BPI

South Africa

Outlook

	Average 10-14	2015	2016	2017	2018	2019	2020	Forecasts 2021	Forecasts 2022
GDP growth (%)	2.6	1.2	0.4	1.4	0.8	0.2	-7.0	3.5	1.9
CPI Inflation (%)*	5.3	4.6	6.3	5.3	4.6	4.1	3.1	4.9	4.9
Fiscal balance (% of GDP)	-4.4	-4.8	-4.1	-4.4	-4.1	-6.3	-14.0(e)	-11.1	-7.9
Public debt (% of GDP)	41.0	49.3	51.5	53.0	56.7	62.2	78.8(e)	82.8	85.7
Reference rate (%)*	5.5	5.9	7.0	6.9	6.6	6.6	4.2	3.5	3.6
Exchange rate (ZAR/USD)*	8.7	12.8	14.7	13.3	13.3	14.4	16.5	14.7	15.7
Current balance (% of GDP)	-3.9	-4.6	-2.9	-2.5	-3.5	-3.0	-1.6(e)	-1.8	-1.8
External debt (% of GDP)	34.9	42.5	44.7	49.7	49.2	52.6	53.0(e)	59.7	62.7

Notes: * Annual average. (e) estimation.
Source: BPI Research, based on data from national statistical agencies and IMF.

- **South Africa is the country with the highest incidence rate of COVID-19 on the African continent, an aspect that has further fuelled the economic and financial difficulties** that the country was already experiencing. In addition to coping with the pandemic, the headwinds facing the economy in the short and medium-term have increased in recent months, with an unemployment rate above 30%, a spiralling budget deficit (due to the slow economic growth and bail outs of state-owned companies) and the high dependence on foreign investment flows. However, the gradual revitalisation of international trade, the expected stabilisation of the rand and a greater number of vaccinations in the second half of 2021 will bring some relief, although the recovery in 2021 will not be dynamic (GDP growth of 3.5%).

- **Real shock of COVID-19.** As in other countries, the pandemic has been a severe obstacle for the South African economy due to the weakening of foreign and domestic demand. Despite the fact that the lifting of mobility restrictions boosted GDP significantly in Q3 2020 (+66.1% quarter-on-quarter compared to –51.7% in Q2), the instability of supply and transport chains, the collapse of the tourism sector and the decline in investment, among others, caused a 7% drop in GDP in 2020. It is therefore the worst recession since 1920, when GDP fell by 11.9% after the First World War. This weakness could continue into the first two quarters of 2021; later, if the expected improvement in the health situation materialises, it would give way to an economic recovery hand-in-hand with the acceleration in exports (30% are destined for China, mainly manufactured goods and base metals) and the recovery of foreign investment flows.

- **Macrofinancial imbalances**
  - **Public debt.** The health crisis has exacerbated the downward spiral of economic growth and the fiscal balance that South Africa has been suffering during the last five years. Beside this is the increase in the very long-term risk premium required by investors to buy South African sovereign debt. Given the poor medium-term growth outlook and the absence of an aggressive and credible fiscal consolidation strategy (see point below), a high level of public debt is anticipated in the coming years.
  - **Financial problems of state-owned enterprises.** The technical and financial difficulties of the main utility company (Eskom) have exhausted state funds and pose a threat to fiscal accounts, limiting the possibility of increasing budgetary stimuli and thus supporting economic growth.

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Outlook (continued)

- **Investment flows.** The downgrade of Moody's credit rating to "speculative-grade", at the start of the pandemic, accelerated the outflow of investment from South Africa and the depreciation of the rand against the dollar to record lows. The partial recovery of commercial revenues, the emergency loan granted by the IMF (4.3 billion dollars), the improvement of global growth prospects and the attractive profitability of emerging assets have favoured the return of part of the investment capital, although to a lesser extent than desirable to give sustainability to public accounts. In this context, the Treasury has announced the intention of returning to international markets with the issuance of Euro bonds (worth $3 billion) in fiscal year 2021-2022.

- **Economic policy response**
  - **Monetary policy.** During the first seven months of 2020, the South African Reserve Bank (SARB) cut interest rates by 300 bp to 3.50%, the historical minimum level, keeping it unchanged subsequently. Since expected inflation will remain within the target range (3%-6%), despite the expected improvement in activity and higher energy and supply prices, we believe that the bank will maintain the monetary policy strategy without any significant changes at least during 2021.
  - **Fiscal policy.** The delicate situation of South African public accounts, highly indebted, has limited the Government's response capacity to the pandemic to resources allocated for emergencies. South Africa's medium-term fiscal strategy has not changed since October 2020, and is based on reducing public debt through reduced spending, mainly by freezing public wages, and improving economic growth. Given recent precedents, there are doubts about the actual capacity to make such a reduction in spending in an unfavourable macroeconomic environment.

- **Evolution of the exchange rate.** The rand exchange rate will remain volatile in the face of investor sentiment towards emerging countries. However, the return of foreign capital flows, the accommodative monetary policy in the United States and the economic recovery favoured by vaccinations should reduce currency depreciation events like those suffered in 2020.

Main risks

The risk balance is trending downward. Specifically, the risks come in several forms:

- **Macroeconomic and social risk.** Any confirmation of the inefficiency of the vaccines for the South African variant of the pandemic would mean a worsening in the health situation and the current account balance, in addition to increasing unemployment and poverty, putting social stability at risk.

- **Public debt risk.** South Africa will depend on foreign capital inflows, currently showing a highly volatile pattern, to finance much of the external needs not covered by new debt.

- **Financial sector risk.** Domestic banks, pension funds and insurance companies own 52% of the debt issued by the Government. Faced with a situation of public over-indebtedness, the high exposure of the private financial sector to sovereign debt could lead to a reduction in the flow of credit and slow down economic growth.

	Rating	Last changed	Outlook	Last changed
Standard & Poor's	BB-	29/04/20	Stable	29/04/20
Moody's	Ba2	20/11/20	Negative	20/11/20
FitchRatings	BB-	20/11/20	Negative	20/11/20

■ Indicates that the country is rated as "investment grade".
□ Indicates that the country is not rated as "investment grade".