

# MOODY'S

## RATINGS

### **Rating Action: Moody's Ratings affirms the Ba2 ratings of South Africa; maintains stable outlook**

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03 Dec 2024

New York, December 03, 2024 -- Moody's Ratings (Moody's) has today affirmed the Government of South Africa's long-term local and foreign currency issuer and senior unsecured ratings at Ba2 and maintained the stable outlook.

The Ba2 ratings affirmation reflects South Africa's credit strengths from effective, core institutions such as the judiciary and the central bank, a robust, deep financial sector and a solid external position. However, it also acknowledges chronic challenges posed by the country's extensive inequalities which hamper reform progress and fuel social risk, as well as persistent structural constraints on economic growth, and a relatively high and costly debt. The recently formed government of national unity (GNU) has committed to continue the reform momentum of the previous administration, which began to show progress in the energy sector. However, we anticipate only a modest acceleration in economic growth. In turn, subdued growth complicates the challenge of preserving debt sustainability while meeting social demands and stimulating investments in critical network infrastructure, particularly in the energy and logistics sectors.

The stable outlook reflects our expectations of low economic growth, a stable government debt burden at around 80% of GDP, and balanced risks. We anticipate the GNU will pursue structural reforms, easing growth bottlenecks and supporting a very gradual uptick in growth to close to 2%. The government's fiscal consolidation efforts to mitigate spending pressures from social demands, interest payments and state-owned enterprises will help stabilize the debt burden. Economic and fiscal reforms could yield more significant and immediate impacts than we currently expect. Conversely, they could fall short in efficiency or be reversed. Moreover, government revenues remain vulnerable to a fall in global demand, potentially arising from reduced trade between its two main partners, China and the US.

Additionally, South Africa's country ceilings remain unchanged. The Baa1 local currency country ceiling is positioned four notches above the sovereign rating, reflecting predictable institutions and government actions as well as limited external

imbalances and macroeconomic risks, but also the government's strong footprint on the economy. One notch below, the Baa2 foreign currency country ceiling reflects effective foreign exchange policy and a track record of maintaining an open capital account, indicating that the risk of restrictions on transfer and convertibility in times of stress remains contained.

## RATINGS RATIONALE

### RATIONALE FOR THE AFFIRMATION OF THE RATINGS AT Ba2

#### SOUTH AFRICA'S CORE INSTITUTIONS SUPPORT ITS CREDIT PROFILE

The Ba2 ratings affirmation is underpinned by South Africa's solid institutions, including the long-established judiciary and central bank, as well as recent confirmation of effective operation of legislative and executive bodies through a significant regime change. The smooth formation of the GNU following the May national elections and its commitment to continuing structural reforms indicate a solid legislative and executive framework.

The transition to coalition government marked the end of 30 years of African National Congress (ANC) ruling, with the Democratic Alliance (DA) —a coalition partner in the GNU— bringing valuable policy experience from managing South Africa's most prosperous region, the Western Cape. This experience may enhance policy effectiveness at the national level. The GNU's more inclusive and cooperative approach to governance along with a more pluralistic political climate bodes well for social cohesion. However, addressing the country's structural credit weaknesses will take time and determination, presenting a significant test for the ruling coalition. The submission of the Medium Term Budget Policy Statement only three months after the GNU's formation is a promising sign of the coalition's commitment to its fiscal priorities.

#### ECONOMIC GROWTH PROSPECTS REMAIN SUBDUED DESPITE NEAR-TERM IMPROVEMENTS

The ratings affirmation highlights that, despite some nascent improvements, South Africa's economic growth is likely to remain subdued. We project a gradual increase in real GDP growth to 1.7% in 2025-26 from 1.1% in 2024 driven by domestic demand, less restrictive monetary policy and continued favorable commodity prices. We expect the energy sector to increasingly drive private sector investments. However, this level of growth is unlikely to significantly reduce unemployment or mitigate social pressures. Further private sector involvement across other sectors is likely to be gradual.

Addressing structural economic challenges, particularly in the energy and logistics sectors, remains a slow process, hindered by the significant investment required, primarily from the private sector. The under-investment over the last 15 years,

especially in the network infrastructure will require time to rectify. Stabilizing the energy sector for the long term demands significant investment and maintenance, as illustrated by Eskom Holdings SOC Limited's (B2 stable) recent efforts to stabilize the electricity grid. Additionally, enhancing South Africa's transmission network and developing less carbon-intensive electricity generation methods, will require significant public and private investment. A marked and sustained boost in investment across the economy would be a clear sign of the effectiveness of the government's strategy to increase private sector participation.

## GOVERNMENT MAINTAINS COMMITMENT TO PRESERVE DEBT SUSTAINABILITY AMID PERSISTENT CHALLENGES

The ratings affirmation reflects the government's commitment to fiscal consolidation to preserve debt sustainability, despite significant spending pressures from the state-owned enterprises and social support programs, such as through the national health care reform and public-sector wage reevaluation.

Due to lower revenues and slightly higher expenditures, the government projects its fiscal deficits over the next three years to be 0.3%-0.4% of GDP higher than planned a year ago. Nevertheless, government projections indicate debt stabilization at 75.5% of GDP in fiscal year 2025 (ending on 31st of March 2026). We expect the consolidated government debt-to-GDP ratio, including some government guarantees to state-owned enterprises, to stabilise at around 80% of GDP over the medium term.

After the use of the Gold and Foreign Exchange Contingency Reserve Account settlement worth 1.4% of GDP in fiscal 2024, which reduced gross borrowing requirements for the government, the recourse to this source of funding will be more limited, increasing borrowing levels to 14.4% of GDP in 2025. Despite better market conditions, the government expects debt affordability to worsen slightly due to lower revenues.

## RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects our central expectations for low economic growth and stable government debt burden, with balanced risks.

We expect the GNU will continue to pursue structural reforms to alleviate current growth bottlenecks resulting in a very gradual uptick in growth to around 2% and a stabilization of South Africa's debt burden at around 80% of GDP. Significant structural economic challenges and a weak state-owned enterprises sector further limit growth and employment prospects. We expect the government will continue fiscal consolidation efforts to mitigate spending pressures from social demands, interest payments and state-owned enterprises.

The GNU has the potential to enhance the implementation of structural reforms to alleviate growth bottlenecks, potentially aiding fiscal consolidation efforts. Factors

such as structural reforms, resolving power outages, reducing inflation and borrowing costs, improving the business climate, and increasing investments could lead to higher-than-expected economic growth. Conversely, deep-rooted social and political divisions could hinder reform progress and reintroduce policy uncertainty. Meanwhile, global economic developments, particularly in China —South Africa's leading trade partner, accounting for 11.3% of exports in 2023 — and a potential escalation of trade tensions between the US and China could weaken our growth outlook for South Africa.

## ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

South Africa's ESG Credit Impact Score assessed at CIS-4 means that ESG considerations have a discernible impact on the current rating, which is lower than it would have been if ESG risks were not present. It takes into account the country's high exposure to social risks and moderate exposure to environment risks combined with relatively low resilience as the weak public finances and relatively low income levels constrain its capacity to respond to environmental and social shocks.

South Africa's E-3 issuer profile score reflects moderate exposure to environmental risks mainly driven by carbon transition, water and physical climate risks. The country's moderate exposure to carbon transition risk is driven mainly by the substantial share of hydrocarbons in the energy supply to its economy (+90%) and also the high-carbon intensity of its GDP due to its large industry sector. In addition, South Africa is comparatively more exposed to the social challenges stemming from the energy transition, due to existing social pressures. Also, as much as a quarter of the population are exposed to unsafe drinking water and significant parts of the population periodically face severe droughts. As climate change intensifies, water scarcity is likely to become increasingly constraining, reflected in our assessment of moderate exposure to physical climate change.

South Africa's S-4 high exposure to social risks is driven by a very high exposure to risks related to labour and income and high exposure to risks in health and safety. South Africa has one of the highest levels of income inequality, very high unemployment especially amongst the young.

While governance is broadly in line with other sovereigns and does not pose particular risk (G-2 issuer profile), it is not strong enough to mitigate South Africa's exposure to social and environmental risks. Moreover, the government's high and rising debt burden and low income levels constrain the sovereign's financial capacity to respond to environmental and social risks.

GDP per capita (PPP basis, US\$): 15,424 (2023) (also known as Per Capita Income)

Real GDP growth (% change): 0.7% (2023) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 6.1% (2023)

Gen. Gov. Financial Balance/GDP: -4.9% (2023) (also known as Fiscal Balance)

Current Account Balance/GDP: -1.6% (2023) (also known as External Balance)

External debt/GDP: 43.2% (2023)

Economic resiliency: baa3

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 28 November 2024, a rating committee was called to discuss the rating of the South Africa, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed.

#### FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

We would consider upgrading the ratings if South Africa significantly alleviates the structural constraints on economic activity, strengthening the prospects of robust growth and eventual reduction in government debt. Clear indicators of sustainable improvement in the energy and logistics sectors would also be important markers, indicating higher growth potential and reduced contingent liability risks from the state-owned enterprise sector. Similarly, a significant and sustained increase in the levels of investment in the economy would indicate that the government's strategy to encourage the private sector is proving effective.

We would consider downgrading South Africa's ratings if the country's economic growth prospects further deteriorate from current subdued levels, coupled with a persistent decline in its fiscal strength. This could occur due to setbacks in implementing structural reforms, particularly those aimed at improving the energy and logistics sectors. Such setbacks might result from political divisions and/or instability within the governing coalition, leading to considerable policy uncertainty and impeding the advancement of crucial structural reforms. Signs that the state-owned enterprises sector requires financial assistance far exceeding our current expectations, thereby hindering the government's fiscal consolidation efforts, would also place pressure on the rating.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at <https://ratings.moodys.com/rmc-documents/395819>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit

rating action, if applicable.

The local market analyst for this rating is Aurelien Mali, +971 (423) 795-37.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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