Euler Hermes Economic Research

Country Report

South Africa

Regional power, but structural rigidities

General Information

GDP	USD350.6 bn (World ranking 33, World Bank 2013)
Population	52.98 mn (World ranking 25, World Bank 2013)
Form of state	Republic
Head of government	Jacob ZUMA
Next elections	2019, presidential and legislative

Strengths

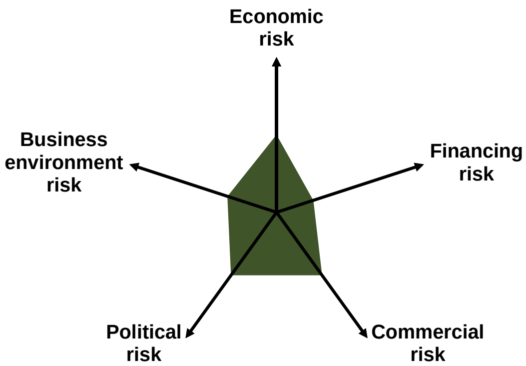
- Natural resource base includes gold, platinum, chrome, manganese, vanadium, coal and diamonds.
- Geographic (strategic) and economic size engender regional dominance.
- ANC government has a strong mandate.
- Judicial and business environments aligned with western 'norms'.
- Economic management (monetary & 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 some rationing of supplies to homes and industry.
- Labour market inflexibility.

Country Rating

BB1



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
China	25%	1	14%	China
United States	7%	2	10%	Germany
United Kingdom	6%	3	7%	Saudi Arabia
India	5%	4	7%	United States
Japan	5%	5	4%	India

By product (% of total)

Exports		Rank		Imports
Metalliferous ores and metal	13%	1	21%	Petroleum, petroleum products
Non-ferrous metals	10%	2	10%	Road vehicles
Road vehicles	7%	3	4%	Other industrial machinery and parts
Gold, non-monetary (excluding gold ores and concentrates)	7%	4	4%	Specialised machinery
Iron and steel	6%	5	4%	Gold, non-monetary (excluding

Source: UNCTAD (2012)

Economic Overview

No longer Sub-Saharan Africa's largest economy, but still a regional power

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 bn (previously USD292 bn) compared with South Africa's USD351 bn. However, South Africa will continue its role as a regional leader.

A feature of economic policymaking is the adoption, to date, of relatively orthodox 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, the 2015 State of the Nation Address made reference to potential land redistribution legislation.

Economic diversification is both organic and through policy directives. Dependence on the gold sector is much reduced, 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.

GDP growth remains weak relative to development needs

GDP growth was an annual average +5.2% in 2004-07 but a ten-year average to end-2014 is +3%. 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 exports.

In Q4 2014, real seasonally-adjusted GDP increased by an annualised +4.2% q/q, compared with +1.2% in Q3. Growth in that period was boosted by output in the mining, manufacturing, and financial sectors. However, the bounce back reflected recovery from weak strike-related outcomes in Q2 and Q3. For 2014 as a whole, GDP increased by only +1.5%, the weakest rate since the 2009 recession. Despite a still strong electoral mandate, the ANC government faces a challenging period. EH revised downwards its forecasts for GDP growth and now expects +2% in 2015 (with a downside bias), followed by +3% in 2016.

Relatively low oil prices mute inflationary pressures

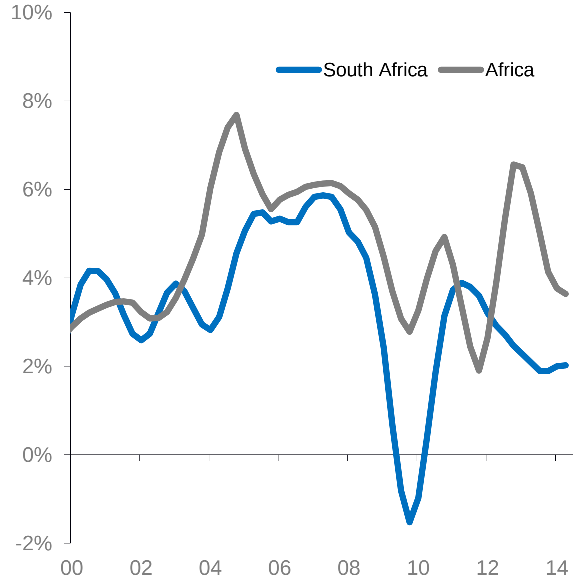
There is a strong correlation between inflation and depreciation of the rand (ZAR). The currency is likely to weaken further, despite less pressure exerted through a large energy import bill. Upside price pressures are likely from rising costs for industry, particularly the wage bill, and increases in electricity tariffs will exert further price pressures. Overall though, EH expects inflation rates will remain within the official target range of 3-6% in 2015 and 2016.

Key economic forecasts

	2012	2013	2014	2015f
GDP growth (% change)	2.5	2.2	1.5	2.0
Inflation (%, end-year)	5.7	5.4	5.3	4.9
Fiscal balance (% of GDP)	-4.1	-4.0	-3.9	-3.3
Public debt (% of GDP)	33.8	37.4	39.8	40.6
Current account (% of GDP)	-5.0	-5.6	-5.3	-5.0
External debt (% of GDP)	36.0	38.8	41.6	38.6

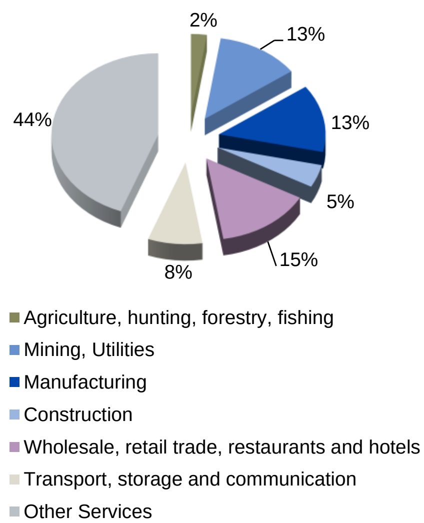
Sources: IHS, national sources, Euler Hermes

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



Sources: IHS, Euler Hermes

GDP breakdown (%)



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, reduced export potential and receipts. In addition, weak gold prices also limit export revenues; the current gold price of USD1200/ounce is over USD680/ounce below its peak in September 2011.

Nevertheless, FX reserves have accumulated. FX reserves totalled around USD6 bn at the time of the closure of the central bank's net open forward position in May 2003, but amounted to over USD44 bn at end-2014 and provided an import cover of almost five months.

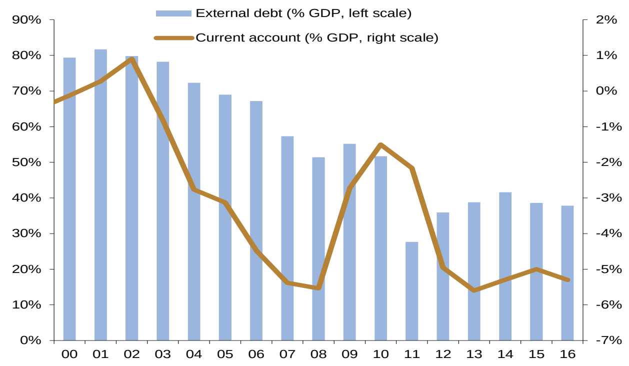
External debt ratios and obligations are relatively comfortable

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 120% of total export earnings, while the external debt service ratio (scheduled repayments/total export earnings) is below 8%.

Public finances

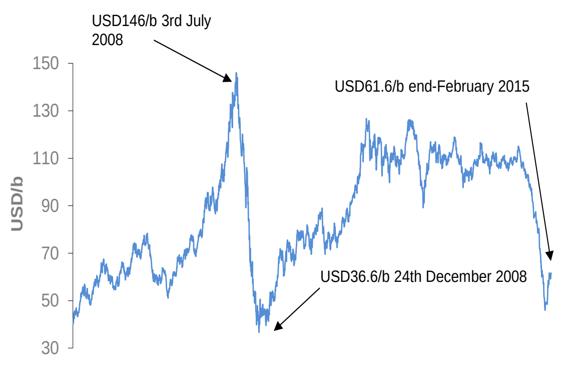
The broad fiscal stance is geared towards supporting the government's overall strategy of poverty reduction but policy has been orthodox and state spending has been set within pragmatic and realistic bands. Indeed, the 2015 budget contains austerity measures (spending cuts and higher taxes) as the authorities try to limit the fiscal deficit. The latter is projected to fall from -3.9% of GDP in FY2015/16 to -2.5% in 2017/18. 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 debt and current account balance (% of GDP)



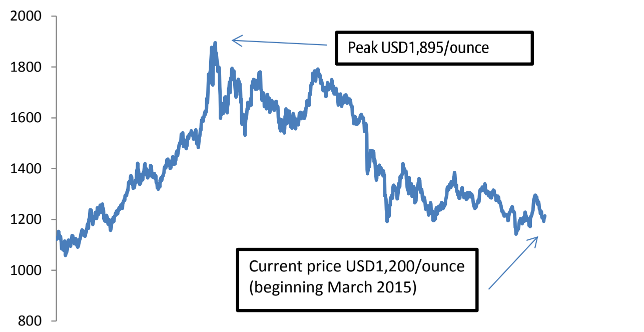
Sources: IHS, Euler Hermes

Oil prices (Brent crude USD/barrel)



Source: Euler Hermes

Gold prices January 2010-February 2015 (USD/ounce)



Source: Euler Hermes

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