R&I

NEWS RELEASE

Dec 15, 2016

R&I Downgrades to BBB/BBB+, Negative, Affirms a-2: Republic of South Africa

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Republic of South Africa**

Foreign Currency Issuer Rating: BBB, Previously BBB+
Rating Outlook: Negative

Domestic Currency Issuer Rating: BBB+, Previously A-
Rating Outlook: Negative

Foreign Currency Short-term Debts: a-2, Affirmed

RATIONALE:

South Africa still sees anemic economic growth due to both cyclical factors, including the external environment, and structural factors. With some government policies yet to make positive contributions, R&I cannot be optimistic about future economic growth, given the uncertainty over economic conditions in and outside of the country. While the government possesses institutional strengths for ensuring fiscal consolidation, its policy reliability has somewhat waned in a situation where a support from the economy is weak and political implications must be noted more than before. In due consideration of these circumstances, R&I has downgraded the Foreign and Domestic Currency Issuer Ratings for South Africa by one notch each. Because the economy remains vulnerable to swings in financial markets and political risk will persist for the foreseeable future, Negative Rating Outlooks have been assigned. The ratings would come under additional downward pressure if economic growth forecasts continue to be revised down and it becomes more likely that prospects for outstanding debt levels will worsen further.

In the October 2016 Medium Term Budget Policy Statement, the government revised down its forecast for real gross domestic product (GDP) growth for 2016 to 0.5%. While this revision was in part attributable to the contraction in 1Q, a subsequent recovery has also lacked momentum. The effects of special factors such as drought damage will be removed, and some degree of cyclical turnaround can take place in 2017. The rest of recovery depends on whether the government will be able to create a supportive environment for private investment by lifting up business confidence through firm policy execution. That said, in 2017, the governing African National Congress (ANC) will hold a national policy conference and an electoral conference in June and December, respectively. With these major political events in mind, business owners may postpone various decisions to wait and see developments. Because this possibility cannot be ignored, R&I continues to believe that an optimistic view should be avoided.

Amid the fragile economic recovery, the government is still challenged by fiscal management in a dilemma between backing up the economy and committing to fiscal consolidation. If economic growth is stagnant for a protracted period of time, outstanding debt could peak out later than the government envisages. R&I favorably views the government's firm commitment to maintaining fiscal discipline, as suggested by its adherence to nominal expenditure ceilings and a move into a current budget surplus. While interest expense is projected to increase, the government plans to achieve a surplus in the primary balance in the fiscal year ending March 2018. Following the downward revision of the economic outlook, a medium-term deficit reduction target was modified to a more conservative figure.

The current account balance, which was in a deficit of over 5% of GDP on average during the period from 2013 through 2015, is likely to improve modestly. Due in part to imports of materials for infrastructure upgrades, the current account deficit is anticipated to hover around 4% of GDP. On the financing front, the country's highly liquid capital market benefiting from a mature regulatory environment underpins stable funding, though the capital comes mainly through portfolio investment, which is deemed volatile. Given the level of external debt, R&I is not concerned about external liquidity for the immediate future.

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Nevertheless, prospects for emerging countries would remain uncertain. Under such circumstances, a large current account deficit is obviously a negative factor for risk-averse investors. This warrants attention.

The political regime led by the ANC is still unlikely to wobble. Moreover, R&I does not anticipate material changes in the ANC's policy stance. Since President Jacob Zuma took office, however, he has been beset by his alleged corruption scandals, and the reliability of the government's policy management capability has been declining on the whole. This is detrimental to the efficient and effective implementation of national-level policies. In December 2017, the ANC's electoral conference will be held as a once-in-five-years event that will elect a new party leader, the most promising candidate for the next president of South Africa. Even after that, the political situation will remain to be seen until President Zuma finishes his term of office in 2019.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
http://www.r-i.co.jp/eng/cfp/about/methodology/index.html

R&I RATINGS:

ISSUER:	**Republic of South Africa**
	Foreign Currency Issuer Rating
RATING:	**BBB, Previously BBB+**
RATING OUTLOOK:	**Negative**
	Domestic Currency Issuer Rating
RATING:	**BBB+, Previously A-**
RATING OUTLOOK:	**Negative**
	Foreign Currency Short-term Debts
RATING:	**a-2, Affirmed**

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