net international reserves increased. Nevertheless, the mission noted that, compared with other emerging-market economies, South Africa's stock of reserves remained relatively low, and a further accretion of reserves to levels comfortably above the stock of short-term external debt would likely help reduce currency volatility and lower spreads.[10]

17. **The SARB has publicly indicated that it will not intervene in the foreign exchange market,** other **than to replenish its international reserves.** In particular, it will not seek to target the exchange rate. The mission agreed with this strategy. Sterilized intervention on a sustained basis that aimed to induce a currency depreciation would be largely self-defeating and could undermine the inflation-targeting strategy.

18. **South Africa has managed its external debt prudently**. Official medium- and long-term external debt presently stands at less than 10 percent of GDP, and the authorities intend to keep it at this level for the foreseeable future. Market confidence in South Africa's debt management, and in its macroeconomic policies more generally, was reflected in the success in May 2004 of an international bond issue of US$1 billion that was heavily oversubscribed.[11]

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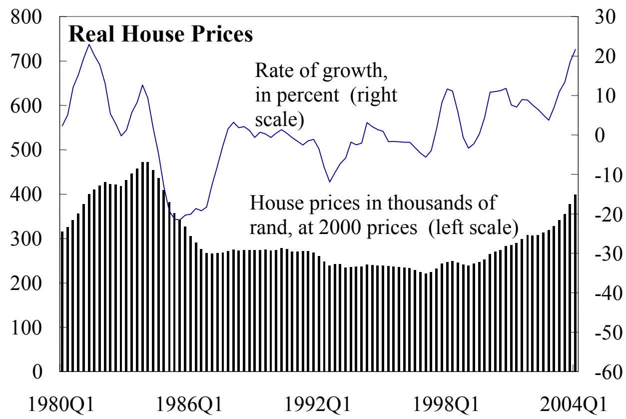
[9] The 2004 Article IV Selected Issues paper analyzes in greater depth property price developments and the potential role of monetary policy.

[10] As of end-June gross reserves stood at US$11.4 billion, while short-term debt is estimated at around US$11 billion.

[11] The bond was issued in New York and included collective action clauses. As with a similar issue in May 2003, there appears to have been no additional cost associated with the inclusion of these clauses.

Box 3. Real Estate Prices and Monetary Policy[1/]

Real estate values in South Africa have risen strongly over the past 18 months. Property prices have increased by 18 percent per year since end-1999, which has been among the highest in the world. This begs the question of whether there is a risk of an emerging bubble in house prices and whether a slump in property prices pose a risk for the banking sector.



Real estate prices and economic development

Asset price fluctuations may affect the real economy through their effect on consumption (via wealth changes), investment, and banks' balance sheets. The latter may give rise to major risks. A rise in property and other asset prices increases a borrowers available collateral and, hence, a lender's willingness to supply credit. At the same time, higher debt may increase a borrower's incentive to pursue more risky projects. Under these circumstances, a subsequent decline in net worth, for example as a result of falling property prices, may set into motion effects that could cause bank distress, and lead to a credit crunch and financial instability.

The extent of property price increases—a bubble?

It is, of course, difficult to distinguish asset price booms driven by fundamentals from pure price bubbles, Empirical work undertaken on industrial countries suggests that an asset price boom period is more likely to be followed by an asset price collapse, with adverse economic consequences, if the boom in asset prices is (a) largely driven by a boom in residential property prices exceeding past trend levels by some 10 percent in real terms and (b) characterized by some easing of monetary policy and strong real credit growth.[2]

Although economic developments in South Africa may share some of these characteristics, at this stage, there are no clear indications of a bubble having developed. Available data suggest that real estate prices rose from very low levels and there are significant regional disparities. In addition, a number of special factors appear to account for the large increase in prices, including increased demand from an emerging black middle class, foreign interest in coastal resort areas, and a switch by small-scale investors from other asset classes to real estate.

Coverage of the banking sector

At present, the banking sector in South Africa, which finances most real estate transactions, appears reasonably well protected against a possible drop in property prices:

- The mortgage debt of households has grown significantly less rapidly than the market value of housing: the ratio of household debt to the market value of housing shrank to 42 percent in 2003 from 58 percent in 1999.
- Banks are well capitalized. The average risk-weighted capital-adequacy ratio stood at 12.2 percent at the end of December 2003. Net nonperforming loans (nonperforming loans less specific provisions) were only 2.4 percent of total loans.
- Banking sector stocks have outperformed the total market index since 2003.

1/ The 2004 Article IV Selected Issues paper examines this issue in greater depth.

2/ For example, International Monetary Fund, 2003, "When Bubbles Burst," in *World Economic Outlook*, pp. 61–94, April; and C. Detken and F. Smeets, 2004, "Asset Price Booms and Monetary Policy," Working Paper Series No. 364, European Central Bank, May.

19. **The mission expressed support for the gradual approach the government had adopted in relaxing capital controls.** The budget for 2004/05 announced some additional, but relatively small, steps to relax controls on resident and nonresident companies. The current strength of the rand and completion of an exchange control amnesty present an opportune time to move ahead in further easing the controls that remain; these relate primarily to unit trusts (mutual funds) and resident companies.[12]

Fiscal policy

20. **The mission noted that prudent fiscal policy, in conjunction with structural budgetary reforms, had been the cornerstone of the stabilization effort in the post-apartheid period.** Relatively small budget deficits and effective tax administration and expenditure control had restored confidence in economic management, contributed to a reduction in sovereign risk spreads, and helped reduce the public debt burden. Savings from lower debt-service payments had been channeled to increased spending on social welfare and economic infrastructure. Fiscal adjustment had also helped dampen price pressures and strengthen international competitiveness.

21. **The budget for 2004/05 provides for a relaxation of the fiscal stance.** The deficit is projected to widen from 2.4 percent of GDP in 2003/04 to 3.1 percent in 2004/05, before falling back below 3 percent of GDP in 2006/07. The budget contains no major tax policy changes, although modest personal income tax relief has been provided through partial bracket adjustments. Major expenditure initiatives include a plan for the universal provision of antiretroviral HIV/AIDS drugs (ARVs) and a further extension of targeted child support grants to older children. Additional outlays are also envisaged for the black economic empowerment (BEE) program, land reform, criminal justice, and the provision of free basic utilities to poor households. In addition, the budget launched a labor-intensive public works program intended to create 1 million temporary jobs for the unemployed over five years at a cost of around 0.2 percent of GDP per year.[13] The larger deficit is expected to lead to a small increase in public debt relative to GDP, although the debt level should remain below 40 percent of GDP over the medium term. Debt dynamics appear manageable under a range of short-term shocks (Appendix IV).

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[12] The exchange control amnesty allowed individuals with excess funds abroad before end-February 2003 to file for an exchange control and income tax amnesty; the amnesty closed in February 2004. Individuals filing for the exchange control amnesty are released from all civil penalties and criminal liabilities. Applicants may pay a 5 percent levy on repatriated holdings, or maintain investments abroad and pay 10 percent. The investments will enter the income tax base from 2004/05 onward.

[13] One million net new jobs would reduce the unemployment rate by 6 percentage points.

22. **The mission expressed support for the stance of fiscal policy.** It noted, however, that allowing the deficit to rise much above 3 percent of GDP could place undue pressure on long-term interest rates and the rand, and it could lead to an unwelcome increase in public debt. The authorities agreed with this assessment and pointed to the possibility of budgetary overperformance in 2004/05. They considered the revenue estimates to be conservative because they did not include the impact of further tax administration improvements or revenues from the exchange control amnesty. Moreover, preliminary indications suggested that there may be underspending on the new expenditure initiatives. Expenditure management efforts need to build on recent reforms at the national and provincial levels. It will be essential to improve the identification of measurable objectives and their linkage to spending requests, strengthen rolling three-year strategic plans, and improve the timeliness and coverage of reporting.

23. **If it became necessary to absorb spending pressures in the future, the mission felt that additional resources should be raised through an increase in the tax effort or cuts in spending on lower priority outlays.** Largely because of equity considerations and the regressive nature of indirect rates, any increase in the tax effort would probably be best borne by income tax adjustments, although there may be some scope for increasing non-oil excise duties. The mission felt that recourse to tax breaks and investment allowances to support social programs, such as black economic empowerment, should be avoided; not only would this raise the deficit and borrowing requirement, but it could distort the tax system and undermine the transparency of fiscal operations.

C. Structural Issues

Financial and corporate sectors

24. **Key macro-prudential indicators for South Africa's financial system are at healthy levels.** The banks remain well capitalized, with a mean capital adequacy ratio above 12 percent. Nonperforming loans represent only 2 percent of total loans and advances, and the foreign exposure of the banks is low. There has been little contagion so far from the distress experienced in the banking sector in neighboring Zimbabwe.

25. **Steps are being considered to strengthen bank supervision.** The Treasury and SARB are jointly reviewing the merits of establishing a single regulator by unifying the supervisory functions of the SARB and the Financial Services Board, which oversees financial markets and the nonbank financial institutions. The review will draw upon the experience of other countries. On the basis of recommendations made in the Financial Sector Assessment Program (FSAP) in 2000, the staff urged that issues relating to the availability of skilled personnel be addressed prior to any unification.

26. **Efforts continue to broaden and deepen the financial system and to address gaps in the regulatory** framework**.** SARB is revising draft legislation on a new, second tier of

banks that will aim to attract deposits from the large unbanked population.[14] The rand has been accepted as a clearing currency by the Continuous Link Settlement (CLS) Bank in London since November 2003, providing for a mitigation of time-zone settlement risk. Participation in the CLS has improved counter-party relations and should increase confidence in the banking system.[15] In March 2004, the SARB published its first Financial Stability Review, which will monitor developments in the financial system and help identify potential risks. South Africa has developed a comprehensive legal structure to combat money laundering and became a member of the Financial Action Task Force on Money Laundering (FATF) in June 2003.[16] The AML requirement for banks to reidentify all 21 million account holders has been postponed, due to capacity constraints, from July 1, 2004 to September 2006, with the provision that high-risk clients be identified by December 31, 2004. In addition to the verification of the clients, increased emphasis needs to be placed on identifying the "beneficial owners" of the accounts.[17]

27. **The corporate sector also appears to be in good health.** Indebtedness is relatively low and declining, while cash flow and liquidity indicators are favorable. Corporate profitability is at levels comparable to those in other emerging markets. Nevertheless, the sector is subject to some vulnerability relating to the large share of interest-sensitive short-term debt held by the corporate sector and the impact that any increase in real interest rates may have on debt-service costs and profitability. The emergence of a corporate bond market in South Africa over the past several years should make it easier for large corporations to gradually shift to longer-term bond financing.

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[14] As the proposals stand, these banks will be required to invest deposits in high-grade paper, such as government bonds.

[15] The authorities also announced that hitherto-unregulated foreign exchange brokers would be regulated under the Financial Services Act effective July 31, 2004.

[16] A Report on the Observance of Standards and Codes (ROSC) for anti-money laundering and combating the financing of terrorism (AMC/CFT) was issued on April 24, 2004, Country Report No. 04/119.

[17] Banks and other "accountable institutions" are developing a risk matrix to deal with cases where a rule-based approach (e.g., ID cards, proof of address) cannot be applied to verify clients' identities, as required under the Finance Intelligence Centre Act (FICA) passed in May 2003.

South Africa: Financial Ratios for the Nonfinancial Corporate Sector, 1998-2003

	1998	1999	2000	2001	2002	2003
Leverage and debt structure						
Debt to equity	0.39	0.44	0.42	0.51	0.52	0.44
Short-term debt to total debt	0.29	0.35	0.38	0.42	0.31	0.42
Liquidity						
Current ratio[1]	1.42	1.34	1.34	1.28	1.34	1.28
Profitability						
Gross margins[2]	0.12	0.10	0.14	0.12	0.12	0.11
Return on equity[3]	0.24	0.24	0.34	0.28	0.29	0.28

Sources: Worldscope; and IMF staff estimates.

1/ Current assets to current liabilities.
2/ Earnings before interest and taxes (EBIT) as a share of sales.
3/ EBIT as a share of shareholders' equity.

Labor market

28. **The persistence of chronically high unemployment is arguably the single most important impediment to poverty reduction in South Africa**. The high unemployment rate is the result of a number of factors, most notably a serious skills mismatch, which is largely the legacy of apartheid, and institutional rigidities that have kept labor costs at artificially high levels relative to the cost of capital. The government recognizes the social impact of unemployment and has set a target of halving the unemployment rate by 2014. This is an ambitious goal that will, the mission argued, require the adoption of labor market and education reforms to raise job skills and labor demand.

29. **The mission noted that progress had been made in skills enhancement**. Execution of the Skills Development Program (SDP) gained some momentum over the past year, and many of the original targets will likely be met. The SDP nevertheless continues to suffer from a number of drawbacks. In particular, it is funded by a levy on labor, which serves to depress labor demand; this problem has been exacerbated by a low take-up of training rebates.[18] Moreover, the program focuses primarily on training those who already have jobs, rather than the unemployed; it is the latter who typically encounter the most difficulty in finding jobs.

30. **The mission expressed support for the new labor-intensive public works program.** Both the authorities and the mission agreed that it would not have a major direct impact on long-term employment, but could provide a useful vehicle for temporarily expanding job opportunities and offering skills training for the unemployed.

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[18] The labor levy, which applies to all but the smallest of businesses, is set at 1 percent. Of this, up to 70 percent may be transferred back to the employers as a rebate, in most circumstances, upon the completion of certified training.

31. **South Africa's collective bargaining system is relatively centralized.** Agreements on minimum wages struck between trade unions and the largest employers are extended by law to small and medium-sized businesses. These businesses are the most important potential source of labor absorption in South Africa but have little autonomy in setting wages that reflect productivity differences. The mission repeated its call, therefore, for a relaxation of the extension principle in order to reduce labor costs and create new jobs.[19]

32. **The application of employment-standard minimum wages appears to have led to job losses.**[20] Recent increases in minimum wages have been well above the prevailing inflation rate and are likely to further aggravate unemployment, particularly in rural areas, where the problem is most acute. While recognizing the importance of protecting the living standards of those who are already employed, the mission urged that the setting of minimum wages place greater emphasis on job creation.

33. **The costs of dismissing and retrenching workers constitute a significant proportion of the total labor costs facing businesses and, therefore, act as a deterrent to the recruitment of new workers.** Legislative amendments passed in 2002 have helped streamline reconciliation and arbitration procedures, but serious bottlenecks remain. This is recognized within government, and steps are being considered to further simplify procedures. An ongoing examination of the labor market commissioned by the Fund staff looks at possible steps, such as making dismissal appeals optional. Most important, these will not require legislative changes.

Trade policy

34. **The country is moving ahead with trade liberalization.** It has been a vocal and effective participant in the Doha round of the World Trade Organization (WTO), pushing in particular for the removal of agricultural subsidies in industrial countries. It is negotiating a number of bilateral trade agreements (including with the United States) and is also pushing forward with tariff reform on a unilateral basis.

35. **Extensive trade reform liberalization undertaken since the early 1990s has been a major source of total factor productivity (TFP) growth, helped lower input costs and consumer prices, and improved competitiveness**. The average tariff (unweighted) was reduced from 22 percent in1988 to an estimated 11 percent in 2003. The tariff structure, however, is highly complex, and a number of sectors, such as textiles and footwear, remain highly protected. The Department of Trade and Industry is of developing proposals for a

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[19] Empirical evidence gathered by the staff suggests that evasion of minimum wage settings by both large and small enterprises may be widespread; evasion, however, is itself likely to be costly, which underscores the need for more flexibility in this area.

[20] These wages are set by the Minister of Labor in a number of sectors (agriculture, retail, and domestic service) that are not covered by bargaining agreements.

further simplification of tariffs that will involve a significant reduction in the number of bands (these are presently around 50) and the application of ad valorem rates for most items. Changes in the tariffs of the South African Customs (SACU) must be approved by a new regional tariff board.[21] The mission suggested that the number of tariff bands be compressed to perhaps three; this would provide an opportunity to significantly reduce effective rates of protection and harmonize protection across different sectors of the economy.

36. **The Motor Industry Development Program (MIDP) has led to gains in employment and a significant increase in automobile exports (Box 4).** The authorities stated that the success of the program also provided a catalyst for new investment more generally in South Africa. It has been extended through 2012. The mission noted, however, that the financial structure of the MIDP was complicated and appeared to involve a combination of export subsidies and heightened protection for domestic production. The cost in terms of forgone fiscal revenue may be considerable. The mission suggested that an in-depth, independent assessment be made of the costs and benefits of the MIDP and that the conclusions of this assessment dictate the pace at which the program is phased down through 2012.

Box 4. The Motor Industry Development Program

The Motor Industry Development Program (MIDP) allows domestic producers of motor vehicles to gain import duty credits when exporting finished motor vehicles or vehicle components. The credits, which are transferable, are granted in proportion to the local content of the exported vehicles or parts. Vehicle producers can also obtain the import duty credits by investing in productive assets for export production. The MIDP was initiated in 1995 and is scheduled to expire in 2012.

South Africa's position in the world vehicle market is widely attributed to the MIDP. From 1995 to 2003, the number of vehicles exported grew more than tenfold, and South Africa's share of the world vehicle market reached 0.7 percent in 2003.

The MIDP differs from the duty drawback system common in many countries. In the case of duty drawback systems, the duty paid on imported components can be claimed back if used for exports, regardless of the domestic contents of the exported goods. A duty drawback system is also available for South African vehicle exporters, but few have chosen to register under this system. This suggests that the MIDP is the financially more attractive option.

[21] SACU consists of South Africa, Botswana, Lesotho, Namibia, and Swaziland.

Parastatal reform and privatization

37. **Progress on major public enterprise reform projects has slowed since the sale of a 28 percent stake in Telkom in 2003.** Most notably, the restructuring of the electricity sector has not proceeded as originally anticipated, and the government is reexamining its plans to privatize generation and separate transmission and distribution.[22] Privatization proceeds were negligible in 2003/04, compared with budgeted receipts of 0.4 percent of GDP. Projected proceeds have also been scaled back sharply.

38. **Inefficiencies in the operations of the major parastatals have added to cost and price pressures, impeded technological progress, and undermined competitiveness.** The government indicated that it was determined to address these inefficiencies. It has responded to concerns over the slowdown in privatization over the past year by stressing in public statements that restructuring would go forward in conjunction with strengthened microeconomic reforms and improved corporate governance.

39. **A review of the reform strategy for the major public enterprises is to be completed by September 2004**. The review will serve as the basis for efforts to strengthen management and accountability and improve efficiency and service provision. The intention is to promote greater investment by the public companies, primarily through concessions and public-private partnerships. Public enterprise reforms are also intended to support improved employment conditions, as well as black economic empowerment through preferential procurement and joint ventures. The mission welcomed the emphasis on microeconomic reforms, but urged the government to move expeditiously to improve parastatal operations and resume the privatization effort. Job retraining or other social safety net policies should be undertaken where needed. The mission also suggested that a clear and effective communications strategy be an integral part of the restructuring process.

D. Social Issues

HIV/AIDS

40. **The HIV/AIDS epidemic is exacting an increasingly heavy toll on society**. According to recent estimates of Statistics South Africa, approximately 15 percent of adult South Africans are estimated to be HIV positive,[23] and prevalence rates continue to rise for most age groups. AIDS claims 800-1,300 lives daily, and demographic projections suggest

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[22] In addition, delays occurred in the sale of a second national license for fixed-line phone operations; the restructuring of units of the air-rail-port enterprise, Transnet; the sale of a stake in the defense aerospace firm, Denel; and finalization of concession arrangements for the Durban port container terminal.

[23] According to previous UN/World Bank estimates, the HIV prevalence rate was around 25 percent.

that, in the absence of corrective measures, 9 million lives, equivalent to 20 percent of the current population, may be lost over the next decade. Estimates suggest that the disease could reduce output growth by between 0.5 and 2.5 percentage points per year.[24] Direct public spending on the disease has increased sharply in recent years, doubling in 2003/04 to 0.2 percent of GDP. Total spending is much higher, since one-fourth of public health spending (0.8 percent of GDP) is HIV/AIDS related. Nutrition and income support programs, which absorb around 0.6 percent of GDP, are also part of the broad response to the disease.

41. **With a drastic reduction of costs, a landmark decision was taken in August 2003 to provide ARVs to the public through the national health system**.[25] The provision of ARVs offers the prospect of mitigating the worst impacts of HIV/AIDS. The treatment regime is complicated, however, and South Africa's program will be unprecedented in scope internationally. Four hundred thousand patients require ARVs, including tens of thousands in remote areas. By 2009, 1.5 million will need the drugs. The program will require a major upgrade of personnel, facilities, and management.[26] The fiscal costs start at 0.1 percent of GDP in 2004/05 and increase to 0.3 percent of GDP per year beginning in 2007/08. The ARV rollout has been running behind schedule so far, as staff training and deployment, drug procurement, and site preparation have taken longer than expected. The rollout is expected to help focus the response of the business community to the disease and stimulate greater testing, possibly leading to higher reported prevalence rates.

Black economic empowerment (BEE) and land reform

42. **There is a broad appreciation within South Africa that initiatives to reduce income and wealth disparities will contribute to greater social cohesion.** The voluntary nature of the government's BEE strategy and land reform programs are important features that should help sustain the support of all groups in the country.

43. **The BEE strategy involves agreement with business on a series of sectoral charters that seek to encourage the transfer of assets and the promotion of black participation in management and operations**. The government has indicated that it would like to see BEE charters completed for all major economic sectors by the end of the year, following the launch of charters in the mining and financial sectors.[27] In expressing support

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[24] A selected issues paper analyzes the impact of HIV/AIDS in greater depth.

[25] Some 7 million South Africans are to receive ARVs through private insurance schemes, rather than the public health system.

[26] South Africa has experienced a steady loss of medical staff, particularly from rural areas, and the 2004 budget provides for additional skill and rural allowances. Over half of ARV program expenditures will go initially to health management, staffing, and infrastructure.

[27] The mining and financial sector charters call for the transfer of 26 percent and 25 percent, respectively, of ownership.

for the overall strategy, the mission identified several key issues that still needed to be addressed. The capacity of the financial sector to lend is limited, and, while a variety of innovative financing options had been discussed, uncertainties remained over how the transfer of assets would be funded. The government had set aside the equivalent of 1 percent of GDP over the next four years to support BEE transactions, but this funding represented only a small proportion of the total value of asset sales envisaged. The authorities and the mission agreed that it would be desirable to avoid financing empowerment deals through tax breaks. The mission also reiterated its concern that there appeared to be few safeguards in the empowerment strategy to prevent the concentration of transferred assets in a few hands.

44. **Land reform is a potentially important vehicle for maintaining social stability and reducing rural unemployment and poverty.** South Africa's land reform program is based on a willing buyer-seller principle, with expropriation provided for only in limited circumstances and subject to appeal procedures. A target has been established for 30 percent of agricultural land to be transferred to black ownership by 2015. After a very slow start, the pace of land redistribution has picked up somewhat over the past year with improvements in procedures and additional funding. To date, around 3 percent of land has been redistributed or restituted. For the program to gain further momentum, issues relating to administrative capacity constraints and restrictions on the subdivision of land will have to be addressed. The government will also need to ensure that the availability of fiscal resources does not constrain the pace of land transfers.[28]

45. **South Africa's progress in achieving the Millennium Development Goals (MDGs) has been somewhat uneven**. In a number of areas, such as poverty reduction, literacy, and the provision of basic amenities, large strides have been made. Other social indicators, however, such as child mortality and life expectancy, have been affected by the HIV/AIDS epidemic. At the current rate of progress, it is unlikely that most of the MDGs will be achieved. Monitoring has been hampered by data availability, but the authorities are undertaking additional efforts to improve the coverage and reliability of the statistical base.

III. Data Issues

46. **Economic data for South Africa are generally of high quality**. They are provided to the Fund (and the public) with detail, frequency, and timeliness fully adequate for surveillance purposes. South Africa subscribes to the SDDS and publishes all the data on the reserve template. Staff encouraged the authorities to continue implementing the recommendations of the 2002 data ROSC (notably those on government finance statistics), as well as those of a more recent mission on monetary and financial statistics. Weaknesses remain with regard to employment and other labor market data, and there have been delays in

[28] The land redistribution program involves the provision of grants to subsidize land purchases. The 2004/05 budget provides the equivalent of 0.1 percent of GDP for this purpose over the next three years.

the publication of selected key economic indicators. In addition, large, unidentified transactions in the balance of payments have been recorded on occasion. For example, during the second half of 2003, these transactions, which are potentially volatile, amounted to the equivalent of 4 percent of GDP. Efforts are under way to improve data collection in order to reduce the large errors and omissions position.

IV. Staff Appraisal

47. **The end of apartheid in 1994 represented a dramatic change in the political landscape and gave rise to strong pressures on the government to use the budget primarily as a tool for income redistribution.** These pressures were wisely resisted, and South Africa has been able to make impressive macroeconomic gains. Since 1994, the average rate of growth has more than doubled to around 3 percent; public finances have been strengthened significantly; inflation has been brought firmly under control; and sovereign risk spreads and long-term interest rates have fallen to historically low levels. Great strides have been made in reducing external vulnerability. A number of social indicators have improved, but the HIV/AIDS epidemic has lowered life expectancy.

48. **Following a slowdown in economic activity in 2003, a rebound now appears to be under way.** The staff expects real GDP to grow by about 2½ percent in 2004 and by more than 3 percent in 2005 in response to a mildly expansionary fiscal stance, low interest rates, and a recovery in the global economy. The high pace of pay settlements, however, poses downside risks that could undermine the recovery and complicate the effort to keep inflation down, while a further currency appreciation or higher oil prices would also have a dampening effect on the recovery.

49. **Growth performance, nonetheless, remains insufficient to make a significant dent in unemployment and poverty reduction**. This highlights the importance of South Africa's pushing ahead with structural reforms that can elevate growth to a higher plateau by raising productivity and enhancing international competitiveness. It also underscores the role that the budget should play in addressing South Africa's acute and pressing social problems, while helping maintain a sound and stable financial environment.

50. **The SARB deserves considerable credit for bringing inflation well within its target range of 3-6 percent and rebuilding its international reserve position**. Looking ahead, the following observations and suggestions may prove helpful to the authorities:

- Several indicators point to a mild buildup in inflationary pressures, and some increase in interest rates may be required if inflation is to stay comfortably within target. However, any adjustment in rates should lag, rather than lead, interest rate changes overseas.

- Once credibility in the inflation-targeting regime becomes firmly established, a downward adjustment in the target band might be warranted since, under such conditions, inflation could probably be lowered with minimal short-term output costs.

- The SARB has allowed the exchange rate to respond to market forces, intervening only to bolster its reserves and not to influence the value of the currency. The staff continues to support this strategy. The rand has strengthened in value over the past year, largely because of increases in commodity prices and stronger sentiment generally in emerging market investments; in the staff's view, the exchange rate remains broadly in line with the long-run real equilibrium level suggested by macroeconomic fundamentals.

- The staff encourages the SARB to continue the process of reserve accumulation at a pace dictated by prevailing balance of payments conditions. Larger reserve holdings should help reduce currency volatility, while the sterilization costs involved would be partly offset by a reduction in spreads and long-term interest rates.

- The staff continues to support the gradual relaxation of capital controls; the present strength of the rand provides a good opportunity to undertake a further round of deregulation.

51. **The government has helped restore confidence in economic management through sustained fiscal discipline and the adoption of important institutional innovations.** The return to this effort has been a healthier external position, and lower interest rates and indebtedness that have freed resources for more productive purposes. The present relaxation in the fiscal stance is appropriate in light of the slowdown in economic activity in 2003 and the need to address social issues. The staff would, nonetheless, caution that deficits significantly above 3 percent of GDP could reverse the stabilization gains that have been achieved, weaken international competitiveness, and lead to an undesirable accumulation of debt. Deficit containment would also alleviate the pressure on monetary policy during the recovery in economic activity. In the event that spending pressures need to be accommodated, funding should rely on tax measures or cuts in low priority spending, rather that borrowing.

52. **The government considers unemployment reduction a central economic and social priority.** To address the problem, it has adopted a multifaceted strategy that includes skills development, improvements in education standards, a public works program, and amendments to labor legislation. Each of these initiatives represents an important step in the right direction. The staff, nevertheless, believes that there is scope for further progress. In particular, small and medium-sized businesses that are legally subject to centralized collective bargaining agreements should be allowed greater latitude in setting wages. Increases in statutory minimum wages for those sectors not covered by bargaining agreements should be tempered by the need to promote job creation, especially in rural areas, where the incidence of unemployment is particularly high. The Skills Development Program should place greater emphasis on training the unemployed, and it should not rely on a labor levy as a source of funding. Finally, relatively high dismissal costs have discouraged labor recruitment, and steps need to be taken to significantly streamline costly arbitration and reconciliation procedures.

53. **A review of the tariff regime is close to completion**. This review will provide an excellent occasion to move ahead forcefully with lowering and harmonizing effective rates of protection and simplifying the tariff regime. It is important, however, that trade liberalization be accompanied by labor market reform, so that the potential benefits of productivity for job creation can be realized in full.

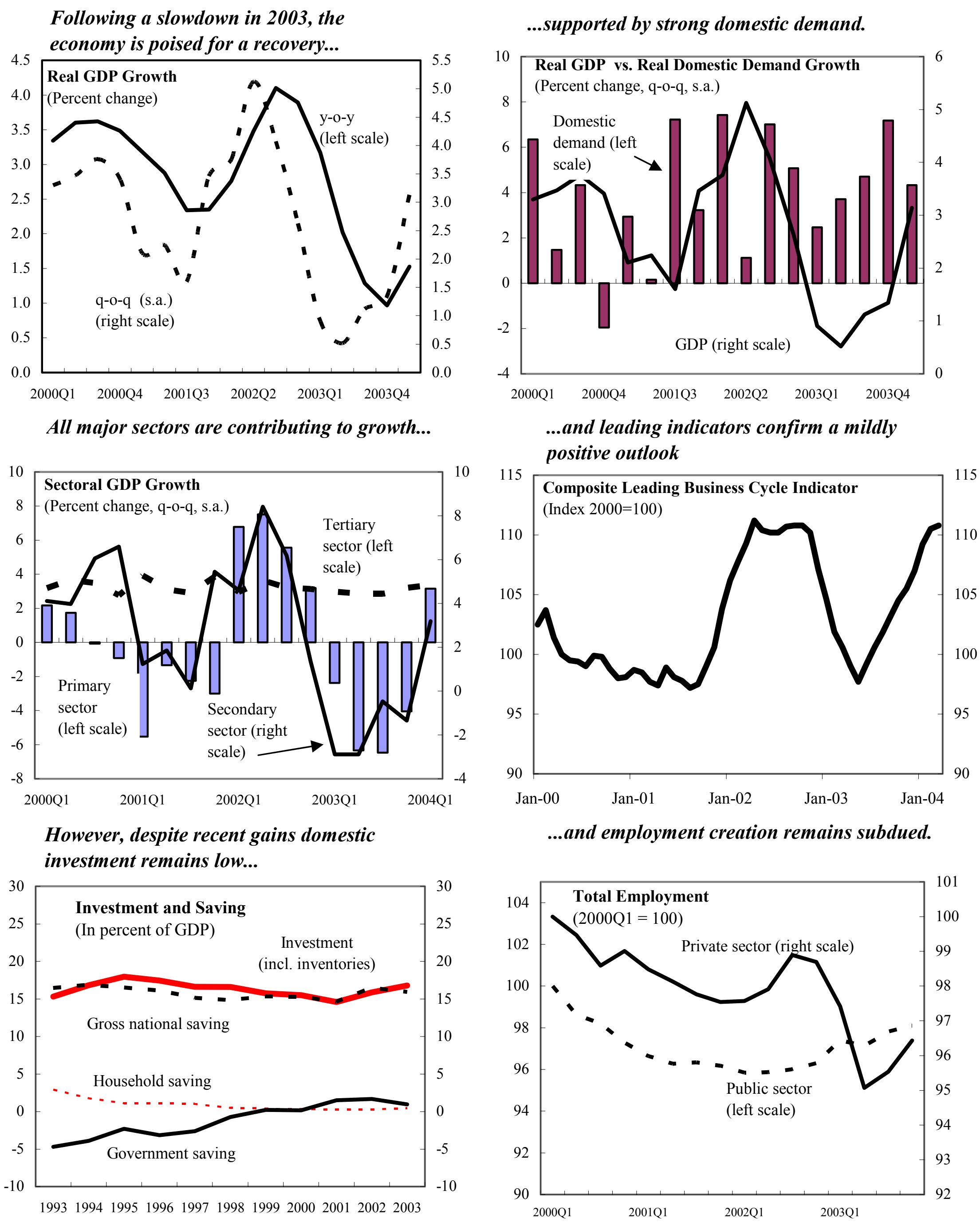
54. **The government is reviewing its strategy for parastatal reform.** The mission would urge that renewed emphasis be placed on privatization as a means of raising industrial efficiency and stimulating technical innovation. In light of the restructuring that has already taken place, any adverse impact on employment is likely to be limited and could be cushioned by an expansion of social safety net programs, such as job retraining. It would be helpful if a transparent mechanism were in place to monitor the risk sharing between the government and the private sector to ensure the success of the public-private partnership programs.

55. **The HIV/AIDS epidemic is having a devastating social impact with costly macroeconomic repercussions**. Quite appropriately, the government decided last year to ramp up its efforts to address the problem. It has put in place a comprehensive plan for the universal rollout of ARV drugs, and parallel steps have been taken to strengthen the public health system and increase child support grants.

56. **South Africa has embarked on important initiatives that seek to reduce income and wealth disparities.** These initiatives, which cover black economic empowerment and land reform, will be vital in helping strengthen the country's social fabric and sustain the process of macroeconomic stabilization and structural change. Funding issues relating to BEE, however, still need to be resolved, and the staff would also reiterate its concern over the apparent absence of safeguards against an undue concentration of assets. It is important that good progress be made in meeting the targets for land distribution, which are ambitious, in order to avoid the risk of unfulfilled expectations. The pace of land redistribution has at last picked up, but certain constraints, such as restrictions on the subdivision of land, remain to be addressed.

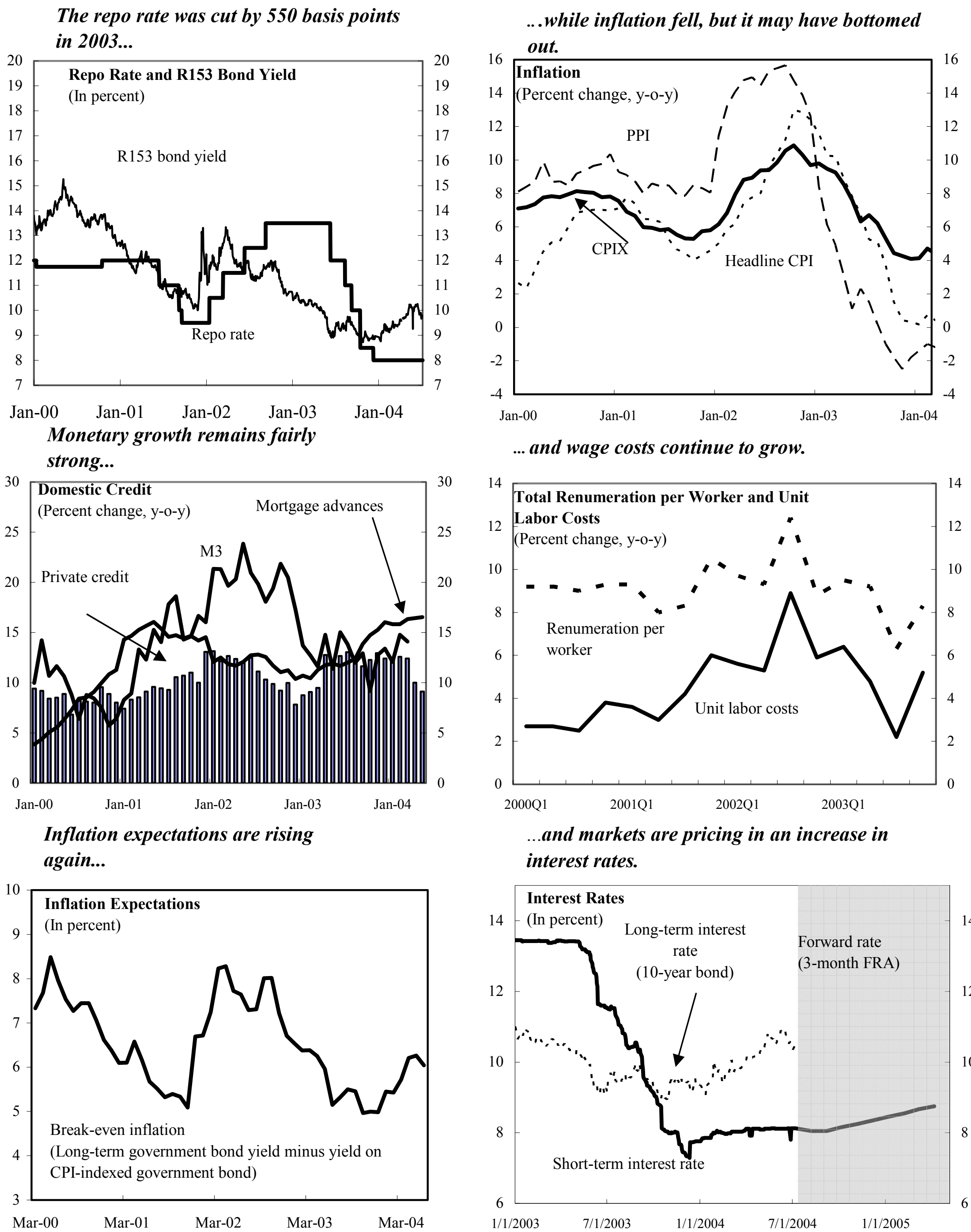
57. It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

Figure 1. South Africa: Real Sector Developments and Outlook



Sources: SARB, IMF.

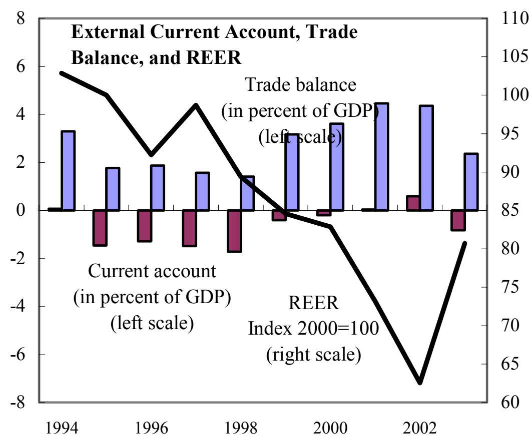
Figure 2. South Africa: Money, Prices, and Interest Rates



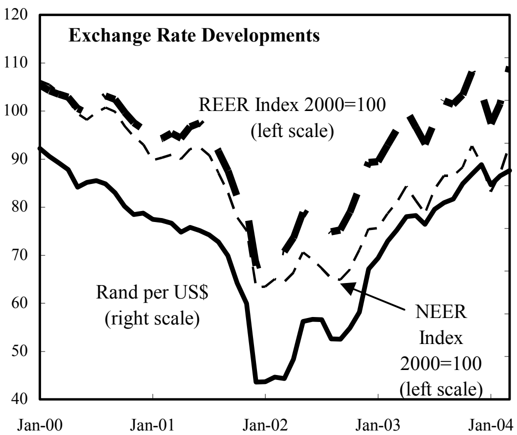
Sources: SARB, BER, Datastream, IMF.

Figure 3. South Africa: External Sector Developments

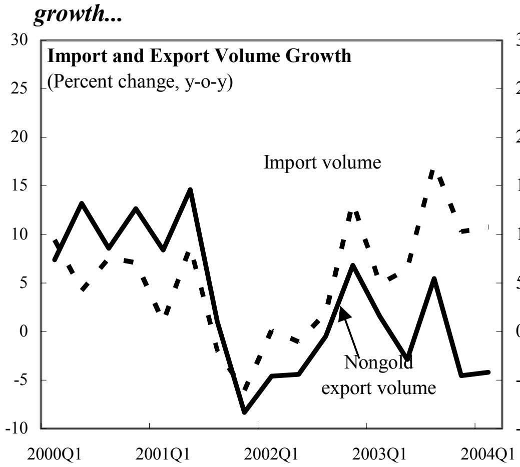
The current account turned from a surplus to a small deficit in 2003...



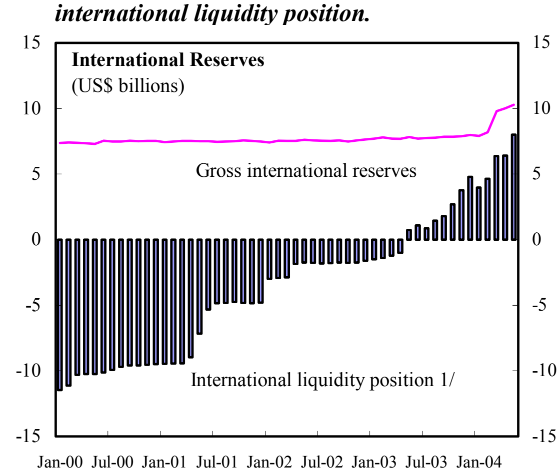
...in response to an appreciation of the rand of more than 50 percent since January 2002.



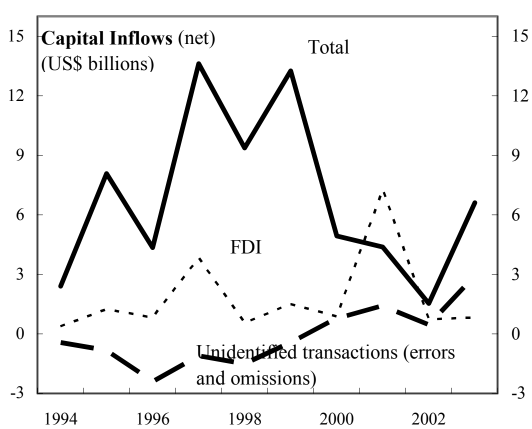
The appreciation led to strong import growth...



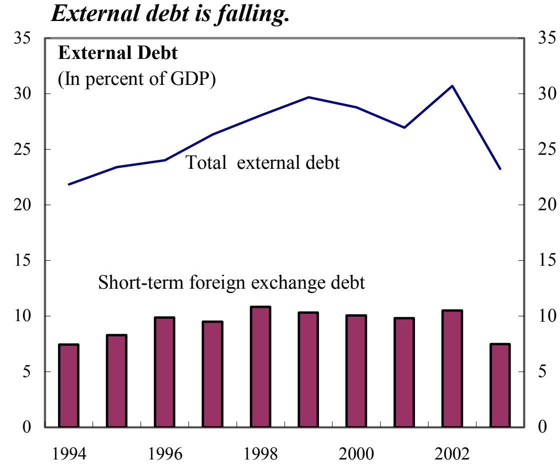
...and allowed the SARB to build up its international liquidity position.



FDI flows remain weak, whereas unidentified transactions increased.



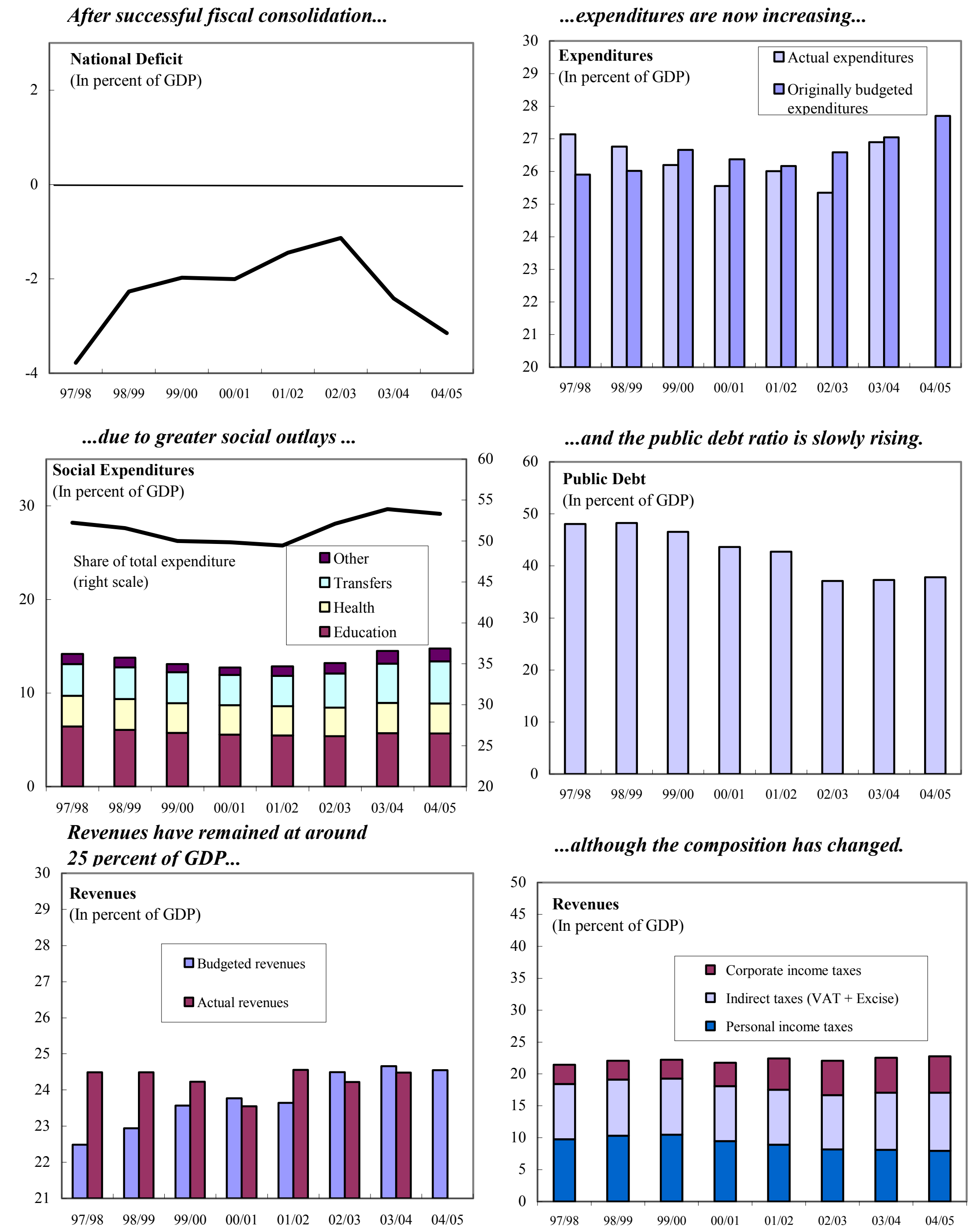
External debt is falling.



Sources: SARB, IMF.

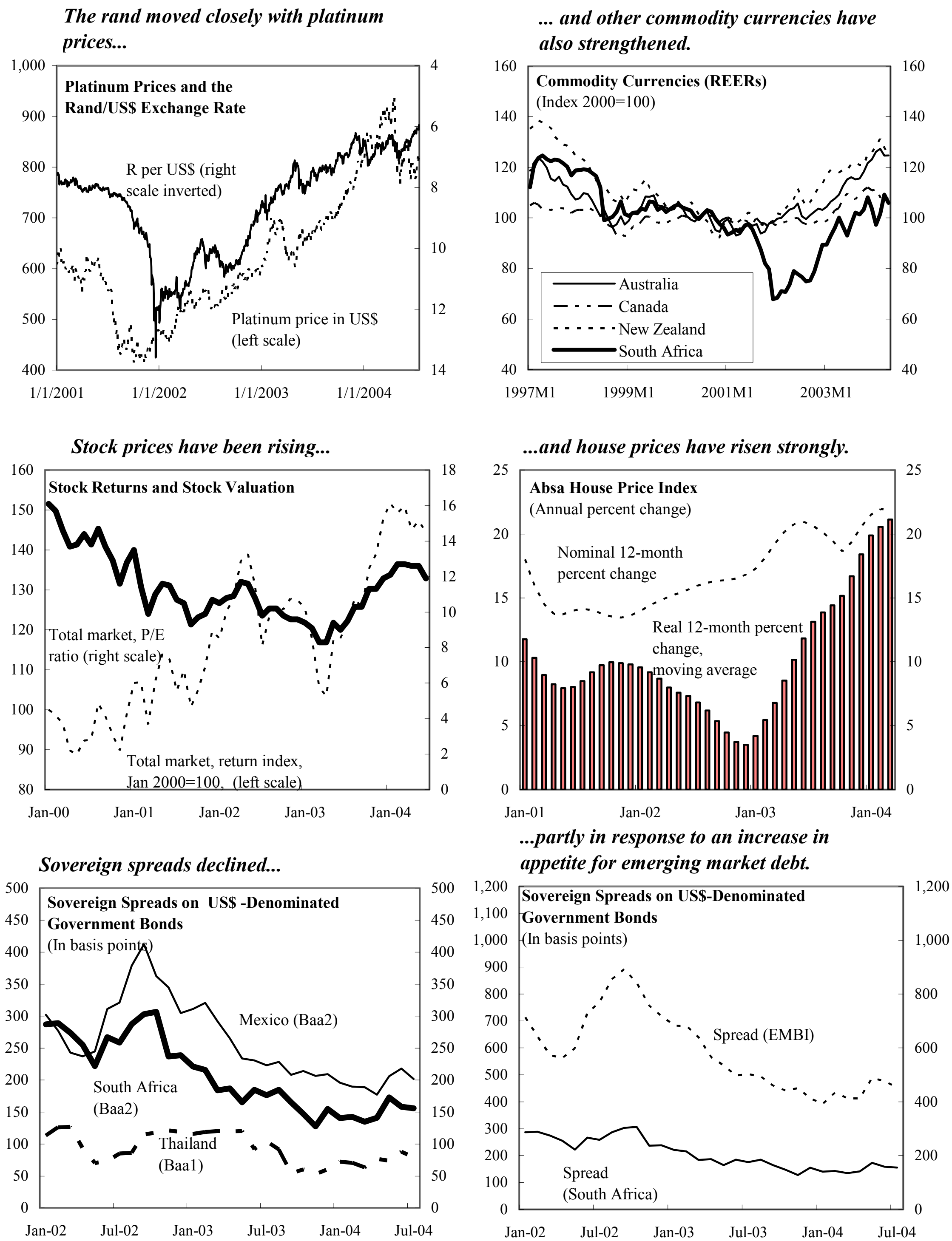
1/ Up to end February, referred to as net open position in foreign currency (NOFP).

Figure 4. South Africa: Fiscal Developments 1/



Sources: Treasury, IMF.
1/ 2004/05 projection.

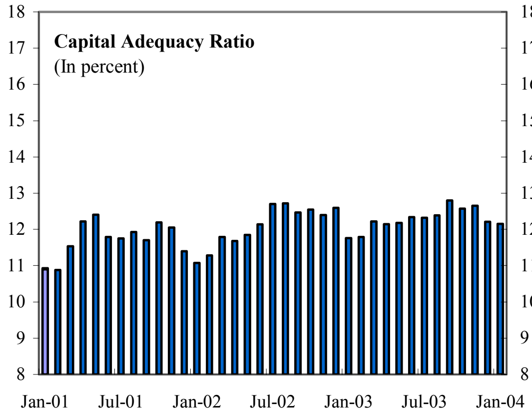
Figure 5. South Africa: Exchange Rates, Asset Prices and Spreads



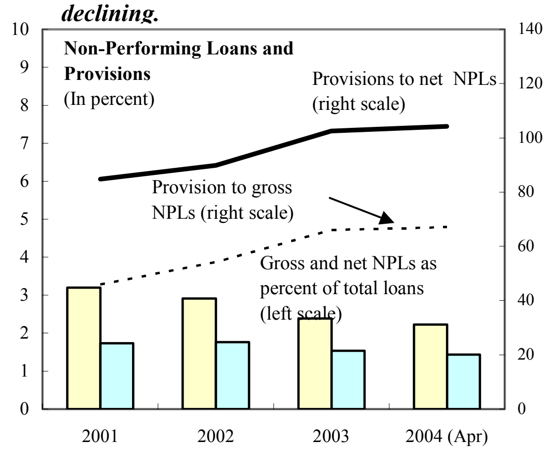
Sources: SARB, Datastream, Absa, IMF.

Figure 6. South Africa: Banking and Corporate Sector Developments

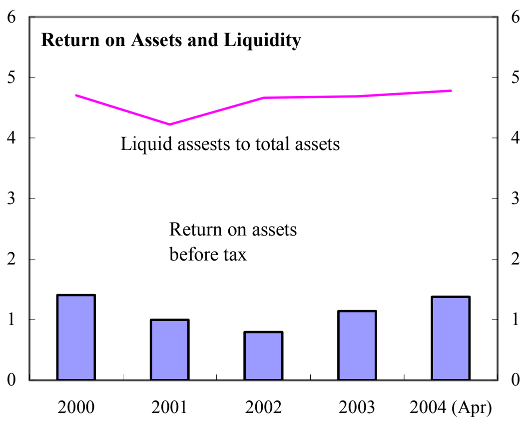
The banks remain well capitalized...



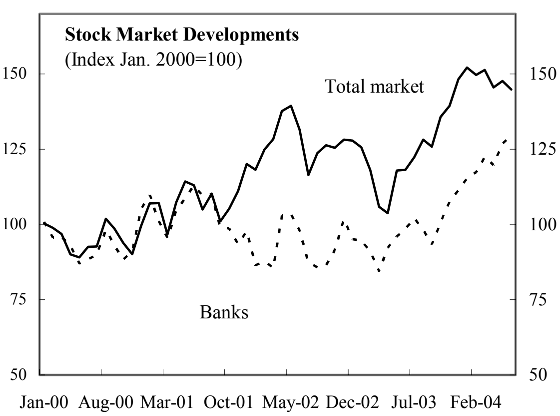
...and nonperforming loans have been declining.



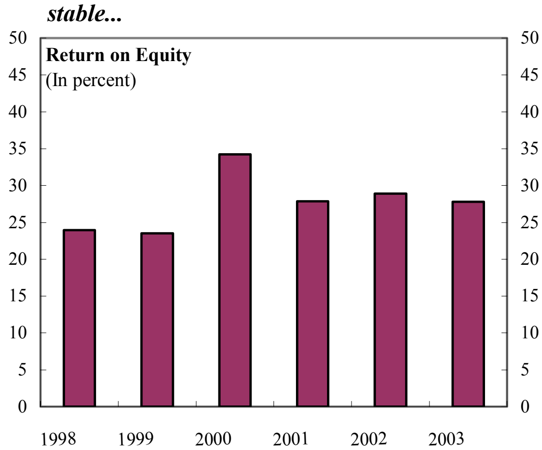
Profitability and liquidity are improving again...



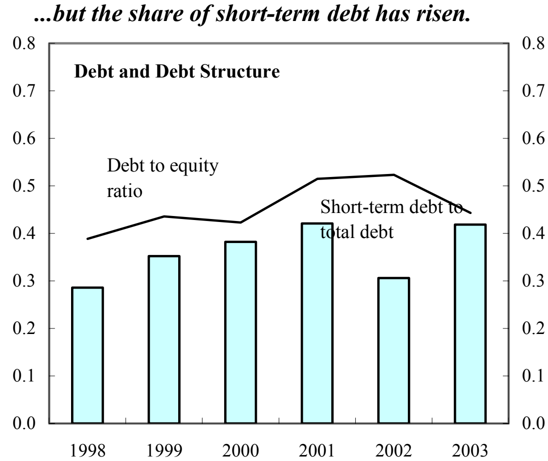
...and markets appear to be regaining a more positive outlook.



Nonfinancial corporate profitability is fairly stable...



...but the share of short-term debt has risen.



Sources: SARB, Datastream, WorldScope, IMF.

Table 1. South Africa: Selected Economic and Financial Indicators, 1999-2005

	1999	2000	2001	2002	2003	2004	2005
						Proj.	
	(Annual percent change, unless otherwise indicated)						
National income and prices							
Real GDP	2.0	3.5	2.7	3.6	1.9	2.6	3.3
Real GDP per capita	-0.2	2.0	0.7	1.5	-0.3	0.7	1.4
Nominal GDP (billions of rand)	801	888	983	1,121	1,209	1,319	1,441
Nominal GDP per capita (U.S. dollars; at purchasing power parity)	9,012	9,385	9,685	9,889	10,045	10,271	10,585
GDP deflator	6.2	7.2	7.8	10.1	5.9	6.3	5.7
CPI (annual average)	5.2	5.4	5.7	9.2	5.8	2.6	5.7
CPIX (end of period) 1/	6.8	7.8	5.8	9.7	4.1	5.9	5.3
CPIX (period average) 1/	6.9	7.8	6.6	9.3	6.8	5.2	5.6
Labor market							
Unemployment rate (official definition; in percent) 2/	23.3	25.8	29.5	30.5	28.2	28.0	28.0
Average remuneration (formal nonagricultural private sector)	9.4	9.2	8.8	10.2	7.7	7.5	7.1
Labor productivity (formal nonagricultural)	4.2	6.3	4.7	3.4	3.9	4.1	4.8
Nominal unit labor costs (formal nonagricultural)	2.9	2.7	4.2	6.0	5.0	3.4	2.3
External sector							
Merchandise exports, f.o.b. 3/	-1.6	11.4	-2.9	1.6	22.8	7.4	4.8
Merchandise imports, f.o.b. 3/	-10.0	11.4	-5.5	4.1	30.3	11.4	5.4
Export (goods and services) volume	1.7	8.9	2.7	-0.8	-0.5	1.2	5.0
Import (goods and services) volume	-7.5	7.1	0.2	3.4	9.7	8.3	5.8
Terms of trade	-3.0	-1.9	0.1	2.4	4.6	-1.4	0.3
Nominal effective exchange rate 4/	-10.9	-5.9	-15.0	-21.7	25.1	…	…
Real effective exchange rate 4/	-5.8	-1.3	-8.9	-9.9	25.0	…	…
Money and credit							
Net domestic assets 5/	2.8	8.6	19.1	4.4	3.3	...	...
Credit to the government 5/	-0.5	0.2	-1.6	3.3	-2.8	...	...
Credit to the rest of the economy 5/	3.3	8.5	20.7	1.1	6.1	...	...
Broad money (including foreign exchange deposits)	10.1	7.5	17.3	17.2	12.3	12.0	9.8
Velocity (GDP/average broad money)	1.8	1.8	1.8	1.7	1.6	1.6	1.6
	(In percent of GDP, unless otherwise indicated)						
Investment and saving							
Investment (including inventories)	15.7	15.5	14.6	15.9	16.8	16.4	16.5
Of which : public fixed investment	2.4	2.3	2.1	2.2	2.3	2.4	2.5
private fixed investment	12.9	12.6	12.5	12.8	13.4	13.8	14.0
Gross national saving	15.3	15.3	14.6	16.5	15.9	14.7	14.8
Public	0.2	0.2	1.5	1.7	1.0	-1.4	-1.4
Private	15.1	15.1	13.1	14.8	15.0	16.2	16.3
National government budget 6/							
Revenue, including grants	24.3	23.7	24.3	24.3	24.4	24.5	24.7
Expenditure and net lending	26.3	25.7	25.9	25.5	26.5	27.5	27.8
Overall balance	-2.0	-2.0	-1.6	-1.2	-2.1	-3.0	-3.1
Primary balance	3.4	3.1	3.2	3.0	1.8	0.8	0.7
National government debt	47.0	44.4	43.0	38.5	37.3	37.7	38.1
General government balance 7/	-1.6	-1.6	-1.2	-1.2	-2.1	-2.8	-2.8
Public sector borrowing requirement of the nonfinancial public sector	2.0	1.1	0.8	0.7	2.1	3.0	3.1
External sector							
Current account balance (In billions of U.S. dollars)	-0.5	-0.3	0.0	0.6	-1.3	-2.8	-3.2
Current account balance	-0.4	-0.2	0.1	0.6	-0.8	-1.6	-1.7
Overall balance of payments	3.3	0.6	0.9	3.2	4.7	2.3	1.3
Foreign currency-denominated debt (In billions of U.S. dollars)	23.9	24.9	24.0	25.0	27.3	29.0	30.0
Of which: short term (In billions of U.S. dollars)	13.5	12.9	11.2	11.2	12.0	12.4	12.6
Total external debt / exports of goods and services (in percent)	114.7	99.7	86.4	90.4	82.0	81.6	80.9
Total external debt service (In billions of U.S. dollars) 8/	6.0	5.1	5.6	5.1	6.1	6.7	6.5
Total external debt service / exports (In percent) 8/	17.8	13.8	15.7	14.2	13.4	13.9	12.9
Gross official reserves (In billions of U.S. dollars)	7.4	7.5	7.5	7.6	8.0	12.0	14.5
(In months of total imports)	2.9	2.7	2.9	2.8	2.2	3.1	3.0
International liquidity position of SARB (In billions of U.S. dollars) 9/	-13.0	-9.5	-4.8	-1.6	4.8	...	...
U.S. dollar exchange rate (End of period)	6.15	7.57	12.13	8.64	6.64	...	...

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

1/ CPIX is the consumer price index (CPI) less the interest on mortgage bonds.
2/ Excludes individuals who have not taken active steps to look for work or start self-employment in the four weeks prior to the interview. September.
3/ In U.S. dollars; annual percent change.
4/ Annual average; Information Notice System (INS) definition.
5/ Contribution (in percentage points) to the growth of broad money.
6/ Calendar-year figures, based on National Treasury data and staff's GDP projections.
7/ Excluding sales of state assets and profit/losses from forward market operations of the SARB.
8/ Excluding rand-demoninated debt held by nonresidents; end of period.
9/ Up to end of February 2004 referred to as net open position in foreign currency of SARB (NOFP), defined as net international reserves (gross reserves minus foreign loans) less net forward foreign exchange liabilities of SARB.

Table 2. South Africa: National Government Main Budget, 1999/2000-2005/06 1/

	1999/00	2000/01	2001/02		2002/03		2003/04			2004/05	2005/06
			Budget	Outturn	Budget	Outturn	Budget	2003 MTBPS 2/	Prelim. Actual	Staff Proj. 3/	Staff Proj. 3/
						(In billions of rand)					
Total revenue and grants	198.6	215.6	233.4	248.3	265.2	278.5	304.5	300.0	299.5	331.1	364.2
Tax revenue	193.8	211.9	228.6	244.1	260.2	274.0	300.3	294.1	292.7	324.4	357.1
Income tax	116.5	126.1	131.6	147.3	155.7	164.6	177.9	176.9	170.6	191.6	211.7
Of which : personal income tax (PIT)	85.9	86.5	90.1	90.4	90.0	94.3	96.7	97.0	99.0	107.3	119.5
corporate taxes (CIT+STC)	24.1	33.5	34.2	49.5	57.4	62.1	73.8	68.8	66.7	76.5	83.6
Indirect taxes	72.2	79.1	86.7	86.9	92.8	97.6	109.6	109.4	109.9	123.1	131.6
Of which : value-added tax (VAT)	48.3	54.5	60.4	61.1	66.2	70.1	81.0	80.0	80.6	90.6	96.8
Trade and other (less SACU payments)	5.0	6.6	10.3	9.9	11.7	11.8	12.8	7.8	12.2	9.7	13.8
Trade taxes	6.8	8.2	9.4	8.7	10.6	9.6	11.3	9.4	8.5	10.6	11.0
Other tax revenue	5.4	6.8	9.1	9.4	9.3	10.4	11.2	8.1	13.3	12.6	14.1
Less: SACU payments 4/	7.2	8.4	8.2	8.2	8.3	8.3	9.7	9.7	9.7	13.5	11.3
Nontax revenue	4.8	3.7	4.8	4.2	5.0	4.4	4.2	5.9	6.7	6.7	7.1
Grants	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.0
Total expenditure	214.8	233.9	258.3	262.9	287.9	291.5	334.0	331.5	329.0	373.6	409.1
Interest	44.3	46.3	48.1	47.6	47.5	46.8	51.0	47.2	47.2	51.1	54.6
Transfer to subnational governments	103.5	114.5	123.9	127.6	141.0	145.6	171.0	173.5	173.9	197.8	218.0
Of which : provinces	99.0	108.9	117.4	121.1	132.4	136.9	159.0	161.5	161.5	183.4	201.9
Other	67.0	73.1	86.3	87.7	99.4	99.1	112.0	110.9	108.0	124.7	136.5
Budgetary balance	-16.2	-18.4	-24.9	-14.6	-22.7	-13.0	-29.5	-31.5	-29.6	-42.5	-44.9
Extraordinary payments 5/	...	...	...	...	...	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0
Augmented balance	-16.2	-18.4	-24.9	-14.6	-22.7	-20.0	-36.5	-38.5	-36.6	-49.5	-51.9
Financing	16.2	18.4	24.9	14.6	22.7	20.0	36.5	38.5	36.6	49.5	51.9
Domestic loans (net)	4.9	11.4	-3.9	-17.8	-7.0	1.2	15.3	30.8	37.8	40.8	39.2
Foreign loans (net)	8.5	1.9	11.3	33.1	16.3	14.3	11.8	1.8	1.0	6.0	10.2
Privatization and other extraordinary receipts	5.7	0.7	17.4	2.1	10.4	7.2	6.3	1.8	1.2	2.7	2.5
Change in cash and other items	-2.9	4.4	0.0	-2.7	2.9	-2.7	3.1	4.1	-3.4	0.0	0.0
						(In percent of GDP, unless otherwise specified)					
Total revenue and grants	24.2	23.6	23.6	24.5	24.5	24.2	24.7	24.8	24.5	24.5	24.8
Tax revenue	23.6	23.1	23.2	24.1	24.0	23.8	24.3	24.4	23.9	24.1	24.3
Income tax	14.2	13.8	13.3	14.6	14.4	14.3	14.4	14.7	13.9	14.2	14.4
Of which : personal income tax (PIT)	10.5	9.4	9.1	8.9	8.3	8.2	7.8	8.0	8.1	8.0	8.1
corporate taxes (CIT+STC)	2.9	3.7	3.5	4.9	5.3	5.4	6.0	5.7	5.5	5.7	5.7
Indirect taxes	8.8	8.6	8.8	8.6	8.6	8.5	8.9	9.1	9.0	9.1	8.9
Of which : value-added tax (VAT)	5.9	5.9	6.1	6.0	6.1	6.1	6.6	6.6	6.6	6.7	6.6
Trade and other (less SACU payments)	0.6	0.7	1.0	1.0	1.1	1.0	1.0	0.6	1.0	0.7	0.9
Of which : trade taxes	0.8	0.9	1.0	0.9	1.0	0.8	0.9	0.8	0.7	0.8	0.7
Of which : SACU payments	0.9	0.9	0.8	0.8	0.8	0.7	0.8	0.8	0.8	1.0	0.8
Nontax revenue	0.6	0.4	0.5	0.4	0.5	0.4	0.3	0.5	0.5	0.5	0.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	26.2	25.6	26.2	26.0	26.6	25.4	27.1	27.5	26.9	27.7	27.8
Interest	5.4	5.1	4.9	4.7	4.4	4.1	4.1	3.9	3.9	3.8	3.7
Transfer to subnational governments	12.6	12.5	12.5	12.6	13.0	12.7	13.9	14.4	14.2	14.7	14.8
Other	8.2	8.0	8.7	8.7	9.2	8.6	9.1	9.2	8.8	9.2	9.3
Budgetary balance	-2.0	-2.0	-2.5	-1.4	-2.1	-1.1	-2.4	-2.6	-2.4	-3.1	-3.0
Extraordinary payments 5/	...	...	...	...	...	-0.6	-0.6	-0.6	-0.6	-0.5	-0.5
Augmented balance	-2.0	-2.0	-2.5	-1.4	-2.1	-1.7	-3.0	-3.2	-3.0	-3.7	-3.5
Financing	2.0	2.0	2.5	1.4	2.1	1.7	3.0	3.2	3.0	3.7	3.5
Domestic loans (net)	0.6	1.2	-0.4	-1.8	-0.6	0.1	1.2	2.5	3.1	3.0	2.7
Foreign loans (net)	1.0	0.2	1.1	3.3	1.5	1.2	1.0	0.2	0.1	0.4	0.7
Privatization and other extraordinary receipts	0.7	0.1	1.8	0.2	1.0	0.6	0.5	0.1	0.1	0.2	0.2
Change in cash and other items	-0.4	0.5	0.0	-0.3	0.3	-0.2	0.3	0.3	-0.3	0.0	0.0
Memorandum items:											
GDP (billions of rand) 1/	820	915.4	987.2	1,012.1	1,082.8	1,149.9	1,234.6	1,207.3	1,223.2	1,348.7	1,471.5
Real GDP growth 1/	2.6	3.5	3.7	2.6	2.7	3.4	3.4	2.2	1.4	3.1	3.2
GDP deflator 1/	6.1	7.9	6.0	7.8	6.5	10.0	6.6	5.1	5.6	6.2	5.7
Primary balance	3.4	3.1	2.4	3.3	2.3	2.9	1.7	1.3	1.4	0.6	0.7
Debt	46.5	43.6	41.6	42.7	39.4	37.1	37.8	37.8	37.3	37.8	38.2
Domestic	43.4	40.1	37.0	34.6	32.6	30.7	29.8	31.7	31.5	32.1	32.3
Foreign	3.1	3.5	4.6	8.1	6.9	6.5	8.0	6.1	5.8	5.7	5.9

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

1/ For fiscal year beginning April 1.

2/ Mid-year (October) budget revision.

3/ Staff estimates based on the 2004 budget and medium-term framework.

4/ Southern African Customs Union (SACU) payments are based on a revenue-sharing formula.

5/ Provision of bonds to the South African Reserve Bank in settlement of the Gold and Foreign Exchange Contingency Account.

Table 3. South Africa: Nonfinancial Public Sector Operations, 1999/2000-2005/06 1/

	1999/00	2000/01	2001/02		2002/03		2003/04		2004/05	2005/06
			Budget	Outturn	Budget	Outturn	Budget	Staff Estimate	Staff Proj. 2/	Staff Proj. 2/
					(In billions of rand)					
General govt. (excl. local govts.)										
Total revenue and grants	211.2	228.2	246.6	261.8	279.3	296.3	323.1	320.5	352.1	387.1
National government	198.6	215.6	233.4	248.3	265.2	278.5	304.5	300.6	331.1	364.2
Provinces (own revenue)	4.0	4.5	4.0	4.3	4.1	5.4	5.7	6.0	5.4	5.9
Social security funds (own revenue)	7.8	7.1	8.4	7.8	9.2	10.6	11.5	12.6	14.1	15.5
Extrabudgetary and other	0.9	1.0	0.8	1.4	0.8	1.7	1.5	1.6	1.5	1.5
Total expenditure	223.6	243.5	270.4	272.4	303.2	310.1	351.3	351.2	391.0	427.8
Current	211.3	230.6	248.4	250.9	280.3	296.6	318.6	335.7	373.2	407.7
Wages and salaries	86.5	91.8	98.9	100.9	106.8	109.8	122.5	120.9	133.4	141.5
Other goods and services	28.2	32.5	39.2	34.3	43.8	40.4	47.4	46.8	55.5	62.4
Interest	44.3	46.3	48.1	47.6	47.5	46.8	51.0	47.3	51.1	54.6
Transfers	52.3	60.0	65.2	68.1	82.3	99.7	97.7	120.8	133.2	149.2
Capital expenditure 3/	12.3	13.0	19.0	21.4	22.8	13.4	32.7	15.5	17.8	20.1
Overall balance	-12.4	-15.4	-23.8	-10.6	-23.8	-13.8	-28.2	-30.7	-38.8	-40.7
Public sector borrowing requirement (PSBR	12.8	8.5	12.4	7.9	14.9	7.1	38.1	33.7	42.6	46.2
National government	16.2	18.4	24.9	14.6	22.7	20.0	36.5	38.1	49.5	51.9
Other government borrowing 4/	-5.7	-4.3	-15.5	-3.3	-7.4	-8.0	-6.3	-0.4	-5.6	-5.3
Nonfinancial public enterprises	2.4	-5.6	3.0	-3.5	-0.5	-5.0	7.8	-4.0	-1.3	-0.4
					(In percent of GDP)					
General govt. (excl. local govts.)										
Total revenue and grants	25.8	24.9	25.0	25.9	25.8	25.8	26.2	26.2	26.1	26.3
National government	24.2	23.6	23.6	24.5	24.5	24.2	24.7	24.6	24.5	24.8
Provinces (own revenue)	0.5	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.4	0.4
Social security funds (own revenue)	0.9	0.8	0.9	0.8	0.9	0.9	0.9	1.0	1.0	1.1
Extrabudgetary and other	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Total expenditure	27.3	26.6	27.4	26.9	28.0	27.0	28.5	28.7	29.0	29.1
Current	25.8	25.2	25.2	24.8	25.9	25.8	25.8	27.4	27.7	27.7
Wages and salaries	10.5	10.0	10.0	10.0	9.9	9.5	9.9	9.9	9.9	9.6
Other goods and services	3.4	3.5	4.0	3.4	4.0	3.5	3.8	3.8	4.1	4.2
Interest	5.4	5.1	4.9	4.7	4.4	4.1	4.1	3.9	3.8	3.7
Transfers	6.4	6.6	6.6	6.7	7.6	8.7	7.9	9.9	9.9	10.1
Capital expenditure 3/	1.5	1.4	1.9	2.1	2.1	1.2	2.6	1.3	1.3	1.4
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.5	-1.7	-2.4	-1.0	-2.2	-1.2	-2.3	-2.5	-2.9	-2.8
Public sector borrowing requirement (PSBR	1.6	0.9	1.3	0.8	1.4	0.6	3.1	2.8	3.2	3.1
National government	2.0	2.0	2.5	1.4	2.1	1.7	3.0	3.1	3.7	3.5
Other government borrowing 4/	-0.7	-0.5	-1.6	-0.3	-0.7	-0.7	-0.5	0.0	-0.4	-0.4
Nonfinancial public enterprises	0.3	-0.6	0.3	-0.3	0.0	-0.4	0.6	-0.3	-0.1	0.0
Memorandum items:						(In percent of GDP)				
Social spending 5/	13.1	12.7	12.8	12.8	13.3	13.2	14.1	14.5	14.8	14.8
Defense spending	1.5	1.7	1.8	1.7	1.9	1.8	1.8	1.8	1.7	1.7

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

1/ For fiscal year beginning April 1.

2/ Staff estimates based on the 2004 budget and medium-term framework.

3/ A portion of capital expenditures was reclassified under transfers in the 2004 Budget (including 2002/03 and 2003/04 outturns).

4/ "Other" includes provincial and local governments, social security funds, other extrabudgetary institutions, and privatization receipts.

5/ Health, education, welfare and community development.

Table 4. South Africa: Balance of Payments, 1999-2005

	1999	2000	2001	2002	2003	Proj. 2004	Proj. 2005
	(U.S. dollar, billions)						
Balance on current account	-0.5	-0.3	0.0	0.6	-1.3	-2.8	-3.2
Balance on goods and services	3.6	3.8	4.6	4.0	2.7	1.5	1.3
Exports of goods and services	33.9	37.0	35.7	36.2	45.3	48.3	50.4
Exports of goods	28.7	31.9	31.0	31.5	38.7	41.6	43.5
Nongold	24.6	28.0	27.5	27.4	34.0	36.6	38.7
Gold	4.0	3.9	3.5	4.1	4.7	4.9	4.8
Exports of services	5.2	5.0	4.7	4.7	6.6	6.7	6.9
Imports of goods and services	-30.3	-33.1	-31.1	-32.2	-42.6	-46.8	-49.1
Imports of goods	-24.5	-27.3	-25.8	-26.9	-35.0	-39.0	-41.1
Imports of services	-5.8	-5.8	-5.3	-5.4	-7.6	-7.8	-8.0
Balance on income	-3.2	-3.2	-3.8	-2.8	-3.4	-3.5	-3.6
Income receipts	1.8	2.5	2.5	2.2	2.8	2.8	2.9
Income payments	-5.0	-5.7	-6.3	-5.0	-6.1	-6.3	-6.5
Balance on transfers	-0.9	-0.9	-0.7	-0.6	-0.8	-0.8	-0.9
Capital flows (including errors and omissions)	4.8	1.1	1.0	2.8	9.0	6.8	5.7
Balance on capital and financial account	5.3	0.3	-0.4	2.4	6.1	6.8	5.7
Balance on capital account	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Balance on financial account	5.3	0.3	-0.4	2.4	6.1	6.8	5.7
Direct investment	-0.1	0.6	10.8	1.1	0.1	0.6	0.7
Liabilities	1.5	0.9	7.3	0.7	0.8	1.4	1.5
Assets	-1.6	-0.3	3.5	0.4	-0.7	-0.7	-0.7
Portfolio investment	8.6	-2.0	-8.3	-0.4	0.8	2.5	1.5
Liabilities	13.7	1.7	-3.0	0.5	0.9	2.6	1.6
Assets	-5.2	-3.7	-5.3	-0.9	-0.1	-0.1	-0.1
Other investment	-3.2	1.7	-2.9	1.7	5.2	3.7	3.4
Liabilities	-1.5	1.6	-1.3	-0.1	2.0	2.2	2.3
Assets	-1.6	0.1	-1.6	1.8	3.2	1.5	1.1
Errors and omissions	-0.4	0.8	1.4	0.5	2.9	0.0	0.0
Overall balance of payments	4.3	0.8	1.0	3.4	7.5	4.0	2.5
Gross reserves (central government and SARB)	7.4	7.5	7.5	7.6	8.0	12.0	14.5
Gross reserves (including the banking sector)	11.2	11.1	12.6	15.4	24.9	28.9	31.4
International liquidity position of SARB 1/	-13.0	-9.5	-4.8	-1.6	4.8	10.0	12.5
	(Percent of GDP)						
Balance on current account	-0.4	-0.2	0.0	0.6	-0.8	-1.6	-1.7
Balance on goods and services	2.7	3.0	4.0	3.7	1.7	0.9	0.7
Exports of goods and services	25.9	28.9	31.2	34.0	28.3	27.7	26.9
Imports of goods and services	-23.1	-25.9	-27.2	-30.2	-26.6	-26.8	-26.2
Balance on income	-2.4	-2.5	-3.3	-2.6	-2.1	-2.0	-1.9
Balance on transfers	-0.7	-0.7	-0.6	-0.5	-0.5	-0.5	-0.5
Capital flows (including errors and omissions)	3.7	0.8	0.8	2.6	5.6	3.9	3.0
Balance on capital and financial account	4.0	0.2	-0.4	2.2	3.8	3.9	3.0
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	4.1	0.2	-0.4	2.2	3.8	3.9	3.0
Direct investment	-0.1	0.5	9.4	1.1	0.1	0.4	0.4
Portfolio investment	6.5	-1.6	-7.3	-0.4	0.5	1.4	0.8
Other investment	-2.4	1.3	-2.5	1.6	3.2	2.1	1.8
Errors and omissions	-0.3	0.6	1.2	0.4	1.8	0.0	0.0
Overall balance of payments	3.3	0.6	0.9	3.2	4.7	2.3	1.3
Gross reserves (central government and SARB)	5.7	5.9	6.5	7.2	5.0	6.9	7.7
Gross reserves (including the banking sector)	8.6	8.7	11.0	14.4	15.6	16.6	16.8
International liqudity position of SARB 1/	-10.0	-7.4	-4.2	-1.5	3.0	5.7	6.7

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

1/ Up to end February 2004, referred to as net open position in foreign currency of SARB (NOFP), defined as net international reserves less net forward foreign exchange liabilites of SARB.

Table 5. South Africa: Monetary Survey, 1999-2003

	1999 Dec.	2000 Dec.	2001 Dec.	2002 Dec.	2003 Dec.
	(In billions of rand)				
Net foreign assets	5.7	14.7	36.0	86.3	128.1
Gross reserves	79.9	102.3	183.7	167.0	215.9
SARB	45.4	57.0	90.6	66.0	52.9
Other monetary institutions	34.5	45.3	93.1	101.0	163.0
Liabilities	74.1	87.6	147.7	80.7	87.8
SARB	18.8	19.7	48.3	21.5	20.0
Other monetary institutions	55.3	67.9	99.4	59.2	67.8
Net domestic assets	466.4	492.9	559.5	611.7	655.5
Credit to government, net	29.2	30.0	21.9	41.6	22.4
Claims on government	61.3	64.2	67.5	84.9	104.2
Government deposits	32.2	34.2	45.6	43.3	81.8
Credit to private sector 1/	532.7	590.1	673.7	703.4	836.7
Other items, net	-95.5	-127.2	-136.1	-133.3	-203.6
Broad money (M3)	472.2	507.6	595.5	698.0	783.6
Of which: M1	258.3	266.9	313.2	350.6	376.9
	(Annual percentage change)				
Net foreign assets	119.9	156.3	144.6	139.9	48.5
Net domestic assets	1.9	5.7	13.5	9.3	7.2
Credit to government, net	-6.6	2.8	-27.1	90.4	-46.2
Credit to private sector	8.7	10.8	14.2	4.4	19.0
Other items, net	-49.6	-33.2	-7.0	2.1	-52.8
Broad money (M3)	10.1	7.5	17.3	17.2	12.3
	(Contribution to growth in M3, unless otherwise specified)				
Net foreign assets	8.1	1.9	4.2	8.4	6.0
Net domestic assets	2.1	5.6	13.1	8.8	6.3
Credit to government, net	-0.5	0.2	-1.6	3.3	-2.8
Credit to private sector 1/	9.9	12.1	16.5	5.0	19.1
Other items, net	-7.4	-6.7	-1.8	0.5	-10.1
Memorandum item:					
Income velocity of M3	1.75	1.85	1.76	1.72	1.66
	(In percent, unless otherwise specified)				
Official risk indicators 2/					
Share of nonperforming loans in total lending	4.9	4.5	3.2	2.9	2.4
Risk-based capital adequacy ratio	12.6	14.5	11.4	12.6	12.2
Financial sector risk factors					
Share of foreign currency loans in total lending 3/	5.9	8.4	13.6	13.2	11.6
Share of foreign currency deposits in total deposits	3.5	4.2	6.2	4.4	2.7
Share of foreign liabilities in total liabilities 3/ 4/	6.1	7.3	9.7	5.4	3.0
Share of short-term deposits in total deposits 5/	49.9	47.9	48.4	46.0	43.8
Share of mortgage advances in private credit	38.2	38.3	38.5	40.7	39.7
Market assessment					
Financial index of Johannesburg Stock Exchange (index, 2000=100) 5/	101.5	100.0	94.2	82.2	92.1

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

1/ Part of the increase in private sector credit in 2003 is due to a change in accounting rules for derivatives. According to Accounting Statement AC133, implemented in January 2003, derivative positions must be marked to market and reported on a gross rather than net basis.

2/ Banks are audited using generally accepted international standards; capital adequacy requirements are also imposed on securities trading.

3/ Including foreign financing in banks' own name on-lent to clients.

4/ Including foreign currency deposits and other foreign loans and advances.

5/ Short-term deposits include check and demand deposits.

Table 6. South Africa: Indicators of External Vulnerability, 1999-2004

(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	*date*
Financial indicators							
Public sector debt 1/	47.0	44.4	43.0	38.5	37.3	37.3	*March*
Broad money (percent change; 12-month basis)	10.1	7.5	17.3	17.2	12.3	12.1	*June*
Private sector credit (percent change; 12-month basis)	8.7	10.8	14.2	4.4	19.0	5.8	*June*
Repurchase rate (in percent) 2/	12.0	12.0	9.5	13.5	8.0	8.0	*June*
Repurchase rate (in percent; real) 2/ 3/	4.9	3.9	3.5	3.5	3.8	2.9	*June*
External indicators							
Exports (percent change; U.S. dollar value)	-1.8	9.2	-3.6	1.5	25.2	...	
Imports (percent change; U.S. dollar value)	-8.0	9.4	-6.2	3.7	32.1	...	
Terms of trade (percent change)	-3.0	-1.9	0.1	2.4	4.6	...	
Current account balance	-0.4	-0.2	0.1	0.6	-0.8	...	
Capital and financial account balance	4.0	0.2	-0.4	2.2	3.8	...	
Gross official reserves (in billions of U.S. dollars) 2/	7.4	7.5	7.5	7.6	8.0	11.4	*June*
Short-term official foreign liabilities (in billions of U.S. dollars) 2/	3.0	2.6	1.0	1.0	0.9	1.7	*June*
Open forward liabilities of SARB (in billions of U.S. dollars) 2/	17.4	14.4	11.3	8.3	2.3	0.0	*June*
International liquidity position of SARB (in billions of U.S. dollars) 2/ 4/	-13.0	-9.5	-4.8	-1.6	4.8	7.9	*June*
Short-term external debt by remaining maturity (in billions of U.S. dollars)	13.5	12.9	11.2	11.2	12.0	...	
Short-term external debt plus open forward position (in billions of U.S. dollars)	30.9	27.3	22.5	19.5	14.3	...	
Gross official reserves as a percent of the above	23.9	27.6	33.2	39.2	55.8	...	
Foreign currency-denominated external debt (in billions of U.S. dollars)	23.9	24.9	24.0	25.0	27.3	...	
As a percent of total exports	70.6	67.2	67.4	69.2	60.4	...	
External interest payments (as a percent of total exports)	8.9	6.5	6.3	6.3	5.1	...	
Exchange rate (per U.S. dollar; period average)	6.11	6.94	8.60	10.52	7.56	6.43	*June*
Real effective exchange rate appreciation (period average; in percent) 5/	-5.8	-1.3	-8.9	-9.9	25.0	...	
Financial market indicators 2/							
Stock market index (1994=100)	143.6	140.0	175.5	155.9	174.2	169.9	*June*
Percent change in U.S. dollar terms	49.8	-20.7	-21.7	24.7	45.3	3.3	*June*
Foreign currency debt rating–Standard & Poor's	BB+	BBB-	BBB-	BBB-	BBB	BBB	*July*
Foreign currency debt rating–Moody's	Baa3	Baa3	Baa2	Baa2	Baa2	Baa2	*July*
Spread of benchmark bonds (basis points) 6/	308	411	281	240	149	181	*June*

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

1/ National government debt; end of period.

2/ End of period.

3/ Deflated by the percent change in end-period CPIX (consumer price index less interest on mortgage bonds).

4/ Up to the end of February 2004 referred to as net open position in foreign currency of SARB (NOFP), defined as net international reserves (gross reserves minus foreign loans) less net forward foreign exchange liabilities of SARB.

5/ Based on IMF's Information Notice System.

6/ Spread on 15-20-year dollar-denominated bond relative to comparable U.S. treasury bond. End of period.

Table 7. South Africa: Social and Demographic Indicators
(2002, unless otherwise specified)

Area		**Population**	
1.22 million square kilometers		Total	45.3 million
		Annual rate of growth	2.0 percent
Population characteristics		**Health**	
Population density	37.2 per sq. km.	Life expectancy at birth	
1.		Total (years)	46
2.			
Urban population			
3. (percentage of total)	58		
Proportion in capital city (1995)		Infant mortality (per thousand	
(as a percentage of urban		live births)	52
population)	13		
Population age structure (percent)		**Labor force**	
0-14 years	34		
15-64	62	Female (percentage of labor force)	38
65 and above	4		
GDP per capita at current prices		**Percentage of employment**	
In U.S. dollars	2,299	Agriculture	12
		Mining	4
		Industry	20
		Government	17
		Trade	25
		Other	22
Nutrition (1999)		**Education**	
Per capita calorie intake per day		Adult literacy (15+, percentage)	
Mean	2,424	Male	87
Median	2,358	Female	85
		Total	86

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

Table 8. South Africa: Millennium Development Goals, 1990-2002

	1990	1995	2001	2002
1. Eradicate extreme poverty and hunger	2015 target = halve 1990 $1 a day poverty and malnutrition rates			
Population below $1 a day (%)	..	11.5	..	10.5
Poverty gap at $1 a day (%)	..	1.1	..	..
Percentage share of income or consumption held by poorest 20%	..	2.0	..	..
Prevalence of child malnutrition (% of children under 5)	..	9.2	..	..
Population below minimum level of dietary energy consumption (%)	..	..	..	..
2. Achieve universal primary education	2015 target=net enrollment to 100			
Net primary enrollment ratio (% of relevant age group)	98.9	98.2	89.5	..
Percentage of cohort reaching grade 5 (%)	75.3	..	..	..
Youth literacy rate (% ages 15-24)	88.5	90.0	91.5	91.8
3. Promote gender equality	2005 target=reduce education ratio to 100			
Ratio of girls to boys in primary and secondary education (%)	102.9	103.0	100.7	..
Ratio of young literate females to males (% ages 15-24)	99.7	99.8	99.0	100.0
Share of women employed in the nonagricultural sector (%)	51.8	39.5	..	..
Proportion of seats held by women in national parliament (%)	..	25.0	..	..
4. Reduce child mortality	2015 target=reduce 1990 under 5 mortality by two-thirds			
Under 5 mortality rate (per 1,000)	60.0	59.0	63.0	65.0
Infant mortality rate (per 1,000 live births)	45.0	45.0	50.0	52.0
Immunization, measles (% of children under 12 months)	79.0	76.0	72.0	78.0
5. Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	340.0	230.0	..
Births attended by skilled health staff (% of total)	..	82.0	..	..
6. Combat HIV/AIDS, malaria and other diseases	2015 target = halt, and begin to reverse, AIDS, etc			
Prevalence of HIV (% ages 15-49) 1/	..	..	..	15.2
Contraceptive prevalence rate (% of women ages 15-49)	57.0	..	..	..
Number of children orphaned by HIV/AIDS	..	..	660,000	..
Incidence of tuberculosis (per 100,000 people)	..	..	556.0	557.6
Tuberculosis cases detected under DOTS (%)	..	6.0	72.0	96.0
7. Ensure environmental sustainability	2015 target = various (see notes)			
Forest area (% of total land area)	7.4	..	7.3	..
Nationally protected areas (% of total land area)	..	5.4	5.4	5.5
GDP per unit of energy use (PPP $ per kg oil equivalent)	3.1	3.2	4.1	..
CO2 emissions (metric tons per capita)	8.3	8.3	7.4	..
Access to an improved water source (% of population)	86.0	..	86.0	..
Access to improved sanitation (% of population)	86.0	..	87.0	..
Access to secure tenure (% of population)	..	..		
8. Develop a Global Partnership for Development	2015 target = various (see notes)			
Youth unemployment rate (% of total labor force ages 15-24)	..	..	55.8	..
Fixed line and mobile telephones (per 1,000 people)	93.6	114.9	364.3	410.5
Personal computers (per 1,000 people)	7.0	27.9	68.5	72.6
General indicators				
Adult literacy rate (% of people ages 15 and over)	81.2	83.3	85.6	86.0
Total fertility rate (births per woman)	3.3	3.1	2.9	2.8
Life expectancy at birth (years)	61.9	58.0	47.8	46.5
Aid (% of GNI)	..	0.3	0.4	0.6

Source: World Bank, Statistics South Africa.

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

1/ Estimate for 2004. Source: Statistics South Africa. According to UN / World Bank estimates, the HIV-prevalence rate (female, % ages 15-24) was 25.6 percent in 2001.

Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse the incidence of malaria and other major diseases.

Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

Goal 8 targets: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the the benefits of new technologies, especially information and communications.

South Africa: Relations with the Fund
(As of July 19, 2004)

I. Membership Status: Joined 12/27/1945; Article VIII

II. General Resources Account:	SDR Million	Percent Quota
Quota	1,868.50	100.00
Fund holdings of currency	1,868.00	99.97
Reserve position in Fund	0.50	0.03

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	220.36	100.00
Holdings	222.80	101.11

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By Arrangement	11/03/1982	12/31/1983	364.00	159.00
CCFF	12/22/1993	--	614.43	614.43

VI. Projected Obligations to Fund: None.

VII. Exchange Rate Arrangement:

The South African rand floats against other currencies. South Africa formally accepted the obligations of Article VIII, Section 2, 3, and 4 of the Fund's Articles of Agreement, as from September 15, 1973. On July 15, 2004 the exchange rate of the rand was US$0.1637=R1.

South Africa has followed a strategy of progressively easing exchange controls on capital transactions since 1994, reflecting the government's commitment to the eventual abolition of these controls, and has made considerable progress in this regard in recent years. With the abolition of the financial rand in 1995, all exchange controls on nonresidents were eliminated. They are free to purchase shares, bonds, and other assets without restriction and to repatriate dividends, interest receipts, and current and capital profits, as well as the original investment capital. Nonresidents are also free to hold rand accounts in the banking system, but they are constrained on the amount they may borrow domestically. This constraint has also been relaxed, and only organizations with more than 75 percent nonresident ownership are subject to limits on their domestic borrowing. In February 2004, this limit was 300 percent of shareholders' investment (increased from 100 percent earlier).
Since 1995, exchange controls on capital transaction by residents have also been relaxed. Rather than allowing complete liberalization of a particular type of current or capital transaction, the authorities have pursued a strategy of allowing an increasing array of

transactions, with each subject to a quantitative cap that has been progressively raised over time. Most of the restrictions are on capital outflows:

On portfolio investment. Institutional investors are permitted to invest in foreign securities, subject to an overall limit of 15 (20) percent of their total assets for insurance companies and pension funds (unit trusts). Corporates may, upon application, be permitted to establish primary listings offshore under certain conditions. Private individuals are allowed to invest up to R750,000 offshore.

On the financing of direct investment. The allowance governing South African corporates' use of South African funds to finance approved foreign direct investment has been increased considerably during 2002 and 2003 and stands at R2 billion per project for investment in Africa and R1 billion per project outside Africa. In addition, South African companies are permitted to finance 10 percent of the excess cost of approved foreign direct investment from South African funds (being the difference between the total cost of the project and the R2 billion/ R1 billion foreign direct investment allowance).

In addition to the above, there are restrictions on, inter alia, the travel allowances (R140,000 for private individuals), the transfer of funds abroad by emigrants ("blocked funds), and the investment of currency proceeds from exports (which must be repatriated within 180 days from accrual). The transfer of blocked funds in excess of R750,000 for individuals and R1.5 million for families is allowed, provided a 10 percent tax is paid and that the amount is below R 5 million. Dividends and interest payments on the blocked funds are freely transferable abroad and travel allowances can be augmented if *bona fide* need is documented.

VIII. Article IV Consultations

The 2003 Article IV consultation was concluded by the Executive Board on August 20, 2003 (Country Report No. 04/178). South Africa is on the standard 12-month Article IV consultation cycle.

IX. Technical Assistance

A FAD mission took place during the period June 2–6, 2003 to discuss with the National Treasury their draft royalty bill (published in March 2003). A monetary and financial statistics mission took place during the period November 4–19, 2003. This mission (i) reviewed the SARB collection and compilation procedures of monetary statistics, (ii) assisted the staff of the SARB in developing a work program to facilitate the full implementation of the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM)* (iii) introduced the standardized report forms for reporting central bank data to STA, and (iv) initiated the development of an integrated database for monetary statistics that will meet the Fund's publication requirements. A follow-up technical assistance mission to introduce the standardized report forms for reporting the remaining monetary data to STA and to finalize the integrated database took place during the period May 26–June 9, 2004.

South Africa: Relations with the World Bank Group

Between 1951 and 1966, the Bank made 11 loans to South Africa, totaling US$241.8 million, largely for expanding the country's rail and harbor systems, and for generating and transmitting electricity. The Bank ceased lending operations to South Africa in 1966 and the loans from that earlier period have been fully repaid.

Between 1990 and 1994, the Bank resumed activities in South Africa through a comprehensive program of economic policy advice and capacity building. There was open participation between the Bank and relevant sectors of the South African society, such as government, the Reserve Bank, (then) opposition parties, universities, labor unions, industrialists, and nongovernmental organizations. Several discussion papers and reports resulted on all the key sectors: the macroeconomy, education, health, agriculture, fiscal decentralization, labor markets, trade policy, and microfinance.

Since 1994, the emphasis has shifted slightly toward the provision of policy advice to government, particularly in the areas of municipal services, welfare financing, macroeconomic strategy, poverty, medium-term expenditure framework, economic impact of HIV/AIDS, and business environment. The Bank's non-lending involvement has ranged from traditional economic and sector work, focusing on sectoral analysis and policy recommendations, to more formal research outputs, including numerous policy support exercises that provided the government with advice on strategic policy options.

In addition, the Bank Group has provided financial and technical support through a number of different channels. The Bank resumed project lending through the Industrial Competitiveness and Job Creation Project in 1997 (initially for an amount US$46 million, but subsequently the amount has been reduced to US$24.5 million at the government's request and US$18.0 million has so far been disbursed). A Technical Assistance Loan for the Municipal Financial Management Technical Assistance Project (MFMTAP) was approved in 2002 for an amount of US$15 million. US$0.15 million was disbursed on initiation and a further R9.6 million was disbursed in June 2004. A number of GEF grants were approved for nature conservation and development projects such as the C.A.P.E. Biodiversity Conservation and Sustainable Development Project (GEF grant of US$9 million in 2004); the Cape Peninsula Biodiversity Conservation Project (GEF grant of US$12.3 million in 1998); the Maloti-Drakensberg Transfrontier Conservation and Development Project for US$7.9 million, the Greater Addo Elephant National Park Project for US$5.5 million and four medium-size projects of US$3 million.

The International Finance Corporation (IFC) has been operating in South Africa for only the last four to five years. However the committed portfolio has grown steadily to US$162.6 million bringing its country portfolio to the second largest position in Africa after Nigeria by converting Johannesburg office into its Africa headquarters. The IFC has invested in Bioventures Fund (US$1.9m), a first for the market, targeting biotechnology firms, an emerging sectoral focus in South Africa. The IFC's continued support for South Africa Home Loans, with an investment holding of US$3.6 million (19.5%), pioneered the securitization of mortgages in 2002, which has led to more efficient and less expensive housing finance products. In FY02, IFC has provided QE - Loan type financing to Mvelaphanda Gold amounting to US$28 million and committed US$ 6.1 million in various Finance and Insurance sector companies. The IFC strategy for South Africa will support the government's objectives in terms of black economic empowerment, the development of the SME sector, as well as developing the financial markets. Another strong element of the strategy will be to support South African companies expanding into Africa.

Multilateral Investment Guarantee Agency (MIGA): South Africa has been a member of MIGA since 1994. Recently, in March 2002, it established a regional office in Johannesburg. South African investors are the most active users of MIGA guarantees among Category Two countries, and currently have US$212.5 million of gross MIGA coverage (and US$161.1 million of net coverage) outstanding across 10 contracts of guarantee. Since inception, MIGA has issued 12 contracts, worth US$298.3 million of gross coverage, to South African investors for investments in Lesotho, Mozambique, Nigeria, Swaziland and Zambia. South African investors now account for US$212.5 million of MIGA's gross exposure as a result of strong relationships with South African banks, development agencies and the Export Credit Insurance Corporation of South Africa. In December 2003, MIGA issued a US$11.4 million guarantee to IP Direct of South Africa for its investment in IP Satellite Services of Nigeria. This support for an SME, south-south investment will allow the project to establish an Internet service provider facility in Nigeria, via a satellite platform. Target markets are individuals, home offices, and SMEs, which currently suffer from a lack of high-speed connectivity. The project is important for pan-African economic integration and is consistent with the NEPAD initiative.

South Africa: Statistical Issues

Real sector

In June 1999, Statistics South Africa released a major revision of the national income accounts based on the United Nations' *System of National Accounts* (1993). The revision raised nominal GDP by some 13 percent for the 1993-98 period and raised the average annual rate of growth of real GDP from 2.2 percent to 2.7 percent for the period 1994-98.

Reporting of real sector data for *International Financial Statistics (IFS)* is timely. Data reported for *Direction of Trade Statistics (DOTS)*, however, show substantial inconsistencies with external trade data reported for *IFS*, particularly exports.

Labor market statistics are published with lags of about six months, and unemployment data are available only at a six month frequency. Given the seriousness of the unemployment problem, labor market analysis and policy design need to be based on better, more frequent, and timely labor market data.

Beginning with the April 2003 index, Statistics South Africa issued revisions to the Consumer Price Index for the period January 2002 to March 2003, reflecting the incorporation of more reliable data on residential rents.

Government finance

South Africa currently reports data for the consolidated central government and for regional and local governments for publication in the *Government Finance Statistics Yearbook.* It also reports monthly data covering the operations of the budgetary central government for publication in *IFS.* GFS data, although still on a cash basis, are compiled and disseminated domestically and internationally according to the *GFSM 2001* framework.

Monetary statistics

South Africa regularly reports monetary statistics for publication in *IFS*, although there is room for improving the timeliness of the data on nonbank financial institutions. The SARB is working on the implementation of the recommendations of the 2003 and 2004 monetary and financial statistics missions towards full implementation of the methodology recommended in the *Monetary and Financial Statistics Manual*.

Balance of payments

South Africa is a regular reporter of balance of payments data. It has recently revised its balance of payments data to be consistent with the fifth edition of the *Balance of Payments Manual*. However, there are deficiencies in the coverage of trade with Southern African Customs Union (SACU) countries, and in the coverage of some service transactions, mainly travel and construction service components. Only partial data are compiled on communications services, and the coverage of reinvested earnings on direct investment is limited to foreign branches of domestic banks. The presentation of foreign reserve accumulation in the balance of payment includes both the central bank's reserves as well as the commercial banks' foreign reserves resulting from exchange control regulations. Net errors and omissions in the balance of payments vary by a large amount from quarter to quarter. Work is ongoing to reduce the large errors and omissions, which in the second half of 2003 reached 4 percent of GDP.

Although South Africa disseminates its international reserve position in line with the requirements of the IMF's template on international reserves and foreign currency liquidity, the reporting of its international reserve position could be brought closer to best practices in a number of ways, including the application of a consistent formula for the valuation of gold, and the exclusion of regional currency holdings from reserves.

Technical assistance missions in statistics (1994-present)

Subject	**Staff Member**	**Date**
Data standards	Peter L. Joyce Ruth Lituma	11/06/95
ROSC mission	Charles Enoch (head) Wipada Soonthornsima Teresa Villacres Nataliya Ivanyk Ana Ansmit	5/7-5/18/01
Monetary and financial statistics	Candida Andrade Marco Martinez	11/4-11/19/03
Monetary and financial statistics	Candida Andrade Marco Martinez	5/26-6/9/04

South Africa: Reporting of Main Statistical Indicators
(As of July 30, 2004)

	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/GNP	Debt Service	Debt	Exchange Rates	Interna-tional Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index
Date of latest Observation	6/04	Q1 2004	Q1 2004	Q1 2004	05/04	Q1 2004	7/30/04	6/30/04	6/30/04	6/30/04	6/04	7/30/04	6/04
Date Received	7/30/04	6/24/04	6/24/04	6/24/04	6/30/04	6/24/04	7/30/04	7/29/04	7/7/04	7/7/04	7/29/04	7/30/04	7/28/04
Frequency of Data[1/]	M	Q	Q	Q	M	Q	D	M	M	M	M	D	M
Frequency of Reporting[1/]	M	Q	Q	Q	M	Q	D	M	M	M	M	D	M
Source of Data[2/]	P, C	P, C	P, C	P, C	P, C	P, C	P, C	P, C	P, C	P, C	P, C	P, C	P, C
Mode of Reporting[3/]	E	R	R	R	E	R	E	E	E	E	E	E	E
Confidentiality[4/]	C	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication[1/]	M	Q	Q	Q	M	Q	D	M	M	M	M	D	M

1/ D – Daily; M – Monthly.
2/ P – Commercial Publication; C- Commercial electronic data provider.
3/ E – Electronic data transfer; R – *Reserve Bank Quarterly Bulletin*.
4/ C – Unrestricted use.

Medium-Term Outlook and Debt Sustainability

Baseline scenario

The staff's baseline medium-term scenario is based on a projection for annual real GDP growth of about 3 percent during 2004–09.[29] The scenario assumes the continuation of current policies, including sound fiscal policy, the achievement of the inflation target, and steady, but very modest, progress with structural reforms. It also incorporates a recovery in the world economic environment in line with the WEO (Table 1).

More specifically, the baseline scenario assumes the following:

annual world real GDP growth of some 4½ in the near future, consistent with the assumptions in the April 2004 *World Economic Outlook;*

implementation and extension of the authorities' medium-term budget framework (MTBF), in which the national budget deficit averages about 3 percent of GDP;

achievement of the inflation target;

a strengthening of the net reserve position;

continued trade liberalization under the commitments to the World Trade Organization (WTO) and in the free trade agreements with the European Union and the Southern African Development Community, including further simplification and reduction of tariff rates;

continued restructuring of public enterprises to realize efficiency gains and benefits from the transfer of technology; and

gradual progress in removing rigidities in the labor market along with training efforts to improve job skills, in particular among the unemployed.

Under these assumptions, achieving a trend decline in unemployment may be difficult as firms may continue to rely on labor-saving technologies as long as skill levels remain low and rigidities persist in the labor market. The national government's medium-term fiscal

[29] The impact of HIV/AIDS on medium-term economic growth is highly uncertain. Estimates of the impact on the decline in annual output growth range from ½ to 2½ percentage points. In the baseline scenario, the HIV/AIDS pandemic is one among several factors that limit potential output growth to 3 percent over the medium term. Public expenditures on antiretroviral HIV/AIDS drugs are assumed to increase from 0.1 percent of GDP in 2004/05 to an annual level of 0.3 percent of GDP from 2007/08. See the Selected Issues Paper on HIV/AIDS in South Africa for details.

program will lead to a small increase in the ratio of debt to GDP, as it incorporates a rise in social expenditures from 2004/05 of approximately 0.7 percent of GDP, due to increased spending on HIV/AIDS, black economic empowerment, and land reform. A fiscal adjustment of some 0.2–0.3 percentage points would be required to stabilize the debt to GDP ratio at its current level.

The acceleration of GDP growth is expected to contribute to growth in import demand and will lead to a somewhat higher current account deficit. Gross reserves are assumed to increase to the equivalent of some three and a half months of imports over the medium term.

The risks to the medium term outlook are broadly balanced. They mainly originate from a more rapid implementation of economic reform policies on the upside and a discontinuation or slowdown in implementing economic reform policies on the downside. The South African economy has proved relatively resilient to external shocks, such as slower global economic activity and higher oil prices.[30] Sustainability analyses for public and external debt (see below) provide further support for South Africa's resilience to external shocks.

Accelerated reforms

Growth effects resulting from the timely implementation of comprehensive reform efforts in the areas of labor markets, trade liberalization, and the public enterprises and continued sound fiscal and monetary policies could increase annual real GDP growth to about 5 percent over the medium term (Table 2).

Overall, the accelerated reform scenario assumes higher growth contributions from all three endogenous growth components, employment, capital, and total factor productivity. This scenario assumes that further labor market deregulation along the lines suggested in this report is implemented without delay to help raise employment creation to some 3 percent per year. Accelerated trade liberalization, public enterprise reform and speedy privatization are essential to help boost factor productivity. To increase total factor productivity growth from present rates of just over 1 percent to the levels of some East Asian countries (2-3 percent), these structural reforms will need to be supplemented by an improvement in infrastructure, enhancements in the effectiveness of all levels of government to deliver public services, and additional efforts in the area of crime reduction. Accelerated reforms should improve the investment climate in South Africa and stimulate FDI inflows.

Increased productivity, a flexible labor market, and a credible inflation targeting regime would slow down the rise in nominal unit labor costs over the medium. This should result in

[30] This resilience has been the result of sound macroeconomic policies, a flexible exchange rate, and a relatively low dependence on oil imports combined with higher world market prices for gold and platinum, which account for about 30 percent of South Africa's goods exports.

lower unemployment. Investment as a share of GDP would rise earlier and more strongly than under the baseline medium-term scenario and would reach 18.6 percent by 2009. Higher GDP growth and higher export-oriented investment through a pick-up in FDI inflows would increase over time import and export growth and would unleash TFP growth. As it may take time before the increased export competitiveness leads to higher exports, the current account deficit is initially expected to rise compared to the baseline scenario. The projected path of inflation remains unchanged under the accelerated reform scenario, consistent with the successful implementation of inflation targeting.

Accelerated GDP growth would likely contribute to enhanced fiscal revenues, particularly to the corporate and personal income taxes. The authorities have long maintained a policy objective of keeping the revenue-to-GDP ratio at around 25 percent to promote competitiveness and spending efficiency. However, increased revenues in the accelerated reform scenario, possibly amounting to around ½ percent of GDP, could be used to improve the primary balance and maintain debt levels at their present levels.

The above analysis suggests that, to decrease unemployment by half within the next 10 years, real GDP growth will have to be substantially higher, on the order of some 5 percent per year. Certainly, increased investment is necessary for generating new jobs and increasing growth. At the same time, investor concerns over business costs, such as those relating to HIV/AIDS and the incidence of crime, need to be addressed. However, additional efforts need to be taken promptly to lower labor costs. Total factor productivity needs to be raised through accelerated trade liberalization and public enterprise reform.

Table 1. South Africa: Medium-Term Baseline Scenario, 2003-2009

	2003	2004	2005	2006	2007	2008	2009
		Proj.					
	(Annual percent change, unless otherwise indicated)						
National income and prices							
Real GDP	1.9	2.6	3.3	3.0	3.0	3.0	3.0
Real GDP per capita	-0.3	0.7	1.4	1.1	1.1	1.1	1.1
Nominal GDP (billions of rand)	1,209	1,319	1441	1560	1673	1785	1901
Nominal GDP per capita (U.S. dollars; at purchasing power parity)	10,045	10,271	10,585	10,915	11,254	11,612	11,982
GDP deflator	5.9	6.3	5.7	5.1	4.1	3.5	3.4
CPI (annual average)	5.8	2.6	5.7	5.0	3.9	3.5	3.4
CPIX (end of period) 1/	4.1	5.9	5.3	4.5	3.8	3.5	3.5
CPIX (period average) 1/	6.8	5.2	5.6	5.0	4.0	3.5	3.5
Labor market							
Unemployment rate (official definition; in percent) 2/	28.2	28.0	28.0	28.0	28.0	28.0	28.0
Average remuneration (formal nonagricultural private sector)	7.7	7.5	7.1	7.2	6.7	5.9	5.5
Labor productivity (formal nonagricultural)	3.9	4.1	4.8	4.5	4.5	4.5	4.5
Nominal unit labor costs (formal nonagricultural)	5.0	3.4	2.3	2.7	2.2	1.4	1.0
External sector							
Merchandise exports, f.o.b. 3/	22.8	7.4	4.8	5.8	6.5	6.4	6.5
Merchandise imports, f.o.b. 3/	30.3	11.4	5.4	6.5	6.8	6.8	7.0
Export (goods and services) volume	-0.5	1.2	5.0	5.3	5.4	5.3	5.4
Import (goods and services) volume	9.7	8.3	5.8	5.8	5.5	5.7	6.3
Terms of trade	4.6	-1.4	0.3	0.9	0.3	0.2	0.3
Nominal effective exchange rate 4/	25.1	…	…	…	…	…	…
Real effective exchange rate 4/	25.0	…	…	…	…	…	…
Money and credit							
Net domestic assets 5/	3.3	...	...	...	...	...	...
Credit to the government 5/	-2.8	...	...	...	...	...	...
Credit to the rest of the economy 5/	6.1	...	...	...	...	...	...
Broad money (including foreign exchange deposits)	12.3	12.0	9.8	7.8	6.9	6.6	6.5
Velocity (GDP/average broad money)	1.6	1.6	1.6	1.6	1.6	1.6	1.6
	(In percent of GDP, unless otherwise indicated)						
Investment and saving							
Investment (including inventories)	16.8	16.4	16.5	16.6	16.7	16.8	16.9
Of which : public fixed investment	2.3	2.4	2.5	2.5	2.4	2.4	2.4
private fixed investment	13.4	13.8	14.0	14.1	14.3	14.4	14.5
Gross national saving	15.9	14.7	14.8	14.9	14.9	15.0	15.2
Public	1.0	-1.4	-1.4	-1.2	-1.2	-1.2	-1.3
Private	15.0	16.2	16.3	16.1	16.1	16.2	16.5
National government budget 6/							
Revenue, including grants	24.4	24.5	24.7	24.7	24.7	24.7	24.7
Expenditure and net lending	26.5	27.5	27.8	27.6	27.6	27.5	27.5
Overall balance	-2.1	-3.0	-3.1	-2.9	-2.8	-2.8	-2.8
Primary balance	1.8	0.8	0.7	0.8	0.8	0.8	0.8
National government debt	37.3	37.7	38.1	38.4	38.7	39.1	39.8
General government balance 7/	-2.1	-2.8	-2.8	-2.6	-2.5	-2.5	-2.5
Public sector borrowing requirement of the nonfinancial public sector	2.1	3.0	3.1	2.8	3.0	3.2	3.2
External sector							
Current account balance (in billions of U.S. dollars)	-1.3	-2.8	-3.2	-3.5	-3.6	-3.9	-4.0
Current account balance	-0.8	-1.6	-1.7	-1.8	-1.8	-1.8	-1.8
Overall balance of payments	4.7	2.3	1.3	1.3	1.0	0.5	0.4
Foreign currency-denominated debt (in billions of U.S. dollars)	27.3	29.0	30.0	31.8	33.3	35.1	36.6
Of which: short term (in billions of U.S. dollars)	12.0	12.4	12.6	13.1	13.5	13.9	14.2
Total external debt / exports of goods and services (in percent)	82.0	81.6	80.9	81.3	80.3	79.8	78.4
Total external debt service (in billions of U.S. dollars) 8/	6.1	6.7	6.5	7.4	7.3	6.9	7.1
Total external debt service / exports (in percent) 8/	13.4	13.9	12.9	14.0	12.9	11.6	11.2
Gross official reserves (in billions of U.S. dollars)	8.0	12.0	14.5	17.0	19.0	20.0	21.0
(in months of total imports)	2.2	3.1	3.0	3.5	3.7	3.7	3.6
International liquidity position of SARB (in billions of U.S. dollars) 9/	4.8	...	...	...	...	...	...
U.S. dollar exchange rate (end of period)	6.6	...	...	...	...	...	...

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

1/ CPIX is the consumer price index (CPI) less the interest on mortgage bonds.
2/ Excludes individuals who have not taken active steps to look for work or start self-employment in the four weeks prior to the interview. September.
3/ In U.S. dollars; annual percent change.
4/ Annual average; Information Notice System (INS) definition.
5/ Contribution (in percentage points) to the growth of broad money.
6/ Calendar-year figures, based on National Treasury data and staff's GDP projections.
7/ Excluding sales of state assets and profit/losses from forward market operations of the SARB.
8/ Excluding rand-demoninated debt held by nonresidents; end of period.
9/ Up to end of February 2004 referred to as net open position in foreign currency of SARB (NOFP), defined as net international reserves (gross reserves minus foreign loans) less net forward foreign exchange liabilities of SARB.

Table 2. South Africa: Selected Economic and Financial Indicators, (2003-2009)
(Accelerated reforms)

	2003	2004	2005	2006	2007	2008	2009
				Proj.			
		(Annual percent change, unless otherwise indicated)					
National income and prices							
Real GDP	1.9	2.6	3.8	4.5	4.9	5.0	5.0
Real GDP per capita	-0.3	0.7	1.9	2.6	2.9	3.0	3.0
CPI (annual average)	5.8	2.6	5.7	5.0	3.9	3.5	3.4
CPIX (period average)	6.8	5.2	5.6	5.0	4.0	3.5	3.5
Labor market							
Unemployment rate (official definition; in percent)	28.2	28.0	26.4	25.3	23.9	23.3	21.3
Nominal unit labor costs (formal nonagricultural)	5.0	3.3	1.8	1.0	0.8	0.4	0.3
National government budget							
Overall balance (in percent of GDP)	-2.1	-3.0	-2.9	-2.7	-2.5	-2.3	-2.3
National government debt (in percent of GDP)	37.3	37.7	37.7	37.5	37.3	37.2	37.1
External sector							
Export (goods and services) volume	-0.5	1.2	5.0	7.1	8.4	8.1	8.0
Import (goods and services) volume	9.7	8.3	6.3	7.3	7.4	7.7	8.1
Current account balance (in percent of GDP)	-0.8	-1.6	-1.9	-1.8	-1.7	-1.6	-1.6
Investment and saving							
Investment (including inventories; in percent of GDP)	16.8	16.6	17.3	17.7	18.1	18.3	18.6
Gross national saving (in percent of GDP)	15.9	14.9	15.4	16.0	16.4	16.7	17.1

Debt sustainability: Medium-term scenarios

South Africa's public debt position appears sustainable. The government's success in consolidating the fiscal position contributed to a reduction of the ratio of medium- and long-term public debt to GDP from 47 percent in 1999 to 38 percent in early 2004.[31] External medium- and long-term debt has increased moderately in recent years, from less than 2 percent of GDP in 1997 to around 6 percent of GDP at present, reflecting increased international borrowing and the real depreciation of the rand. Under the policies outlined in the 2004 budget and the medium-term expenditure framework, South Africa's debt should remain moderate and sustainable over the coming decade, albeit with some slight increase in the public debt-to-GDP ratio from 37 percent of GDP at end-2003 to 40 percent in 2009 (Table 3). Gross financing needs amount to just over 5 percent of GDP per year over the medium-term, slightly below the average of the past five years (Table 4).

[31] Contingent liabilities amount to approximately 11 percent of GDP, including government guarantees and actuarial liabilities for pension and insurance funds.

Public debt dynamics appear to be manageable under a variety of short-term shocks, including lower GDP growth, a temporary weakening of the primary balance, a 30 percent real depreciation of the exchange rate, and a ten percent increase of the debt stock. Although under each of these shocks, the public debt ratio increases over the projection period, it remains at or below 50 percent of GDP. Gross financing needs increase by as much as 2 percentage points of GDP per year in scenarios involving lower GDP growth.

With regard to external debt, the baseline projection implies a stabilization of the external debt-to-GDP ratio at slightly above 20 percent. This reflects a moderate increase in the current account deficit to about 1.8 percent of GDP—of which half is covered by net direct investment and equity flows. The overall stable current account outlook masks an expected recomposition of exports as gold exports are gradually replaced by other metals and services (tourism). On the investment income side, higher earnings on non-resident investments in South Africa should be more than compensated by a gradual reduction in debt service costs as the emerging market risk premium narrows. Overall, the current account deficit is expected to increase by a small amount, as the increase in the investment ratio is not fully compensated by increased private saving. Public sector saving is expected to remain roughly unchanged.

The main risk to this relatively benign outlook stems from a larger than expected negative impact of the AIDS pandemic on productivity growth. While the expiration in 2005 of preferential textile and clothing quotas will negatively affect South Africa's export of textiles and/or increase its imports, the overall economic impact is likely to be relatively small, as textiles and clothing exports corresponds to only about 1 percent of merchandise exports. Similarly, the impact of increased oil prices would be relatively limited. A $5 per barrel increase in the oil import price is likely to result in an increase of, at most, 0.2 percent of GDP in the annual current account deficit, assuming unchanged oil consumption.

The sustainability of South Africa's external position is relatively robust to reasonable shocks. Of the bound tests presented in Table 5, the largest increase in the external debt-to-GDP ratio would occur if the GDP deflator as measured in U.S. dollars decreased over two years by 2 standard deviations below its historical average. Given the historically high volatility of the real exchange rate (and the dollar-based GDP deflator), this would imply a real deprecation of the exchange rate of close to 70 percent. Even in this case, however, the external debt-to-GDP ratio would not increase beyond 40 percent of GDP. Moreover, the impact of a given real deprecation of the exchange rate would result in a smaller impact than in most countries as only 75 percent of the external debt is denominated in foreign currencies.

Table 3. South Africa: Public Sector Debt Sustainability Framework, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
								I. Baseline Projections						Debt-stabilizing primary balance 11/
Public sector debt 1/	47.0	44.4	43.0	38.5	37.3			**37.7**	**38.1**	**38.4**	**38.9**	**39.5**	**40.0**	**1.0**
o/w foreign-currency denominated	2.9	3.4	7.0	6.9	6.0			5.7	5.9	5.8	5.9	6.1	6.2	
Change in public sector debt	-1.2	-2.6	-1.4	-4.4	-1.2			0.4	0.4	0.3	0.4	0.7	0.5	
Identified debt-creating flows (4+7+12)	-2.3	-2.4	-1.1	-6.6	-2.5			-0.1	-0.4	-0.1	0.3	0.6	0.4	
Primary deficit	-3.4	-3.1	-3.2	-3.0	-1.8			-0.8	-0.7	-0.8	-0.8	-0.6	-0.5	
Revenue and grants	24.3	23.7	24.3	24.3	24.4			24.5	24.7	24.7	24.7	24.7	24.7	
Primary (noninterest) expenditure	20.9	20.6	21.1	21.3	22.6			23.7	24.0	24.0	24.0	24.1	24.2	
Automatic debt dynamics 2/	1.9	1.2	2.5	-2.9	-0.5			0.9	0.5	0.7	1.1	1.2	0.9	
Contribution from interest rate/growth differential 3/	1.7	0.5	0.5	-1.0	1.1			0.9	0.5	0.7	1.1	1.2	0.9	
Of which contribution from real interest rate	2.7	2.0	1.6	0.3	1.8			1.8	1.6	1.8	2.1	2.3	2.1	
Of which contribution from real GDP growth	-0.9	-1.5	-1.1	-1.3	-0.7			-0.9	-1.1	-1.1	-1.1	-1.1	-1.1	
Contribution from exchange rate depreciation 4/	0.1	0.7	2.0	-1.9	-1.6			...	...	...	...	...	...	
Other identified debt-creating flows	-0.8	-0.5	-0.4	-0.6	-0.2			-0.2	-0.2	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.8	-0.5	-0.4	-0.6	-0.2			-0.2	-0.2	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	1.1	-0.2	-0.3	2.1	1.3			0.5	0.8	0.4	0.1	0.1	0.1	
Public sector debt-to-revenue ratio 1/	193.4	187.0	176.9	158.5	152.6			153.7	154.4	155.3	157.1	159.8	161.7	
Gross financing need 6/	6.2	6.5	4.1	7.0	5.6			6.0	5.6	5.3	4.8	4.7	5.2	
in billions of U.S. dollars	8.2	8.3	4.7	7.5	9.0			10.6	10.5	10.4	10.1	10.1	12.0	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	2.0	3.5	2.7	3.6	1.9	2.8	1.0	2.6	3.3	3.0	3.0	3.0	3.0	3.0
Average nominal interest rate on public debt (in percent) 7/	12.3	12.2	12.0	11.2	11.0	13.0	1.6	11.1	10.8	10.4	10.2	9.9	9.0	10.3
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	6.1	5.0	4.2	1.2	5.0	5.0	1.5	5.5	4.9	5.3	6.1	6.4	5.6	5.6
Nominal appreciation (increase in US dollar value of local currency, in percent)	-4.8	-18.7	-37.6	40.4	30.1	-3.6	23.5	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.2	7.2	7.8	10.1	5.9	8.0	1.5	5.7	5.9	5.1	4.1	3.5	3.4	4.6
Growth of real primary spending (deflated by GDP deflator, in percent)	0.4	2.0	5.2	4.5	8.2	2.4	3.1	8.3	4.6	2.7	3.0	3.6	3.5	4.3
Primary deficit	-3.4	-3.1	-3.2	-3.0	-1.8	-2.0	1.4	-0.8	-0.7	-0.8	-0.8	-0.6	-0.5	-0.7
								II. Stress Tests for Public Debt Ratio						Debt-stabilizing primary balance 10/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 8/								**37.7**	**37.1**	**36.1**	**35.0**	**33.8**	**32.5**	**0.7**
A2. Primary balance under no policy change in 2005-09								**37.7**	**38.2**	**38.5**	**38.9**	**39.6**	**40.1**	**1.0**
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation								**37.7**	**38.3**	**38.6**	**39.0**	**39.7**	**40.2**	**1.0**
A4. Selected variables are consistent with market forecast in 2005-09								**37.7**	**38.1**	**38.4**	**38.9**	**39.5**	**40.0**	**1.0**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**37.7**	**39.5**	**40.9**	**41.5**	**42.3**	**43.0**	**1.1**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**37.7**	**40.0**	**42.5**	**44.4**	**46.5**	**48.4**	**1.2**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**37.7**	**39.7**	**41.6**	**42.2**	**43.1**	**43.7**	**1.1**
B4. Combination of 2-4 using one standard deviation shocks								**37.7**	**39.5**	**41.0**	**41.5**	**42.2**	**42.8**	**1.1**
B5. One time 30 percent real depreciation in 2005 9/								**37.7**	**41.5**	**41.9**	**42.6**	**43.4**	**44.1**	**1.1**
B6. 10 percent of GDP increase in other debt-creating flows in 2005								**37.7**	**48.3**	**48.8**	**49.6**	**50.6**	**51.4**	**1.3**

Sources: South African National Treasury and Fund staff estimates.

1/ Data covers gross debt of the national and provincial governments, calendar year basis.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 4. South Africa: Public Sector Debt Sustainability Framework--Gross Public Sector Financing Need, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
I. Baseline Projections											
Gross financing need 1/	6.2	6.5	4.1	7.0	5.6	6.0	5.6	5.3	4.8	4.7	5.2
in billions of U.S. dollars	8.2	8.3	4.7	7.5	9.0	10.6	10.5	10.4	10.1	10.1	12.0
II. Stress Tests											
Gross financing need 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 4/						6.0	4.2	3.8	2.9	2.3	2.6
A2. Primary balance under no policy change in 2005-09						6.0	5.6	5.3	4.9	4.7	5.2
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation						6.0	5.6	5.3	4.9	4.7	5.2
A4. Selected variables are consistent with market forecast in 2004-09						6.0	5.6	5.3	4.9	4.7	5.2
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						6.0	6.8	6.6	5.3	5.1	5.7
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						6.0	6.5	7.0	6.8	6.7	7.6
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						6.0	7.1	7.1	5.4	5.2	5.8
B4. Combination of 2-4 using one standard deviation shocks						6.0	6.3	6.2	5.2	5.0	5.6
B5. One time 30 percent real depreciation in 2005 4/						6.0	5.8	5.9	5.5	5.3	5.9
B6. 10 percent of GDP increase in other debt-creating flows in 2005						6.0	6.1	6.9	6.4	6.1	6.8
Gross financing need in billions of U.S. dollars 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						10.6	7.9	7.3	5.9	4.8	5.9
A2. Primary balance under no policy change in 2005-09						10.6	10.5	10.4	10.1	10.1	11.9
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation						10.6	10.5	10.4	10.1	10.1	12.0
A4. Selected variables are consistent with market forecast in 2005-09						10.6	10.4	10.4	10.0	10.1	11.9
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						10.6	12.8	13.1	11.0	11.1	13.1
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						10.6	11.9	13.2	13.4	13.9	16.5
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						10.6	13.3	14.1	11.2	11.3	13.3
B4. Combination of 2-4 using one standard deviation shocks						10.6	11.7	11.9	10.5	10.6	12.5
B5. One time 30 percent real depreciation in 2005 4/						10.6	7.2	7.6	7.4	7.4	8.8
B6. 10 percent of GDP increase in other debt-creating flows in 2005						10.6	11.5	13.6	13.2	13.3	15.6

Sources: South African National Treasury and Fund staff estimates.

1/ Defined as the deficit of the national and provincial governments (calendar year basis), plus amortization of medium and long-term national government debt, plus short-term debt at end of previous period.

2/ Gross financing under the stress test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.

3/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

4/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 5. South Africa: External Debt Sustainability Framework, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Projections								
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009			
								I. Baseline Projections								**Debt-stabilizing non-interest current account 7/**
External debt	29.7	28.8	27.0	30.7	23.2			**22.6**	**21.8**	**22.0**	**21.9**	**22.0**	**21.8**		**0.6**	**-0.9**
Change in external debt	1.6	-0.9	-1.8	3.7	-7.5			-0.6	-0.8	0.2	-0.1	0.1	-0.2	0.0		
Identified external debt-creating flows (4+8+9)	-7.7	-2.1	-3.2	-0.6	-8.1			-0.5	-0.2	0.0	-0.1	0.0	0.0	0.0		
Current account deficit, excluding interest payments	-1.9	-1.7	-2.0	-2.7	-0.6			0.1	0.2	0.4	0.3	0.3	0.3	0.9		
Deficit in balance of goods and services	-2.7	-3.0	-4.0	-3.7	-1.7			-0.9	-0.7	-0.6	-0.5	-0.5	-0.4			
Exports	25.9	28.9	31.2	34.0	28.3			27.7	26.9	27.0	27.3	27.5	27.8			
Imports	23.1	25.9	27.2	30.2	26.6			26.8	26.2	26.4	26.7	27.1	27.4			
Net non-debt creating capital inflows (negative)	-7.7	-1.5	-4.5	-0.7	-0.7			-1.5	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2		
Automatic debt dynamics 1/	1.9	1.1	3.3	2.8	-6.8			0.9	0.7	0.8	0.8	0.8	0.8	0.3		
Contribution from nominal interest rate	2.3	1.9	2.0	2.1	1.4			1.5	1.4	1.4	1.4	1.4	1.4	1.4		
Contribution from real GDP growth	-0.6	-1.1	-0.9	-1.0	-0.4			-0.6	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6		
Contribution from price and exchange rate changes 2/	0.2	0.3	2.2	1.7	-7.8			...	...	...	...	...	...	-0.5		
Residual, incl. change in gross foreign assets (2-3) 3/	9.3	1.2	1.4	4.3	0.6			-0.2	-0.7	0.2	0.0	0.1	-0.2	0.0		
External debt-to-exports ratio (in percent)	114.7	99.7	86.4	90.4	82.0			81.6	80.9	81.3	80.3	79.8	78.4			
Gross external financing need (in billions of US dollars) 4/	14.8	13.5	13.5	10.1	13.4			15.2	15.3	16.9	16.5	16.8	18.0			
in percent of GDP	11.3	10.5	11.8	9.5	8.4			8.7	8.2	8.6	8.0	7.7	7.9			
Key Macroeconomic Assumptions						Historical Average	Standard Deviation							For debt stabilization		Projected Average
Real GDP growth (in percent)	2.0	3.5	2.7	3.6	1.9	2.8	1.0	2.6	3.3	3.0	3.0	3.0	3.0	3.0		3.0
GDP deflator in US dollars (change in percent)	-3.9	-5.5	-13.1	-10.0	47.3	0.5	17.7	6.3	3.9	2.0	2.0	1.8	2.0	2.0		3.0
Nominal external interest rate (in percent)	8.0	6.2	6.1	7.4	7.1	7.5	0.9	7.0	6.9	6.9	6.9	6.9	6.9	6.9		6.9
Growth of exports (US dollar terms, in percent)	-1.8	9.2	-3.6	1.5	25.2	5.3	9.4	6.5	4.5	5.4	6.1	6.0	6.1			5.8
Growth of imports (US dollar terms, in percent)	-8.0	9.4	-6.2	3.7	32.1	7.0	13.4	9.9	5.0	5.9	6.2	6.2	6.3			6.6
Current account balance, excluding interest payments	1.9	1.7	2.0	2.7	0.6	1.2	0.8	-0.1	-0.2	-0.4	-0.3	-0.3	-0.3			-0.3
Net non-debt creating capital inflows	7.7	1.5	4.5	0.7	0.7	3.3	2.8	1.5	1.1	1.2	1.2	1.2	1.2			1.2
								II. Stress Tests for External Debt Ratio								**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios																
A1. Key variables are at their historical averages in 2005-09 5/								**22.6**	**19.1**	**16.1**	**12.7**	**9.3**	**5.4**			**-1.0**
A2. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 6/								**22.6**	**21.8**	**22.0**	**21.9**	**22.0**	**21.8**			**-0.9**
B. Bound Tests																
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**22.6**	**22.3**	**23.0**	**22.9**	**23.0**	**22.9**			**-0.9**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**22.6**	**22.3**	**23.0**	**22.9**	**23.0**	**22.8**			**-0.9**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**22.6**	**31.1**	**44.0**	**43.3**	**42.8**	**41.7**			**-2.4**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**22.6**	**22.0**	**22.3**	**22.2**	**22.3**	**22.1**			**-0.9**
B5. Combination of 2-5 using one standard deviation shocks								**22.6**	**27.5**	**34.1**	**34.0**	**34.1**	**33.8**			**-1.4**
B6. One time 30 percent nominal depreciation in 2005								**22.6**	**28.1**	**28.2**	**28.0**	**27.9**	**27.5**			**-1.3**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = 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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes 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/ The implied change in other key variables under this scenario is discussed in the text.

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

Statement by the IMF Staff Representative
September 3, 2004

This statement provides information that has become available since the staff report was issued. The thrust of the staff appraisal remains unchanged.

1. **Latest activity indicators support the view that the broad based economic recovery is gaining strength.** South Africa's economic growth rose to an annualized rate of 3.9 percent in the second quarter, underpinned by strong performance in all sectors. First quarter growth has also been revised upwards from 3.1 percent to 3.6 percent, which suggests that the staff's growth projection of 2.6 percent for 2004 may be exceeded slightly.

2. **As indicated in the staff report, the South African Reserve Bank lowered its repo rate by 50 basis points to 7.5 percent in mid-August.** The reason explained for the rate cut was an improved inflation outlook, but it had not been anticipated in the market. Since the rate cut, the rand has depreciated by nearly 10 percent against the U.S. dollar.

3. **Mild price pressures remain in the pipeline.** Although inflation fell further slightly to 4.2 percent in July, the staff remains of the view that some increase in interest rates would be advisable over the next 12 months if inflation is to stay comfortably in the target range of 3–6 percent. Inflationary pressures are likely to develop since domestic demand growth has been very strong, the pace of monetary expansion remains relatively high, and ongoing wage settlements have been well in excess of inflation and productivity gains.

4. **Fiscal data through end-July indicate that the budget is on track.** While total revenues are in line with budget estimates, revenues from the VAT and the personal income tax have been running well above projections. On the other hand, corporate income tax proceeds are well below target. Public sector wage negotiations, which are usually completed in July, are continuing.

5. **According to preliminary estimates, the deficit on the external current account widened to 2.7 percent of GDP in the first half of 2004, from 1.2 percent in the second half of 2003.** This deterioration largely reflects the impact of buoyant domestic demand conditions and the strength of the rand on import volumes. It also includes the purchase of aircraft.

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IMF Concludes Article IV Consultation with South Africa

On September, 3, 2004 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with South Africa.[1]

Background

Growth slowed in 2003 to 1.9 percent, from 3.6 percent in 2002, despite strong domestic demand. Fuelled by low interest rates, a more expansionary fiscal stance, and the wealth effects from strong commodity and property price increases, domestic expenditures rose strongly in 2003. But the increase in aggregate demand did not translate into higher growth, largely because of a strong currency appreciation, weak overseas demand, and poor weather-related performance in agriculture.

Developments so far in 2004, point to a rebound in growth. Real GDP grew by 3.9 percent in the second quarter (quarter-on-quarter, annualized) and a range of indicators, such as retail sales and consumer and business confidence measures, point to an acceleration in activity. The strength of the rand has contributed to a marked dissipation of inflationary pressures and has also enabled the South African Reserve Bank to reconstitute its net international reserve position. Inflation fell from a peak of over 10 percent in October 2002 to 4.4 percent in May 2004, which is well within the SARB target range of 3-6 percent.[2] The SARB has been

[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 Executive Board. 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.

[2] These are CPIX inflation rates. CPIX is the CPI less interest payments on mortgage bonds and is the measure targeted by the SARB under its inflation-targeting framework.

purchasing modest amounts of foreign exchange in the market and in February 2004 closed its open position in the forward market; in the past, this exposure had been a major source of external vulnerability and macroeconomic instability. The increase in net international reserves, together with sound financial policies more generally, has contributed to a substantial decline in sovereign risk spreads.

Prudent fiscal policy has been the cornerstone of South Africa's stabilization effort in the first ten years after apartheid. To help address South Africa's pressing social problems and provide a mild countercyclical boost to the economy, fiscal policy was eased somewhat in 2003/04. The budget deficit increased to 2.4 percent of GDP from 1.1 percent in 2002/03, reflecting an increase in social spending of 1.3 percent of GDP. The budget for 2004/05 provides for a further relaxation of the fiscal stance. The envisaged moderate expansion in the fiscal stance seems appropriate to help address South Africa's pressing social problems. However, a deficit in the region of 3 percent should be considered the upper limit of what is desirable to maintain macroeconomic stability and keep indebtedness low.

While the stabilization effort is now largely complete, South Africa faces formidable challenges in the form of high unemployment and widespread poverty. The official rate of unemployment fell to 28.2 percent in September 2003 from 31.2 percent in March 2003, but this mainly reflected a sharp drop in the number of people looking for work. The government is implementing a multi-faceted strategy to increase employment that includes skills development, improvements in education standards, a public works program, and amendments to labor legislation. These elements represent important steps in the right direction. Ongoing reviews of the tariff regime and the strategy for parastatal restructuring also provide an excellent opportunity to move ahead forcefully with reforms that enhance industrial efficiency and competitiveness. Black economic empowerment and land reform will be vital in helping to reduce social disparities. The HIV/AIDS epidemic is having a devastating social impact with costly macroeconomic repercussions. The government has put in place a comprehensive plan for the universal roll-out of ARV drugs and parallel steps are being taken to strengthen the public health system and provide social safety nets in the form of child support grants.

Executive Board Assessment

They commended the South African authorities for the success in stabilizing the economy through skillful macroeconomic management, and for the considerable progress in structural reforms. Inflation has been brought under control, public finances have been strengthened, and the international reserve position has improved. Directors considered that these achievements have laid the strong foundation for higher sustained growth, greater competition, increased efficiency, and reduced external vulnerability.

Directors agreed that the economy appears poised for a recovery in activity, supported by monetary easing over the past year, a moderately expansionary fiscal policy, and a pick up in overseas demand. They noted, however, that the main risks to the outlook relate to a continuation of the high pace of wage settlements, higher oil prices, and renewed currency appreciation, which could put a break on the recovery. Directors emphasized that the policy challenge facing South Africa is to achieve, over the longer run, higher sustainable economic growth and substantive reductions in unemployment, poverty, and the prevalence of HIV/AIDS. The authorities' approach to tackling HIV/AIDS is exemplary, but a more concerted effort will be needed in this regard to improve the public health system and mitigate the social and economic effects of HIV/AIDS. Directors stressed the importance of removing structural impediments to growth, particularly in the areas of the labor market, trade, and public enterprises. The government also needs to implement initiatives aimed at reducing income and wealth disparities, which will help maintain social cohesion.

Directors noted that prudent fiscal policy, in conjunction with budgetary reforms, has been the cornerstone of the stabilization effort. They supported the budget for 2004/05, which provides for a modest expansion of the fiscal stance, in light of the slowdown in economic activity in 2003 and social and infrastructure needs. Directors cautioned, however, that fiscal deficits should be contained within levels that will not exert undue pressure on long-term interest rates and the exchange rate, or lead to an undesirable accumulation of public debt. They considered that additional resources, if needed to support social programs, should be raised through new tax initiatives, cuts in non-priority spending, and strengthening of tax administration and expenditure management. It was suggested also that more resources be made available for HIV/AIDS prevention and treatment programs.

Directors commended the authorities for the progress made in bringing inflation down to within the central bank's target range, which had enabled a significant reduction in short-term interest rates. They noted, however, that several indicators—including continued high oil prices and exchange rate developments—point to a mild buildup in inflationary pressures over the next year. Directors therefore urged the authorities to remain vigilant and stand ready to raise interest rates in a timely manner, but cautioned that any such adjustment should lag, rather than lead, interest rate changes abroad. They also considered that enhancing the credibility of the inflation-targeting framework will help anchor inflation expectations, and that bringing projected inflation targets to a rate closer to the midpoint of the band would help in this regard.

Directors noted that the closure of the South African Reserve Bank (SARB)'s open position in the forward market has helped remove a potential source of external vulnerability and strengthen investor confidence. They agreed that the exchange rate remains broadly consistent with macroeconomic fundamentals, and welcomed the authorities' commitment to a free floating exchange rate regime, with intervention limited to strengthening international reserves as needed to cushion against currency volatility and speculation. Directors welcomed the authorities' prudent debt management strategy, and supported the approach to gradually relaxing capital controls. The current strength of the rand presents an opportune time to ease controls further.

Directors welcomed that South Africa's financial and corporate sectors are healthy and appear resilient to major exchange and interest rate shocks. While agreeing that the banks seem reasonably well protected in the event of adverse developments in the real estate market, Directors cautioned that vulnerability could potentially rise if a fall in property prices were to be accompanied by increases in interest rates. They therefore encouraged the authorities to monitor closely bank lending to the real estate sector, and welcomed the efforts underway to address gaps in the regulatory framework and to strengthen bank supervision in line with the Financial Sector Assessment Program recommendations. Directors praised the authorities for including collective action clauses in their recent international bond issue. They also welcomed the progress made in implementing the AML/CFT regime, and urged increased emphasis on identifying beneficial owners of accounts. Directors looked forward to parliamentary passage of legislation that criminalizes the financing of terrorism, terrorist acts, and terrorist organizations.

Directors welcomed the authorities' strategy to address the acute unemployment problem, but urged them to take more determined action in labor market reforms aimed at enhancing job skills, removing barriers to job creation, and increasing labor mobility. In this context, they agreed that the collective bargaining system should be made more decentralized to allow small- and medium-sized enterprises greater autonomy in setting wages. The government's Skills Development Program should be Directors stressed that improved by placing greater emphasis on training the unemployed and reducing labor taxes.care should be exercised in implementing the labor-intensive public works program to ensure its accountability, and that procedures for dismissing and retrenching workers be streamlined.

Directors urged stronger efforts to raise productivity, enhance international competitiveness, and promote private-sector-led growth, particularly through further trade liberalization, privatization, and wage restraint. The completion of an import tariff review would provide a good occasion to move ahead vigorously with lowering and harmonizing effective rates of protection and simplifying the tariff regime. To realize the potential employment benefits, trade liberalization should be accompanied by labor market reforms. Directors underscored the importance of accelerating the privatization program to improve efficiency in the operations of major parastatals, and looked forward to the completion of the review of the reform strategy for these enterprises. They considered that the restructuring process should be supported by social safety net programs and job training, together with a clear, effective communication strategy. In addition, a transparent mechanism should be put in place to monitor the risk sharing between the government and the private sector to ensure the success of the public-private partnership programs. It would also be important that these programs are not used to bail out financially troubled private firms. Imposing hard budget constraints and improving corporate governance were also considered priorities.

Directors welcomed the black economic empowerment and land reform programs as key components of the initiatives to reduce income and wealth disparities. Funding issues relating to black empowerment, however, still need to be resolved and safeguards against an undue concentration of assets strengthened. Directors emphasized that it would be essential to make good progress in meeting the targets for land redistribution and in achieving the Millennium Development Goals.

Directors encouraged the authorities to address remaining weaknesses in employment and other labor market data. They welcomed the authorities' ongoing efforts to identify the origins of the large net errors and omissions in the balance of payments.

Directors commended the South African authorities for their leadership role in conflict resolution and poverty reduction in Africa, particularly through contributions to the PRGF-HIPC Trust and in the context of NEPAD and the African Union.

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South Africa: Selected Economic Indicators

	2000	2001	2002	2003
		(In percent)		
Domestic Economy				
Change in real GDP	3.5	2.7	3.6	1.9
Change in consumer prices (metrop. areas, end of period)	7.2	3.7	12.1	0.7
Unemployment rate 1/	25.8	29.5	30.5	28.2
		(In billions of U.S. dollars, unless otherwise noted)		
External Economy				
Exports, f.o.b.	31.9	31.0	31.5	38.7
Imports, f.o.b.	27.3	25.8	26.9	35.0
Current account balance (deficit -)	-0.3	0.0	0.6	-1.3
Direct investment	0.6	10.8	1.1	0.1
Portfolio investment	-2.0	-8.3	-0.4	0.8
Financial account balance (in percent of GDP, deficit -)	0.2	-0.4	2.2	3.8
Gross official reserves (in billions of U.S. dollars)	7.5	7.5	7.6	8.0
Current account balance (in percent of GDP, deficit -)	-0.2	0.0	0.6	-0.8
Change in real effective exchange rate (in percent) 2/	-1.3	-8.9	-9.9	25.0
International liquidity position 3/	-9.5	-4.8	-1.6	4.8
External debt (in percent of GDP) 4/	28.8	27.0	30.7	23.2
Exchange rate, rand per U.S. dollar (end of period)	7.57	12.13	8.64	6.64
		(In percent, unless otherwise noted)		
Financial Variables				
National government balance (in percent of GDP, deficit -) 5/	-2.0	-1.4	-1.1	-2.4
Change in broad money	7.5	17.3	17.2	12.3
Interest rate 6/	12.0	9.5	13.5	8.0

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

1/ Official definition.

2/ (+) = appreciation (period average)

3/ Up to end of February 2004 referred to as net open position in foreign currency of SARB (NOFP), defined as net international reserves (gross reserves minus foreign loans) less net forward foreign exchange liabilities of SARB

4/ Includes rand denominated debt.

5/ Main budget. Fiscal year starting on April 1.

6/ Bank/repo rate (end of period).