Euler Hermes Economic Research

Country Report

South Africa

An extended period of sub-par GDP growth

General Information

GDP	USD349.8bn (World ranking 33, World Bank 2014)
Population	54mn (World ranking 24, World Bank 2014)
Form of state	Republic
Head of government	Jacob ZUMA
Next elections	2019, presidential and legislative

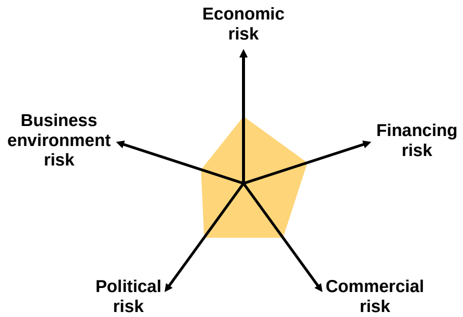
Strengths

- 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 BB2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
China	16%	1	18%	China
LDCs in Africa	10%	2	10%	Germany
United States	7%	3	7%	Saudi Arabia
United Kingdom	7%	4	6%	United States
India	6%	5	6%	India

By product (% of total)

Exports		Rank		Imports
Non-Monetary Gold	18%	1	13%	Crude Oil
Non Ferrous Metals	11%	2	6%	Refined Petroleum Products
Jewellery, Works Of Art	9%	3	5%	Cars And Cycles
Iron Ores	7%	4	4%	Engines
Non Ferrous Ores	7%	5	4%	Telecommunications Equipment

Source: Chelem

Fading glory?

Although South Africa is no longer Sub-Saharan Africa's largest economy, following Nigeria's rebasing of its GDP data, it continues to be a regional leader and representative of the region at international meetings.

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. 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 is now gaining 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.

Insolvencies will increase as the business environment is deteriorating

The business environment is clouded by ongoing structural rigidities, including uneasy labour relations and periodic disruptions to power supplies, and is compounded by at least four other factors: (i) weak international commodity prices, with commodities accounting for 14% of total GDP; (ii) slowdown in China, the country's largest trade partner; (iii) drought conditions, which weaken agricultural output, with the possibility of the country needing to import maize and other foodstuffs; and (iv) uncertainties relating to U.S. monetary policy tightening.

Against this background, EH expects insolvencies will increase by +10% y/y in 2016, the first outright deterioration since 2009 and the global financial crisis. Moreover, a significant lengthening in Days Sales Outstanding (DSO) is already apparent and two key sectors, accounting for 1 of every 3 insolvencies, are already registering a rebound in insolvencies: construction (+26% y/y for the last 12 months, as at September 2015) and trade (+8%). However, in relation to resolution of insolvencies, South Africa ranks 41 out of 189 countries assessed in the World Bank Doing Business 2016 survey and the recovery rate is almost double the regional average and the time taken and cost involved in insolvency resolution are both markedly lower.

GDP growth likely to remain sub-par

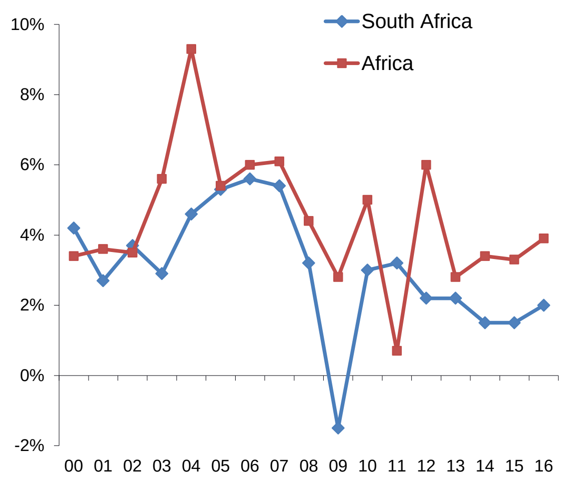
GDP growth was an annual average +5.2% in 2004-07 but a ten-year average to end-2014 is +3%. Rates of expansion of around +5% are required to make meaningful improvements in incomes and living standards. However, structural impediments have generally limited GDP growth to below that rate. These constraints 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. GDP contracted by -1.3% q/q annualised in Q2 2015 and EH expects annual GDP growth will be capped at +2% in 2016 and 2017.

Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	1.5	1.5	2.0	2.0
Inflation (%, end-year)	5.3	5.2	6.5	6.0
Fiscal balance (% of GDP)	-3.5	-4.0	-4.5	-4.0
Public debt (% of GDP)	43.8	45.0	46.0	47.0
Current account (% of GDP)	-5.5	-4.8	-4.7	-4.8
External debt (% of GDP)	41.4	45.8	44.6	43.0

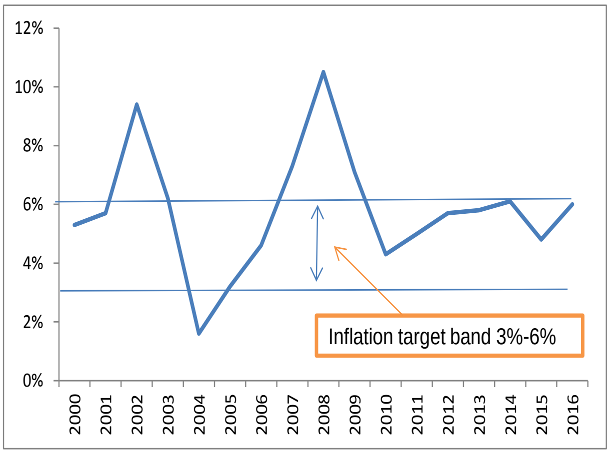
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Consumer Price Inflation (%)



Sources: National sources, IHS, Euler Hermes

Inflationary pressures suggest monetary policy will remain tight

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. Additionally, current drought conditions will exert further upward pressure on inflation. Overall EH expects inflation will average around 6% in 2016 and end the year at 6.5%. As a result, monetary policy is likely to remain tight, despite weak GDP growth; the official target range for inflation is 3-6%.

External accounts are also under pressure

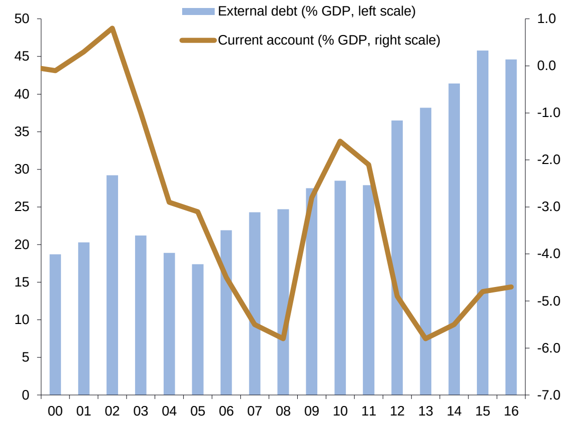
Annual average current account deficits in the period 2000-08 were -2.9% of GDP but shortfalls have been larger than that marker since then, reflecting strong consumer demand for imports and high cost of inflows of oil (crude petroleum and oil products now account for around 19% of the total import bill). Potential benefits for the trade and current accounts from recent weak oil prices are offset by low market prices for commodity exports (minerals and ores, metals and precious metals). The current gold price of USD1,065/ounce is -USD830 below its peak in September 2011. Further pressure on the external accounts stems from industrial action in the mining sector, particularly in the platinum sub-sector, which has further reduced export potential and receipts, and from the current drought, which may result in imports of foodstuffs. EH expects current accounts equivalent to around -5% of GDP throughout the period to end-2017.

FX reserves amounted to only USD6bn in May 2003 at the time of the closure of the Central Bank's net open forward position. By end-2014, FX reserves totalled over USD44bn and provided an import cover of almost five months.

External debt is comfortable, but increasing

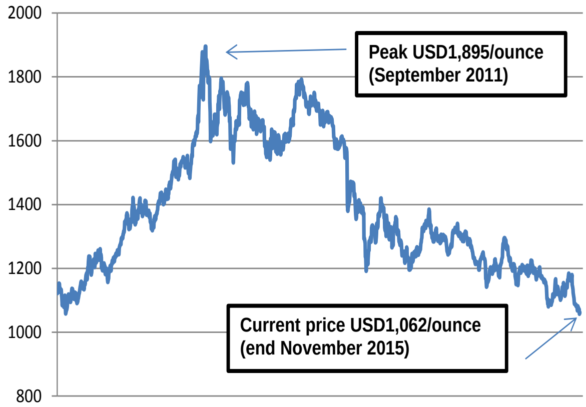
South Africa underwent an exemplary exodus from external debt problems arising in the 1980s. This reflected the generally sound economic management that carried over into the post-transition period. Despite accumulation of FX reserves, some external liquidity indicators remain weak. Nevertheless, solvency 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 around 8%.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Gold Prices (January 2005-November 2015, USD/ounce)



Sources: FT, Euler Hermes

Last review: 2015-12-17
Country Risk Analyst:
Andrew Atkinson
andrew.atkinson@eulerhermes.com