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Research Update:

South Africa Ratings Affirmed; Outlook Remains Negative

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Overview

- The pace of economic growth remains weak, posing risks to the pace of fiscal consolidation, with rising contingent liabilities, and South Africa's ability to reduce economic inequalities in the medium term.
- South Africa's exchange rate appreciation in the last year, improving agricultural output, and inflation-targeting regime have helped ease inflation back into the central bank's target range, and we view South Africa's monetary flexibility as a strength for the ratings.
- We are affirming our 'BB+/B' foreign currency, 'BBB-/A-3' local currency, and zaAA-/zaA-1 national scale ratings on South Africa.
- The negative outlook on the foreign and local currency ratings reflects our view that political risks will remain elevated this year, which could undermine economic growth and fiscal outcomes more than we currently project.

Rating Action

On June 2, 2017, S&P Global Ratings affirmed its long- and short-term 'BB+/B' foreign currency and 'BBB-/A-3' local currency sovereign credit ratings on the Republic of South Africa. The outlook remains negative.

At the same time, we affirmed the 'zaAA-/zaA-1' South Africa national scale ratings.

Rationale

Our ratings on South Africa are constrained by the weak pace of economic growth and limited fiscal flexibility, with a high stock of government debt. The ratings are supported by the country's high monetary flexibility, which we view as a strength, and an improving external position.

We consider that political risks will remain elevated this year, which could distract from economic growth-enhancing priorities, slow the pace of fiscal consolidation, and weigh on investor and consumer confidence, more than we currently project. Political risks will remain high at least for the remainder of the year, in the run-up to the African National Congress (ANC) elective conference to be held in December 2017. In our view, the policy agenda is at increased risk of being overshadowed by political infighting. We believe the current political environment could result in the private sector delaying business investment decisions, thereby restraining GDP growth. Nevertheless, we believe growth will rebound from the paltry 0.3% of GDP in 2016 to 1% in 2017 and average 1.5% in 2017-2020, thanks to an improvement in agriculture output after a drought and improved terms of trade. Since 2015, South Africa's real per capita GDP growth rate has continued to decline, averaging -0.7% over 2015-2018. We estimate GDP per capita at US$6,000 in 2017.

More broadly, we consider that South Africa faces reduced predictability of future policy responses, due to the moderate risk of challenges to political institutions owing to demands by parts of the population desiring greater economic participation. The socioeconomic dynamics of skewed income distribution, poverty, and high unemployment have the potential, in our view, to shift policy toward intervention and income redistribution, at the cost of headline GDP growth. However, the government is committed to the current conservative economic policy framework rather than an outright interventionist stance. Requests for additional funding for new policy priorities could weaken support for sustainable public finances. That said, we think South Africa has a strong democracy with independent media and reporting. We believe South Africa will continue to maintain checks and balances provided by the judiciary and other independent institutions.

While government ostensibly remains committed to the current fiscal framework and a path of gradual fiscal consolidation, the weak pace of economic growth may result in a shortfall of tax revenues. We believe the government will try to keep expenditures below its targeted expenditure ceiling. In our view, new policy priorities could be covered within the existing budgetary framework to minimize slippages. Overall we see fiscal deficits declining marginally slower than our previous assumptions. We estimate that the change in general government debt will average 4.3% of GDP over 2017-2020.

General government debt net of liquid assets increased to 49% of GDP in 2017 from about 30% in 2010, and we expect it will stabilize at 50% of GDP in the next three years. Although one-tenth of the government's debt stock is denominated in foreign currency, nonresidents hold about 35% of the government's rand-denominated debt, which could make financing costs vulnerable to foreign investor sentiment, exchange rate fluctuations, and rises in developed market interest rates. We project interest expense will remain at about 12% of government revenues over the medium term.

We view contingent liabilities as moderate. We estimate public sector debt at 70% of GDP in 2017. We observe increased risks mainly from nonfinancial public enterprises (NFPEs) with weak balance sheets that require further extraordinary government support. Formal financial support to NFPEs is being provided through equity injections and government guarantees. We expect overall guarantee utilizations will reach South African rand (ZAR) 500 billion (about US$38.5 billion) in 2020, or 10% of 2017 GDP. The utilizations are dominated mainly by Eskom (B+/Negative/--; zaBB-/zaB), which benefits from a government guarantee framework of ZAR350 billion (US$25 billion) or about 7% of 2017 GDP. We estimate Eskom will have used up to ZAR300 billion of this framework by 2020. We think previous plans to improve Eskom's underlying financial position may not be implemented in a comprehensive and timely manner, as it is still addressing its governance issues. Eskom still has to complete its board appointments and appoint a permanent CEO. Broader reforms to state-owned enterprises are still being discussed and we do not foresee implementation in the near term.

We estimate current account deficits will average close to 3.4% of GDP over 2017-2020. The trade balance improved to a small surplus in 2016, which should continue over the forecast. This is thanks to improvement in South Africa's terms of trade, with commodity exports from the mining and manufacturing sectors showing a notable increase over the past year, supporting higher exports. At the same time, lower oil prices and weaker domestic demand have contributed to a reduction in import spending. Oil constitutes about one-fifth of South Africa's imports, and as oil prices gradually recover (see "S&P Global Ratings Raises Its Oil And Natural Gas Prices Assumptions For 2017," published Dec. 14, 2016, on RatingsDirect), we could see the trade balance gradually weakening again.

South Africa's gross external financing needs are large, but declining. They average about 100% of current account receipts (CARs) plus usable reserves, due mainly to short-term external debt of close to 35% of CARs owed by banks and the private sector in 2017. The short-term external debt for banks is predominantly trade finance facilities and deposits from multinational companies. South Africa funds part of its current account deficits with portfolio and other investment flows, which could be volatile. This volatility could stem from global changes in risk appetite, foreign investors reappraising prospective returns in the event of growth or policy slippage in South Africa, or rising interest rates in developed markets.

We consider South Africa's monetary flexibility, and its track record in achieving price stability, to be important credit strengths. South Africa continues to pursue a floating exchange-rate regime. The South African Reserve Bank (SARB; the central bank) does not have exchange-rate targets and does not defend any particular exchange-rate level. The SARB is operationally independent, in our opinion, with transparent and credible policies. The repurchase rate is the bank's most important monetary policy instrument. Currency appreciation, which we estimate at close to 10% in 2017, has helped ease inflation, which fell back below 6% in May 2017. We expect that inflation will remain below 6% this year and remain in the target range of 3%-6% over our three-year forecast horizon.

Outlook

The negative outlook reflects our view that political risks will remain elevated this year, which could distract from economic growth-enhancing priorities, slow the pace of fiscal consolidation, and impact upon investor and consumer confidence, more than we currently project.

If fiscal and macroeconomic performance deteriorates substantially from our baseline forecasts, we could consider lowering the ratings.

We could revise the outlook to stable if we see political risks reduce and economic growth or fiscal outcomes strengthen compared with our base-case projections.

Key Statistics

Table 1

Republic of South Africa Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. ZAR)	3,024	3,254	3,540	3,808	4,050	4,337	4,621	4,958	5,339	5,768
Nominal GDP (bil. US$)	416	396	367	351	317	295	343	348	355	364
GDP per capita (US$000s)	8.1	7.6	6.9	6.5	5.8	5.3	6.0	6.0	6.1	6.1
Real GDP growth	3.3	2.2	2.5	1.7	1.3	0.3	1.0	1.3	1.7	2.0
Real GDP per capita growth	1.7	0.6	0.9	0.1	(0.4)	(1.4)	(0.6)	(0.3)	0.1	0.4
Real investment growth	5.5	2.6	7.2	1.7	2.3	(3.9)	(0.9)	1.5	2.3	2.4
Investment/GDP	19.8	20.2	21.2	21.1	21.1	19.9	19.7	19.7	19.2	18.6
Savings/GDP	17.5	15.1	15.4	15.8	16.7	16.7	16.5	16.3	15.7	15.0
Exports/GDP	30.5	29.7	30.9	31.2	30.4	30.3	30.4	30.9	31.6	32.4
Real exports growth	3.5	0.8	3.6	3.2	3.9	(0.1)	2.7	3.3	3.8	4.5
Unemployment rate	24.7	24.9	24.7	25.1	25.4	26.7	26.9	27.2	27.0	26.8
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(2.2)	(5.1)	(5.9)	(5.3)	(4.4)	(3.3)	(3.2)	(3.4)	(3.6)	(3.6)
Current account balance/CARs	(7.0)	(16.4)	(18.0)	(15.9)	(13.4)	(10.1)	(9.9)	(10.5)	(10.8)	(10.6)
CARs/GDP	31.7	31.2	32.7	33.4	32.8	32.3	32.2	32.6	33.3	34.0
Trade balance/GDP	1.6	(1.1)	(2.1)	(1.7)	(0.9)	0.3	0.3	0.2	0.1	0.1
Net FDI/GDP	1.1	0.4	0.5	(0.5)	(1.3)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)
Net portfolio equity inflow/GDP	(1.3)	0.1	1.3	2.9	3.1	3.1	1.3	1.3	1.3	1.3
Gross external financing needs/CARs plus usable reserves	100.7	104.5	109.6	107.5	110.4	106.2	101.7	102.6	103.2	103.5
Narrow net external debt/CARs	3.7	21.5	19.0	26.6	21.9	18.1	17.8	19.8	21.6	23.0
Net external liabilities/CARs	31.2	42.7	11.1	20.3	(40.4)	(45.8)	(34.1)	(33.2)	(26.9)	(20.3)
Short-term external debt by remaining maturity/CARs	27.1	29.4	37.9	37.2	49.1	47.2	35.3	34.8	33.8	32.6
Usable reserves/CAPs (months)	3.7	4.1	4.3	4.4	5.0	5.2	4.7	4.5	4.3	4.2
Usable reserves (mil. US$)	48,923	50,688	49,696	49,094	45,891	47,187	47,229	47,403	47,580	47,763
FISCAL INDICATORS (%, General government)										
Balance/GDP	(3.7)	(4.2)	(3.8)	(3.5)	(3.5)	(3.5)	(3.4)	(3.0)	(2.8)	(2.7)
Change in debt/GDP	6.5	5.5	6.2	5.6	5.4	5.1	5.3	4.8	3.5	3.7
Primary balance/GDP	(1.1)	(1.5)	(1.0)	(0.5)	(0.3)	(0.2)	0.1	0.6	0.9	1.0
Revenues/GDP	27.9	27.9	28.5	28.9	30.2	29.8	30.4	30.6	30.9	30.6
Expenditures/GDP	31.5	32.1	32.3	32.4	33.7	33.3	33.8	33.6	33.7	33.3
Interest/revenues	9.1	9.7	10.0	10.4	10.5	11.3	11.5	11.9	12.0	12.0
Debt/GDP	39.3	42.0	44.8	47.2	49.9	51.7	53.7	54.9	54.5	54.2
Debt/revenues	141.0	150.5	157.2	163.7	165.2	173.3	176.6	179.5	176.5	177.1
Net debt/GDP	32.7	36.3	39.6	42.3	45.5	46.9	48.7	49.7	50.2	50.2

Table 1

Republic of South Africa Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Liquid assets/GDP	6.6	5.7	5.2	5.0	4.4	4.8	5.0	5.2	4.3	4.0
MONETARY INDICATORS (%)										
CPI growth	5.0	5.7	5.7	6.2	4.5	6.3	5.7	5.4	5.4	5.4
GDP deflator growth	6.5	5.3	6.1	5.8	5.0	6.8	5.5	5.9	5.9	5.9
Exchange rate, year-end (ZAR/US$)	8.1	8.5	10.5	11.6	15.5	13.7	14.3	14.5	15.6	16.1
Banks' claims on resident non-gov't sector growth	5.6	10.6	6.0	9.0	11.0	4.5	6.0	6.5	8.0	8.0
Banks' claims on resident non-gov't sector/GDP	75.6	77.7	75.7	76.7	80.0	78.1	77.7	77.1	77.3	77.3
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	2.8	3.5	3.9	4.6	5.9	5.1	4.8	4.6	4.3	4.4
Real effective exchange rate growth	(2.1)	(5.4)	(10.5)	(6.3)	(0.6)	(7.3)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. ZAR--South African rand. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. N/A--Not applicable. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Republic of South Africa Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Neutral
Economic assessment	Weakness
External assessment	Neutral
Fiscal assessment: flexibility and performance	Weakness
Fiscal assessment: debt burden	Weakness
Monetary assessment	Strength

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - June 01, 2016
- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23, 2014
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18, 2009

Related Research

- Research Update: South Africa Long-Term Foreign Currency Rating Cut To 'BB+' On Political And Institutional Uncertainty; Outlook Negative - April 03, 2017
- Sovereign Ratings History – May 05, 2017
- Credit Trends: 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions – April 18, 2017
- Global Sovereign Rating Trends: First-Quarter 2017 – April 10, 2017
- Sovereign Risk Indicators - April 10, 2017. An interactive version is available at http://www.spratings.com/SRI
- Research Update: South Africa Long-Term Foreign Currency Rating Cut To 'BB+' On Political And Institutional Uncertainty; Outlook Negative - April 03, 2017
- 2016 Annual Sovereign Default Study And Rating Transitions, April 03, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion - February

23, 2017
- S&P Global Ratings Raises Its Oil And Natural Gas Prices Assumptions For 2017 - December 14, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

	Rating	
	To	From
South Africa (Republic of)		
Sovereign Credit Rating		
Foreign Currency	BB+/Negative/B	BB+/Negative/B
Local Currency	BBB-/Negative/A-3	BBB-/Negative/A-3
South Africa National Scale	zaAA-/--/zaA-1	zaAA-/--/zaA-1
Transfer & Convertibility Assessment	BBB	BBB
Senior Unsecured		
Foreign Currency	BB+	BB+
Local Currency [#1]	BBB-	BBB-
Local Currency	BBB-	BBB-

Ratings List Continued...

Local Currency	BBB-	BBB-
South Africa National Scale	zaAA-	zaAA-
Short-Term Debt		
Foreign Currency	B	B
Republic of South Africa Sukuk No. 1 Trust		
Senior Unsecured		
Foreign Currency	BB+	BB+

[#1] Issuer: Development Bank of Southern Africa Ltd., Guarantor: South Africa (Republic of)

Regulatory Disclosures

- Primary Credit Analyst: Gardner Rusike, Associate Director
- Rating Committee Chairperson: Christian Esters
- Date initial rating assigned: Oct. 3, 1994
- Date of previous review: April 3, 2017

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Glossary

- Consumer price index (CPI): Index of prices of a representative set of consumer goods regularly bought by a typical household.
- Current account balance: Exports of goods and services minus imports of the same plus net factor income plus official and private net transfers.
- Current account receipts (CAR): Proceeds from exports of goods and services plus factor income earned by residents from nonresidents plus official and private transfers to residents from nonresidents.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term

foreign currency issuer credit rating on the entity.

- Date of previous review: The date S&P Global Ratings last reviewed the credit rating on the entity.
- Debt burden assessment: Reflects a sovereign's prospective debt level, as indicated by the general government debt relative to GDP (including assessment of contingent liabilities), the interest cost of the debt relative to general government revenue, and debt structure and funding access.
- Depository corporation claims: Claims from resident depository corporations (excluding those of the central bank) on the resident nongovernment sector.
- Economic assessment: Based on the analysis of economic structure and growth prospects. Reflects income levels (GDP per capita), economic growth prospects, and economic diversity and volatility.
- External assessment: Based on the analysis of external liquidity and international investment position as well as the status of a sovereign's currency in international transactions. Reflects a country's ability to obtain funds from abroad necessary to meet its public- and private-sector obligations to nonresidents.
- Fiscal performance and flexibility assessment: Reflects the sustainability of sovereign's fiscal deficits. Based on the prospective change in general government debt, calculated as a percentage of GDP, taking into account long-term trends and a government's fiscal flexibility and vulnerabilities.
- Foreign direct investment (FDI): Direct investment by nonresidents.
- GDP per capita: GDP divided by population.
- General government: Aggregate of the national, regional, and local government sectors, including social security and other defined benefit public-sector pension systems, and excluding intergovernmental transactions.
- General government debt: Debt incurred by national, regional, and local governments and central bank debt.
- General government interest: Interest payments on general government debt.
- General government liquid financial assets: General government deposits in financial institutions (unless the deposits are a source of support to the recipient institution), widely traded securities, plus minority arms-length holdings of incorporated enterprises that are widely traded plus balances of defined-benefit government-run pension plans or social security funds (or stabilization or other freely available funds) that are held in bank deposits, widely traded securities, or other liquid forms.
- Gross domestic product (GDP): Total market value of goods and services produced by resident factors of production.
- Gross external financing needs: Current account payments plus short-term external debt at the end of the prior year, including nonresident deposits at the end of the prior year plus long-term external debt maturing within the year.
- Institutional assessment: An analysis of how a government's institutions and policymaking affect a sovereign's credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks. Reflects the effectiveness, stability, and predictability of the sovereign's policymaking and political institutions; transparency and accountability of institutions, data, and processes; the sovereign's debt payment culture; and security risks.
- Monetary base: Local currency in circulation plus the monetary authority's local currency liabilities to other depository corporations.
- Monetary assessment: The extent to which a sovereign's monetary authority can

fulfil its mandate while supporting sustainable economic growth and attenuating major economic or financial shocks. Based on the analysis of the sovereign's ability to coordinate monetary policy with fiscal and other economic policies to support sustainable economic growth; the credibility of monetary policy, and the effectiveness of market-oriented monetary mechanisms.

- Narrow net external debt: Stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities.
- Net general government debt: General government debt minus general government liquid financial assets.
- Net external liabilities: Total public- and private-sector liabilities to nonresidents minus total external assets.
- Official reserves: Monetary authority liquid claims in foreign currency (including gold) on nonresidents.
- Real GDP per capita: Constant-price per capita GDP.
- Terms of trade: Price of goods exports relative to price of goods imports.
- Usable reserves: Official reserves minus items not readily available for foreign exchange operations and repayment of external debt.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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