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## Research Update:

# Ratings On South Africa Affirmed; Outlook Stable

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## Research Update:

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## Overview

- We expect real GDP growth in South Africa to be limited to 2.1% in 2015, owing to electricity supply shortages among other factors, but we think there will be a slight acceleration to an average of 2.7% per year over 2016-2018 thanks to an increase in electricity generating capacity, domestic consumption, and rising net exports.
- Tax increases, alongside the recent wage settlement for public sector workers, should help limit fiscal risks in 2015-2018, and we expect the treasury to stick to its pledged hard expenditure ceiling.
- Nevertheless, GDP growth remains low, current account deficits still remain relatively high, general government debt sizable, and portfolio flows potentially volatile.
- We are affirming our long- and short-term foreign currency sovereign credit ratings on South Africa at 'BBB-/A-3'.
- The stable outlook reflects our view that a slight improvement in GDP growth in 2015-2018 and ongoing fiscal prudence will help contain South Africa's fiscal and external balances within our expectations.

## Rating Action

On June 12, 2015, Standard & Poor's Ratings Services affirmed its long- and short-term foreign currency sovereign credit ratings on the Republic of South Africa at 'BBB-/A-3'. We also affirmed the 'BBB+/A-2' long- and short-term local currency ratings. The outlooks remain stable.

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

## Rationale

The ratings are supported by our assumption that South Africa will experience continued broad political and institutional stability and policy continuity. We also take into account our view that South Africa will maintain fairly strong and transparent institutions and deep financial markets. Nevertheless, reform efforts remain lackluster, GDP growth low, current-account-deficit financing needs relatively high, general government debt sizable, and external financing flows potentially volatile.

We now expect real GDP growth of 2.1% in 2015, gradually rising to 2.8% by 2017, based on incremental increases in electricity generation capacity, rising consumer demand, and a slight rebound in net exports. However, this follows relatively slow growth of 1.5% in 2014, and it continues to highlight a prolonged period of low growth for a country with per capita GDP of about US\$6,300. The improvement in growth in 2015-2018 will also depend on wage negotiations in the gold and coal sectors, among others, not leading to prolonged strikes. Furthermore, continued shortages of electricity could jeopardize any possible recovery.

Although we expect the South African Treasury to abide by its expenditure ceiling, as detailed in the 2015/16 budget, lower-than-forecast growth and other factors may reduce revenues and obstruct fiscal targets. That said, South Africa's fiscal outturn in 2014/15 broadly held up in line with initial expectations despite lower-than-forecast GDP growth, as, on the revenue side, tax revenue had been underestimated, while expenditure control remained robust. The 2015/16 budget has facilitated higher revenues through a hike in income tax and fuel levy, while continuing to maintain a strict control on expenditures.

General government debt, net of liquid assets, increased to 41% of GDP in 2014 from 22% in 2008, and we expect it to reach 44% by 2017. Although less than 10% 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 vulnerable to foreign investor sentiment.

The ratings are also constrained by the need to fund the country's sizable current account deficits, although these could narrow from 2014 levels in 2015-2018, owing to the fall in global oil prices (oil constitutes about one-fifth of South Africa's imports) as well as a rebound in exports. Although the rand floats and is an actively traded currency (according to the BIS triennial survey of foreign exchange dealing, it is traded in 1.1% of global foreign-exchange contracts), the portfolio and other investment flows that finance these deficits can be volatile. Outflows could result from global changes in risk appetite or from foreign investors reappraising prospective returns in the event of growth or policy slippage in South Africa, or rising interest rates in advanced markets. While capital inflows have largely been maintained--a reappraisal of risk is possible. Slow economic growth and prolonged strikes may heighten both fiscal and external pressures.

While we think that President Jacob Zuma's second administration will continue the policies of his first administration, which controlled fiscal expenditure, it has so far not undertaken key labor market and other economic reforms that are likely to significantly boost GDP growth. However, at the same time, we also do not believe the government, led by the African National Congress (ANC), will pursue radical policies, such as the nationalization of mines.

With 2014 per capita GDP estimated at about \$6,300, South Africa is a middle-income country. We consider its economy to be diverse, yet with wide income disparities. Real per capita GDP growth is forecast to average 1.6% in 2015-2018.

We view South Africa's contingent liabilities as currently limited. Nevertheless, the government has South African rand (ZAR) 350 billion (US\$28 billion)--about 8% of GDP--available in potential guarantees for the state-owned power utility Eskom. Eskom currently uses about ZAR150 billion of these guarantees. Eskom's operating margins have been hurt by low tariffs over many years, although the regulator recently permitted a 13% hike. Eskom's funding needs might affect our contingent liability estimate in the future. Nevertheless, further planned electricity price hikes may help Eskom's finances and mitigate risks.

The long-term local currency sovereign rating on South Africa is two notches above the long-term foreign currency sovereign rating. This is because we believe that the sovereign's flexibility in its own currency is supported by the independent monetary policy of the central bank, the South African Reserve Bank, and a large and active local currency fixed-income market.

## Outlook

The stable outlook reflects our view that a slight improvement in GDP growth in 2015-2018, combined with ongoing fiscal prudence and expenditure control, will help contain South Africa's fiscal and external balances within our expectations.

We could lower the ratings if external imbalances increase, or funding for South Africa's current account or fiscal deficits becomes less readily available. We could also lower the ratings if South Africa's business and investment climate weakens, for instance if labor disputes escalate again or GDP growth weakens significantly; if significant electricity shortages persist; or if political tensions increase.

We could lower the local currency ratings--potentially by more than one notch--if the government's fiscal policy flexibility decreases, particularly if public sector wages, fiscal expenditures, or debt-service costs increase more than we currently expect.

We could raise the ratings if fiscal debt looks likely to rise materially slower than our current expectations and if GDP growth accelerates beyond our current forecasts.

## Key Statistics

Republic of South Africa Selected Indicators											
	2008	2009	2010	2011	2012	2013	2014	2015f	2016f	2017f	2018f
Nominal GDP (bil. US\$)	286.77	295.94	375.35	416.59	397.39	366.06	349.82	337.82	345.84	359.49	375.79
GDP per capita (US\$)	5,705	5,815	7,295	8,019	7,586	6,936	6,572	6,294	6,389	6,585	6,825
Real GDP growth (%)	3.2	(1.5)	3.0	3.2	2.2	2.2	1.5	2.1	2.4	2.8	2.8
Real GDP per capita growth (%)	1.8	(2.7)	1.9	2.2	1.4	1.5	0.7	1.2	1.5	1.9	1.9
Change in general government debt/GDP (%)	2.1	7.1	6.8	6.5	5.5	6.2	4.7	3.3	3.7	3.9	3.7
General government balance/GDP (%)	(1.1)	(6.4)	(4.3)	(3.7)	(4.2)	(3.9)	(3.5)	(3.6)	(3.5)	(3.4)	(3.2)
General government	26.5	32.1	36.0	39.3	41.9	44.8	46.4	46.8	46.9	46.9	46.8

## Republic of South Africa Selected Indicators (cont.)

	2008	2009	2010	2011	2012	2013	2014	2015f	2016f	2017f	2018f
debt/GDP (%)											
Net general government debt/GDP (%)	22.2	26.8	29.9	32.7	36.2	39.6	41.4	42.4	42.8	43.2	43.4
General government interest expenditure/revenues (%)	8.0	8.6	8.7	9.1	9.7	10.0	10.4	10.6	10.6	10.7	10.7
Other dc claims on resident nongovernment sector/GDP (%)	86.1	81.3	78.7	75.6	77.5	75.8	76.9	79.3	82.6	85.7	89.0
CPI growth (%)	11.5	6.7	4.3	5.0	5.6	5.7	6.1	4.9	5.7	5.4	5.4
Gross external financing needs/CARs plus usable reserves (%)	112.5	107.7	98.9	100.5	104.1	109.3	107.8	102.0	103.6	104.1	105.5
Current account balance/GDP (%)	(5.5)	(2.7)	(1.5)	(2.2)	(5.0)	(5.8)	(5.4)	(4.6)	(4.9)	(4.8)	(4.7)
Current account balance/CARs (%)	(14.7)	(9.3)	(5.0)	(6.8)	(15.9)	(17.6)	(16.3)	(13.8)	(14.5)	(13.8)	(13.5)
Narrow net external debt/CARs (%)	1.3	(4.8)	1.4	3.7	21.4	19.0	21.0	27.3	32.3	34.6	39.4
Net external liabilities/CARs (%)	22.1	64.9	84.0	31.2	42.6	11.1	23.7	38.4	51.3	61.8	72.3

Other depository corporations (dc) are financial 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. CARs--Current account receipts. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. f--Standard & Poor's base-case forecast.

## Ratings Score Snapshot

## Republic of South Africa Ratings Score Snapshot

### Key rating factors

Institutional assessment	Neutral
Economic assessment	Neutral
External assessment	Neutral
Fiscal assessment: flexibility and performance	Weakness
Fiscal assessment: debt burden	Neutral
Monetary assessment	Strength

Standard & Poor's 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 Standard & Poor's "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 Standard & Poor's 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

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23, 2014
- General Criteria: Standard & Poor's National And Regional Scale Mapping Tables - September 30, 2014
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18, 2009

### Related Research

- Sovereign Risk Indicators, March 31, 2015. An interactive version is available at [www.spratings.com/SRI](http://www.spratings.com/SRI).
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Default Study: Sovereign Defaults And Rating Transition Data, 2012 Update, March 29, 2013

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 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

	Ratings	
	To	From
South Africa (Republic of)		
Sovereign credit rating		
Foreign Currency	BBB-/Stable/A-3	BBB-/Stable/A-3
Local Currency	BBB+/Stable/A-2	BBB+/Stable/A-2
South Africa National Scale	zaAAA/--/zaA-1	zaAAA/--/zaA-1
Transfer & Convertibility Assessment		
T&C Assessment	BBB+	BBB+
Senior Unsecured		
Foreign Currency	BBB-	BBB-
Local Currency [#1] [#2]	BBB+	BBB+
Local Currency	BBB+	BBB+
Short-Term Debt		
Foreign Currency	A-3	A-3
Republic of South Africa Sukuk No. 1 Trust		
Senior Unsecured		
Foreign Currency	BBB-	BBB-

[#1] Issuer: Transnet SOC Ltd., Guarantor: South Africa (Republic of).

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

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