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Research Update:

South Africa Long-Term Foreign Currency Rating Cut To 'BB+' On Political And Institutional Uncertainty; Outlook Negative

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Overview

- In our opinion, the executive changes initiated by President Zuma have put at risk fiscal and growth outcomes.
- We assess that contingent liabilities to the state are rising.
- We are therefore lowering our long-term foreign currency sovereign credit rating on the Republic of South Africa to 'BB+' from 'BBB-' and the long-term local currency rating to 'BBB-' from 'BBB'.
- The negative outlook reflects our view that political risks will remain elevated this year, and that policy shifts are likely, which could undermine fiscal and economic growth outcomes more than we currently project.

Rating Action

On April 3, 2017, S&P Global Ratings lowered the long-term foreign currency sovereign credit rating on the Republic of South Africa to 'BB+' from 'BBB-' and the long-term local currency rating to 'BBB-' from 'BBB'.

We also lowered the short-term foreign currency rating to 'B' from 'A-3' and the short-term local currency rating to 'A-3' from 'A-2'. The outlook on all the long-term ratings is negative.

In addition, we lowered the long-term South Africa national scale rating to 'zaAA-' from 'zaAAA'. We affirmed the short-term national scale rating at 'zaA-1'.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on the Republic of South Africa are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see

"Calendar Of 2017 EMEA Sovereign, Regional, And Local Government Rating Publication Dates

," published Dec. 16, 2016, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation.

In this case, the reasons for the deviation are the heightened political and institutional uncertainties that have arisen from the recent changes in executive leadership. The next scheduled rating publication on the sovereign rating on the Republic of South Africa will be on June 2, 2017.

Rationale

The downgrade reflects our view that the divisions in the ANC-led government that have led to changes in the executive leadership, including the finance minister, have put policy continuity at risk. This has increased the likelihood that economic growth and fiscal outcomes could suffer. The rating action also reflects our view that contingent liabilities to the state, particularly in the energy sector, are on the rise, and that previous plans to improve the underlying financial position of Eskom may not be implemented in a comprehensive and timely manner. In our view, higher risks of budgetary slippage will also put upward pressure on South Africa's cost of capital, further dampening already-modest growth.

Internal government and party divisions could, we believe, delay fiscal and structural reforms, and potentially erode the trust that had been established between business leaders and labor representatives (including in the critical mining sector). An additional risk is that businesses may now choose to withhold investment decisions that would otherwise have supported economic growth. We think that ongoing tensions and the potential for further event risk could weigh on investor confidence and exchange rates, and potentially drive increases in real interest rates.

We have also reassessed South Africa's contingent liabilities. This reflects the increased risk that nonfinancial public enterprises will need further extraordinary government support. We expect guarantee utilizations will reach South African rand (ZAR) 500 billion in 2020, or 10% of 2017 GDP. The utilizations are dominated mainly by Eskom (BB-/Negative/--), which benefits from a government guarantee framework of ZAR350 billion (US$25 billion)--about 7% of 2017 GDP. We estimate Eskom will have used up to ZAR300 billion of this framework by 2020.

South Africa's energy regulator has capped Eskom's permitted 2017/2018 tariff increase at 2.2%--with negative implications for its financial performance. Eskom will fund the resulting revenue gap via borrowings of up to ZAR70 billion, of which up to half may utilize government guarantees. Other state-owned entities that we think still pose a risk to the country's fiscal outlook include national road agency Sanral (not rated), which is reported to have revenue collection challenges with its Gauteng tolling system, and South African Airways (not rated), which may be unable to obtain financing without additional government support. While governance reforms have proceeded at the airline, 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.

South Africa continues to depend on resident and nonresident purchases of rand-denominated local currency debt to finance its fiscal and external deficits. We estimate that the change in general government debt will average 4.2% of GDP over 2017-2020. On a stock basis, general government debt net of liquid assets increased to about 48% of GDP in 2017 from about 30% in 2010, and we expect it will stabilize at just below 50% of GDP in the next three years. Although less than 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 11% of government revenues this year.

South Africa's pace of economic growth remains a ratings weakness. It continues to be negative on a per capita GDP basis. While the government has identified important reforms and supply bottlenecks in South Africa's highly concentrated economy, delivery has been piecemeal in our opinion. The country's longstanding skills shortage and adverse terms of trade also explain poor growth outcomes, as does the corporate sector's current preference to delay private investment, despite high margins and large cash positions.

South Africa's gross external financing needs are large, averaging over 100% of current account receipts (CARs) plus usable reserves. However, they are declining because the current account deficit is narrowing. The trade deficit (surplus in 2016) has seen contraction, but given the small recovery in oil prices (oil constitutes about one-fifth of South Africa's imports) we could see the trade balance weakening again. We could also see weaker domestic demand and a notable increase in exports from the mining and manufacturing sectors, along with a slower pace of increase in imports.

We believe sustained real exports growth is likely to be slow over 2017-2020 because of persistent supply-side constraints to production. Import growth will be compressed amid currency weakness and the subdued domestic economy. Therefore, we estimate current account deficits will average close to 4% of GDP over 2017-2020. However, 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 policy 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. We assess the SARB as being operationally independent, with transparent and credible policies. The repurchase rate is the bank's most important monetary policy instrument. Absent large currency depreciations, we expect that inflation will fall back 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, and that policy shifts are likely which could undermine fiscal and growth outcomes 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 and/or fiscal outcomes strengthen compared to our baseline 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. LC)	3,024	3,254	3,540	3,808	4,050	4,337	4,640	5,001	5,400	5,834
Nominal GDP (bil. $)	416	396	367	351	317	295	344	351	359	369
GDP per capita (000s $)	8.1	7.6	6.9	6.5	5.8	5.3	6.1	6.1	6.1	6.2
Real GDP growth	3.3	2.2	2.5	1.7	1.3	0.3	1.4	1.8	2.0	2.0
Real GDP per capita growth	1.7	0.6	0.9	0.1	(0.4)	(1.4)	(0.2)	0.2	0.4	0.4
Real investment growth	5.5	2.6	7.2	1.7	2.3	(3.9)	1.3	2.0	2.5	2.5
Investment/GDP	19.8	20.2	21.2	21.1	21.1	19.9	20.0	20.4	20.0	19.6
Savings/GDP	17.5	15.1	15.4	15.8	16.7	16.7	16.3	16.5	16.0	15.5
Exports/GDP	30.5	29.7	30.9	31.2	30.4	30.3	30.3	30.6	31.2	32.0
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	26.5	26.3	26.3	26.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(2.2)	(5.1)	(5.9)	(5.3)	(4.4)	(3.3)	(3.7)	(3.9)	(4.0)	(4.0)
Current account balance/CARs	(7.0)	(16.4)	(18.0)	(15.9)	(13.4)	(10.1)	(11.5)	(12.0)	(12.2)	(11.8)
CARs/GDP	31.7	31.2	32.7	33.4	32.8	32.3	32.2	32.6	33.2	34.0
Trade balance/GDP	1.6	(1.1)	(2.1)	(1.7)	(0.9)	0.3	0.0	(0.3)	(0.4)	(0.3)
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	101.9	102.6	103.1	103.6
Narrow net external debt/CARs	3.7	21.5	19.0	26.6	21.9	16.6	16.1	18.0	20.2	21.6
Net external liabilities/CARs	31.2	42.7	11.1	20.3	(40.4)	(49.1)	(36.7)	(35.5)	(29.2)	(23.3)
Short-term external debt by remaining maturity/CARs	27.1	29.4	37.9	37.2	49.1	47.2	35.1	34.5	33.5	32.4
Usable reserves/CAPs (months)	3.7	4.1	4.3	4.4	5.0	5.2	4.7	4.6	4.4	4.2
Usable reserves (mil. $)	48,923	50,688	49,696	49,094	45,891	48,669	49,013	49,364	49,004	49,373
FISCAL INDICATORS (%, General government)										
Balance/GDP	(3.7)	(4.2)	(3.8)	(3.5)	(3.5)	(3.5)	(3.2)	(2.8)	(2.6)	(2.6)
Change in debt/GDP	6.5	5.5	6.2	5.6	5.4	5.0	5.1	4.8	3.4	3.6
Primary balance/GDP	(1.1)	(1.5)	(1.0)	(0.5)	(0.3)	(0.1)	0.3	0.8	1.1	1.0
Revenue/GDP	27.9	27.9	28.5	28.9	30.2	29.9	30.6	30.7	30.9	30.8
Expenditures/GDP	31.5	32.1	32.3	32.4	33.7	33.4	33.8	33.5	33.5	33.4
Interest /revenues	9.1	9.7	10.0	10.4	10.5	11.3	11.4	11.8	11.8	11.7

Table 1

Republic of South Africa Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Debt/GDP	39.3	42.0	44.8	47.2	49.9	51.5	53.3	54.2	53.7	53.3
Debt/Revenue	141.0	150.5	157.2	163.7	165.2	172.3	174.2	176.7	173.7	173.0
Net debt/GDP	32.7	36.3	39.6	42.3	45.5	46.8	48.3	49.0	49.4	49.3
Liquid assets/GDP	6.6	5.7	5.2	5.0	4.4	4.8	5.0	5.2	4.3	3.9
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 (LC/$)	8.1	8.5	10.5	11.6	15.5	13.7	14.2	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	8.0	8.0	8.0	8.0	8.0
Banks' claims on resident non-gov't sector/GDP	75.6	77.7	75.7	76.7	80.0	80.7	81.4	81.6	81.6	81.6
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	4.0	4.0	4.0	4.0
Real effective exchange rate growth	(2.1)	(5.4)	(10.5)	(6.3)	(0.6)	(7.4)	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. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. 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: 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: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- 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

- Sovereign Risk Indicators - Dec. 14, 2016. An interactive version is available at http://www.spratings.com/SRI
- Default, Transition, and Recovery: 2015 Annual Sovereign Default Study And Rating Transitions - May 24, 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 the institutional and debt burden assessments had deteriorated. All other 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	BBB-/Negative/A-3
Local Currency	BBB-/Negative/A-3	BBB/Negative/A-2
South Africa National Scale	zaAA-/--/zaA-1	zaAAA/--/zaA-1
Transfer & Convertibility Assessment	BBB	BBB+
Senior Unsecured		
Foreign Currency [#1]	BB+	BBB-
Foreign Currency	BB+	BBB-
Local Currency [#2]	BBB-	BBB
Local Currency [#1]	BBB-	BBB
Local Currency	BBB-	BBB
Short-Term Debt		
Foreign Currency	B	A-3
Republic of South Africa Sukuk No. 1 Trust		
Senior Unsecured		
Foreign Currency	BB+	BBB-

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

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

Regulatory Disclosures

- Primary Credit Analyst: Gardner Rusike, Associate Director
- Rating Committee Chairperson: Moritz Kraemer
- Date initial rating assigned: Oct. 3, 1994
- Date of previous review: Dec. 2, 2016

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: 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.