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# South Africa Economic Update

## Focus on Financial Inclusion

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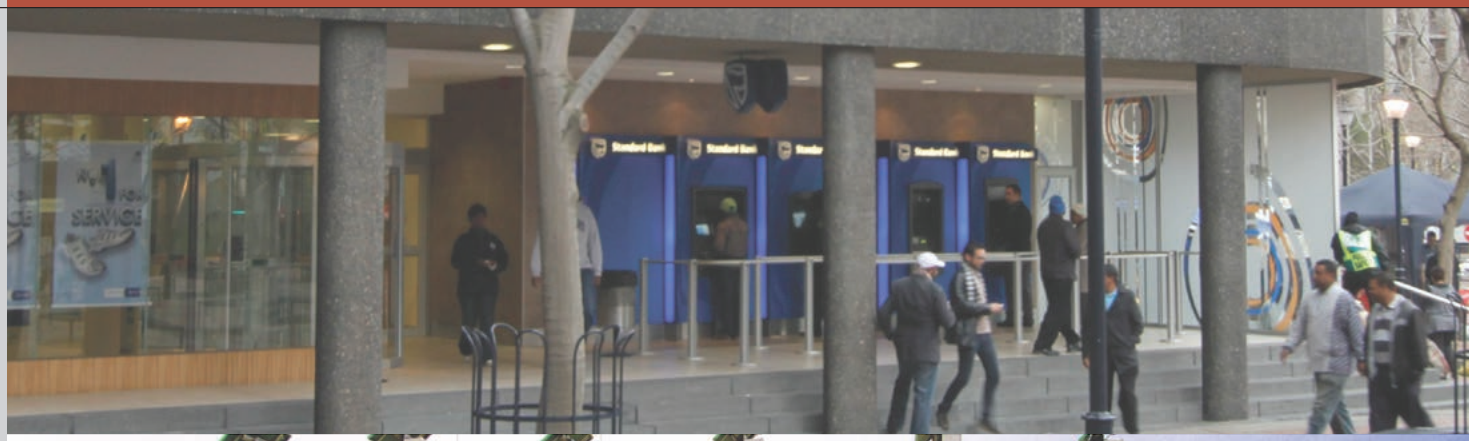


THE WORLD BANK GROUP AFRICA REGION POVERTY REDUCTION & ECONOMIC MANAGEMENT

THE WORLD BANK

# South Africa Economic Update

## Focus on Financial Inclusion

THE WORLD BANK

1818 H Street NW
Washington, DC 20433
USA



This report was prepared by the staff of the Africa Region Poverty Reduction and Economic Management. The findings, interpretations, and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the World Bank's Board of Executive Directors or the countries they represent.

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# Foreword

The World Bank is pleased to present the fourth South Africa Economic Update, with a focus on financial inclusion.

This topic is particularly important for South Africa, where the expansion of access to financial services for both individuals and small enterprises could help reduce poverty and inequality and stimulate job creation. For these reasons, South Africa's National Development Plan targets as one of its outcomes an increase in access to financial services by poorer people, who are mostly excluded from participating in the country's formal economy.

As with our previous Economic Updates, this report has two parts. Section 1 assesses South Africa's economic prospects within the context of the current challenging global economic environment and prospects. It also explores the economic outlook for South Africa as well as the risks to this outlook.

Section 2 analyzes South Africa's financial inclusion landscape and highlights the country's unique challenges and opportunities. It also cites case studies from countries with comparable economies to show potential approaches that South Africa might consider for enhancing financial inclusion.

This report is intended not to be prescriptive but to offer evidence-based analysis. We hope that it will enrich the debate on financial inclusion and bring South Africa's policymakers, researchers, and other financial sector stakeholders closer to finding innovative and sustainable solutions to this crucial challenge.

Asad Alam
Country Director for South Africa
World Bank

# Acknowledgments

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A team at Communications Development Incorporated edited, proofread, and laid out the report.

SECTION I

# Recent economic developments

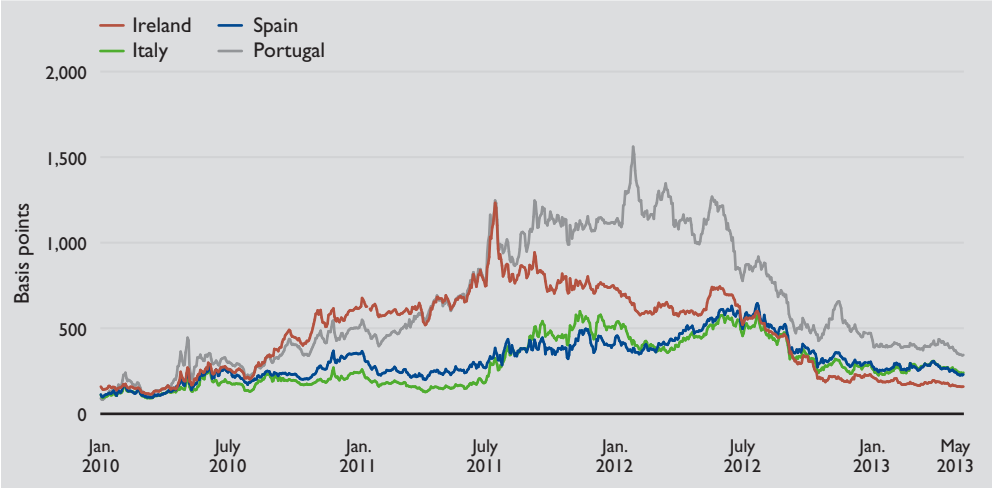
## Global economic prospects

### Financial market conditions ease as countries take steps to manage systemic risks

Conditions in global financial markets have eased since mid-2012, reflecting improvements in fiscal sustainability and the establishment of mutual support mechanisms in the European Union, even as the global economic recovery remains fragile and susceptible to downside risks.[1] Positive steps include fiscal austerity measures in debt-laden Eurozone countries, agreements to create a pan-European banking supervision authority and pan-European institutions to bail out struggling economies, and the decision by the European Central Bank to do what is needed to preserve the euro. At the same time, substantial progress has been made to recapitalize banks in the United States and Europe. Finally, the decisions by the central banks of the United States, the Eurozone, and Japan to pursue further quantitative easing have lifted global financial market sentiment. Financial markets' response to the Cyprus crisis has been muted thus far.

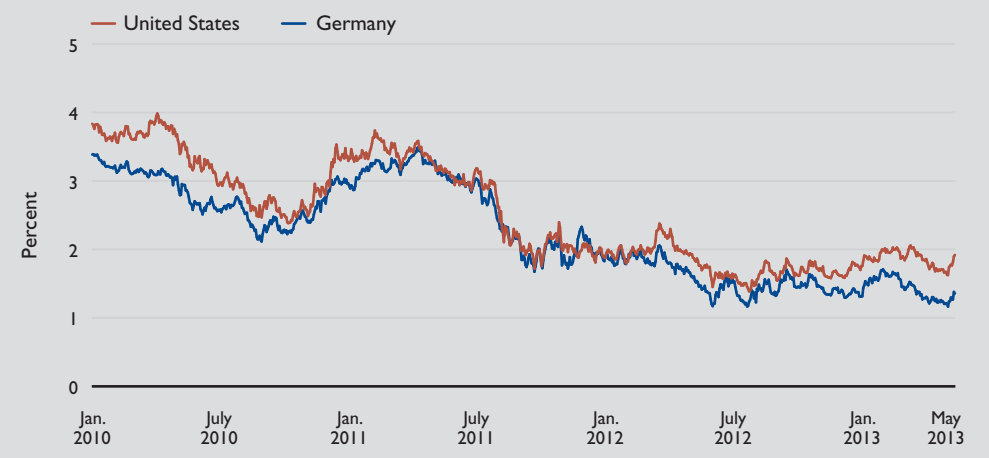
These steps have led to a worldwide decline in the price of risk. For example, the cost of insuring against sovereign default on high-spread European bonds has fallen more than 500 basis points from earlier highs. Credit default swap rates for most Eurozone countries, which had been rising since early 2010, are now below their April 2010 levels (figure 1.1). Perceived credit risk also declined for developing countries, with credit default swap rates falling about 60 basis points on average between end-June 2012 and mid-May

Figure 1.1 **Credit default swap spreads for troubled Eurozone economies have tightened substantially (five-year sovereign credit default swap spreads)**




Source: World Bank DEC Prospects Group.

**Figure 1.2** Yields on safe-haven government bonds have fallen since 2011 (10-year government bond yield)



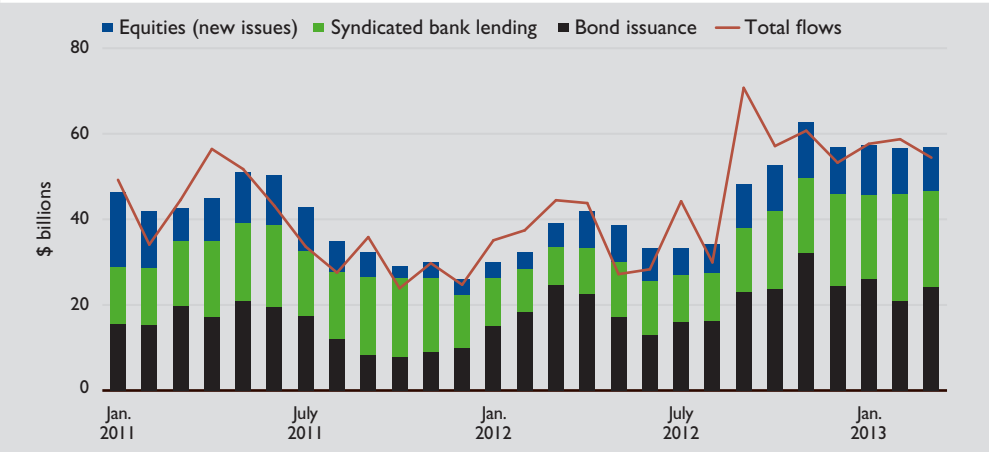

Source: World Bank DEC Prospects Group.

**Capital flows to developing countries remained robust in 2013q1**

2013. Over the same period, bond yield spreads for developing country debt fell some 93.4 basis points, though spreads ticked up slightly in May. Developing country international bond yields are more than 290 basis points lower than their 2000–10 average. Reflecting declining risk perceptions, yields on safe-haven assets (German Bunds and U.S. Treasuries) are rising as portfolios are rebalanced toward higher yielding assets (figure 1.2).

Capital flows to developing countries remained robust in 2013q1, after rebounding strongly in the second half of 2012, gaining from the global decline in the price of risk and the additional monetary stimulus provided by high-income (and many developing country) central banks. Gross capital flows to developing countries rebounded sharply to $171 billion in 2012q4, the highest flows since August 2008. (In South Africa, gross capital flows increased to a seven-quarter high of $5 billion in 2012q4.) This solid rebound has been sustained thus far in 2013 (figure 1.3). In 2013q1, gross capital flows to developing countries reached $160 billion, 46 percent higher than in the same period last year. The beginning of 2013q2 has also started strong, with capital flows in April totaling $64 billion, 42 percent higher than a year earlier and some 9 percent above March levels. Increased appetite for higher yield developing country debt has created an opportunity for several non-investment-grade sovereigns and companies to tap the international bond market—often for the first time. In Sub-Saharan Africa, Angola and Zambia issued international bonds for the first time

**Figure 1.3** Private capital flows to developing countries remained strong in 2013q1 (gross capital flows to developing countries)




Note: Bars represent three-month moving averages of reported flows; line shows raw unsmoothed data for the total of the flows.
Source: Dealogic; World Bank DEC Prospects Group.

in August and September 2012, respectively, while Rwanda issued its first Eurobond in April 2013. Bangladesh, Ghana, Kenya, Nigeria, Papua New Guinea, and Vietnam are all expected to issue bonds in coming months. Stock markets in developing countries are up 11 percent since June 2012. (The FTSE/Johannesburg Stock Exchange Africa index hit an all-time high in May 2013.)

Economic weakness and mid-year financial market uncertainty cut into foreign direct investment (FDI) inflows in 2012, especially flows into high-income countries. Global FDI inflows fell an estimated 6 percent (to $600 billion) in 2012, recovering somewhat in the final quarter after declining 16 percent in the first three quarters compared with the same period in 2011. The decline was felt especially in high-income countries, where FDI flows were halved. By contrast, FDI flows to developing countries declined a much smaller 4 percent—and even increased in Latin America and Sub-Saharan Africa (including South Africa, where they increased from a net outflow in 2011 to a net inflow of more than $2 billion in the first three quarters of 2012).[2] Flows to developing countries were supported by stronger growth prospects and by stable reinvested earnings and intracompany loans.

### Improved financial conditions have had only a modest effect on real-side activity

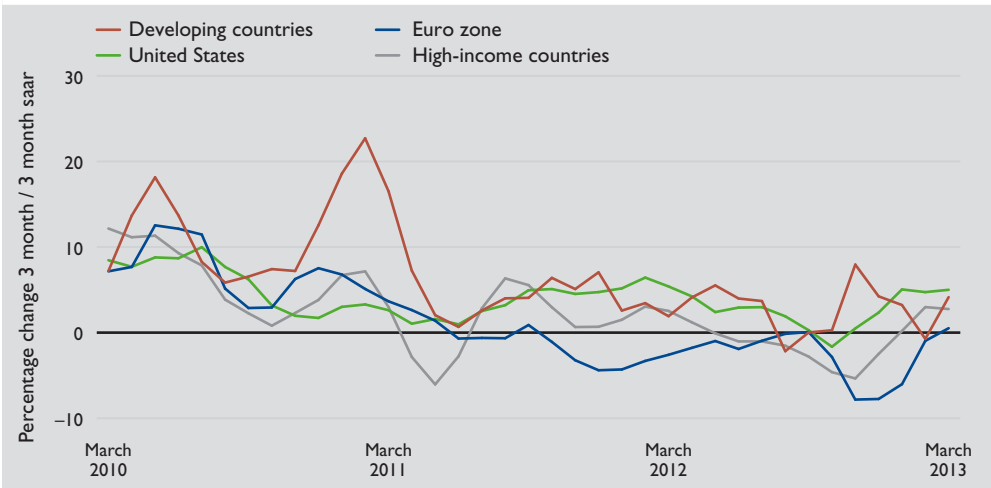
Global industrial production continues to show modest recovery, helped by rising output growth in developing countries and a sustained though modest upturn in the United States (figure 1.4). Industrial production volumes expanded at a seasonally adjusted annualized rate (saar) of 3.8 percent in 2013q1, led by improved growth of 4.3 percent (saar) among developing countries—growth in the "BRIC" economies (Brazil, the Russian Federation, India, and China) was even faster, at 8.3 percent. Led by the United States (2.8 percent saar) and Japan (7.9 percent saar), industrial production in high-income economies expanded 2.8 percent (saar) in 2013q1. This expansion in industrial production was supported by solid growth in global trade since November 2012. In February 2013, the pace of expansion in global trade (14.6 percent, 3 month/3 month saar) was about four times that of industrial production.

Business sentiment indices suggest a slower pace of activity for 2013q2. The global manufacturing Purchasing Managers' Index (PMI) declined in April but remained above the 50 mark that indicates expansion (figure 1.5). Sentiment indices on output, orders, and employment were all down in April. In high-income countries, sentiment deteriorated to a six-month low in the United States and to the lowest level this year in Germany. Despite slight improvements in France, Italy, and Spain, PMI remains depressed (below 50) in these and several other Eurozone countries. Sentiments also deteriorated in developing countries. The PMI receded in all major developing countries, including Brazil, China, India, Mexico, and Turkey, while remaining above 50, indicating expansion



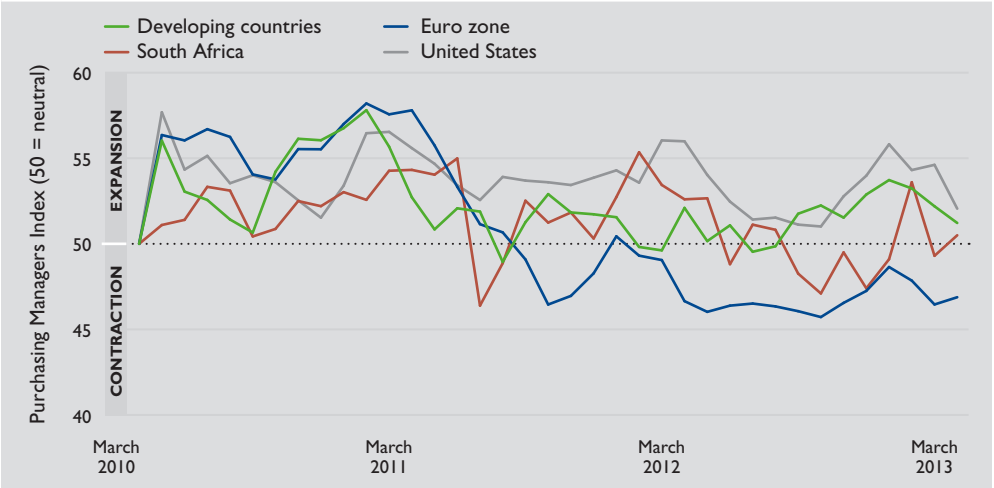
**Economic weakness and mid-year financial market uncertainty cut into foreign direct investment inflows in 2012**

Figure 1.4 **Industrial production strengthens in developing countries even as it remains weak in high-income economies (industrial production volumes)**




Source: Thomson Datastream n.d.; World Bank DEC Prospects Group.

Figure 1.5 **Business sentiment indicators suggest a pick-up in activity in a number of major economies**




Source: Markit; Haver Analytics; World Bank DEC Prospects Group.

**Global baseline projections indicate sustained recovery over the medium term, but this modest growth outlook is subject to considerable risks**

albeit at a slower pace. South Africa's PMI rose from 49.3 in March to 50.5 in April.

Global baseline projections indicate sustained recovery over the medium term (table 1.1). In the United States, credit and housing market conditions have eased, and improving labor market conditions are helping support income and consumer demand growth. Provided fiscal uncertainty lifts, these improvements should lead to stronger investment growth. In the Eurozone, amid a prolonged recession (with the sixth consecutive quarterly decline in GDP recorded in 2013q1), fiscal consolidation is expected to continue, but with less austerity, and the negative impact on GDP growth should decline—contributing to a modest firming of growth during 2013 and a return to mildly positive growth in the second half of the year. Tight credit conditions on the supply side on account of fragile bank balance sheets and continued competitiveness issues in the periphery countries would limit any meaningful resurgence in growth.[3] Among developing economies, a pick-up in global demand, increased capital flows, and an accommodative monetary stance enabled by a generally low inflationary environment should support growth prospects.

This modest growth outlook is subject to considerable risks. Although the likelihood of a serious crisis of confidence in the Eurozone has declined considerably, continuing progress is needed on improving national finances and reinforcing pan-European schemes for a banking union and sovereign rescue funds. If the reform momentum fades, some of the more vulnerable Eurozone countries could be frozen out of capital markets, provoking a global slowdown that, by our calculations, could subtract 1 percentage point from developing country GDP growth.

The United States needs credible progress toward medium-term fiscal consolidation. Because of the failure to reach agreement on deficit reduction before the end of February 2013, legislation mandated automatic public spending cuts amounting to some $70 billion (0.4 percent of GDP) in 2013 and about $1 trillion over 10 years (sequestration). Though the direct impact on GDP will be limited, the indirect impact of uncertainties generated by prolonged negotiations could be much larger and last longer. Simulations of repeated failures to set fiscal policy on a sustainable path resulting in a downgrading of U.S. debt show that growth in the United States could slow by some 2.3 percentage points.

On the upside, a rapid end to policy uncertainty in the United States, a decrease in capacity constraint tensions in Asia, or an improvement in European confidence could speed the return of high-income countries to stronger growth—with positive effects for developing country exports and GDP.

### Commodity prices have softened despite the improved global economic outlook

Despite the modest strengthening of the global economy, prices of most industrial commodities dipped between mid-February 2013 and the end of April (figure 1.6). Nickel was down 19.4 percent, copper 17.4 percent, aluminum

**Table 1.1 The global outlook in summary**

Percentage change from previous year, excluding interest rates and oil prices

| Indicator | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| *Global conditions* | | | | | |
| World trade volume (goods and nonfactor services) | 6.2 | 2.6 | 4.1 | 5.0 | 5.5 |
| *Consumer prices* | | | | | |
| G-7 countries[a,b] | 5.3 | –0.6 | –0.1 | 0.9 | 1.0 |
| United States | 2.4 | 2.1 | 2.4 | 2.5 | 2.5 |
| *Commodity prices ($)* | | | | | |
| Nonoil commodities | 20.7 | –9.5 | –2.0 | –3.2 | –2.8 |
| Oil, $ per barrel[c] | 104.0 | 105.0 | 102.4 | 101.0 | 101.0 |
| Oil, percentage change | 31.6 | 1.0 | –2.9 | 0.2 | –0.1 |
| Manufactures unit export value[d] | 8.9 | –2.1 | 2.4 | 2.2 | 1.9 |
| *Interest rates* | | | | | |
| $, 6-month (percent) | 0.8 | 0.5 | 0.7 | 1.1 | 1.4 |
| €, 6-month (percent) | 1.6 | 0.2 | 0.5 | 1.2 | 1.5 |
| *Real GDP growth[e]* | | | | | |
| World | 2.7 | 2.3 | 2.3 | 3.0 | 3.3 |
| With 2005 purchasing power parity weights | 3.8 | 2.9 | 3.2 | 3.8 | 4.1 |
| High-income countries | 1.6 | 1.3 | 1.2 | 2.0 | 2.3 |
| OECD countries | 1.5 | 1.2 | 1.1 | 1.9 | 2.2 |
| Eurozone | 1.5 | –0.5 | –0.6 | 0.9 | 1.5 |
| Japan | –0.7 | 2.0 | 1.4 | 1.4 | 1.3 |
| United States | 1.8 | 2.2 | 2.0 | 2.8 | 3.0 |
| Non-OECD countries | 5.0 | 2.8 | 3.2 | 3.8 | 3.9 |
| Developing countries | 5.9 | 4.9 | 5.2 | 5.6 | 5.7 |
| Excluding transition economies | 6.5 | 5.0 | 5.5 | 5.9 | 5.9 |
| Excluding China and India | 4.5 | 3.2 | 3.6 | 4.2 | 4.4 |
| China | 9.3 | 7.8 | 8.0 | 8.0 | 7.9 |
| Sub-Saharan Africa | 4.5 | 4.3 | 4.9 | 5.2 | 5.4 |
| South Africa | 3.5 | 2.5 | 2.5 | 3.2 | 3.3 |

OECD is Organisation for Economic Co-operation and Development.
Note: Data for 2012 are estimates; data for 2013–15 are forecasts.
a. Canada, France, Germany, Italy, Japan, the UK, and the United States.
b. In local currency, aggregated using 2005 GDP weights.
c. Simple average of Dubai, Brent, and West Texas Intermediate.
d. Unit value index of manufactured exports from major economies, expressed in $.
e. Aggregate growth rates calculated using 2005 dollars GDP weights.
Source: World Bank.

**A rapid end to policy uncertainty in the United States, a decrease in capacity constraint tensions in Asia, or an improvement in European confidence could have positive effects for developing country exports and GDP**

15.0 percent, crude oil (Brent) 13.2 percent, and natural rubber 10.4 percent. In part, the declines likely reflected the suggestions in the recent U.S. Federal Open Market Committee's minutes that quantitative easing could end sooner than expected. Further, signals by Chinese authorities of intentions to cool their property markets and weaker-than-expected Chinese growth (7.7 percent) in 2013q1 added to the bearish sentiments; China accounts for more than 40 percent of global metals consumption. For 2013, the World Bank forecasts a 2.9 percent year-over-year decline in oil prices and a 2.0 percent decline in nonoil commodity prices.

## Recent economic developments in South Africa

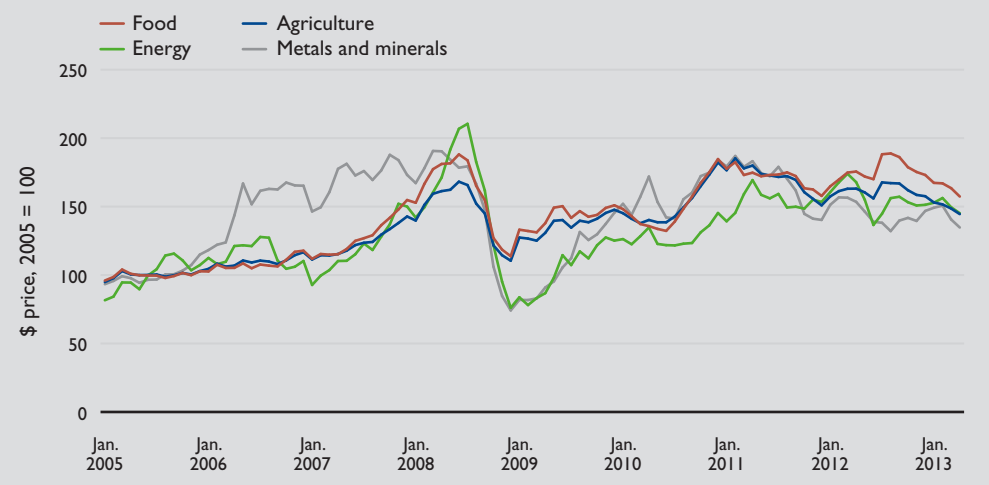
### Growth remains below potential

South Africa's growth slowed from 3.5 percent in 2011 to 2.5 percent in 2012 (table 1.2), reflecting primarily the sluggish external environment and domestic labor strife. Growth declined in 8 of the 10 major subsectors (all but agriculture and construction). Growth is projected to remain around 2.5 percent in 2013, below its potential trend rate of 3.1 percent until 2015.

Despite the turnaround in agriculture, the primary sector contracted sharply in the

**South Africa's growth slowed from 3.5 percent in 2011 to 2.5 percent in 2012, reflecting the sluggish external environment and domestic labor strife**

Figure 1.6 **A weak demand environment lowered metal and mineral prices, while supply-side pressures affected food prices in 2012**




Source: World Bank DEC Prospects Group.

Table 1.2 **Real GDP growth and economic performance, 2009–12**

Percentage change, seasonally adjusted and annualized, unless otherwise noted

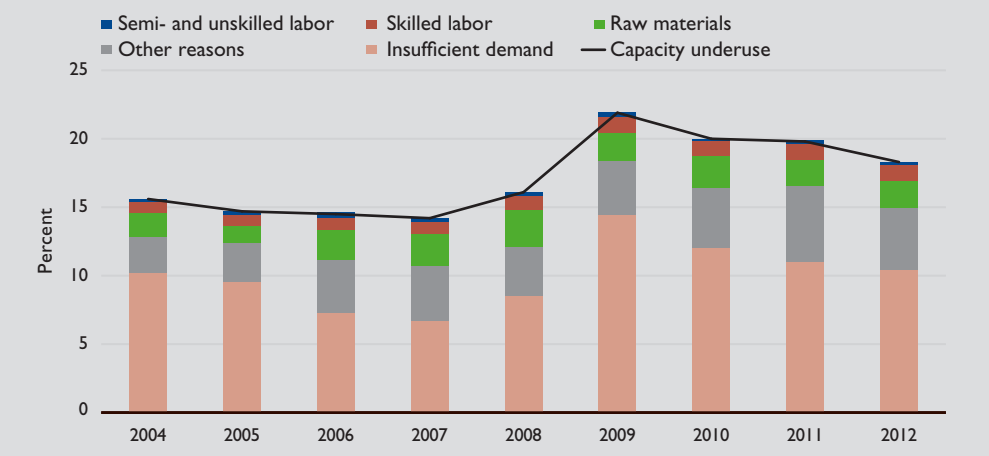
| Sector | 2009 | 2010 | 2011 | 2012q1 | 2012q2 | 2012q3 | 2012q4 | 2012 |
|---|---|---|---|---|---|---|---|---|
| GDP at market prices | –1.5 | 3.1 | 3.5 | 2.5 | 3.4 | 1.2 | 2.1 | 2.5 |
| *Primary sector* | –4.3 | 4.1 | 0.2 | –9.5 | 24.0 | –7.1 | –3.7 | –2.2 |
| Agriculture, forestry, and fishing | –1.6 | 0.4 | –0.1 | 4.8 | 9.3 | 7.4 | 10.0 | 2.3 |
| Mining and quarrying | –5.4 | 5.7 | 0.3 | –15.1 | 30.9 | –12.7 | –9.3 | –4.0 |
| *Secondary sector* | –6.9 | 4.4 | 2.9 | 5.5 | –0.5 | 1.5 | 3.6 | 2.1 |
| Manufacturing | –10.1 | 5.5 | 3.6 | 6.4 | –0.8 | 1.2 | 5.0 | 2.4 |
| Electricity, gas, and water | –1.4 | 2.1 | 1.1 | –0.8 | –4.3 | 1.6 | –2.2 | –1.2 |
| Construction | 7.8 | 0.7 | 0.5 | 5.1 | 3.4 | 3.3 | 0.2 | 2.5 |
| *Tertiary sector* | 1.0 | 2.5 | 3.8 | 3.1 | 2.3 | 1.9 | 2.4 | 3.0 |
| Wholesale and retail trade, catering, and accommodations | –1.2 | 3.8 | 4.5 | 3.2 | 2.7 | 1.7 | 1.5 | 3.6 |
| Transport, storage, and communication | 0.9 | 2.0 | 3.1 | 2.4 | 2.2 | 1.1 | 1.9 | 2.3 |
| Finance, insurance, real estate, and business services | 1.0 | 2.2 | 4.0 | 4.4 | 2.1 | 1.8 | 2.9 | 3.3 |
| Community, social, and personal services | 2.5 | 2.2 | 3.5 | 1.7 | 2.3 | 2.6 | 2.6 | 2.8 |
| General government services | 3.9 | 2.9 | 3.9 | 1.8 | 2.5 | 2.7 | 2.6 | 3.1 |

Source: South African Reserve Bank.

second half of 2012. Work stoppages and disruptions in production arising from violent clashes in the mines led to a dismal performance for the mining sector. By end-2012, mining production had declined in seven of the previous eight quarters and remained below its precrisis peak. Growth in manufacturing output accelerated in 2012q4, benefiting in part from stronger demand from South Africa's developing country trade partners (see below). Capacity utilization by large manufacturers continued upward, averaging 81.7 percent in 2012. Nevertheless, manufacturing production remains below its level before the 2009 global economic and financial crisis, with insufficient demand contributing most to the considerable, if declining, capacity underutilization (figure 1.7). In the service sector, gross value added accelerated moderately in 2012q4, driven by transport, finance, insurance, and real estate.

Business confidence indices were slightly positive. The seasonally adjusted Kagiso PMI index rose 1.2 points in April, climbing to 50.5, indicating modest expansion. This was only the second time since October 2012 that the index rose above the crucial 50-point neutral mark. The uptick was on the back of improvements in the subindices related to new sales orders (demand conditions), business activity (output conditions), expected business conditions (business confidence), and supplier performance (supply conditions). However, five of the nine

Figure 1.7 **Capacity underutilization is declining in manufacturing**




Source: Statistics South Africa.



**Business confidence indices were slightly positive, but growth of real gross domestic expenditure shrank half a percentage point in 2012**

subindices declined in April, including that for employment, which fell to its lowest level since July 2011, dampening the increase in the overall score. Meanwhile, the Rand Merchant Bank/Bureau for Economic Research Business Confidence Index rose from 46 in 2012q4 to 52 in 2013q1—with improved conditions in four of five sectors—signaling that slightly more than half of respondents were optimistic about business prospects. The index rose in manufacturing, wholesale, new vehicle trade, and building contractors but declined in retail. However, the index remained below the neutral mark of 50 for manufacturing and construction and was at 50 for retail.

On the demand side, growth of real gross domestic expenditure (GDE) shrank half a percentage point in 2012, as growth moderated in all components other than gross fixed capital formation (table 1.3). Growth in fixed capital formation picked up by more than 1 percentage point in 2012, as accelerated investment spending by state-owned enterprises and the government overcame continuing slight increases in private investment. Real GDE shrank in 2012q4, mainly because of contractions in general government consumption and in inventories and a slowdown in gross fixed capital formation. Moreover, the global economic slowdown kept export growth to 1.1 percent, while household

Table 1.3 **Gross domestic expenditure, 2008–12**

Percentage change, seasonally adjusted and annualized, unless otherwise indicated

| Component | 2008 | 2009 | 2010 | 2011 | 2012/01 | 2012/02 | 2012/03 | 2012/04 | 2012 |
|---|---|---|---|---|---|---|---|---|---|
| Total final consumption | 2.8 | –0.1 | 4.6 | 4.8 | 3.5 | 3.3 | 4.1 | 1.6 | 3.7 |
| Final consumption expenditure by household (PCE) | 2.2 | –1.6 | 4.4 | 4.8 | 4.0 | 3.2 | 2.7 | 2.4 | 3.5 |
| Durable goods | –8.3 | –12.6 | 18.8 | 15.8 | 8.1 | 8.9 | 7.8 | 6.1 | 11.0 |
| Semidurable goods | 4.7 | –1.9 | 3.6 | 5.9 | 6.1 | 6.8 | 6.2 | 5.1 | 6.2 |
| Nondurable goods | 0.2 | –0.9 | 1.8 | 3.1 | 2.5 | 2.2 | 1.7 | 2.3 | 2.5 |
| Services | 6.1 | 0.4 | 4.0 | 3.5 | 3.6 | 1.7 | 1.3 | 0.8 | 1.8 |
| Final consumption expenditure by general government | 4.6 | 4.8 | 5.0 | 4.6 | 1.9 | 3.7 | 8.3 | –0.7 | 4.2 |
| Gross fixed capital formation (investment) | 13.0 | –4.3 | –2.0 | 4.5 | 4.6 | 5.4 | 5.6 | 4.3 | 5.7 |
| General government | 10.9 | –6.6 | –9.0 | 8.6 | 4.9 | 10.9 | 10.3 | 2.1 | 8.5 |
| Public corporations | 36.2 | 22.2 | –1.5 | 1.5 | 11.0 | 9.8 | 10.6 | 7.2 | 9.1 |
| Private business enterprises | 8.8 | –10.4 | –0.5 | 4.6 | 2.5 | 2.7 | 2.8 | 3.8 | 3.9 |
| Domestic final demand | 4.7 | –0.9 | 3.3 | 4.7 | 3.7 | 3.7 | 4.3 | 2.1 | 4.0 |
| Change in inventories (R millions) | –8,229 | –23,984 | –1,398 | 5,058 | 5,861 | 6,321 | 5,089 | –4,055 | 3,304 |
| Gross domestic expenditure | 3.5 | –1.6 | 4.4 | 4.6 | 4.4 | 4.4 | 4.1 | –0.9 | 4.1 |

PCE is personal consumption expenditure.
Source: South African Reserve Bank.

consumption growth remained slow as consumer confidence weakened on account of heightened unemployment, global economic uncertainties, and a weakened rand. The outlook for consumer demand remains weak. The First National Bank/Bureau for Economic Research Consumer Confidence Index trended down in 2013q1, posting a nine-year low of –7 index points.

Real gross fixed capital formation moderated to 4.3 percent in 2012q4, as the acceleration in private sector investment only partially offset the slowdown in capital spending by public corporations—mainly in electricity and transport—and by general government. Shaky business confidence arising from domestic labor unrest, the slowdown in domestic demand, and the still precarious (despite modest recent improvements) global growth prospects do not bode well for private investment growth. Electricity buybacks by Eskom (the public electricity utility), and the decision by the National Energy Regulator of South Africa to grant a much lower electricity hike schedule than requested by Eskom, while a positive development for the inflation outlook, could curtail the expansion of electricity-generating capacity in the medium term because of its detrimental effect on Eskom's balance sheet.

**Between 2008q4 and 2012q4 about 628,000 people joined the ranks of the unemployed, and roughly 1.1 million people joined the ranks of discouraged workers**

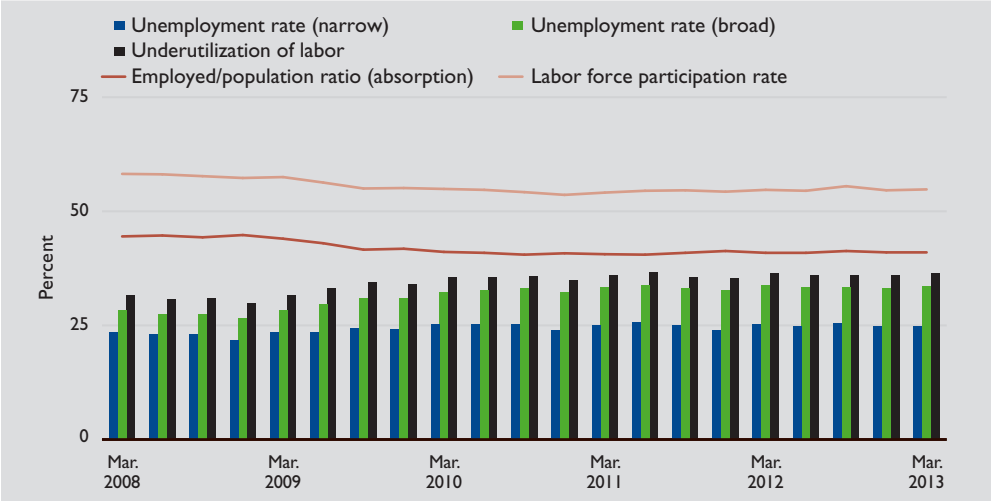
### Labor markets remain weak

South Africa's labor markets continue to perform poorly (figure 1.8). The unemployment rate remained stubbornly high, at 25.2 percent in 2013q1—and an even higher 33.7 percent if discouraged workers are included. Long-term unemployment represents about two-thirds of total unemployment, indicating that structural factors are at play. The unemployment rate has been consistently at or above 25 percent in the first quarter of the year since 2010.

While 2.2 million people transitioned into the working-age population (15–64 years) between 2008q4 and 2012q4, 267,000 jobs were lost in that time. About 628,000 people joined the ranks of the unemployed, and roughly 1.1 million people joined the ranks of discouraged workers, having given up hope of landing a job. About 29 percent of those unemployed in 2012q4 were work-seekers ages 15–24, and just 1.2 young people in 10 (12 percent) are employed, much lower than the overall employment rate for South Africa (41 percent). Moreover, roughly 31.6 percent of young people (3.3 million) were not in employment, education, or training in 2012q4, meaning they were disengaged from any economic activity and were not accumulating human capital that could improve their employability.

Table 1.4 presents the transition matrix across employment statuses from 2012q2 to 2012q4. In the upper panel, diagonal elements indicate the probability of remaining in the same employment status after six months (between the initial and end periods). Nondiagonal elements indicate the probability of moving from one employment status to another. Consistent with findings

Figure 1.8 **Broad and narrow unemployment rates remain high**




Source: Statistics South Africa Quarterly Labor Force Surveys (2008q1–2012q4); staff calculations.

Table 1.4 **Transition matrices and newcomers' probability of finding a job, 2012q2 to 2012q4**

Percent

| Status | Employed | Unemployed | Discouraged | Other not economically active |
|---|---|---|---|---|
| Employed | 91.5 | 3.7 | 1.3 | 3.5 |
| Unemployed | 15.0 | 64.0 | 7.3 | 13.7 |
| Discouraged | 9.9 | 16.0 | 50.7 | 23.5 |
| Other not economically active | 3.4 | 5.1 | 4.0 | 87.5 |
| Transitions from broad unemployment to other employment status | | | | |
| *Unemployed* | | | | |
| New entrant | 9.4 | 68.8 | 7.0 | 14.8 |
| Job loser, job leaver, or re-entrant | 22.2 | 59.7 | 7.1 | 11.1 |
| Other (last time worked +5 years) | 11.3 | 62.6 | 8.1 | 18.0 |
| *Discouraged* | | | | |
| New entrant | 5.5 | 15.5 | 55.3 | 23.6 |
| Job loser, job leaver, or re-entrant | 19.5 | 17.8 | 44.2 | 18.5 |
| Other (last time worked +5 years) | 9.9 | 14.8 | 47.0 | 28.3 |

Source: Statistics South Africa Quarterly Labor Force Surveys (2012q2 and 2012q4); staff calculations.

of the November 2011 and July 2012 South Africa Economic Updates, the probability of staying in the same employment status after six months remained high: the probability of retaining a job was about 91.5 percent while the probability of remaining unemployed was 64 percent. The probability of landing a job remains very low for both unemployed workers (15 percent) and discouraged workers (9.9 percent).

The lower panel of table 1.4 explores the transitions from unemployment (broadly defined, including discouraged workers) to other employment statuses, with an emphasis on whether a person looking for a job has been employed before. The results are revealing. For unemployed new entrants in the labor market, the probability of landing a job six months later was just 9.4 percent, while the probability of remaining unemployed was almost 70 percent. Chances of success also vary by experience. An unemployed person who has worked in the past five years is twice as likely to be hired as a person who has not worked in more than five years. For discouraged workers, results are even starker. The probability of a first-time entrant discouraged worker finding a job within six months is just 5.5 percent, which is slightly over half the probability of success for someone who has not worked in the past five years and one-fourth that of someone who held a job in the past five years. These findings are in line with other findings on the difficulties young people have transitioning into employment.[4]

### Fiscal policy

Even with more limited fiscal space and an environment of high unemployment and weak domestic and global growth prospects, the 2013 budget maintained a countercyclical stance while committing to a medium-term fiscal consolidation path to slow spending growth, shrink the fiscal deficit, and stabilize the debt-to-GDP ratio by fiscal 2015/16. Given the goal of moderating expenditure growth, a key priority in the 2013 budget was to improve the impact and efficiency of public spending by reprioritizing capital and recurrent spending in line with national policy priorities in the National Development Plan. Given South Africa's social challenges, government spending in the "social wage" category (education, health services, social development, public transport, housing, and local amenities) accounts for about 60 percent of total spending. More than 16 million people receive some form of social grants. By the end of the Medium-Term Expenditure Framework period in 2016, that number is projected to reach 17.2 million.

Lackluster domestic economic performance resulted in lower than anticipated tax revenue: R11.3 billion lower than projected in the 2012/13 Medium-Term Budget Policy Statement and R16.3 billion lower than in the 2012/13 budget. The moderation in expenditure growth only partially countered the shortfall in revenue collection in 2012/13, resulting in a higher than



**Even with more limited fiscal space, the 2013 budget maintained a countercyclical stance while committing to medium-term fiscal consolidation to slow spending growth**

**Several indicators point to building inflationary pressures because of the sustained weakening of the rand**

expected budget deficit. Fiscal consolidation—achieved through a moderation in the growth of allocations to national departments and a reduction in contingency allocations—is expected to be greater over the Medium-Term Expenditure Framework period than proposed in the Medium-Term Budget Policy Statement, with real expenditure growth set to average about 2.3 percent rather than 2.9 percent.

Fiscal consolidation depends strongly on how quickly the economy recovers. Faster economic growth would be supported by public investment in infrastructure and electricity generation, low interest rates and low and stable inflation, and faster growth in private investment. The 2013/14 budget foresees higher revenue collection as economic conditions improve, reducing the budget deficit to 3.1 percent of GDP by fiscal 2015/16 (table 1.5). Debt-service costs are forecast to stabilize at a manageable 2.8 percent of GDP. Contingent liabilities stood at R373.2 billion in fiscal 2012/13 (about 11.6 percent of GDP), almost half of which arising from exposure to state-owned enterprises and development finance institutions.

### Inflation and monetary policy

Headline Consumer Price Index inflation moved sideways in April 2013 from February and March and stood at 5.9 percent year over year (figure 1.9). Food and nonalcoholic beverages, housing and utilities, and transport contributed about 56 percent of the annual change. Increases in administered prices continue to be a major driver of

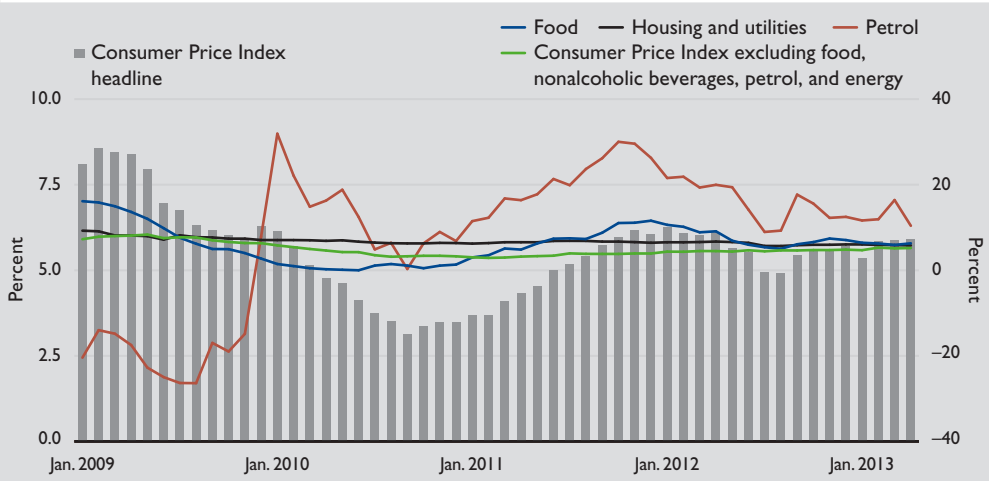
**Table 1.5 Consolidated fiscal framework, 2010/11–2015/16**

Percent of GDP, unless otherwise noted

| | Outcome | | Estimate | | Budget forecast | | |
|---|---|---|---|---|---|---|---|
| | | | MTBPS | Budget | | | |
| Item | 2010/11 | 2011/12 | 2012/13 | 2012/13 | 2013/14 | 2014/15 | 2015/16 |
| Revenue | 27.7 | 28.1 | 27.5 | 27.7 | 28.0 | 28.1 | 28.1 |
| Expenditure | 32.1 | 32.1 | 32.3 | 32.9 | 32.6 | 32.1 | 31.2 |
| Budget balance | –4.4 | –3.9 | –4.8 | –5.2 | –4.6 | –3.9 | –3.1 |
| Debt service cost | 2.4 | 2.6 | 2.7 | 2.8 | 2.8 | 2.8 | 2.8 |
| Primary balance | –2.0 | –1.4 | –2.1 | –2.5 | –1.8 | –1.1 | –0.4 |
| Net borrowing requirement | 4.3 | 3.8 | 5.1 | 5.0 | 45.6 | 3.9 | 3.1 |
| Total net government debt | 30.0 | 33.3 | 35.7 | 36.3 | 38.6 | 39.8 | 40.3 |
| Southern African Customs Union payments (R millions) | 17,905.7 | 21,760.0 | 42,151.0 | 42,151.3 | 43,374.3 | 43,036.0 | 48,469.3 |

MTBPS is Medium-Term Budget Policy Statement.
Source: South Africa National Treasury 2012, 2013.

**Figure 1.9 Consumer price index headline inflation and core inflation**




Source: Statistics South Africa.

inflation, with petrol inflation still recording two-digit increases (10.4 percent year over year). Core inflation (excluding food and nonalcoholic beverages, petrol, and energy) stood at 5.2 percent year over year. Supply-side price developments, such as the smaller-than-requested electricity hike schedule the National Electricity Regulator of South Africa granted Eskom and moderation of inflationary pressures from food prices, have been outweighed by the sustained depreciation of the rand.

Several indicators point to building inflationary pressures because of the sustained weakening of the rand. Although input cost prices reflected in the PMI price subindex fell 9.3 index points to 78.0 in April (following eight consecutive increases since July 2012), input cost pressures remain high in manufacturing. The Producer Price Index (PPI) for final manufactured goods rose slightly in March to 5.7 percent year over year from 5.4 percent in February. PPI for intermediate inputs for manufactured goods rose to 7.7 percent year over year, whereas PPI for electricity and water moderated to 11.4 percent year over year in March.

On the demand side, underlying inflationary pressures remain muted, given the weak domestic economic growth and the subdued global economic environment expected to prevail for some time. Multiple signs suggest little or no demand-side inflationary pressure: slack labor markets with persistently high levels of unemployment; capacity utilization still below the precrisis peaks (79.0 percent in 2013q1 in the manufacturing sector); and moderating household consumption spending due to slower real income growth, eroding purchasing power, high household debt to disposable income (75.8 percent), shaky business and consumer confidence, and moderating consumer credit.

South Africa's inflation outlook is affected by both domestic and global developments, most recently the adverse impact of wages and sustained exchange rate depreciation on production costs and price of imported goods. While recent moderation in food prices and a lower schedule of electricity price increases were positive signs for the inflation outlook, future labor unrest, adverse shocks in major South African export destinations, and loss of investor confidence, which may further weaken the rand, threaten a deteriorating outlook.

### External sector

The current account deficit narrowed slightly in 2012q4, receding from 6.8 percent of GDP in 2012q3 to 6.5 percent, as both the trade account and the services, income, and current transfer accounts improved marginally (figure 1.10). Fragile economic conditions in advanced economies—particularly in the Eurozone—translated into a contraction in manufactured exports. That effect was fully countered by an increase in primary sector exports to emerging markets, reflecting a partial recovery in mining production and fairly robust economic growth in emerging markets.

Higher commodity prices, together with a sustained depreciation of the rand, bumped up export earnings. While the contraction in domestic demand reduced imports, the depreciation of the rand caused import receipts to rise, so the trade deficit was only slightly smaller in 2012q4. South Africa's terms of trade deteriorated in 2012q4, as prices rose faster for imports than for exports.

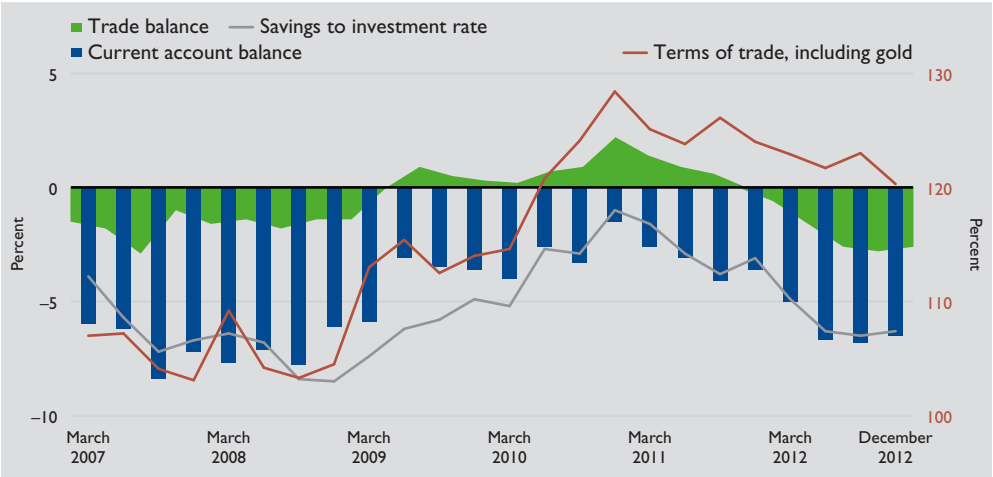
Net nonresident bond flows totaled R87.8 billion in 2012, more than double the inflows in 2011 (R41.9 billion). South Africa's inclusion in the Citigroup World Government Bond Index seems to have offset several negative developments in 2012—poor performance of the domestic economy, credit rating downgrades by all three major rating agencies, labor unrest in the second half of 2012, declining business and consumer confidence, setbacks in electricity supply, and widening current account deficits. These factors also led to a sustained depreciation of the rand in the second half of 2012. Spikes of risk aversion from global developments (particularly the financial bailout in Cyprus and the slowdown of China's economy) also put added upward pressure on the exchange rate in 2013q1.

Currencies of large emerging market economies have gained in recent months. Growth acceleration in China and higher international capital flows (figure 1.11) and commodity prices (until recent weeks) have strengthened the real effective exchange rates of the Brazilian, Chinese, Mexican, Russian, and Turkish currencies (figure 1.12). However, currencies have not strengthened in all large emerging market economies.



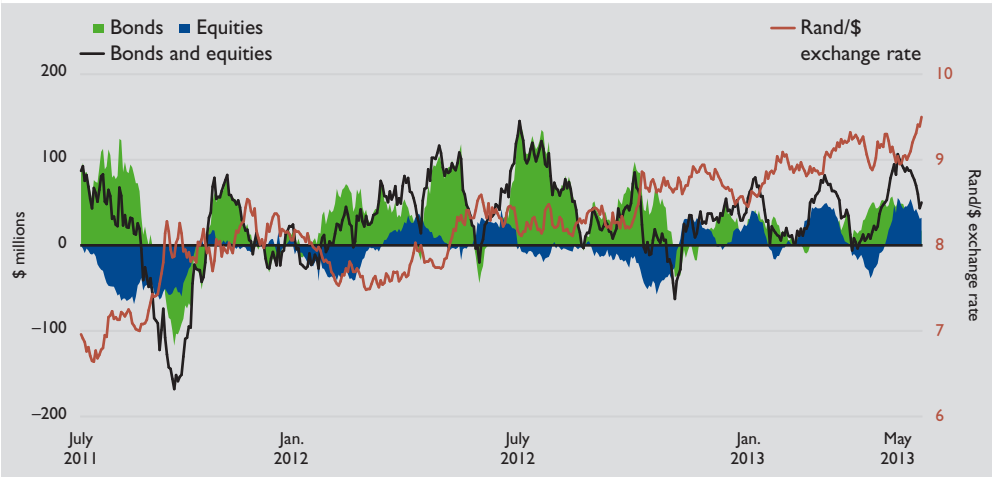
**The current account deficit narrowed slightly in 2012q4, as both the trade account and the services, income, and current transfer accounts improved marginally**

Figure 1.10 **Current account and trade balance improve slightly in 2012q4**



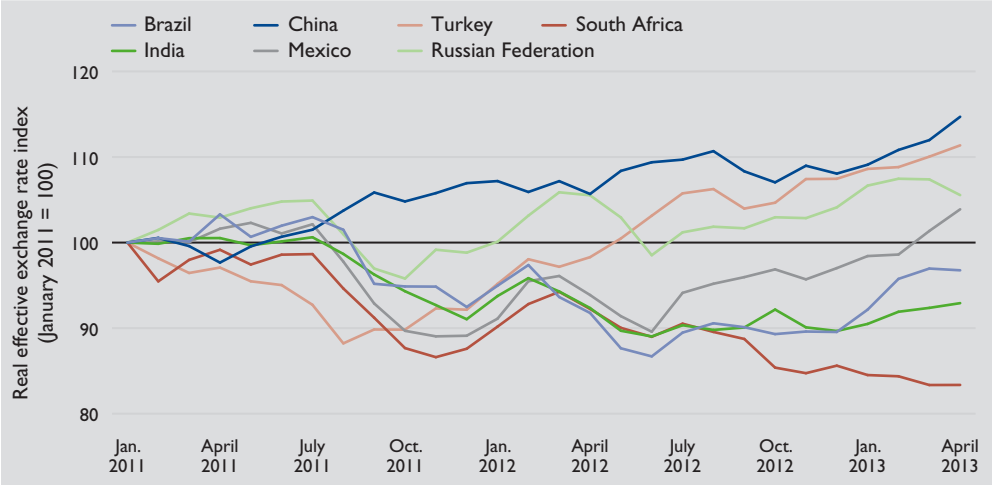

Source: South African Reserve Bank.

Figure 1.11 **Nonresident capital flows (22-day moving average) rising**




Source: Citigroup; Johannesburg Stock Exchange; staff calculations.

Figure 1.12 **The real effective exchange rates for several large developing countries have strengthened in recent months, but not for South Africa**




Source: World Bank DEC Prospects Group.

Weaker growth concerns, wider current account deficits, and higher inflation differentials in India and South Africa have led to a depreciation of their currency on a real effective exchange rate basis, in particular the rand.

There has been a steady increase in the importance of developing countries as South Africa's trade partners (table 1.6), reflecting the much faster trade among developing countries than between developing countries and high-income countries over the past decade. In 2006, trade with other African countries and with the BRIC countries represented 22 percent of total exports and 21 percent of total imports. By 2012, those figures had risen to 40 percent and 31 percent. While China is at the center of this change, exports to the rest of Africa as a share of total exports grew almost 38 percent over 2006–2012, reflecting the region's strong growth.

South Africa's trade has shifted away from advanced economies, largely as a result of weak growth there. The decline in exports has been noticeable, falling from 57 percent of the total in 2006 to just 40 percent in 2012, led by a significant drop in South African exports to the European Union. Shares to the United States and Japan have also declined somewhat.

South Africa's export mix has not changed much since 2006 (table 1.7). About 77 percent or more of its export value consists of natural and cultured pearls; precious and semiprecious stones; precious metals; base metals and articles of base metal; mineral products; machinery, mechanical appliances, and electrical equipment; vehicles, aircraft, vessels, and transport equipment; and chemical products. Exports to China have been mainly mineral products and base metals (88.1 percent in 2012). Of exports to Africa,



**There has been a steady increase in the importance of developing countries as South Africa's trade partners**

**Table 1.6 South Africa's trade by geographical destination, as a share of total exports and imports**

| | Imports | | | Exports | | |
|---|---|---|---|---|---|---|
| Trade partner | 2006 | 2009 | 2012 | 2006 | 2009 | 2012 |
| Developing economies: Africa + BRIC | 21.7 | 26.4 | 30.6 | 21.4 | 35.0 | 39.8 |
| Africa | 6.7 | 7.8 | 9.7 | 14.8 | 19.6 | 20.4 |
| BRIC | 14.9 | 18.6 | 20.9 | 6.5 | 15.3 | 19.3 |
| China | 10.1 | 13.1 | 14.5 | 4.0 | 10.5 | 13.1 |
| Advanced economies: European Union + United States + Japan | 44.1 | 44.9 | 40.7 | 57.0 | 42.8 | 40.0 |
| European Union | 29.9 | 32.3 | 28.8 | 33.5 | 26.8 | 22.3 |
| United States | 7.6 | 7.7 | 7.3 | 11.6 | 8.3 | 9.8 |
| Japan | 6.6 | 4.9 | 4.6 | 11.9 | 7.6 | 7.9 |

BRIC is Brazil, the Russian Federation, India, and China.
Source: South African Revenue Service; staff calculations.

**Table 1.7 Natural resources–based and manufactured exports as a share of total exports for a given destination, 2006, 2009, and 2012**

| Year and export product | Africa | BRIC | China | European Union | United States | Japan |
|---|---|---|---|---|---|---|
| *2006* | | | | | | |
| Natural resources (sections 5, 14, 15) | 29.7 | 73.1 | 84.1 | 54.9 | 64.2 | 69.6 |
| Manufactured goods (sections 6, 16, 17) | 42.1 | 20.1 | 8.8 | 27.7 | 26.9 | 22.4 |
| *2009* | | | | | | |
| Natural resources (sections 5, 14, 15) | 25.2 | 83.4 | 90.8 | 49.6 | 41.2 | 79.3 |
| Manufactured goods (sections 6, 16, 17) | 41.0 | 8.9 | 2.7 | 27.7 | 51.2 | 11.8 |
| *2012* | | | | | | |
| Natural resources (sections 5, 14, 15) | 23.9 | 85.2 | 90.2 | 50.3 | 47.6 | 72.4 |
| Manufactured goods (sections 6, 16, 17) | 47.5 | 7.8 | 4.0 | 29.8 | 46.5 | 21.5 |

BRIC is Brazil, the Russian Federation, India, and China.
Note: Section 5 is mineral products; section 6 is chemical products; section 14 is natural or cultured pearls, precious or semiprecious stones, and precious metals; section 15 is base metals; section 16 is machinery, mechanical appliances, and electrical equipment; and section 17 is vehicles, aircraft, vessels, and transport equipment.
Source: South African Revenue Service; staff calculations.

manufactured goods rose from 42.1 percent of the total in 2006 to 47.5 percent in 2012, while for the European Union manufactured exports made up just 29.8 percent of the total in 2012. This means that Africa is the main recipient of South African manufactured goods (9.7 percent of manufactured exports go to Africa and 6.6 percent to the European Union). While advanced economies remain the main destination of South Africa's manufactured exports, these shifting shares emphasize the increasing role of emerging markets in light of sluggish growth in the center.

**Medium-term growth prospects for South Africa have been revised down because of lower estimates of potential GDP and the severity of the domestic and external downside risks**

## Economic outlook for South Africa

Against the backdrop of a much weaker domestic investment climate, deceleration in consumer spending, and a subdued external demand environment, medium-term growth prospects for South Africa have been revised down. GDP growth is projected at 2.5 percent for 2013, 3.2 percent for 2014, and 3.3 percent for 2015, down from 3.2 percent for 2013 and 3.5 percent for 2014 in the July 2012 Economic Update (table 1.8).

Lower estimates of South Africa's potential GDP and the severity of the domestic and external downside risks are chiefly behind the downward revision in the medium-term growth projections. Updated with more recent data, revised estimates show a decline in potential GDP growth from a boom period high of about 4.0 percent and of 3.5 percent since the start of the crisis to about 3.1 percent in 2013. The analysis shows that the decline in potential GDP growth came from slower growth of both capital stock (investment) and total factor productivity.[5] The revised output gap (difference between potential and actual GDP) of close to 1 percent is therefore also smaller than previously estimated (the July 2011 Economic Update estimated the gap at 2.3 percent for 2010 and 2011), with implications for medium-term growth; the output gap will close more slowly once demand conditions are relaxed.

Delays in adding large-scale new electricity generation are likely to further constrain catch-up growth. Domestic risk factors (especially volatile labor relations in mines) have also emerged more forcefully since the previous Update and are likely to play a stronger role in shaping investor confidence in the medium term, a trend already reflected in the business confidence index of the South African Chamber of Commerce and Industry.[6] A marked recent decline in the national savings rate would constrain the financing available for fixed investment, also taking some steam out of the growth momentum. Consumer spending would further decelerate as debt-saddled households faced with slow job creation gradually build up their savings or ease their debt pressures. Indeed, the deceleration in household spending is already under way. It is likely to persist, as indicated by the First National Bank Bureau for Economic Research Consumer Confidence Index, which fell to –7 index points in March 2013, much lower than at the onset of the global financial crisis in 2008.

Labor market relations, which became more disruptive in the second half of 2012, especially through channels outside the conventional bargaining mechanisms, could have lasting effects on labor market dynamics and investor confidence. Firms are delaying

**Table 1.8 Medium-term economic outlook**

Percentage change, seasonally adjusted and annualized, unless otherwise indicated

| Indicator | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| Real GDP growth | 3.1 | 3.5 | 2.5 | 2.5 | 3.2 | 3.3 |
| Household consumption | 4.4 | 4.8 | 3.5 | 1.9 | 2.5 | 2.9 |
| Government consumption | 5.0 | 4.6 | 3.9 | 3.1 | 3.0 | 2.8 |
| Gross fixed capital formation | –2.0 | 4.5 | 5.7 | 2.9 | 3.5 | 3.7 |
| Exports | 4.5 | 5.9 | 0.1 | 3.0 | 3.9 | 4.4 |
| Imports | 9.6 | 9.7 | 6.3 | 2.5 | 2.8 | 3.7 |
| Headline inflation | 4.3 | 5.0 | 5.7 | 5.7 | 5.5 | 5.1 |
| Current account balance (percent of GDP) | –2.8 | –3.4 | –6.3 | –6.2 | –5.9 | –5.7 |

Source: South Africa National Treasury estimates and projections; staff calculations.

investment and hiring decisions—and as a result slowing the rebound of private investment and household consumption. Our forecasts suggest a timid recovery in both household final consumption expenditure and gross fixed capital formation by the private sector.

Further, external demand, particularly from the Eurozone, an important destination for South Africa's manufactured exports, remains weak. When combined with the slowdown of China's economy and its rebalancing from an investment-driven to a consumption-driven growth model, the external environment suggests that growth in demand for some of South Africa's industrial metals will slow. Moreover, South Africa's terms of trade (ratio of the price of exports to the price of imports) fell almost 6 percent in 2012 and is projected to continue declining over the medium term on the back of softening precious metal prices. Net exports therefore will continue to drag on GDP growth, though not as severely as in 2012.

### Domestic risks to the outlook

As observed in the second half of 2012, domestic developments represent a major downside risk to the medium-term outlook, particularly the potential for worsening labor unrest. The overall effects could be contained within a specific sector or spill over to the rest of the economy. Should a widespread labor dispute arise within the forecast horizon, output could contract substantially and business confidence could fall, adversely affecting investment and hiring decisions.

As stated in previous issues of the Economic Update, South Africa's low national savings and heavy reliance on foreign funds—with short-term portfolio flows an important share—to finance investment makes the economy susceptible to capital flow reversals. Both domestic and global events could trigger a sudden capital outflow, requiring a sharp correction in domestic absorption and a depreciation of the rand in the absence of government intervention. Should this situation arise, output and investment would contract.

### External risks to the outlook

While the baseline scenario includes a modest recovery of global economic activity, the many tension points in the global economy could result in a much weaker global outcome. Indeed, the three main tension points in the global economy are not mutually exclusive, and one event could trigger others.

Financial market tensions have eased in the Eurozone since 2012q2, and the likelihood of a serious deterioration in conditions has lessened; nonetheless, conditions remain fragile, and sentiment is vulnerable to bad news. Should circumstances deteriorate markedly, with a credit freeze on some of the larger, troubled Eurozone economies, global economic activity could return to recession-like conditions, resulting in a 0.9 percentage point drop in South Africa's GDP from the baseline forecasts.

The fiscal consolidation in the United States is already sapping growth. The baseline assumes agreement on a credible medium-term plan to restore fiscal sustainability. If this does not occur and a deeper fiscal contraction takes place, U.S. growth would slow even more. In an alternate scenario in which uncertainty in U.S. fiscal policy leads to increased precautionary savings by U.S. consumers and businesses, U.S. growth could slow by some 2.3 percentage points. Should that occur, the impact on the trade channel alone could cause South African GDP to decline 0.7 percentage point from the baseline. However, the indirect impacts through weaker confidence and the potential rattling of global financial and commodity markets would likely be even stronger considering the importance of the U.S. economy in global markets.

A third tension point is the possibility of a disorderly unwinding of China's unusually high investment rate. With Chinese demand accounting for half of African exports of many industrial metals, a sharper-than-envisaged downturn in China could result in a slump in commodity prices. An abrupt slowdown in Chinese investment would reduce South Africa's GDP 0.3 percentage point, with the current account deteriorating 0.3 percentage point of GDP and fiscal balances 0.2 percentage point.



**The many tension points in the global economy could result in a much weaker global outcome than the modest recovery in the baseline scenario**

SECTION 2

# Financial inclusion in South Africa

Researchers, policymakers, and other financial sector stakeholders are becoming more interested in the transformative power of financial inclusion.[7] In South Africa, expanding access to financial services for individuals and small enterprises could reduce the country's persistent income inequality and stimulate growth (box 2.1). South Africa, as Africa's only G20 member and as one of the BRICS, plays an influential global role, and progress in financial inclusion could thus have an important demonstration effect. While formal financial institutions offer an array of financial services, this Update focuses on formal payments, savings, and credit.[8]

But the ability of financial systems to perform these tasks is often limited by market imperfections. The price of financial services may be distorted, for example, because of excessive regulation, lack of competition, or information asymmetry between borrowers and lenders. As a result, some households and firms may not be able to access the financial services they need. Data from users of financial services show that the share of adults with a bank account is higher in South Africa than in other African and BRICS economies. But these aggregate statistics mask financial inequality between rich and poor, men and women, and rural and urban residents. Further, while payday loans to individuals are quite prevalent, micro and small businesses have little access to financing. High concentration of financial service providers, a lack of microfinance institutions, and gaps in the regulatory environment all pose challenges to financial inclusion, while the highly developed technology infrastructure of the financial sector offers promising opportunities.

## The financial inclusion landscape

On aggregate, Global Findex data suggest that South Africa's financial sector is fairly inclusive.[9] Some 54 percent of adults in South Africa report using a formal account enabling both deposits and withdrawals at a bank, credit union, cooperative, post office, or microfinance institution (figure 2.1).

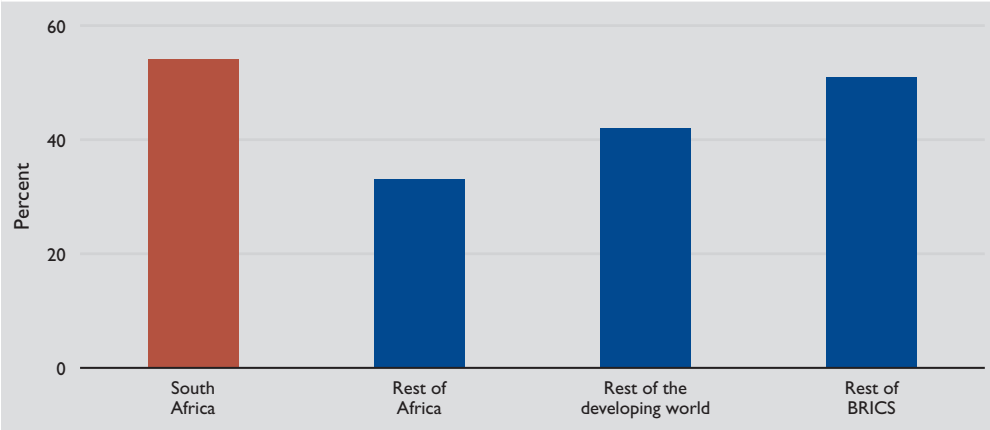
**Box 2.1 Financial inclusion and development**

Financial inclusion is vital because of the role of financial services in helping individuals and firms withstand income shocks and smooth spending. A well-functioning financial system produces and processes information on investment opportunities and allocates capital based on these assessments; monitors individuals' and firms' performance after allocating capital; facilitates the trading, diversification, and management of risk; mobilizes and pools savings; and eases the exchange of goods, services, and financial instruments. Financial services thus allow individuals and businesses to pool their risk and minimize the impact of idiosyncratic shocks (ranging from losses of income to rising commodity prices, illness, theft, and unemployment) on their economic welfare. Without inclusive financial systems, individuals and small businesses have to rely on their own resources or on informal social support systems, such as family and friends, to meet their financial needs (saving for retirement, investing in education, taking advantage of business opportunities, and the like).

Source: Levine 2005.

**While the share of adults with a bank account is higher in South Africa, aggregate statistics mask financial inequality between rich and poor, men and women, and rural and urban residents**

Figure 2.1 **South Africa fares well on aggregate data on financial account penetration (adults with an account at a formal financial institution)**




Source: Demirgüç-Kunt and Klapper forthcoming.

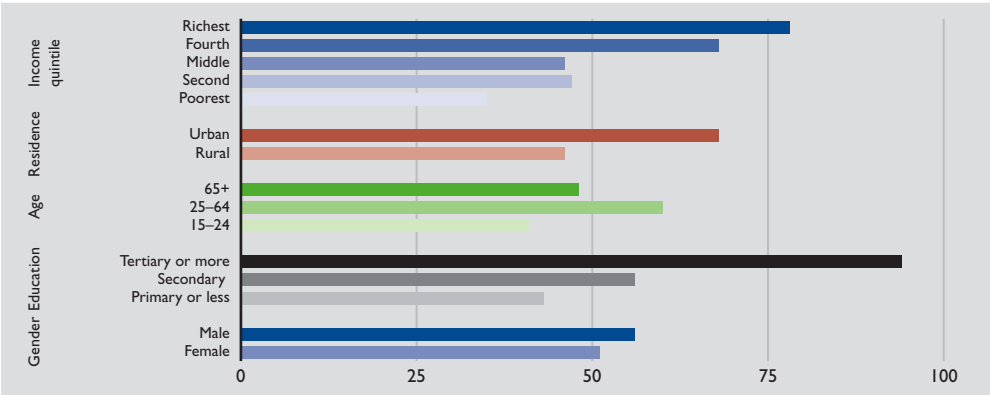
Although lower than the Finscope[10] estimate of 67 percent (which includes the use of debit cards to withdraw government transfers), this share is higher than the average for the group of African countries and developing countries covered by Global Findex and higher than that of the other BRICS economies.

### Access to and use of formal bank accounts

This aggregate picture conceals large inequalities. In South Africa, the gaps between the poorest and richest quintiles are large. More than 12 million adults lack a basic bank account, the first step to financial inclusion.[11] For example, while only 35 percent of adults in the poorest 20 percent of income earners have a formal account, 78 percent of those in the richest 20 percent do (figure 2.2). The distribution of account ownership across the top and bottom income quintiles is much larger in South Africa than in the other BRICS countries (figure 2.3). Among the other BRICS countries, account ownership exhibits a linearly expanding pattern from the bottom 20 percent of income earners to the top, reflecting the presence of a middle class, a pattern far less visible for South Africa.

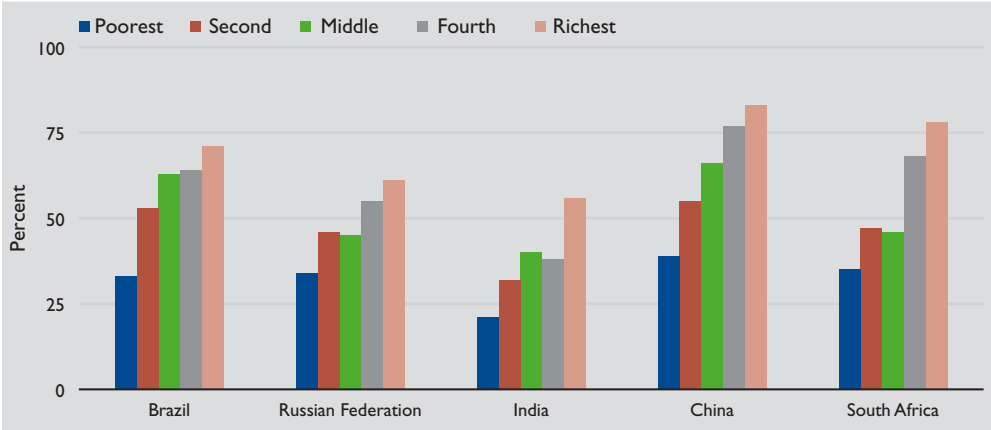
Account penetration in South Africa also varies by individual characteristics, such as income, residence, age, education, and gender. For instance, 94 percent of adults with a tertiary education have a formal account while only 43 percent of those with a primary education or less do. This disparity between education and financial inclusion holds even after controlling for income. Adults ages 25–64 and those residing in urban areas are also more likely to report having a formal bank account. Women are considerably less likely than men to have an account, even after controlling for income. For instance, among the poorest 40 percent of earners,

Figure 2.2 **Financial account penetration in South Africa exhibits considerable disparities, 2011 (percentage of adults with an account at a formal financial institution)**




Source: Demirgüç-Kunt and Klapper forthcoming.

Figure 2.3 **Financial account penetration across income quintiles is more uneven in South Africa than in the other BRICS, 2011 (adults with an account at a formal financial institution)**




Source: Demirgüç-Kunt and Klapper forthcoming.

women are 7 percentage points less likely to have an account than men.

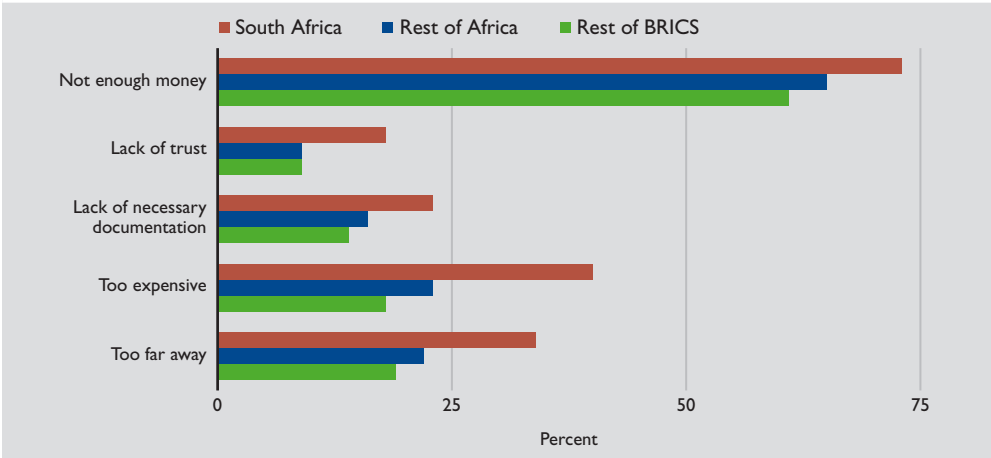
Demand-side data (surveys of users of financial services) suggest that banking costs pose high barriers to people who are unbanked. Global Findex asks the unbanked about perceived barriers to using a bank account. The largest self-reported barrier is a lack of money, which is in line with the proportion of unbanked respondents reporting the same reason in the other BRICS countries and in other African countries (figure 2.4). However, the unbanked in South Africa are almost twice as likely as the unbanked in other African and other BRICS countries to cite high costs as a perceived barrier and considerably more likely to also cite distance, lack of documentation, and low trust.

Along the modes-of-access indicators of financial inclusion, South Africa is more in line with high-income countries than developing countries. The country's access to financial institutions, as measured by bank branch or automated teller machine (ATM) penetration, is better than India's and the rest of Sub-Saharan Africa's but worse than Brazil's (table 2.1). Moreover, ATM use is much higher in South Africa than in the other BRICS countries or the developing world average. In South Africa, 89 percent of account holders use an ATM to withdraw cash, compared with 42 percent in the other BRICS countries and 49 percent in other developing countries. Despite this good showing, the self-reported barriers to access in South Africa suggest the need to establish a more conducive and enabling environment for new delivery mechanisms, particularly in a country with vast geographic segmentation. An example is mobile and retail agent banking, which is more cost effective in servicing



**Along the modes-of-access indicators of financial inclusion, South Africa is more in line with high-income countries than developing countries**

Figure 2.4 **Self-reported barriers to formal account use, 2011 (percentage of unbanked)**




Source: Demirgüç-Kunt and Klapper forthcoming.

Table 2.1 **Bank branch and automated teller machine penetration, 2011**

Per 100,000 adults

| Branch or ATM | South Africa | Brazil | India | Sub-Saharan Africa |
|---|---|---|---|---|
| Commercial bank branches | 10.71 | 46.15 | 10.64 | 4.90 |
| Automated teller machines | 60.01 | 119.63 | 8.90 | 13.47 |

Source: IMF 2012.



**The financial inclusion challenge extends beyond the 12 million unbanked people to millions more who are underbanked**

lower transaction volumes, as in less densely populated rural areas.[12]

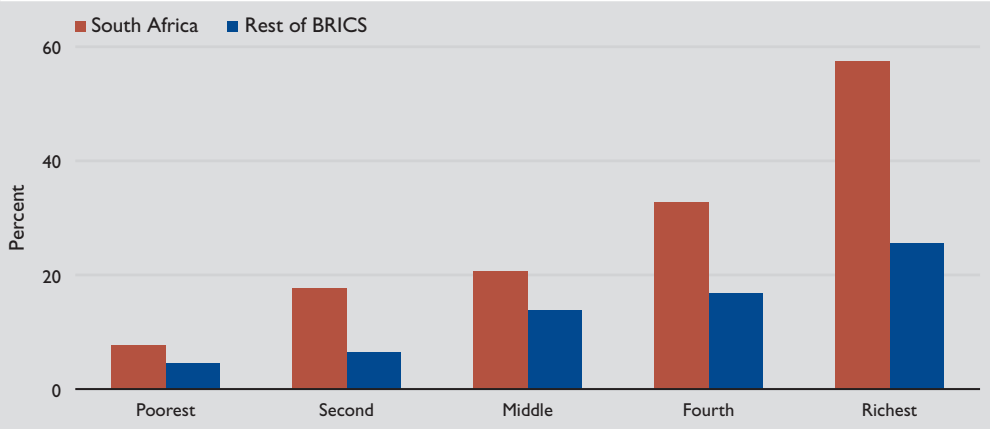
The financial inclusion challenge extends beyond the 12 million unbanked people to millions more who are underbanked—those with a bank account but who do not use it in a meaningful way. Of those with an account, 43 percent said they used it to receive wages and 37 percent to receive government payments, underscoring the success of private and public sector initiatives to increase the use of electronic payments. Yet, in line with the average in other developing countries, only 18 percent of adults reported using their account three or more times a month, which would indicate using an account to manage cash and as an alternative to holding it. Account use also reflects the inequalities evident in account access. While the share of adults who frequently use their accounts is higher in South Africa than in the other BRICS countries at every level of income (figure 2.5), the disparity between the highest and lowest income quintiles is much wider in South Africa. These low use ratios compromise the objectives of faster growth and greater equality and job creation. They also suggest considerable scope for introducing new technologies to make it cheaper and easier for the underbanked to use their accounts for electronic payments.

Overall, 31 percent of South African adults save formally, with a community savings club, or informally, in line with the global average in developing countries and the other BRICS countries (figure 2.6). Informal savings might include assets, such as gold or livestock, or savings kept in the home. Of the sample of adults who reported saving in South Africa, 50 percent said they used a formal account (both exclusively and along with informal savings), higher than in the rest of Africa and the other BRICS countries. South African adults are also more likely to use a mix of formal and informal savings. But formal savings, relative to informal savings only, is again much lower among lower income quintiles.

### Use of credit

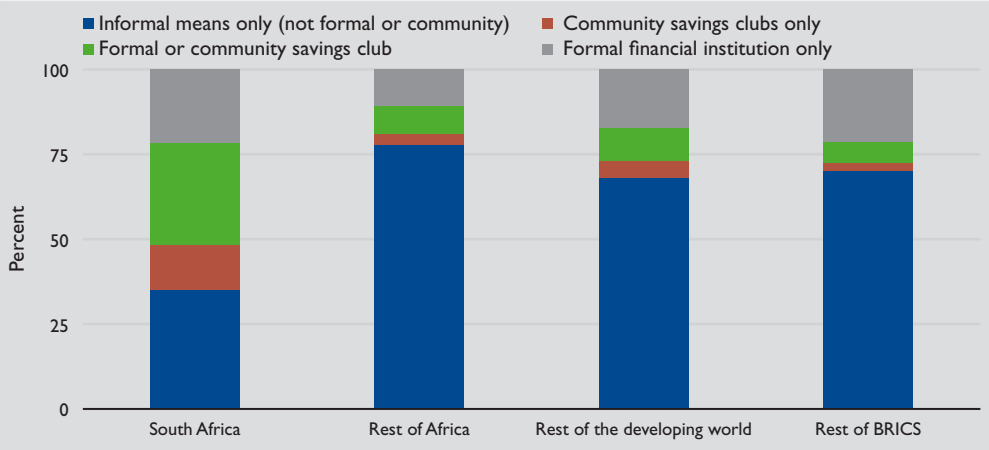
Reliance on informal credit is high in South Africa. At 36 percent, the share of adults with informal credit is much higher than in the other BRICS countries, the rest of Africa, and other developing countries (figure 2.7). Friends and family are the most common

Figure 2.5 **High-frequency use of financial accounts is greater in South Africa, but still low, 2011 (percentage of adults who withdraw money from their accounts three or more times a month)**



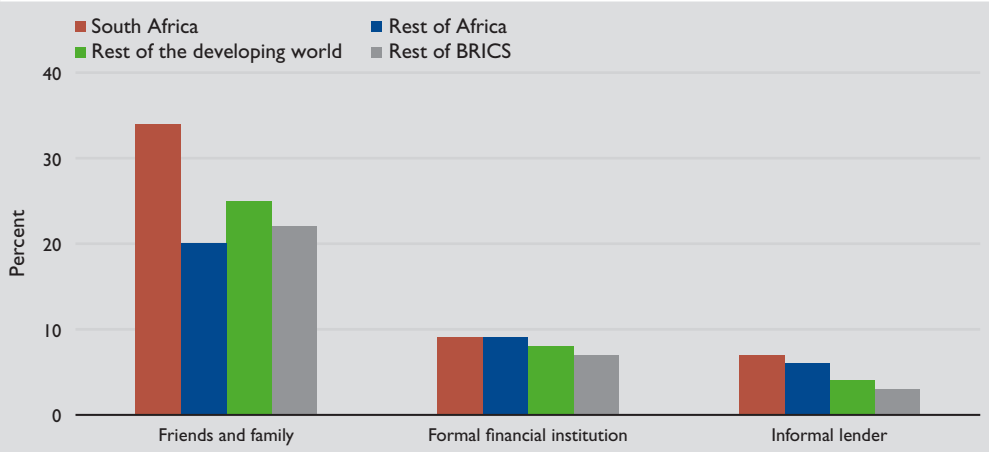

Source: Demirgüç-Kunt and Klapper forthcoming.

Figure 2.6 **Formal and informal savings in South Africa are in line with savings in other developing countries, 2011 (percentage of adults who reported saving any money in the past year)**




Source: Demirgüç-Kunt and Klapper forthcoming.

Figure 2.7 **Informal borrowing is high in South Africa, 2011 (percentage of adults who reported borrowing from formal or informal sources in the past year)**




Source: Demirgüç-Kunt and Klapper forthcoming.

source of informal borrowing in all developing countries. Excluding credit card debt, only 9 percent of adults reported borrowing from a bank, credit union, or microfinance institution in the past year (most likely in the form of salary-based loans), in line with or slightly higher than in other developing countries. Reflecting the rise in consumer hire-purchase lending in South Africa, an additional 11 percent reported borrowing from a store, a higher percentage than in other Sub-Saharan African countries and other BRICS countries.

Access to enterprise credit is limited in South Africa, particularly for small and medium-size enterprises (SMEs).[13] While 98 percent of formal SMEs (registered firms with at least one employee) in South Africa have a bank account—comparable to the share in the other BRICS countries and in high-income countries and higher than in the rest of Africa and the average of all developing countries—less than 25 percent use formal credit,[14] on par with other African and developing countries but well lower than in Brazil (figure 2.8).[15] Access to credit is likely to be lower for sole proprietors and lower still for informally operating firms.

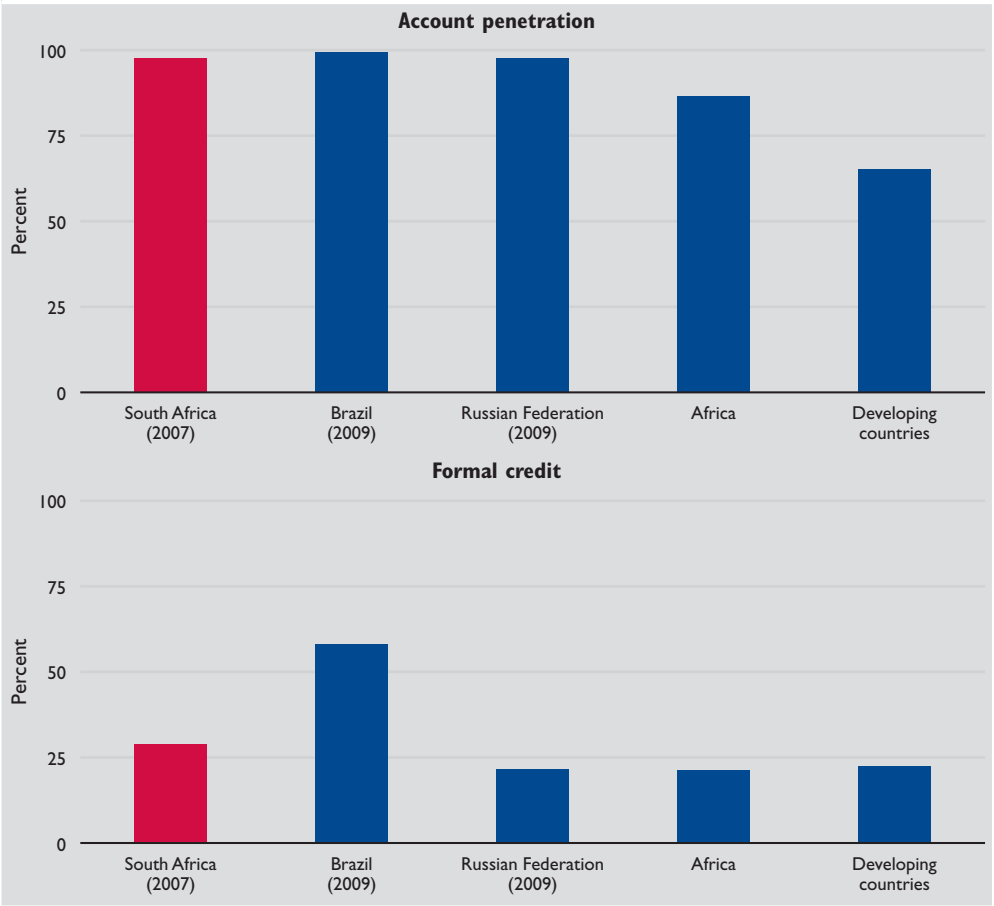
In recent years, banks have developed highly profitable payroll-based lending products that compete in the same market served by the nonbank credit providers. African Bank (offers credit services only), Capitec, and bigger banks now compete in this market. Consequently, "unsecured lending," which uses well-developed and efficient real-time payment technology to use an individual's salary to "secure" the loan, increased 49 percent year over year in 2012q2 (table 2.2). Notably, only a small percentage of



**Access to enterprise credit is limited, particularly for small and medium-size enterprises**

**South Africa faces challenges in financial inclusion, particularly the highly uneven access to and use of financial services and the concentrated ownership structure of the banking sector**

Figure 2.8 **Financial inclusion for small and medium-size firms in South Africa, 2011**




Note: Data for Africa and developing countries include measurement, reporting, and verification.
Source: World Bank Enterprise Surveys.

Table 2.2 **Total outstanding consumer credit balances, 2012q2**

| Credit type | Balance (rand billion) | Share of total (percent) | Growth (year over year, percent) |
|---|---|---|---|
| Mortgage | 814.65 | 59.8 | 5.3 |
| Secured credit | 263.11 | 19.3 | 14.9 |
| Credit facilities | 153.57 | 11.3 | 13.2 |
| Unsecured credit | 131.31 | 9.6 | 49.3 |
| Short-term credit | 0.86 | 0.1 | 14.5 |
| Total | 1,363.48 | 100.0 | 11.1 |

Note: Data are based on quarterly returns from 51 large credit providers representing 95 percent of the consumer credit market. Data might not sum to total because of rounding.
Source: National Credit Regulator of South Africa 2012.

unsecured lending is related to microenterprise lending, which typically relies less on formal collateral and more on cash flow, relationships with customers, and transaction-based lending.

## Unique challenges and opportunities

As evident from the discussion above, beyond the headline figures South Africa still faces considerable challenges in financial inclusion, particularly the highly uneven access to and use of financial services and the concentrated ownership structure of the banking sector.[16] Distance and travel costs also likely play a role, as do policy-induced distortions to incentives—such as interest rate caps on lending and limitations on competition in the retail payment sector.

The South African economy is often described as a "dual economy," with a

developed, high-end economy that resembles that in Organisation for Economic Co-operation and Development countries coexisting with a less developed, low-end economy functioning mostly in townships and informal settlements in urban areas and former homelands in rural areas.[17] The less developed economy consists mostly of informal, small-scale activities similar to the micro- and small enterprise sectors of other Sub-Saharan African countries. The high income inequality generated by this segmented structure[18] is reflected in, among other things, highly unequal access to finance.

The banking sector is much more concentrated in South Africa than in comparator countries (table 2.3), further stifling financial inclusion. The four largest banks (Absa Bank, Standard Bank, First National Bank, and Nedbank), accounting for 84 percent of banking sector assets,[19] have developed into large organizations, with operations and technology systems, compliance structures and procedures, and decisionmaking processes better aligned with the middle-high-income population segments than with the lower income segments. This concentrated ownership structure has distorted the incentives to migrate down market. The push-down market in banking tends to arise over time, as growth opportunities diminish and profitability erodes in the higher income segments. While this transition is occurring in South Africa, the big banks have struggled to meet the needs of potential customers in the low-end economy in a financially viable manner.

Inappropriate cost-allocation processes further impede banks' willingness to serve lower income segments of the population, especially in South Africa's limited competitive financial services markets. If banks treated their high cost structures (for head office, branches, ATMs, system costs) as the fixed costs they really are, they would have room to leverage these existing investments to serve new segments at a fairly low marginal cost. For example, several banks have traditionally allocated head office and other fixed costs to different segments based on the number of customers per segment (or used similar methods) rather than calculating the marginal cost of serving these new segments. The entry of new players, such as Capitec, has demonstrated the potential to challenge the traditional cost and competitive structures.

The cost structure of banks reflects the high concentration in the banking sector. The big banks charge high fees because of complex operations and technology systems that were not designed for simple accounts; the costs of security and cash handling; and relatively high labor costs and organizational complexity, among other reasons. FinWeek conducted a "mystery shopper" exercise in which individuals posing as a hypothetical wealthy South African family earning R800,000 a year inquired about bank fees.[20] The exercise revealed that bank fees fell substantially between 2011 and 2012 (table 2.4), though they remain high in absolute terms.

The highly developed technology infrastructure in the developed, high-end South African economy offers the potential to provide appropriate, affordable, and accessible payment and savings products to the poor in



**Highly developed technology in the developed, high-end economy offers the potential to provide affordable and accessible payment and savings products in the less developed, low-end economy**

**Table 2.3 Bank concentration in South Africa and comparator countries, 2010**

Percent of banking sector assets

| Country | Three largest banks | Five largest banks |
|---|---|---|
| South Africa | 73.1 | 96.6 |
| Brazil | 58.6 | 70.3 |
| Russian Federation | 43.4 | 49.9 |
| India | 30.1 | 39.6 |
| China | 51.3 | 69.3 |
| Kenya | 36.2 | 54.4 |
| Nigeria | 35.6 | 50.0 |
| Sub-Saharan Africa average | 61.3 | 78.5 |

Note: Bank concentration is defined as total assets at the three (or five) largest commercial banks as a share of total commercial banking assets. Total assets include total earning assets, cash and due from banks, foreclosed real estate, fixed assets, goodwill, other intangibles, current tax assets, deferred tax, discontinued operations, and other assets. Data for Brazil and China are for 2009.
Source: World Bank 2012a.

**Table 2.4 Monthly bank charges in South Africa, four largest banks**

| Service | First National Bank 2012 (rand) | First National Bank Change from 2011 (percent) | Standard Bank 2012 (rand) | Standard Bank Change from 2011 (percent) | Absa Bank 2012 (rand) | Absa Bank Change from 2011 (percent) | Nedbank 2012 (rand) | Nedbank Change from 2011 (percent) |
|---|---|---|---|---|---|---|---|---|
| Pay-as-you-go transaction | 375.88 | –15.6 | 482.32 | –38.1 | 530.27 | –25.3 | 595.35 | 3.3 |
| Package | 273.78 | –5.0 | 431.4 | –1.6 | 258.47 | –32.8 | 323 | –1.3 |

Note: Fees quoted to hypothetical wealthy individuals in a FinWeek "mystery shopper" exercise.
Source: FinWeek 2012.



**While new banks have entered slowly, they have demonstrated how greater competition can enhance product choice and reduce customer costs**

the less developed, low-end economy. While the banking sector is considered innovative, most of the innovation is focused on more profitable, higher income segments thought to be less risky or in segments where technology allows the traditional players to lower their risks. Lenders have not yet exploited comprehensive credit information technology (both data and credit scoring) to expand productive microfinance and SME lending or invested in the technologies required to make such lending profitable.

While new banks have entered slowly, they have demonstrated how greater competition can lead to innovations that enhance product choice and reduce customer costs. Consider Capitec Bank, which leveraged profits from its salary-based microlending business to invest in retail banking infrastructure. Presumably, the decision to expand into retail banking was made in part to lower Capitec's cost of funding, but over time the bank has taken an increasing market share from the bigger banks, expanding to more than 4.2 million clients (only 1.1 million of which are loan-only clients) fairly quickly. Nedbank, the smallest of the big four banks, has about 5.6 million retail clients. Perhaps nudged by this competition from Capitec, some of the big four banks have rolled out low-cost branches of their own and introduced similarly low-cost and attractive transactional banking products. The fact that Capitec was competing with a different business model helped drive competition. For example, while the big banks were accustomed to paying lower interest rates on short-term retail deposits, Capitec was used to paying higher medium-term wholesale funding interest rates.

A large number of small, weakly regulated operators have emerged to cater to the less developed economy. These institutions fall into three broad categories: a large number of informal stokvels (rotating savings and credit associations); financial cooperatives, which are smaller than other financial institutions; and nonbank credit providers, including microfinance institutions, which focus mainly on salary-based or payroll lending (table 2.5). Absent in the South African financial service sector are institutions that specialize in leveraging relationships and links to more informal enterprises, such as larger savings and credit cooperatives and deposit-taking microfinance institutions.

Several nonfinancial businesses are moving into financial services, using their outlets as points of service. Large, formal consumer retailers such as Pick n Pay, Shoprite

**Table 2.5 Statistics on smaller financial institutions**

| Type of financial institution | As of | Number of institutions | Total assets (rand millions) | Gross loans and advances (rand millions) | Total deposits (rand millions) |
|---|---|---|---|---|---|
| Banks (commercial/ mutual) | November 2012 | 17/3 | 3,689,000 | 2,770,000 | 2,271,000 |
| Cooperative banks | March 2012 | 2 | 61 | 42 | 56 |
| Nonbank credit providers | December 2010 | ~ 4,200 | 118,183 | na | na |
| Financial services cooperative/ Savings and credit cooperative | March 12 | 104 | 156.5 | na | 131.9 |
| Stokvels | July 2003 | ~ 1,050,000 | 34,622.2 | 543.5 | 33,984.6 |

na is not applicable.
Source: South Africa National Treasury; South African Reserve Bank; Co-operative Banks Development Agency.

Checkers, Woolworths, and Spar have developed into large, sophisticated organizations with extensive distribution footprints and have expanded into financial services. For example, Shoprite Checkers is leveraging its large footprint to offer domestic money transfers (with support from Capitec Bank). Retailers are drawn into providing financial services to attract customers into their stores who will then spend money on other goods and services. Other retailers, such as Spar in partnership with Standard Bank, are following the Shoprite model. Clothing retailers such as Edcon and furniture retailers such as Ellerines have also become very involved in providing credit, building extensive credit books that they later sold to banks.[21]

Recent technological breakthroughs offer new opportunities to narrow the gap in financial inclusion. These include cell phones and the rapid rise in mobile payment services and low-cost point-of-sale devices, which have created new delivery mechanisms for cost-effective outreach.[22] In addition to technological advances, changes in business models (such as the agency banking model), supportive regulatory changes, and increased competition from nontraditional financial service providers offer promise for financial inclusion. For example, the widespread availability of electronic payment technology enabled South Africa to become an early experimenter with pro-poor financial inclusion policies based on electronic payments and cash transfers. In turn, greater financial inclusion shows promise for more efficient delivery mechanisms for social payments, expanding public policy options.

## Enhancing financial inclusion

The financial inclusion initiative is now well entrenched in South Africa, in a process that began with the Financial Sector Charter almost a decade ago (box 2.2). The initiative encouraged financial institutions to engage with a largely neglected segment of the population. Banks have since introduced a range of products targeting this segment, though not yet on scale. Considerable progress was made over 2004–12, with the proportion of banked people rising from 46 percent to 67 percent.[23] In addition, several well-qualified entities are now investing resources in monitoring progress, understanding key issues, and working with the government to advance financial inclusion–focused entities, such as FinMark Trust, the Centre for Inclusive Banking in Africa, and the Centre for Financial Regulation and Inclusion.

### Expanding access for small businesses

South Africa's financial market lacks institutions catering to the lower end of the SME market. Limited access is due largely to the high administrative costs of small-scale lending, the perception that risk is high in lending to smaller enterprises, and small enterprises' lack of collateral and financial records. In addition, the popularity of payroll lending



**Recent technological breakthroughs offer new opportunities to narrow the gap in financial inclusion**

**Box 2.2 The Financial Sector Charter**

The first phase of the Financial Sector Charter, in 2004, targeted basic bank accounts, geographic access to bank infrastructure, housing finance, small and medium-size enterprise finance, agricultural finance, and other aspects of financial inclusion. A major outcome was the Mzansi initiative, designed to make simple, low-cost accounts available to the poor. The charter committed financial institutions to provide 0.2 percent of their after-tax profits to financial education. Phase two of the charter, initiated at the end of 2012, expanded access by going beyond traditional branches and ATMs to include alternative delivery channels that offer predefined services (such as cash out or cash deposit).

Introduction of the Mzansi accounts demonstrated the strong demand among the poor for simple accounts. Product take-up was substantial, with 6 million new accounts and a 10 percent penetration rate within four years. The Mzansi initiative also increased banks' understanding of this market. Today, the four largest banks all offer their own no-frills, simple bank accounts.

However, Mzansi lost money. In-branch origination costs were high, servicing was expensive, and account transactions were very low, perhaps a reflection of banks' inadequate cost accounting systems and limited competition. From a market perspective, banks' commitments to specific targets need to be supplemented by reforms in the institutional and regulatory framework that encourage a broader range of financial service providers to enter the market and apply technological innovations. Reforms need to focus on reducing barriers to entry and unleashing innovative collaboration among financial institutions, retail chains, and mobile operators.

Source: World Bank 2012c; Bankable Frontier Associates 2009.

may be undercutting incentives for financial institutions—both banks and microfinance institutions—to venture into the microenterprise and small and medium-size enterprise (MSME) lending space. Given the large scale of the problem, a few piecemeal changes are unlikely to be effective, because blockages elsewhere might prevent growth. The need is for a sequenced, multipronged strategy.[24]

A strong determinant of banks' involvement with SMEs is the degree of market competition and the amount of innovation introduced by domestic or foreign institutions. Because of higher lending costs for smaller enterprises (due to higher appraisal and monitoring costs), commercial banks are reluctant to venture beyond corporate and retail lending unless driven into new business segments by competition. In Sub-Saharan Africa, competition in the SME market is strongest in Kenya, where many commercial banks contend for different market segments. By contrast, bank concentration in South Africa has inhibited innovation. Best practice in MSME lending is based on decentralized outbound models, not the inbound centralized business models popular among the large commercial banks in South Africa (and elsewhere).

Despite a legal framework that allows the use of movable assets as collateral, South African lenders appear reluctant to do so. Because MSMEs rarely have immovable assets, such as land and property, movable assets are widely used as collateral in international MSME lending. The hesitancy of South African lenders relates to difficulties in realizing interests in movable property, which requires a court process (resulting in substantial delay) or agreement between parties and the lack of a centralized registry for security interests over movable property.[25]

Partial credit guarantees are one way to transfer and diversify risk, by encouraging banks to lend to riskier market segments and thus enabling enterprises with insufficient collateral to acquire loans. This also enables smaller firms to establish a repayment record and credit history, which can reduce the need for collateral. Finally, in extending more loans to smaller businesses, lending institutions gain experience in managing these types of loans, encouraging further development in this market segment. However, the design of partial credit guarantees is crucial to their success (box 2.3).

**South Africa's dearth of microfinance institutions is partly related to the regulatory system**

South Africa's dearth of microfinance institutions is partly related to the regulatory system, which grants licenses only for commercial banks, mutual banks, cooperatives, and nonbank credit providers. A microfinance institution wanting to accept deposits and international equity investments to finance its growth would require a full commercial bank license, with a minimum capital requirement of R250 million, too high for an institution focused on MSME lending. A credit-only license, the same institutional structure used by payroll lenders, is currently the only viable option for microfinance institutions and requires them to access wholesale funding. Regulatory systems in some other countries have found better ways to support the development of this market (box 2.4). The Dedicated Banks Bill, which has been on and off the table for a decade, proposes a suitable

**Box 2.3 The role of partial credit guarantees in expanding lending to smaller firms**

Several factors are crucial in the design of partial credit guarantees, such as size of coverage, designation of the party responsible for assessing credit risk, and criteria for payment of the guarantee in case of loan delinquency. Requiring such schemes to be financially self-sustaining is likely to be inconsistent with the "infant industry" objective of encouraging banks to expand the scope of their credit exposure to microenterprises and small and medium-size enterprises.

Partial credit guarantees can influence both access to financing and performance. For example, a study of the partial credit guarantees of the Fund for Small Businesses in Chile (FOGAPE) found evidence of improved access to credit and enhanced economic activity. FOGAPE is administrated by a government agency and covers loans totaling more than $500 million, with an average coverage ratio of 65 percent. FOGAPE's success stems from a strong regulatory and supervisory system, transparent guarantee allocations (through a sealed bid auction), an extensive publicity campaign explaining the benefits of the program, and training programs to enable commercial bankers to better understand the product. Financial institutions also participate on FOGAPE committees, which engage the banking community.

Source: Fuchs and others 2011; Larraín and Quiroz 2006; Llisterri and others 2006.

**Box 2.4 Supportive microfinance regulations in other countries**

Many developing countries have developed special regulations for deposit-taking microfinance institutions that typically include lower minimum capital requirements than for commercial banks, similar or higher capital adequacy and liquidity ratios, and a tighter provisioning schedule for nonperforming loans, which are typically unsecured.

Kenya introduced a separate deposit-taking license for microfinance institutions in 2008. As of February 2013, eight microfinance institutions were licensed to take deposits from the general public. They are regulated by the Central Bank of Kenya under the Microfinance Act of 2006 and the 2008 regulations. Two types of licenses are offered: one for national microfinance institutions, with a minimum capital requirement of 60 million Kenyan shillings (approximately R6.1 million), and one for community institutions, with a minimum of 20 million Kenyan shillings (approximately R2 million). Regulations are aligned closely with commercial bank regulations, including a capital adequacy ratio of 12 percent and a minimum liquidity ratio of 20 percent. Deposit-taking microfinance institutions are required to hold a higher share of core capital, however—10 percent of risk-weighted assets, compared with 8 percent for commercial banks.

regulatory framework in support of smaller banks that focus on finance for small businesses.

Interest rate caps may also have discouraged financial institutions wanting to lend to MSMEs. Rates are the same for secured and unsecured loans (table 2.6), even though the risk is fundamentally different. In addition, the recent drop in the repo rate has lowered effective interest rate caps. South African stakeholders are therefore considering a floor for maximum interest rates so as to not further discourage lending, especially to MSMEs.

### Expanding access for individuals

Noteworthy initiatives promoting financial inclusion for individuals are using the tiered Know Your Customer (KYC) framework to promote simplified bank accounts and mobile banking, regulating financial cooperatives, expanding use of electronic payment of social grants, improving consumer protection and market conduct, creating a contestable and proportionately regulated payment sector, leveraging the national payment system for financial inclusion, and connecting the less developed economy.

**Several recent initiatives promote financial inclusion for individuals**

#### *Introducing a tiered Know Your Customer framework*

Several innovative schemes have granted exemptions to some of the documentation requirements that have impeded use of formal financial services. The exemptions were designed to facilitate specific market innovations. In preparing to launch the Mzansi initiative in 2004, the Minister of Finance amended Exemption 17 (2004) of the Financial Intelligence Centre Act of 2001, exempting banks from having to verify a customer's address for some lower risk accounts (including a maximum balance of R25,000 and maximum daily and monthly transaction limits of R5,000 and R25,000). This positioned South Africa as a leader in the use of risk-based KYC. In addition, to realize the full benefits of mobile banking, General Notice 6 allows

**Table 2.6 Maximum interest rates on loans**

| Subsector or type of credit | Maximum interest rate (annual percent) 2008 | 2013 | Maximum interest rate formula[a] |
|---|---|---|---|
| Mortgage loan | 31.4 | 16 | RR x 2.2 + 5 percent p.a. |
| Other credit agreements | 36.4 | 21 | RR x 2.2 + 10 percent p.a. |
| Credit facilities | 36.4 | 21 | RR x 2.2 + 10 percent p.a. |
| Unsecured credit transactions | 46.4 | 31 | RR x 2.2 + 20 percent p.a. |
| Short-term credit transactions | 5.0 (monthly) | 5.0 (monthly) | 5 percent a month |
| Developmental credit agreements | 46.4 | 31 | RR x 2.2 + 20 percent p.a. |

Note: *Credit facility* is an overdraft or credit available on a credit card; *unsecured credit* is a credit transaction unsupported (unsecured) by a pledge or other right in property or other form of personal security, such as a personal loan; *short-term credit transaction* is a transaction of R8,000 or less repayable within a maximum of six months, such as a microloan; *developmental credit agreement* is a loan for the development of a small business or unsecured low-income housing.
a. RR is repo rate; p.a. is per annum.
Source: National Credit Act of South Africa 2005.

**South Africa's 15 million social grant payments each month offer an opportunity to use electronic payment systems to promote broader financial inclusion**

for non-face-to-face account opening subject to lower transaction limits on the account (R1,000 per day).[26]

There are some challenges in using these allowances, however. For example, Wizzit, a mobile banking provider, argues that a lack of clarity from regulators on the interpretation and application of the exemption has seriously hampered its progress. Wizzit is not the only nonbank to argue that banks tend to interpret the regulations too cautiously, in part due to harsh penalties for noncompliance.[27] In addition, subsidiaries of foreign-owned banks are still subject to KYC requirements in their home countries, and domestic banks have the discretion to require additional verification.

*Regulating cooperative financial institutions*

The cooperative banking sector, which aims to provide banking services at lower fees, remains insignificant, despite the introduction of the Co-operative Banks Act and associated regulations in 2007. All financial cooperatives with more than R1 million in deposits and 200 members are required to register and be regulated under the act (see annex 1 for details on regulations). While there were 106 cooperative financial institutions with total assets of R217.5 million and 53,240 members at end-February 2012, only 2 were registered and 19 were eligible for registration. Of the cooperative financial institutions assessed during 2011/12, none managed to address the weaknesses noted by the supervisors and were therefore unable to register as cooperative banks.

The National Treasury is introducing amendments to the Cooperatives Bank Act to move the supervisory function from the Co-operative Banks Development Agency (CBDA) to the South African Reserve Bank (SARB). Prudential supervision of financial intermediaries is being concentrated under the SARB. The focus of the CBDA will shift to its new mandate of regulating cooperative financial institutions that operate outside the ambit of the act but in compliance with a new exemption notice.[28] The CBDA will continue to support the cooperative bank network with such initiatives as developing a payments platform for cooperatives, along with an unbranded ("white label") card, to allow cooperatives to access and leverage the banks' ATM networks and offer low-cost withdrawals and payments.

*Expanding use of electronic government payments*

South Africa makes more than 15 million social grant payments to approximately 9.2 million beneficiaries each month, totaling more than R105 billion a year.[29] This offers a tremendous opportunity for the South African Social Security Agency (SASSA) to take advantage of advances in electronic payment systems to promote broader financial inclusion. In 2012, SASSA awarded a contract to Cash Paymaster Services, a subsidiary of Net 1. Net 1, which offers a biometric identification process, has partnered with a small local bank, Grindrod, to offer MasterCard-branded interoperable debit cards to grant recipients.[30] These cards could theoretically be used on the more than 170,000 ATMs and point-of-sale devices in the country,[31] but only once the face-to-face biometric verification has occurred.[32] SASSA account use is reportedly limited and focused on cash withdrawals (see below). There is clearly an opportunity to promote more meaningful financial inclusion for SASSA grant recipients. This would require customer education and a better understanding of customer needs.

*Improving consumer protection and market conduct*

Building trust among the poor, who have been excluded from formal banking, is important for financial inclusion. One way to build that trust is to improve transparency and fairness through consumer protection provisions focusing on bank disclosure requirements and through financial education campaigns. While market conduct regulations have been strengthened, mandates of the National Credit Regulator, the Financial Services Board (FSB), and the National Consumer Commission still overlap, and enforcement remains a major concern. As personal indebtedness has increased, the lack of enforcement has also become cause for concern.

Household debt has become a rising problem in South Africa over the last decade. According to the SARB, debt accounted for some 76 percent of households' disposable income as of 2012q2.[33] In June 2012, the National Credit Regulator reported that

of the 19.6 million credit-active consumers covered by the credit bureaus, 9.22 million (47 percent) had impaired records.[34] The share of consumers with impaired records has been above 45 percent since December 2009, highlighting this as a structural problem on both the supply and demand side. On the supply side, lending appears to be taking place without appropriate consideration of affordability, while on the demand side, low financial literacy seems to be leading to poor financial decisions.

Clarifying the roles and responsibilities for regulating market conduct and assigning regulation to a single regulator, in line with the proposal by the National Treasury, could improve consumer protection and strengthen oversight and enforcement. That proposal envisages expanding the FSB's market conduct role by creating a dedicated banking services market conduct regulator within the FSB that encompasses the National Credit Regulator, in line with plans to separate prudential and market conduct regulation.

The National Treasury has also proposed developing a national financial education strategy with risk-based priorities, an action plan, and clearly assigned responsibilities. A 2011 FSB study found financial literacy levels to be low to moderate, depending largely on education and income in South Africa's dual economy.[35] The FSB has undertaken several financial education initiatives, and many others are under way, but they are not adequately coordinated or monitored for effectiveness, making it difficult to judge their impact. Box 2.5 summarizes experiences with several successful financial education programs in Brazil and South Africa.

*Creating a contestable and proportionately regulated payment sector*

South Africa's national payment system, though world class, is not yet properly leveraged for financial inclusion. Enhancing information flows within the economy could provide the foundation for microsavings, microinsurance, and microenterprise credit and foster the survival of informal businesses (box 2.6). In South Africa, the majority of adults and small firms function in a high-risk, high-cost cash economy largely decoupled from the electronic payment network and the formal economy.[36] Changing this requires more competition in the market for retail payment services. Capacity is not the issue, with the current payment system operating well within its means. Nor is a lack of effort; banks and other service providers are developing innovative payment solutions, though none has achieved adequate scale.

Various retailers, mobile network operators, and other nonbank third parties are interested in offering retail payment services, but they are stifled by regulations that allow market entry only in partnership with a bank.



**South Africa's national payment system, though world class, is not yet properly leveraged for financial inclusion**

**Box 2.5 Successful financial education programs in Brazil and South Africa**

Evidence is growing on what makes a financial education program successful. An evaluation of a pilot three-semester high school–based financial education program in Brazil found that it significantly improved students' financial knowledge, attitudes, and behavior. The pilot program, running over April–December 2011, involved 891 schools in five provinces and reached 26,000 students. The program selected students in their last two years of secondary school because they were closer to becoming economically active and thus closer to making a wider range of financial decisions. It aimed at building skills through exercises relevant for this age group, such as applying for jobs and planning events. The curriculum was designed with a multidisciplinary approach and involved parents, both to support students' learning and to promote behavior change in the household. The program is expected to be rolled out nationally.

Television and radio have been used to deliver financial education messages in South Africa. These interventions have the potential to reach a large audience. One project produced financial capability storylines for inclusion in a popular South African soap opera called "Scandal!". The program aimed at enhancing knowledge, attitudes, and behavior in making sound financial decisions, with a focus on debt management. An impact evaluation showed improvements in content-specific financial knowledge, affinity for formal borrowing, less use of hire-purchase deals, and less gambling—all messages conveyed in the soap opera's storyline. A televised public call to action on seeking financial advice through the National Debt Mediation Association led to a significant upsurge in calls immediately after the messages were aired. However, the effect dissipated over time, suggesting the need for complementary interventions to reinforce the message. Overall, the study shows significant and favorable impacts on financial knowledge and behavior.

Source: Bruhn, Legovini, and Zia 2012; Berg and Zia 2013.

**Retailers, mobile network operators, and other nonbank third parties are interested in offering retail payment services, but they are stifled by regulations**

**Box 2.6 Banco Azteca/Grupo Elektra in Mexico leverages consumer goods retailer information**

In 2002, Mexico's Banco Azteca opened branches in all the stores of its parent company, Grupo Elektra, a large consumer goods retailer. This allowed Banco Azteca to establish 800 branches at once, creating the second largest branch network in Mexico.

Banco Azteca catered to low- and middle-income groups, which had been mostly excluded from commercial banking. Capitalizing on Grupo Elektra's decades of experience in making small installment loans for its merchandise, its rich data, and its well-established information and collection technologies, Banco Azteca was uniquely positioned to target this segment of the population, which it estimated at more than 70 percent of households. Many of these households were part of the informal economy, operating small businesses that lacked the documentation necessary for obtaining bank loans.

An impact evaluation of the expansion of access to finance to low-income individuals suggests that Banco Azteca helped informal business owners keep their business running instead of becoming wage earners or unemployed. As a result of this rise in informal businesses and employment, income rose an average of 7 percent. The impact was more pronounced for individuals with incomes below the median, which was the population targeted by Banco Azteca, and in municipalities that had been underserved by the formal banking sector.

There is no viable tiered licensing framework for nonbank service providers that separates the provision of payment services from banking services. International experience shows that separating payments from other banking business to level the playing field tends to be effective (box 2.7).

Regulatory requirements inhibit entry and innovation in a variety of ways. First, partnering with a bank means an extra party to share the revenue within an already low-margin business. Second, negotiations and logistical collaboration can delay the time to market, raising the cost and diminishing the viability of delivering new financial services. Third, banks, with their traditional business model and focus, are often conservative in interpreting regulations and approaching new market segments. Taken together, these factors discourage innovative new competitors and products. There is a conflict of interest in the bank not wanting to create a competitor to its core business and not wanting to cannibalize margins in its core business. In addition, there is often duplication in the processes of nonbanks and banks that participate in such regulation-induced collaborations. Compliance is a good example: the nonbank invests in compliance only to have the bank disregard the results and re-evaluate the nonbank's approach on its own. Regulation needs instead to support innovation while still reflecting risk. The mechanism needs to be appropriate for the local environment, to encourage

**Box 2.7 Leveling the playing field for payments in the European Union**

The 2009 EU directive on electronic money defines it in a technology-neutral way. The definition covers all situations in which a payment services provider issues a prepaid stored value in exchange for funds to be used for making payments. Therefore, for instance, a reference to "payment institutions" is now read as a reference to an electronic money institution and a reference to a "payment service" as an activity of payment services and issuing electronic money.

Crucially, electronic money institutions can now be involved in distributing electronic money, including selling or reselling electronic money products to the public and providing means of distributing electronic money to customers, including topping-up and redeeming electronic money on the request of customers through agents. However, electronic money institutions are not allowed to pay interest tied to the length of time electronic money is held by the institution.

The conditions for granting authorization to electronic money institutions include prudential requirements that are proportionate to the operational and financial risks faced in the business related to the issuance of electronic money, independent of any other commercial activities carried out by the electronic money institutions. The directive also establishes a proportionate regime for initial capital combined with one for ongoing capital, analogous to the capital requirements for credit institutions (banks), to ensure adequate user protection and the sound and prudent operation of electronic money institutions. Electronic money institutions are also subject to effective rules to prevent money laundering and the financing of terrorism.

The issuance of electronic money is not viewed as a deposit-taking activity related to the business of credit institutions (banking). Electronic money institutions are not allowed to provide credit (loans) from the funds received or held. This preserves the level playing field between electronic money institutions and banks with regard to the issuance of electronic money—to ensure fair completion for the same service among a wider range of institutions for the benefit of users.

Source: Official Journal of the European Union 2009.

competition and to be proportional to the level of risk introduced by the product or service offered and the values involved.

The large mobile network operators and organized retail chains are well placed to offer certain financial products in a cost-effective and competitive manner—not least because of the extensive, and often better positioned, footprint of large retailers and the communication channels and distribution networks of the mobile network operators. It could also be argued that both retailers and mobile network operators have more experience in dealing with lower income retail customers. Analysis by the Consultative Group to Assist the Poor highlights the benefits of branchless banking and how some players are better positioned to offer certain aspects of financial services—retailers to acquire customers and mobile network operators to serve customers more cost-effectively, for example (figure 2.9).

Post offices could be used to provide payment and savings services in more remote areas, if not credit, which requires a skill set (not least in evaluating credit risks) that goes beyond the capacity of post offices. The franchising model used by Banco Postal in Brazil offers a useful model (box 2.8).

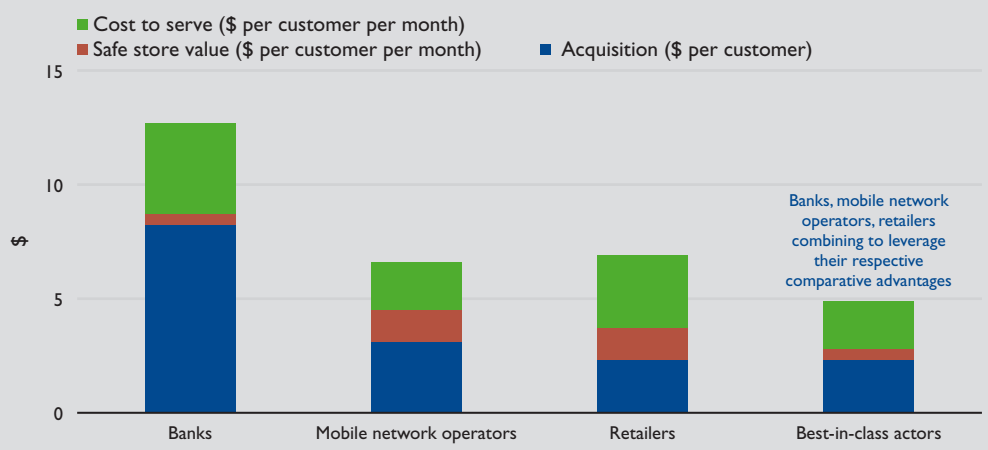
*Leveraging the national payment system for financial inclusion*

The highly uneven use of financial and payment services in South Africa suggests that promoting wider use of the national payment system could exploit complementarities



**The large mobile network operators and organized retail chains are well placed to offer financial products in a cost-effective and competitive manner**

Figure 2.9 **Estimated cost of providing financial services-benefits of branchless banking: banks, mobile network operators, retailers, and a hypothetical initiative leveraging assets of each**




Note: Best-in-class actor is hypothetical and does not incorporate the costs of collaboration, which can vary substantially depending on the relationship between the parties and the engagement model but which needs to be taken into account.
Source: Consultative Group to Assist the Poor estimates of retail, bank, and mobile network operator economics 2011.

Box 2.8 **How post offices can contribute to financial inclusion**

In 2000, a project was launched to establish the Brazilian Post as a banking correspondent (agent), providing basic banking services through its retail network. Bradesco, a private bank, was chosen as the bank partner, providing Brazilian Post with financial sector expertise and investing in the modernization of its network and infrastructure. Bradesco handled the cash logistics. Bradesco benefited from the Post's large network to offer its services in quickly developing rural areas. Banco Postal is not a subsidiary of the Post. Nor is it regulated directly by the central bank, because it does not offer its own services. The partner bank is responsible for all regulatory and compliance issues, while Banco Postal acts as an agent for its financial services partner.

Banco Postal is the most successful postal financial inclusion model in terms of the number of unbanked people eventually entering the formal financial system. Over 2002–11, 10 million accounts were opened in partnership with Bradesco Bank. During the 10 years of partnership, Banco Postal opened more than 6,300 postal bank branches, sometimes in places where there were no banking services at all. In these branches, people could open accounts; make deposits and withdrawals; check account balances; apply for loans; request credit cards; pay bills, invoices, and taxes; and receive government social benefit payments.

On December 31, 2011, Brazil Post ended its first partnership with Bradesco and started a new cycle with Banco do Brasil as the exclusive partner for financial services.

among public policy objectives. According to the Bank for International Settlements, national payment systems can incorporate public policy needs in addition to safety and efficiency, especially for retail payment systems.[37]

The 2008 Banking Enquiry Report questioned the process by which interchange in various payment streams was being set.[38] Following consultation among the Competition Commission, the National Treasury, and the SARB, it was agreed that the SARB would facilitate a review of the determination of interchange in South Africa. This project is well under way, with an auditing firm now developing a cost-based estimate of interchange in various payment streams.

The interchange-determination process gives the SARB an opening to incentivize the behavior of financial institutions, small businesses, and individuals in line with the objective of shifting toward efficient electronic payment to address the segmented use of the national payment infrastructure.[39] Incentives could prioritize broader objectives, such as financial inclusion and use of electronic payment instruments, particularly among underbanked segments of society. There are useful lessons from the experiences of advanced economies in developing broad-based access and from the use of retail payment systems. For example, the Danish central bank, while optimizing system efficiency and security, was equally focused on developing the national payment systems jointly with market participants, lowering transaction costs for services, and emphasizing financial inclusion (box 2.9).

**The low connectivity between the developed, high-end economy and the less developed, low-end economy has affected the spread of financial inclusion from the top down**

*Connecting the low-end, less-developed economy*

The low connectivity between the developed, high-end economy and the less developed, low-end economy has affected the extent (and pace) of the spread of financial inclusion from the top down. Once adopted, technologies with network effects, such as payments, often spread rapidly. The benefits of adopting such network technologies rise exponentially as adoption spreads. The more people and businesses that use electronic payment mechanisms, the more costs fall and penetration increases.

**Box 2.9 The experience of Danmarks Nationalbank with expansion of the national payment system**

According to Danmarks Nationalbank, the Danish central bank, milestones in the evolution of the Danish national payment systems were the result of the emergence of new payment instruments, the establishment of new institutions to channel and process payments, and the development of new rules, procedures, and systems driven by the need to optimize efficiency and security of systems.

The introduction of salary accounts (basic transactional accounts) in the early 1960s generated the need for secure and easy remote access to accounts. Checks emerged as the payment instrument of choice and were in widespread use in Denmark until the mid-1980s. In the late 1960s, Danish banks and savings banks set up a payment systems committee to coordinate initiatives in retail payments and develop joint infrastructure for processing payment transactions. In 1975, the banks established a joint venture, Payment Business Services, to design a national payment card, the Dankort, which was launched in 1983.

Following the Dankort's introduction, the Payment Card Act of 1985 stipulated that card issuers' cost of operating the payment system could not be passed on to the recipients and that the Dankort should be free to use for consumers and retailers. In 1988, Payment Business Services and the Danish bankers association and savings bankers association launched the Visa/Dankort, giving customers a choice between the traditional Dankort and a cobranded Visa/Dankort that could be used both nationally and internationally.

In 1999, an amendment to the Payment Card Act relaxed the prohibition on charging fees for customers' use of the payment card, provided that the following conditions relating to competition, cooperation, and interoperability were met by 2001:

- Multiple banks issued the Dankort.
- Multiple banks acted as acquirers of Dankort transactions.
- Banks did not prohibit retailers from using the same terminals for all payment cards, whether a Dankort or other card.
- Acquirers of Dankort transactions did not prevent the retailers' Dankort terminal from being connected to the terminal of acquirers/operators other than the banks' or Payment Business Services.

From 2005, banks were authorized to charge businesses up to a ceiling fee when Dankort cards were used. Danmarks Nationalbank participates, to a limited extent, in the Danish payment infrastructure on a par with other financial institutions. This applies, for instance, in the settlement of retail payments and securities transactions. The central bank's tasks in this connection do not differ from those performed by any other bank.

Source: Danmarks Nationalbank 2005.

Early adoption by the wealthier, often more technology savvy segments of society is not peculiar to South Africa. However, weak links between the two economies have slowed the spread of electronic payment mechanisms. Kenya's M-Pesa (a mobile-phone based money transfer and microfinance service) was initially highly skewed toward wealthier, already banked individuals, but it quickly spread to the broader population. The share of poor people living outside Nairobi that use M-Pesa grew from 20 percent in 2008 to 72 percent in 2011.[40] While Kenya is unusual in the speed with which M-Pesa spread to poorer segments of the population, its experience highlights the opportunity for South Africa to prioritize alternative, appropriately tailored approaches.

The delivery of social grants is a great opportunity for advancing financial inclusion of lower income population segments. Once the social grant transfer system recently introduced by SASSA has stabilized, ways could be explored to link it with the banking system to bring grant recipients into the formal financial system.

Using social cash transfers to advance financial inclusion has multiple advantages—beyond payments (box 2.10). Achieving that requires a holistic approach that includes improved communication on product features and pricing, along with financial education more broadly. Correcting misperceptions about savings leading to ineligibility for cash transfers is also important, as is developing incentives to promote savings (as is being piloted in Columbia). Encouraging use may also require providers of social grants to develop simpler products that meet the needs of poorer segments of the population.

## What next?

While the first generation of policies embodied in the Financial Sector Charter has achieved considerable success, the authorities recognize the need to do more. The National Development Plan targets an increase in the share of the population with access to transactional banking services and savings facilities from 63 percent in 2011 to 90 percent in 2030.[41] It also highlights areas for prioritization, such as broadening access to banking services, reducing costs through competitive pressures and lower infrastructure costs, and expanding credit for productive investments and working capital, especially for small and expanding firms. The government and the private sector are to work together to boost business lending.

Compared with other developing countries, South Africa was early to commit to policies for financial inclusion, developing a sophisticated financial sector deploying the most advanced technological solutions. This first-world financial sector is highly concentrated—with just four large banks—and services the advanced segment of the South African economy well. But coexisting with this high-end segment of the economy is a severely underserviced developing economy segment similar to those throughout Africa. Even initiatives that have provided this low-end segment with some access to low-cost banking services, such as the low-cost Mzansi accounts, have not lived up to expectations. Although these products have reduced the share of unbanked people, they have



**Although new, low-cost banking products have reduced the share of unbanked people, they have increased the share of underbanked people because of low use of the products for payments and savings**

**Box 2.10 Social cash transfers and financial inclusion**

A study by the Consultative Group to Assist the Poor in four middle-income countries (Brazil, Colombia, Mexico, and South Africa) on early evidence on social cash transfers and financial inclusion found that recipients are unlikely to automatically use their new bank account to do anything other than withdraw their benefits. Realizing the full benefit of these accounts through increased use of payments, savings, credit, and insurance products remained a challenge. However, interviews and focus groups with more than 400 grant recipients revealed the logic behind this limited use. For example, grant recipients are often unaware that these accounts can be used for savings and other purposes. Many recipients are concerned that accruing funds in the account could make them ineligible for future benefits. Confusion and anxiety related to fees also limited use. Finally, the products were designed to meet a basic payment need; little thought had been given to customer's savings needs.

The report notes that the "existence of a mainstream financial account at least creates the potential for recipients to use other financial services (beyond savings) over time, unlike the more limited purpose options."

Source: Bold, Porteous, and Rotman 2012.

**There could be high payoff from introducing a tiered licensing system that opens the market to institutions that can service unbanked and underbanked individuals and small and microenterprises**

increased the percentage of underbanked people because of the very low use for formal payments and savings. And public policy initiatives, such as the tiering of KYC requirements introduced by SARB, suggest a need to re-examine the effectiveness of these and other initiatives in providing affordable and accessible financial products to the poor.

Crucially, South Africa lacks institutions devoted to the financial service needs of the underbanked and unbanked. The stalling of experiments in mobile money and the absence of deposit-taking small and microcredit providers suggest missed opportunities.

Rapid growth in salary-based lending demonstrates the strengths and weaknesses of financial service provision in South Africa. This growth depends on the high percentage of adults who are banked and the high technology security available to banks to secure loan repayments against salary payments. So, although this type of loan is called "unsecured," it is in reality heavily secured. And small and microenterprises have shared in very little of this lending growth. This has raised serious concerns about consumer overindebtedness and loan impairment. On the positive side, the resulting focus on weaknesses in the regulatory structure, particularly governing market conduct (most notably in consumer protection and financial literacy initiatives), and recognition of the need for more streamlined and effective regulation that separates prudential and market conduct regulation are welcome. But the fundamental challenge of developing innovative initiatives that bridge the financial inclusion gap remains unaddressed.

Doing that requires harnessing the comparative advantages of South Africa's developed economy for the benefit of its less developed economy. South Africa is at the forefront of applying advanced technological solutions to financial intermediation, as exemplified by the national payment system and the advanced information exchange provided by credit bureaus.

While the big four banks have made efforts to innovate in servicing the less developed economy, the results have been uneven and halting. This partly reflects the business profile and cost structure of the large, vertically integrated banks and aspects of the regulatory structure, which have not been conducive to inclusion. For example, only banks can provide payment services and collect deposits. While South Africa's big banks do a capable job of servicing the advanced economy, their limited inroads into servicing the less developed economy suggests that there are high opportunity costs in restricting market entry to banks alone.

Global experience shows that less endowed segments of the population are best serviced by specialized institutions with a cost structure and business model adapted to their needs. There could be high payoff from introducing a tiered licensing system that opens the market to institutions that can tailor their services to unbanked and underbanked individuals and small and microenterprises—such as smaller, dedicated banks and financial institutions with restricted licenses that can provide payment services. With government already committed to reform, the time is right to encourage private sector initiatives that can harness technology and design products that will expand financial inclusion and reduce inequality.

## ANNEX I

# Financial institutions and regulatory requirements

| Regulatory status | Type of financial institution | Deposit taking | Credit provision | Prudential requirements: Minimum capital (rand million) | Prudential requirements: Capital–asset ratio (percent) | Prudential requirements: Liquidity ratio (percent) | Law/regulation | Supervision/oversight |
|---|---|---|---|---|---|---|---|---|
| Subject to prudential regulation | Commercial bank | Yes | Yes | 250 | 9.75 | 5 | Banks Act (1990) and regulations | South African Reserve Bank |
| | Mutual bank | Yes | Yes | 10 | 10 | 5 | Mutual Banks Act (1993) and regulations | South African Reserve Bank |
| | Primary savings cooperative bank | Yes (members only) | No | None, but minimum of 200 members and deposits of R1 million | 6 | 10 | Co-operative Banks Act (2007) and regulations | South African Reserve Bank (> R20 million deposits) Co-operative Banks Development Agency (< R20 million deposits) |
| | Primary savings and loans cooperative bank | Yes (members only) | Yes | | 6 | 10 | | |
| | Secondary cooperative bank | Yes (members only) | Yes | | Not yet defined | | | |
| | Tertiary cooperative bank | Yes (members only) | Yes | | | | | |
| Not subject to prudential regulation | Microfinance institution | No | Yes | na | na | na | National Credit Act (2005) | National Credit Regulator |
| | Financial services cooperative/ Savings and credit cooperative | Yes (members only) | Yes | na | na | na | Banks Act Exemption Notice 35368 (2012) | Co-operative Banks Development Agency |
| | Stokvels | Yes (only from members) | Yes (only to members) | na | na | na | | National Stokvel Association of South Africa |

na is not applicable.
Source: Applicable laws and regulations.

# Notes

1. Parts of this section on global economic prospects draws on the Developing Trends report of March 2013 prepared by the Development Economics group of the World Bank.
2. In South Africa, FDI flows were up 41 percent for the first three quarters of 2012 from the same period in 2011, mainly because of a strong recovery (from $812 million in q2 to $2.7 billion in q3).
3. IMF 2013.
4. World Bank 2011.
5. These results are similar to those of Ehlers, Mboji, and Smal (2013), who use an average estimate of four approaches to measuring potential growth to estimate that South Africa's potential GDP growth rate declined from 3.9 percent over 2000–07 to 2.8 percent over 2008–10.
6. The year-average South African Chamber of Commerce and Industry Business Confidence Index fell 6.3 points (from 100.4 to 94.1) in 2012 from 2011. The index average similarly fell 4.2 points in 2013q1 compared with the same time in the previous year.
7. Among policymakers, interest in the potential transformative power of financial inclusion has clearly increased. In international forums, such as the Group of Twenty (G20), financial inclusion has moved up the reform agenda. The G20 recently created the Global Partnership for Financial Inclusion, an inclusive platform for all G20 countries, interested non-G20 countries, and relevant stakeholders to carry forward work on financial inclusion, including the implementation of the Financial Inclusion Action Plan, endorsed at the G20 Summit in South Korea in December 2010. In its most recent public report, the G20 agreed to "take the financial inclusion agenda forward" and to "assist countries, policymakers, and stakeholders in focusing global efforts on measuring and sustainably tracking progress on access to financial services globally." Notably, the Global Partnership for Financial Inclusion Data and Measurement and Small and Medium-Size Enterprise Finance Working Groups are cochaired by South Africa. Further, according to a recent survey of bank regulators across 143 jurisdictions, 67 percent of regulators are charged with promoting financial inclusion (Cihak and others 2012).
8. Insurance and retirement savings are beyond the scope of this Update.
9. Global Findex is the Global Financial Inclusion Database, which includes indicators of financial inclusion for 148 economies (http://go.worldbank.org/1F2V9ZK8C0).
10. FinScope.
11. FinScope.
12. CGAP 2012.
13. See, for example, Beck, Demirgüç-Kunt, and Maksimovic (2005, 2008); Beck and Demirgüç-Kunt (2006); and Beck and others (2006).

14. There is a formal/informal dichotomy at play here; with the access-to-credit problem much more severe among informal sector SMEs. Formal SMEs in South Africa are less likely to report being credit constrained than in other Sub-Saharan African and developing countries globally, according to the 2007 World Bank Enterprise Survey. For instance, while more than 40 percent of South African firms reported crime and theft as a business constraint, only 7.5 percent reported access to finance as a constraint, compared with 45 percent of firms on average in Sub-Saharan Africa and 31 percent globally. This is explained in part by South Africa's relatively highly (vertically) integrated enterprise structure, resulting in high supplier credit and buyer credit (or prefinancing). For instance, 50 percent of SMEs in South Africa reported that they did not need a loan, compared with 40 percent globally.
15. World Bank Enterprise Surveys.
16. Another factor making delivery of financial services more difficult in South Africa is pervasive crime. For example, ATM bombings have become an additional cost for the banking sector, while cash in transit hijackings are not uncommon.
17. As argued by Philip (2010), both ends of the economy are products of the same inequality-breeding superstructure whose roots were planted during apartheid.
18. With an income Gini of .70 (measured in 2010), South Africa has one of the highest recorded levels of inequality in the world (World Bank 2012b).
19. The Banking Association South Africa 2012.
20. Such mystery shopping exercises are particularly useful in revealing differences in user costs across institutions for standard "bundles" of services.
21. Ellerines was acquired by African Bank in 2008 for more than R9 billion (Cairns 2011), while Edcon recently sold its store cards to Absa for approximately R10 billion (Kew and Bonorchis 2012).
22. See, for example, Jack and Suri (2011) on Kenya, where mobile payments now reach more than 68 percent of the population.
23. Finmark Trust 2012. The reported percentage of banked adults in Findex is higher than the percentage reported in the Findex database because of differences in the questionnaire.
24. See Fuchs and others (2011) for further discussion.
25. See World Bank (2012c) for more details.
26. General Notice 6/2008 issued in terms of Section 6(5) of the Banks Act, 1990: Cell-Phone Banking.
27. CGAP 2011.
28. The new exemption notice replaces the previous exemption notices, which stipulate the Small Enterprise Finance Agency and the Savings and Credit Cooperative League as the supervisors of the financial services cooperatives and savings and credit cooperatives, respectively.
29. MasterCard 2012.
30. The MasterCard branding offers functionality (for example, by allowing cards to be used abroad) that is unlikely to be relevant to recipients of social payments and that adds considerably to the cost of the debit cards. As yet, no domestic issuer has issued interoperable cards that were not MasterCard- or Visa-branded.
31. The Banking Association South Africa 2012.
32. The capability for voice verification is currently being developed. Once that is available, recipients should be able to do voice biometric verification from anywhere and therefore not need to visit an SASSA biometric verification point.
33. South African Reserve Bank 2012.
34. National Credit Regulator of South Africa 2012.
35. Having a household budget, typically indicative of a higher awareness of financial management, is strongly correlated with income: 79 percent of households in the richest income quintile reported having household budgets compared with 36 percent in the poorest (Berg and Zia 2013).
36. While approximately 47 percent of small businesses reported having a bank account in 2010, 89 percent reported paying their employees in cash (FinMark Trust 2011).

37. Bank for International Settlements 2005.
38. "Interchange is a mechanism that enables both the issuing bank and the acquiring bank to offer or support a payment product and/or service and ensures that both the paying client and the beneficiary would wish to use the payment product and/or service." Interchange can flow from an acquirer (the merchant's bank) to an issuer (the cardholder's bank) or vice versa. For card transactions at point-of-sale interchange flows from the acquirer to the issuer (card holder's bank), whereas in ATM transactions the fee is paid from the issuing bank to the acquiring bank. (South African Reserve Bank 2011).
39. There are large differences in the fees charged by banks for customers using ATMs within the bank's own network and the fees charged to use other banks' networks. ATM interchange needs to be carefully balanced to encourage the continuing roll out of ATMs while also encouraging rational use.
40. Suri and Jack 2012.
41. National Planning Commission of South Africa 2011.

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