Rabobank

Country report **SOUTH AFRICA**

Summary

The South African economy is one of the biggest, most diversified and most developed economies of the sub-Saharan African region. Economic growth is expected to ease from 3.1% last year to about 2% this year, as the economy is very susceptible to subdued external demand from Europe. Also, a dysfunctional labor market – unemployment is above 20% – continues to hamper productivity. Main political issues in the country are set around the vote for the presidential candidate of the ruling African National Congress (ANC) this year, the general elections of 2014, the nationalization and/or taxation of the mines and the position of expelled ANC's youth leader Julius Malema. Especially Malema's actions could elevate political and social risks. Public finances have deteriorated since the recession of 2009. Public debt has increased from 24% of GDP in 2008 to an expected 38% of GDP this year, as fiscal deficits remain high around 4-5% of GDP. South Africa shows persistent current account deficits (around 4-5% of GDP in 2012), while its external debt remains sound at around 12% of GDP.

Things to watch:

- Civil unrest triggered by rampant youth unemployment and poverty
- Activities of Julius Malema, the expelled ANC youth leader
- Subdued external demand on the back of weak global recovery

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South Africa

National facts		
Type of government	Federal republic	
Capital	Capetown, Pretoria & Bloemfontein	
Surface area (thousand sq km)	1,219	
Population (millions)	49.1	
Main languages	English, Afrikaans	
	9 local languages	
Main religions	Christian (68%)	
	Traditional African (29%)	
	Other (3%)	
Head of State (president)	Jacob Zuma	
Head of Government	Jacob Zuma	
Monetary unit	Rand (ZAR)	

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	405	0.59
Nominal GDP at PPP	552	0.70
Export value of goods and services	110	0.50
IMF quota (in m SDR)	1869	0.86
Economic structure	*2011*	*5-year av.*
Real GDP growth	3.1	3.2
Agriculture (% of GDP)	2	3
Industry (% of GDP)	31	31
Services (% of GDP)	66	66
Standards of living	*USD*	*% world av.*
Nominal GDP per head	8272	77
Nominal GDP per head at PPP	11257	91
Real GDP per head	6081	75

Social and governance indicators	rank / total
Human Development Index (rank)	123 / 187
Ease of doing business (rank)	35 / 183
Economic freedom index (rank)	70 / 179
Corruption perceptions index (rank)	64 / 183
Press freedom index (rank)	42 / 178
Gini index (income distribution)	63.1
Population below $1.25 per day (PPP)	14%

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
China	13	China	15
US	9	Germany	12
Japan	8	US	8
Germany	8	Saudi Arabia	6

Main export products (%)	*2011*
Platinum	14
Gold	12
Coal	9
Cars & other components	6
Main import products (%)	
Petrochemicals	17
Equipment components for cars	7
Motor cars & other components	6
Petroleum oils & other	5
Openness of the economy	
Export value of G&S (% of GDP)	27
Import value of G&S (% of GDP)	28
Inward FDI (% of GDP)	1.4

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

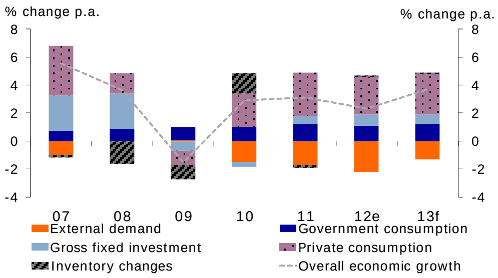
The South African economy is one of the biggest, most diversified and most developed economies of the sub-Saharan African region. Its services sector makes up two-thirds of GDP and the industry sector accounts for nearly one-third of GDP. The country is the world's largest producer and exporter of platinum, accounting for 13% of the country's total exports. The country also has substantial deposits of gold, coal and other metals. South Africa's largest trade partners are the European Union, China and United States.

In 2009, South Africa experienced its first recession since 1992, as the economy contracted by 1.5%. The recession showed that the South African economy is very susceptible to shocks in external demand. Led by strong consumption growth, economic growth was back in 2010, at 2.9%. Last year's growth remained subdued at 3.1%, driven by consumer spending, which makes up 60% of GDP. Meanwhile, the role of investment and exports in economic growth remains weak, as they remain well below pre-crisis levels. This year, economic growth is expected to ease to about 2%, as European demand and business confidence in South Africa remain subdued.

One of the most important factors that severely hamper productivity is South Africa's dysfunctional labor market, with unemployment well above 20% for the past 15 years and currently standing at 24%. The younger generation is most affected, with over half of 18- to 25-year-olds unemployed. Structural causes for the labor market issues are an apartheid-induced geographic gap between population and economic activity centers, skills shortages and a high prevalence of HIV/AIDS. Other constraints to the productivity are the country's ineffective goods and services markets, as they are highly (physically) concentrated and lack competition. This is partly policy-induced (among others regulatory entry barriers), and partly natural (mines are only there where minerals are found). Also, the high prevalence of crime is an important factor for the ineffectiveness of the product market. The murder rate has declined from 68 homicides per 100,000 people in 1995 to 32 per 100,000 in 2010. Nevertheless, it remains among the highest in the world and still scares investors.

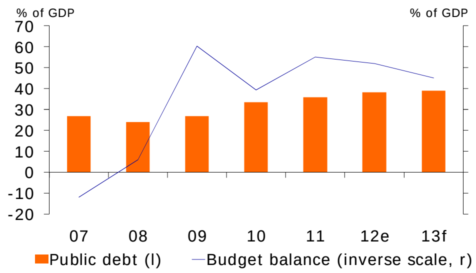
South Africa has the most advanced financial system in sub-Saharan Africa and compares with some of the best industrialized banking sectors of the world. The sector has invested extensively in other sub-Saharan countries. In South Africa, the banking sector is highly concentrated, but well capitalized. Since 2009's recession, profitability of the sector has declined due to fallen interest margins compared to income, higher operational expenses compared to income and persistent impaired advances. Continued vigilance in the financial sector by the authorities is needed, as the sector is very susceptible to shocks in external demand. Despite the high development level, the share of South Africans with access to formal financial services grew from 25% in 1994 to only two-thirds in 2010.

Figure 1: Growth performance



Source: EIU

Figure 2: Public finances



Source: EIU

Political and social situation

South Africa is a democracy led by President Jacob Zuma of the African National Congress (ANC). The ANC came into power in 1994, after South Africa transitioned from an apartheid system to majority rule. In December 2012, the ANC will choose its candidate for the next presidential elections. Although the appeal of the main opposition party Democratic Alliance (DA) is growing and mass support for the ANC seems to be moderating, we expect the ANC to remain the largest of the two after the general elections of 2014. However, the ANC may encounter opposition from Julius Malema.

Julius Malema, until recently the popular leader of ANC's Youth League, was expelled by the ANC in the beginning of 2012. Malema was suspended for five years for sowing division in the party, for bringing it into disrepute by unfavorably comparing the leadership style of President Jacob Zuma to that of former President Thabo Mbeki, and for making remarks about bringing about regime change in Botswana. Although Malema has been expelled by the ANC and his appeal to this sentence is not expected to lead to any results, he will likely remain a political force. A plausible option is that he will start a new political party and he may use his support among the younger generation. Another option is that Malema continues to agitate against the incumbent political elite – or do both. Potentially, the situation could escalate into an uprising similar to the Arab Spring last year, as there is a perfect mix of a young generation feeling alienated from politics, most of them having access to social networks and rampant youth unemployment.

Another factor that may trigger social instability in South Africa is inequality in the distribution of income. Although the inequality is slightly decreasing – the Gini coefficient declined from 67.4 in 2006 to 63.1 in 2010 – South Africa remains one of the most unequal countries in the world. The apartheid-induced system still causes the country to have a mainly white rich minority and largely black poor majority. Also, in spite of the fact that South Africa is one of the most developed countries in sub-Saharan Africa, nearly one-third of the population still lives from less than 2 US dollars a day. Overall, key enabling factors that have the potential to inspire civil unrest are present in the country. In the medium to long term, an uprising by the youth should not be considered out of the question, with considerable impact on the country's economy.

Spurred by Malema, ANC has been debating heavily on mine nationalization since 2011. Recent signals are that ANC is stepping away from mine nationalization, but instead is thinking of proposing resource rent and capital gains taxes, with rates around 50%. The party will take its 'final' decision on the issue end-2012. Although executives of mining companies have initially welcomed stepping away from mine nationalization, saying that the more than year-long debate has obstructed investment in the sector, large increases in taxes may also severely impact profitability.

On the Corruption Perceptions Index, South Africa ranks on the 64th place out of 183 countries, better than Greece and Italy. However, South Africa's controversial Protection of State Information Bill may negatively affect the country's position. The bill - initiated by the ANC - would punish those who publish classified information with up to 25 years in jail. Thereby, it makes it easier for officials to conceal graft. End-2011, the bill was passed by the national assembly. As the bill is likely to be approved by the upper chamber and the president, it will probably come into force later this year. Opposition parties, media and civil-society groups condemn the lack of adequate checks and balances in the bill. The bill will substantially affect the freedoms of press and expression and is expected to foster corruption. A newly opened corruption scandal from three years ago around President Zuma may further affect the view on corruption in the country.

South Africa has a lot of power in the sub-Saharan African region. The country represents the continent in international fora, including the UN Security Council, and plays a leading role in regional peace, security and economic revival operations.

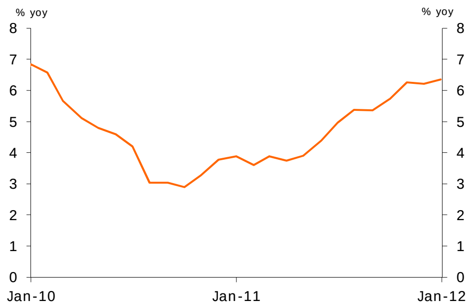
Economic policy

The policy of the ANC-led government is focused on addressing poverty, inequality and unemployment. The government tries to tackle unemployment and poverty in combination with improving infrastructure. In the next three years, the country plans to spend ZAR 844bn (or USD 110bn) on infrastructure projects. Together with the government's other job creation programs – amounting to ZAR 94bn or USD 12bn in the same period, it is expected to add 850,000 jobs by 2014. Overall, South Africa's budget expenditure is expected to come in at USD 120bn or 30% of GDP this year. Meanwhile, higher tax revenues from businesses and individuals are expected to boost budget revenues, which are forecast to reach USD 100bn or 25% of GDP this year. Therefore, South Africa's budget balance is expected to remain in deficit - after it dipped into red figures in 2008/09, mainly due to a drop in tax revenues, but also owing to the government's policy towards supporting economic activity after the recession. The budget deficit is expected to decline from 5.5% of GDP in 2011 to 5% of GDP this year. By targeting narrowing deficits in the medium term, the government aims to please the rating agencies that recently gave the country's debt a negative outlook, citing increased government debt as well as unemployment and heightened political risk. It remains to be seen whether the deficit can really be pushed down by the proposed higher tax revenues. Public debt remains at manageable levels, but has been rising. Public debt went up from 24% of GDP in 2008 to an expected 38% of GDP this year, fuelled by persistent pressure on the government to step up spending.

South Africa's central bank, the South African Reserve Bank (SARB), has adopted an inflation-targeting framework as the cornerstone of its monetary policy. In this framework, the SARB is tasked with keeping the consumer price index, excluding mortgage costs, within a band of 3-6%. However, the central bank follows the band in a flexible manner, and proposes policy that supports the economy best. The central bank adjusts its policy only if inflation is higher or lower than the band for six months or more. The SARB cut its policy rate by 150bps to 5.5% in November 2010 in an attempt to boost the economy, as inflation was expected to remain within the inflation band. Since then, the central bank has kept the rate stable at a low 5.5%. In 2011, inflation strongly increased, as it rose from 3.8% end-December 2010 to just above the band (6.4% in December 2011), due to upward pressure from steep rising electricity prices and wage increases, which were stronger than expected when the SARB cut its policy rate in 2010. As inflation is not expected to rise further and is expected to return to the targeted band later this year in the wake of a persisting weak economy, no action by the central bank seems required and the SARB is expected to continue its current monetary stance.

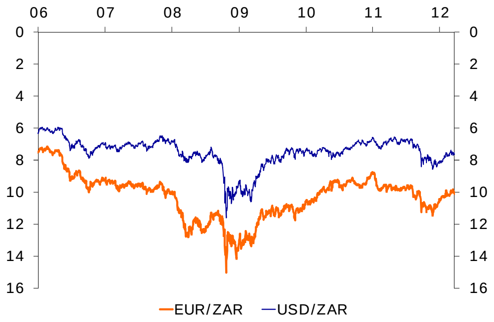
South Africa manages a floating exchange rate regime for its currency, the rand. Historically, the rand tends to be very vulnerable to shocks in the world economy. Last year, anxiety over the euro area debt crisis led to a sell-off of assets. As a result, the rand depreciated by about 25% against the US dollar between early August 2011 and mid-December 2011. Since then, the currency has recovered partly. However, the rand is expected to further depreciate in the medium term, due to a persistent current account deficit, relatively high inflation and political uncertainty in the run-up to the elections of 2014.

Figure 3: Inflation



Source: EIU

Figure 4: Exchange rate



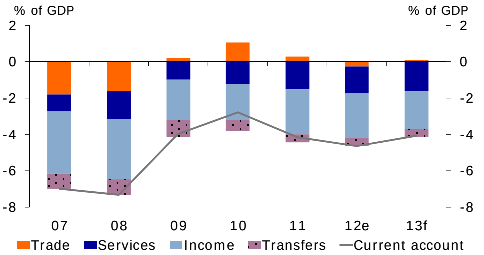
Source: EcoWin

Balance of Payments

South Africa's trade balance usually moves around 1.5% of GDP plus or minus zero and is expected to decline from a small surplus (0.3% of GDP) in 2011 to a similarly small deficit this year, as export growth has been constrained by global growth concerns and infrastructural bottlenecks. The services balance usually records a deficit. In 2011, the deficit increased to USD 6.2bn or 1.5% of GDP, from USD 4.5bn or 1.2% of GDP the year before, as imported services recorded a strong rise. The deficit is expected to remain around USD 6bn this year. Overall, South Africa's current account balance usually shows a deficit, as a potential trade surplus cannot offset the deficits on the services, income and transfer balances. The current account deficit deteriorated from 2.8% of GDP in 2010 to 4.2% of GDP in 2011, resulting from the constrained export growth and a worsening of the services and income balances. This trend is expected to continue, reaching a deficit around 4.5-5.0% of GDP this year.

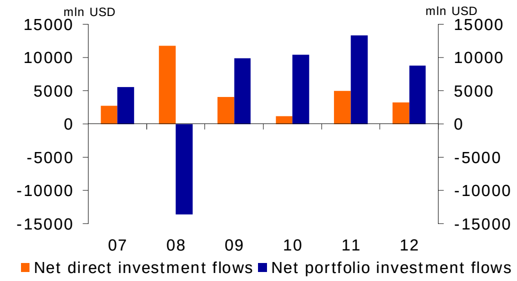
The savings propensity of the South Africans is low, leading to a strong dependence on foreign capital to finance future investment. Net foreign direct investment flows recorded a steep rise to 1.4% of GDP or USD 5bn last year, from 0.4% of GDP or USD 1.2bn the year before, as investment from the UK and China increased in the communications, mining and financial sectors. However, the increase was the result from a few large acquisitions, which are not automatically expected to be repeated in the coming years. In 2011, net portfolio investment flows came in at USD 13bn. All in all, the current account deficit was fully financed by net direct investment inflows and net portfolio inflows in 2011. This year, these investment inflows are not expected to fully cover the current account deficit, as investment and portfolio inflows are forecast to decline and the current account deficit is predicted to increase. The country is expected to finance the deficit by debt flows. Even though the rating agencies are increasingly skeptical about the country's slow economic growth, high unemployment and political debate, South Africa is expected to have sufficient access to international capital markets.

Figure 5: Current account



Source: EIU

Figure 6: Investment flows

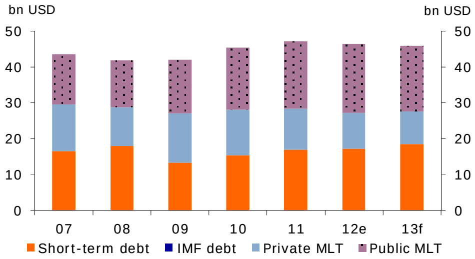


Source: IMF

External position

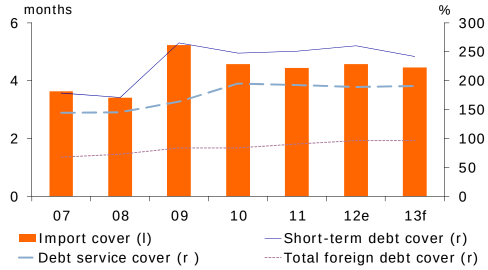
South Africa's external debt is low, around 12% of GDP or USD 47bn in 2011. About one-third of it is short-term debt. Almost all debt is owed to private creditors. South Africa does not have arrears to private or official creditors. The country's liquidity ratio deteriorated from 150% in 2010 to 141% in 2011, as current account receipts and debt repayments recorded a strong increase. However, the liquidity ratio is expected to remain around 140% this year and, all in all, South Africa's external position remains sustainable. Last year, foreign reserves increased from USD 38bn in 2010 to USD 42-43bn. As a result, the import cover slightly improved and now stands at a sound 4.6 months.

Figure 7: Foreign debt



Source: EIU

Figure 8: External liquidity



Covers offered by official FX-reserves Source: EIU

South Africa

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	5.5	3.6	-1.5	2.9	3.1	2.3	3.7
Consumer prices (average % change pa)	6.2	10.1	7.2	4.1	5.0	5.3	4.3
Current account balance (% of GDP)	-7.0	-7.3	-4.0	-2.8	-4.2	-4.6	-4.1
Total foreign exchange reserves (mln USD)	29589	30584	35237	38175	42595	44670	44520
Economic growth							
GDP (% real change pa)	5.5	3.6	-1.5	2.9	3.1	2.3	3.7
Gross fixed investment (% real change pa)	14.0	13.3	-3.2	-1.6	3.1	3.9	3.7
Private consumption (% real change pa)	5.5	2.2	-1.6	3.7	4.8	4.1	4.4
Government consumption (% real change pa)	4.0	4.5	4.7	4.9	6.0	5.0	5.6
Exports of G&S (% real change pa)	6.6	1.8	-19.5	4.5	7.6	0.5	6.2
Imports of G&S (% real change pa)	9.0	1.5	-17.4	9.6	12.0	7.7	8.7
Economic policy							
Budget balance (% of GDP)	1.2	-0.6	-6.0	-3.9	-5.5	-5.2	-4.5
Public debt (% of GDP)	27	24	27	34	36	38	39
Money market interest rate (%)	9.2	11.3	8.2	6.2	5.3	5.9	6.5
M2 growth (% change pa)	21	12	2	6	12	7	8
Consumer prices (average % change pa)	6.2	10.1	7.2	4.1	5.0	5.3	4.3
Exchange rate LCU to USD (average)	7.0	8.3	8.4	7.3	7.3	7.9	8.1
Recorded unemployment (%)	23.3	22.9	24.0	24.9	23.9	23.3	21.9
Balance of payments (mln USD)							
Current account balance	-20019	-20083	-11327	-10118	-16842	-18430	-16930
Trade balance	-5161	-4448	533	3838	1142	-1020	240
Export value of goods and services	76436	86119	66542	85699	94306	94370	97410
Import value of goods and services	81596	90567	66008	81862	93164	95390	97170
Services balance	-2663	-4170	-2787	-4452	-6159	-5920	-6760
Income balance	-9843	-9133	-6389	-7223	-10097	-9800	-8640
Transfer balance	-2351	-2333	-2684	-2279	-1728	-1690	-1780
Net direct investment flows	2755	11764	4043	1184	4985	3230	3760
Net portfolio investment flows	5596	-13605	9873	10409	13305	8760	12290
Net debt flows	6672	-147	-660	3573	1509	-150	-340
Other capital flows (negative is flight)	12352	23197	3677	-894	2082	8490	1260
Change in international reserves	7356	1126	5606	4154	5038	1910	40
External position (mln USD)							
Total foreign debt	43610	41943	42102	45390	47203	46480	46020
Short-term debt	16558	17937	13274	15434	16972	17200	18450
Total debt service due, incl. short-term debt	20524	21112	21525	19553	22156	23630	23330
Total foreign exchange reserves	29589	30584	35237	38175	42595	44670	44520
International investment position	-68380	-11294	-40208	-10662	n.a.	n.a.	n.a.
Total assets	214832	181299	242848	181116	n.a.	n.a.	n.a.
Total liabilities	283212	192593	283056	191778	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-1.8	-1.6	0.2	1.1	0.3	-0.3	0.1
Current account balance (% of GDP)	-7.0	-7.3	-4.0	-2.8	-4.2	-4.6	-4.1
Inward FDI (% of GDP)	2.0	3.5	1.9	0.4	1.4	1.0	1.3
Foreign debt (% of GDP)	15	15	15	12	12	12	11
Foreign debt (% of XGSIT)	44	39	50	43	40	39	37
International investment position (% of GDP)	-23.9	-4.1	-14.1	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	21	20	26	19	19	20	19
Interest service ratio incl. arrears (% of XGSIT)	1.9	1.7	1.9	1.2	1.1	1.0	0.8
FX-reserves import cover (months)	3.6	3.4	5.2	4.6	4.4	4.6	4.4
FX-reserves debt service cover (%)	144	145	164	195	192	189	191
Liquidity ratio	130	133	148	150	141	139	140

Source: EIU