CREDENDO 100 YEARS

# SOUTH AFRICA: REASONABLE ECONOMIC RECOVERY AMONG DIFFICULT GLOBAL CIRCUMSTANCES

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## Highlights

- The 2022 growth expectation is above pre-Covid-19 levels despite structural and temporary constraints.
- External and fiscal balances are benefiting from soaring metal and mineral prices.
- Non-resident local currency-denominated government debt holdings have fallen in favour of domestically held government debt.
- Credendo has affirmed a stable outlook for South Africa's country risk ratings.

### Pros

- Abundant natural resources, including gold, platinum, chromium and other metals
- Solid domestic financial market
- Tradition of central bank independence (floating exchange rate)
- Strong institutions and judiciary system

### Cons

- A decade of weak growth performance
- Exposure to shocks related to climate change
- Worsening unemployment, poverty and inequality
- Corruption and state capture
- Weak financial state of major public enterprises (in particular Eskom)
- Balance of payments relies heavily on volatile portfolio investment flows

## Head of State

- President Cyril Ramaphosa (since 15 February 2018)

## Population

- 59.3 million

## GNP per capita

- USD 6010

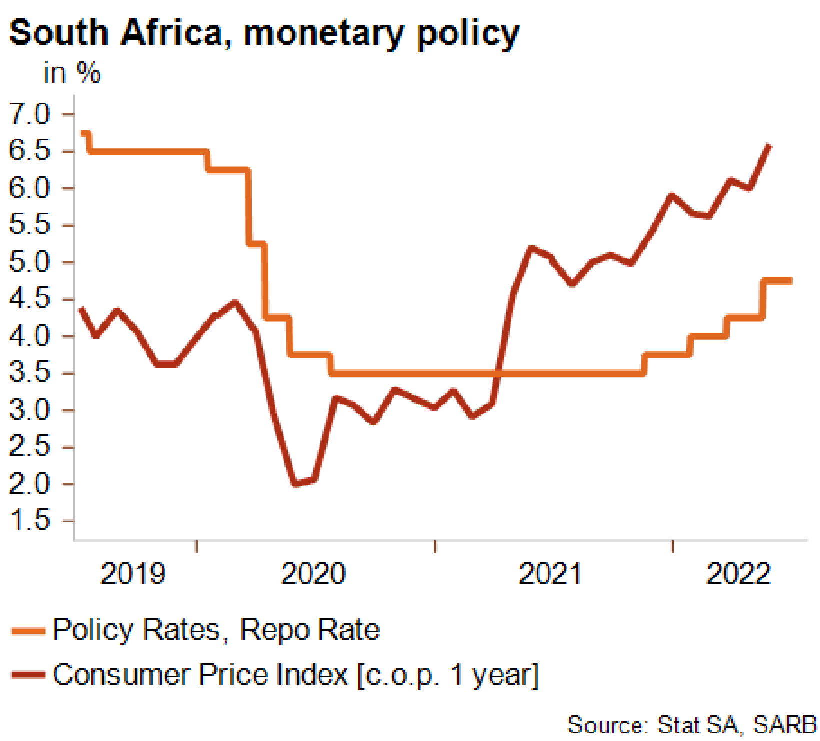
## Income group

- Upper middle income

## Main export products

- Ores and metals (26.4% of current-accounts receipts in 2020), food (10%), investment income (7.3%), private transfers (2.6%)

After the lifting of Covid-19 restrictions, a rebound in household and government spending pushed 2021 real GDP growth to 4.9%, while 2022 growth is expected to reach 1.9% based on IMF WEO projections. Despite the fallback from last year, this reflects a stronger growth level than before the pandemic. South Africa's growth limitations have both temporary and structural causes. Long-lasting structural issues like energy shortages, high unemployment and inequality need to be tackled to allow the country to reach its full potential in the longer run. South Africa's unemployment rate of 35% has increased substantially since the end of apartheid and is one of the highest among emerging markets. In addition, floods in KwaZulu-Natal in April caused major trade disruptions while a growth slowdown in major trade partners (United States, eurozone) and the Russia-Ukraine conflict will add to the near-term growth restrictions in South Africa. As in many countries today, South Africa's central bank is confronted with the difficult trade-off between restraining inflation and not compromising the economic recovery. Since November 2021, the South African Reserve Bank started introducing gradual policy rate hikes, leading to a year-on-year increase of 1 percentage point to 4.75% in June 2022 (graph).




## Political climate dominated by the ANC leadership elections

The ANC (African National Congress) received its lowest number of votes ever in the November 2021 municipal elections, reflecting growing discontent with the ruling party. Besides serious socio-economic hurdles, the successive reports on corruption and state capture of the judicial 'Zondo commission' have only worsened the ANC's reputation. There is still a significant risk of violent protests whenever former president Jacob Zuma's medical parole is overturned, comparable to the popular outrage witnessed after his arrest in July 2021. President Cyril Ramaphosa will be running for re-election as head of the ANC for the next 5 years in the electoral conference in December 2022. However, a recent corruption report is also very critical of the President's role in covering up the theft of millions of US dollars in foreign exchange. Still, his chances remain relatively solid, as he is the only leading figure who enjoys popularity beyond ANC voters.

internal rehabilitation of the party, empowering institutions to tackle deep-rooted corruption while delivering investment and development-enhancing reforms. Another major risk relates to climate change as the country is situated in a drought belt, while the economy is highly dependent on climate-sensitive sectors like agriculture, tourism and forestry. Changing rainfall patterns and rising temperatures also lead to the spread of diseases and increase social tensions.

## Relief for South Africa's external and fiscal balances thanks to stronger trade terms

Since 2019, South Africa's public finances have come under increased pressure due to heavy financial support for struggling public entities (especially Eskom), higher borrowing costs and a bloated public wage bill. More recently, it appears that South Africa's external and fiscal balances are benefiting from the high prices of its key metals and mining export goods resulting from the war in Ukraine. In fact, high gold, platinum and coal prices are offsetting the impact of the increase in oil and food import costs. The complementary boost in tax revenues will slow down the projected rise in public debt (estimated to reach 70% of GDP by the end of this year) as the overall fiscal deficit is currently projected to reach 5.8% of GDP in 2022, instead of the 7.5% deficit expected earlier this year. The significant trade surplus in 2021 and 2022 will result in a positive current-account balance, which will in turn temper the depreciation pressure on the rand from sales of local currency denominated bonds. In fact, South Africa's ability to borrow domestically has helped the country weather the impact of the pandemic on its external debt levels. Non-resident investors have been selling their domestically issued government bonds denominated in local currency since early 2022. However, thanks to South Africa's strong domestic financial market, most of the capital outflows were compensated by domestic purchases by local investors of government bonds. Consequently, the proportion of domestically held public debt has increased, lowering South Africa's general external debt level. Nevertheless, ongoing fiscal consolidation, management reforms and the tackling of long-lasting domestic constraints remain essential for sustainable public finances in the long run. As of 2023, the current-account balance is expected to move back into a limited deficit, which is expected to be fully financed. Credendo considers the general outlook for South Africa's country risk rating to be stable.

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