Euler Hermes
Economic
Research

Country Report

South Africa

Elections point to continuity, but frailties remain

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 (monetary & fiscal policy) 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.

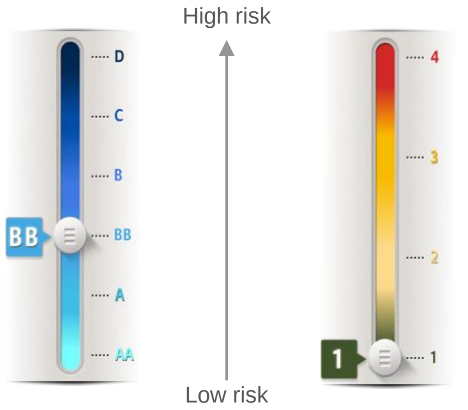
Weaknesses

- 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 13% 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.

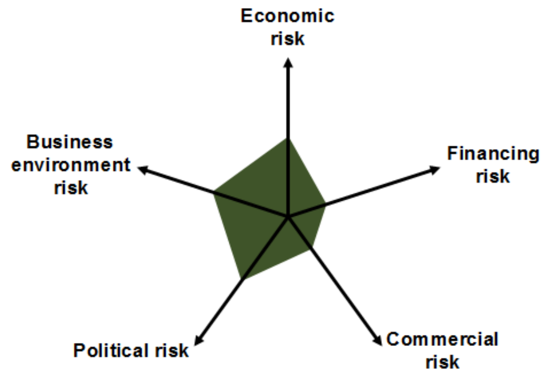
Country Rating

BB1

Country Grade **Country Risk Level**



Risk Dimensions



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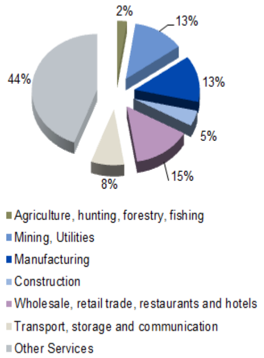
Economic Structure

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 materials
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
Gold, non-monetary (excluding gold ores and	8%	5	4.5%	Specialised machinery

Economic Forecast

	2010	2011	2012	2013	2014f	2015f
GDP growth (% change)	3.1	3.6	2.5	1.9	2.0	3.0
Inflation (%, end-year)	3.5	6.1	5.7	5.4	6.3	5.4
Fiscal balance (% of GDP)	-4.9	-4.0	-4.3	-5.0	-4.5	-4.0
Public debt (% of GDP)	35.3	38.8	42.1	37.3	38.1	38.8
Current account (% of GDP)	-1.9	-2.3	-5.2	-5.5	-6.0	-5.6
External debt (% of GDP)	30.5	29.2	37.2	37.4	41.2	36.8

Sources: IHS Global Insight, national sources, Euler Hermes

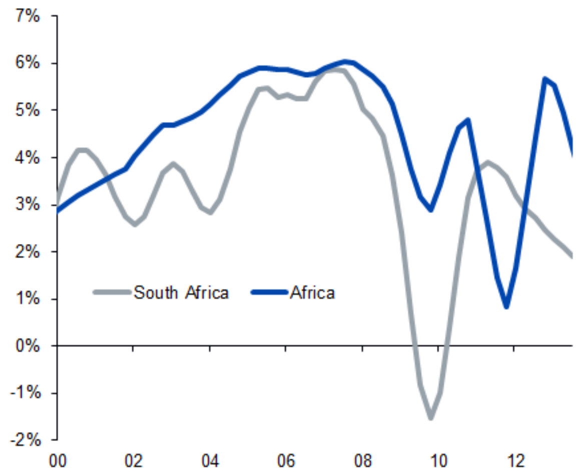
Economic Growth

Generally weak growth outlook

GDP growth was an annual average +5.2% in 2004-07 but a ten-year average to end-2013 is +3.4%, 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.

Q1 2014 GDP contracted by a seasonally-adjusted -0.6% q/q, compared with +3.8% in Q4 2013, the first contraction since 2009 and largely reflecting lost output in the mining industry (-24.7% q/q) as strikes in the platinum sector (mining's largest employer) continue to be unresolved. Manufacturing output also contracted (-4.4%), partly because of knock-on effects from the mining sector. Despite a renewed electoral mandate, the ANC government faces a challenging period. EH revised downwards its forecasts for GDP and now expects +2% in 2014 as a whole (with a downside bias), followed by +3% in 2015.

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



Sources: IHS Global Insight, Euler Hermes

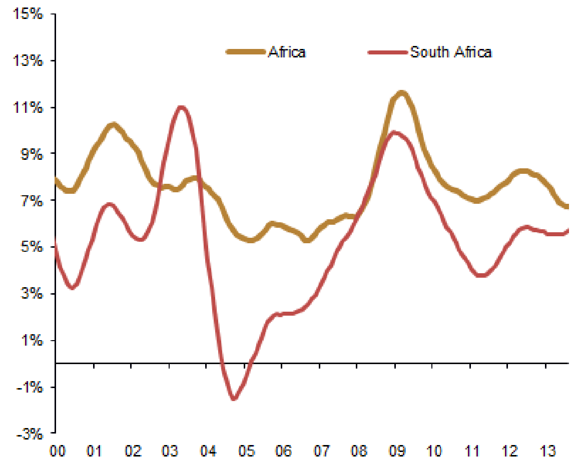
Economic Policies

Following Nigeria's rebasing of its GDP data, South Africa is no longer Sub-Saharan Africa's largest economy. Nigeria's 2013 GDP is now estimated at USD510 billion (previously USD292 billion) compared with South Africa's USD351 billion. However, South Africa will continue its role as a regional leader.

A feature of the post-transition environment is 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 investment. However, there are 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 is both organic and through policy directives. Dependence on the gold sector has been reduced significantly, with mining as a whole now accounting for around 13% of GDP, a similar share to manufacturing. Platinum and coal are both larger contributors to mining output than gold.

Inflation rate (%)



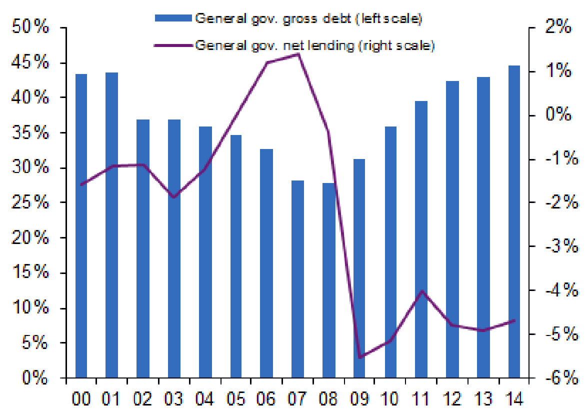
Sources: IHS Global Insight, Euler Hermes

Inflation and ZAR pressures

The rand (ZAR) is weak 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 last year and in 2014 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.

General government gross debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

Fiscal rectitude, but regular 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. The budget in March 2014 continued the country's recent record of generally sound fiscal management, despite a temptation for budgetary expansionism in an election year. Indeed, the budget deficit is projected to fall to -2.8% of GDP in FY2016/17 (-4% in 2013/14 and also in 2014/15). 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.

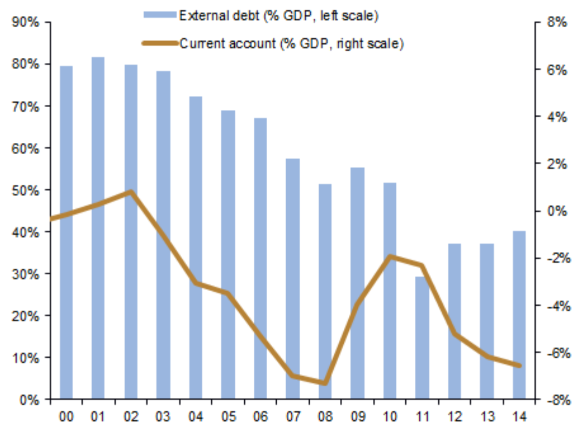
External Sector

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 and oil products now account for around 21% of the total import bill). More recently, industrial action in the mining sector, particularly in the platinum sub-sector, is reducing export potential and receipts. In addition, weak gold prices also limit export revenues; the gold price fell over USD490/ounce over the course of 2013 and is currently over USD650/ounce below its peak of USD1,895/ounce in September 2011.

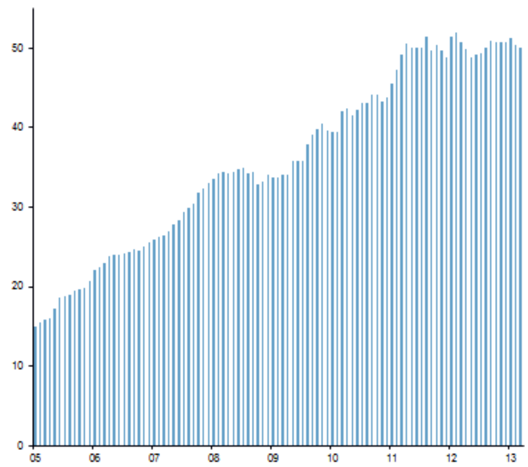
Nevertheless, FX reserves have accumulated. FX reserves totalled around USD6 billion at the time of the closure of the central bank's net open forward position in May 2003, but now total over USD50 billion and these provide an import cover of over five months.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

External debt stock and ratios and repayment obligations are relatively 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 stock is around 40% of GDP and 110% of total export earnings, while the external debt service ratio (scheduled repayments/total export earnings) is below 8%.

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2014-06-13
Country Risk Analyst:
Andrew Atkinson
andrew.atkinson@eulerhermes.com