Euler Hermes Economic Research

Country Risk Analysis

South Africa

Regional power, but structural rigidities

General Information

GDP	USD384.313bn (World ranking 28, World Bank 2012)
Population	51.19 million (World ranking 25, World Bank 2012)
Form of state	Republic
Head of government	Jacob ZUMA
Next elections	2014, presidential and legislative

Strengths

- Natural resource base includes gold, platinum, chrome, manganese, vanadium, coal and diamonds.
- Geographic (strategic) and economic size engender regional dominance.
- ANC government has a strong mandate.
- Judicial and business environments aligned with western ‘norms’.
- Economic management has a track record of being sound.
- Exemplary exodus from foreign debt problems in the 1990s.
- Good relations with IFIs and assistance would be readily available, in need.

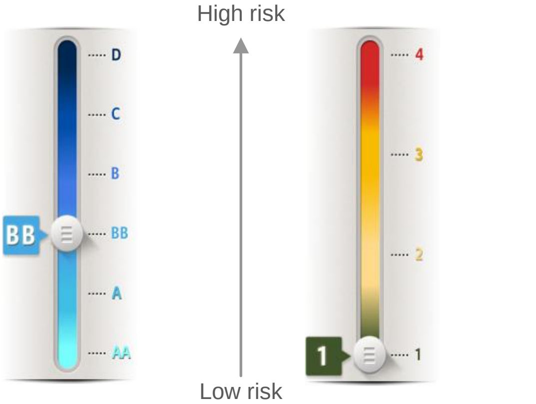
Weaknesses

- Long-term structural problems include unemployment, rural poverty, skewed incomes, incidence of HIV/AIDS, track record of labour militancy and weak educational standards.
- Open economy can result in currency and external account pressures.
- Despite lower dependence on mining (now accounting for around 12% of GDP), vulnerability to commodity price fluctuations.
- Current and fiscal account deficits.
- Inward investment weighted to portfolio flows rather than FDI.
- Lack of investment in power generation has resulted in occasional rationing of supplies to homes and industry.
- Labour market inflexibility.

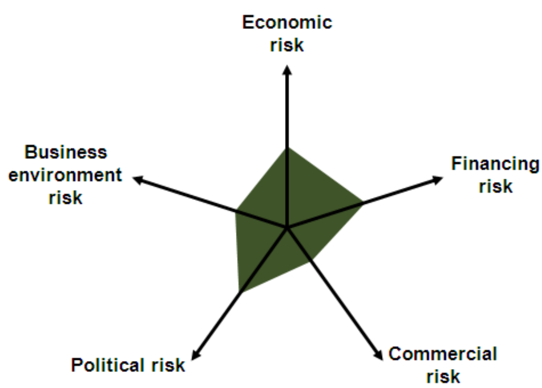
Country Rating

BB1

Country Grade **Country Risk Level**

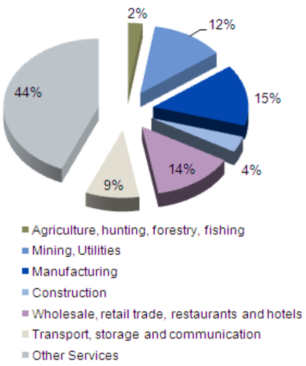


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2011)

By destination/origin

Exports		Rank		Imports
China	18%	1	12%	China
United States	9%	2	11%	Germany
Japan	8%	3	7%	United States
Germany	7%	4	5%	United Kingdom
India	6%	5	4%	Saudi Arabia

By product

Exports		Rank		Imports
Non-ferrous metals	16%	1	21%	Petroleum, petroleum products and related
Metalliferous ores and metal scrap	16%	2	9%	Road vehicles
Iron and steel	8%	3	5%	Other industrial machinery and parts
Road vehicles	8%	4	5%	Telecommunication and sound recording apparatus

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	-1.5	3.1	3.5	2.5	2.5	3.5
Inflation (%, end-year)	6.3	3.5	6.1	5.0	5.5	5.8
Fiscal balance (% of GDP)	-5.5	-5.1	-4.0	-4.5	-4.6	-4.0
Public debt (% of GDP)	31.3	35.8	39.6	33.7	32.8	34.4
Current account (% of GDP)	-4.0	-2.8	-3.4	-5.6	-5.9	-5.9
External debt (% of GDP)	27.5	28.8	28.1	35.8	29.1	29.9

Sources: IHS Global Insight, National sources, Euler Hermes

Economic Growth

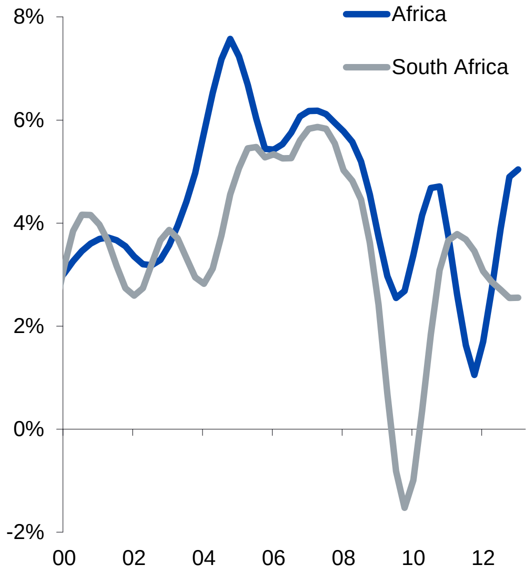
Growth constraints

GDP growth was an annual average +5.2% in 2004-07 but a ten-year average to 2012 is +3.5%, which is a benchmark for realistic growth assessments. Rates of expansion of around +5% are required to make meaningful improvements in incomes and living standards. However, structural impediments have generally limited GDP growth to below that rate. These constraints include a lack of skilled labour, limited job creation (capital intensive industry), high unemployment and under-employment, infrastructure bottlenecks, weak public sector delivery and disruptions to power supplies. In addition, although external trade links are now more diversified, the recent weakness in some European markets has reduced demand growth for South African exports.

Outlook for growth is for continuing under achievement in 2013-14

The impediments to growth (see above) are unlikely to be resolved quickly and GDP will continue to expand at below-potential rates. Despite a gradual improvement in the external environment (more evident in 2014), EH expects GDP growth to be limited to +2.5% in 2013 and +3.5% in 2014.

GDP growth (y/y, 4 qtrs cumulated %)

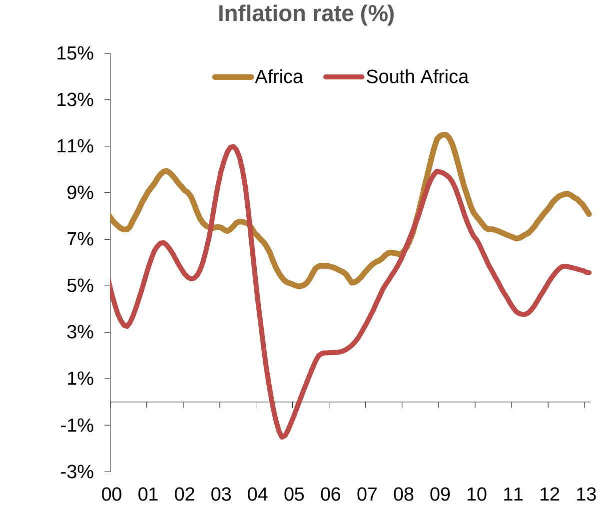


Sources: IHS Global Insight, Euler Hermes

Economic Policies

A feature of the post-transition environment has been the adoption, to date, of relatively orthodox economic policies and perceptions (acknowledged by multilateral agencies) that economic management has been generally good. This allayed some concerns that an ANC government would adopt populist policies that would deter both domestic and foreign investment. However, there are some recent concerns that policy implementation is slipping and that a more popular agenda may yet gain traction, although mine nationalisation remains absent from official statements of intent.

Economic diversification has taken place both organically and through policy directives. Dependence on the gold sector has been reduced significantly, with mining as a whole now accounting for around 12% of GDP, compared with manufacturing's 15%. Platinum and coal are both larger contributors to mining output than gold.

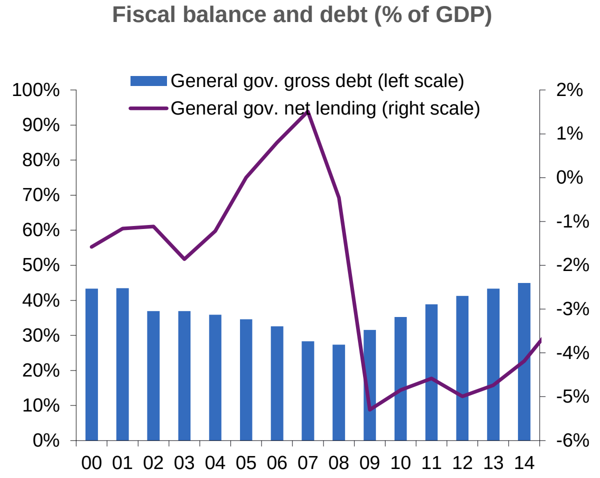


Sources: IHS Global Insight, Euler Hermes

Inflationary pressures

The rand (ZAR) has weakened against its major trading partners, partly reflecting downgrades in sovereign ratings, partly concerns relating to linkages with a generally weak eurozone but also on perceptions that the government in Pretoria is not addressing effectively underlying economic weaknesses. There is a strong correlation between depreciation of the ZAR and price pressures and the currency is likely to weaken further. In addition, upward price pressures are likely from rising costs for industry as the latest wage negotiations are settled. Moreover, increases in electricity tariffs this year and next will exert further price pressures for consumers and industry. EH expects inflation rates to be towards the top end (or exceed) the official target range of 3-6%.

The ZAR is an openly traded currency and is susceptible to periodic volatility. Exchange rate depreciation (see also above) also stems from a structural weakness in the external accounts, with a strong propensity to import and current relatively weak export markets. South Africa's inflation differential with its trading partners is around 3% and ZAR depreciation of around this order (if not more) is expected in 2013 and 2014.



Sources: IHS Global Insight, Euler Hermes

Continuing fiscal deficits

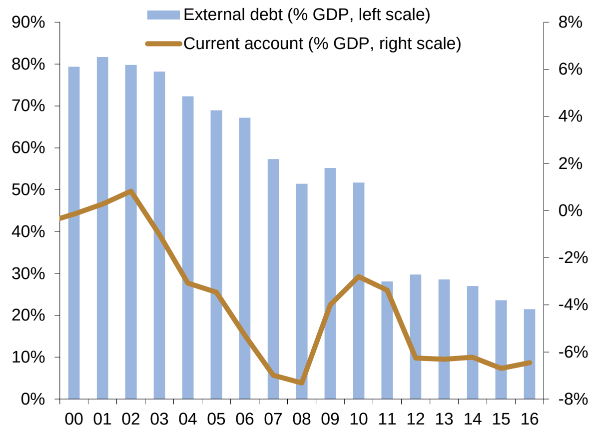
The broad fiscal stance is geared towards supporting the government's overall strategy of poverty reduction but policy has been orthodox and state spending has been set within pragmatic and realistic bands. In this regard, current Finance Minister Pravin Gordhan has followed the path of his predecessor, Trevor Manuel, in observing fiscal rectitude. The budget Gordhan announced in February 2013 sets a fiscal deficit for FY2013/14 at -4.6% of GDP (ZAR163.7 billion) and through reductions in the growth of expenditures and through use of contingency reserves, the deficit target for FY2015/16 is -3.1% of GDP. Given a recent track record of marked improvements in the efficiency of the revenue service, these targets are achievable, providing scope for some slippage without risking excessive debt accumulation.

Large current account deficits

During the period of sanctions, large current account surpluses were engineered as a way to counter the impact of large capital outflows. With a new political dispensation and trade liberalisation, South Africa in 1995 recorded its first current account deficit for ten years. Annual average current account deficits in the period 2000-08 were -2.9% of GDP but shortfalls have increased since then, reflecting strong consumer demand for imports and high cost of inflows of oil (crude petroleum accounts for around 12% of the total import bill).

Nevertheless, FX reserves have accumulated. FX reserves totalled around USD6 billion at the time of the closure of the central bank's net open forward position in May 2003, but now total over USD40 billion and these provide an import cover of almost five months.

Current account and external debt (% of GDP)



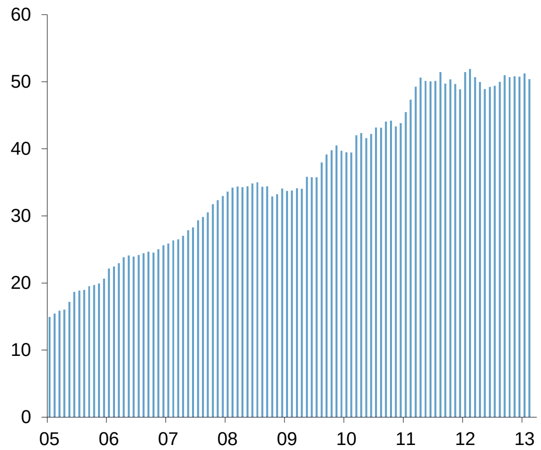
Sources: IHS Global Insight, Euler Hermes

External debt stock and repayment obligations are comfortable

Unlike some other Sub-Saharan economies during the same period, South Africa underwent an exemplary exodus from external debt problems arising in the 1980s. This reflected the generally sound economic management that carried over into the post-transition period.

Despite accumulation of FX reserves, some external liquidity indicators remain weak, particularly M2/FX. Nevertheless, solvency ratios are comfortable—external debt is around 30% of GDP and 90% of export earnings, while the debt service ratio (scheduled repayments/export earnings) is only around 6%.

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

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