SOVEREIGN
AFRICA RATINGS

REPUBLIC OF SOUTH AFRICA

SOVEREIGN CREDIT RATING

22 December 2023

RATING ACTION

Sovereign Africa Ratings (SAR) affirmed its 'BBB' long-term and 'B+' short-term issuer credit ratings on the South African government. The outlook on the local currency ratings is stable while foreign currency ratings are assigned a negative outlook.

Date	Rating Category	Rating	Outlook
Foreign Currency Ratings:			
22 December 2023	Long term	BBB	Negative
22 December 2023	Short term	B	Negative
Local Currency Ratings:			
22 December 2023	Long term	BBB	Stable
22 December 2023	Short term	B	Stable

RATING RATIONALE

The ratings and outlook are indicative of SAR's evaluation of South Africa's economic outlook. We affirmed the ratings on the Republic of South Africa because we expect the National Treasury to stabilise the public purse, pursuing a fiscal policy that is supportive of stabilising debt and fast-rising debt-service costs, and cost containment that has been tabled for the next two fiscal years. The National Treasury is also focusing on improving the efficiency of public resource spending.

The rationale for the stable outlook on local currency ratings is attributed to SAR's anticipation of no significant changes in the government's ability to raise rand denominated debt. In assigning the negative outlook on the foreign currency ratings, the rationale is predicated on SAR's view of elevated risk on trade given the amount of foreign exchange reserves that could be drained if the National Treasury utilises these funds to cover fiscal expenses such as public sector wages. SAR also views the high levels of Government Debt to GDP ratios as well as increased government debt as high risks for South Africa's ability to borrow in international markets. SAR, however, considers the low levels of risk in terms of the vulnerability of the SA banking system to sovereign debt problems. It is therefore SAR's assertion that South Africa is characterised by a higher relative creditworthiness of sovereign debt in local currency.

The ratings are supported by our view that South Africa will experience continued economic, political, and institutional stability and policy continuity despite the prospects of a coalition government post-2024 national elections. We also consider that South Africa will maintain resilience despite headwinds tied to low GDP growth, a current account deficit, sizeable general government debt, electricity shortages, transport and port infrastructure constraints, weaker rand exchange rate, elevated global goods prices, and geopolitical factors.

In the medium term, the National Treasury will be unlocking investment in infrastructure to stimulate economic growth. The Medium-Term Budget Policy Statement (MTBPS) emphasises the commitment of the government to enhance infrastructure delivery. This includes bringing in more private-sector financing for larger projects through the implementation of recommendations as per the public-private partnership framework (PPP). SAR notes the National Treasury's commitment to continued progress on structural economic reforms in the electricity and logistics sectors. The economic costs of failure and inefficiency in these sectors have mounted over the past year, in part due to the lack of investment in deteriorating infrastructure. SAR does not view exchange rate movements as the main driver of sovereign debt risk nor considers changes in exchange rates as having the ability to create sovereign debt crises in South Africa due to the debt structure, which mainly consists of local currency-denominated debt. However, in the short term, the local currency could be impacted if the government's fiscal policy flexibility diminishes, particularly if public sector wages, fiscal expenditures related to electioneering season, inefficient expenditure related to implementing the NHI Fund, or debt-service costs increase more than the current thresholds.

The credit challenges will be escalated if public finances weaken further. SAR will monitor any increase in the budget deficit, especially amid lower tax revenue collection. Gross debt is expected to rise and stabilise at a high of 77.7% of GDP.

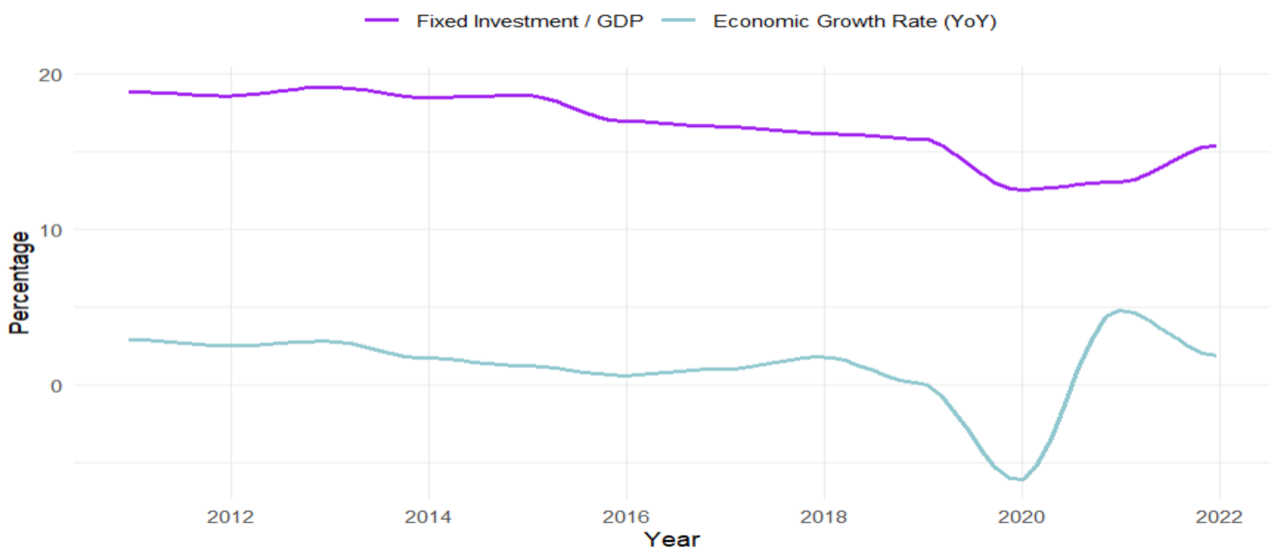
SAR also views the financial position of the state as moderately strong, noting the South African Reserve Bank’s high levels of preceding reserves and strong liquidity position. This is viewed as a credit positive for the South African economy. The country’s large external asset position, low levels of foreign currency debt, diversified economy, sophisticated financial system, and flexible exchange rate regime are sources of strength, supported by the South African Reserve Bank’s (SARB) pro-active monetary policy that has kept inflation expectations anchored, are regarded as credit positive.

Shortages of electricity supply, logistics and other infrastructure constraints, high levels of corruption (energy and construction mafias in particular) and sluggish economic growth have impacted South Africa’s fiscal position. The economy’s medium-term outlook remains subdued. The South African economy has been weakened by electricity supply interruptions; rail, ports, and other infrastructure constraints coupled with the challenges of geopolitical factors, weak currency performance, and an uncertain global environment have impacted South Africa’s public finances unfavourably.

South Africa’s National Planning Commission, in its recent review report of September 2023, assessed the progress made over the past ten years in terms of the National Development Plan (NDP) that was set in motion in 2012. The latest numbers suggest an unsatisfactory result with no main target within reach. Factors like COVID-19, infrastructure challenges, and the Russian/Ukraine conflict hampered NDP objectives, while inefficiencies in controls for the effective implementation of economic policies hampered economic growth.

Goals set for 2030 such as economic growth, a lower rate of unemployment, fixed investment at 30% of GDP by 2030, and the reduction of inequality are far below target. With the poor levels of fixed investment, a critical element of the production function (presently around 17% of a much-reduced GDP level), the original goals set by the NDP were not achieved. See Figure 1.

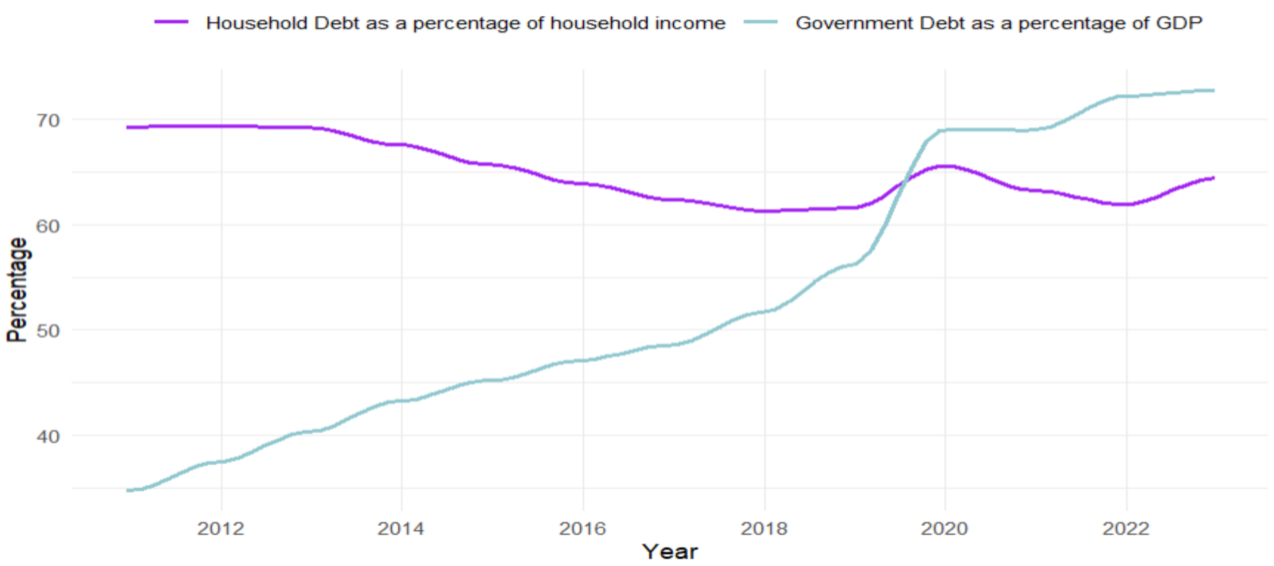
Figure 1: Economic Growth and Investment, 2011 - 2023



Source: SAR's calculations based on StatsSA data.

South Africa's National Treasury revised the country's growth outlook from 0.9% for 2023 to 0.8%. Similarly, the growth outlook for the coming years has been adjusted from 1.5% in 2024 to 1% and from 1.8% in 2025 to 1.6%; it is expected to average 1.4% over the period 2024 to 2026. This is far below the economic growth projections of emerging and developing economies as projected by the International Monetary Fund. This is also driven to some extent by lower household expenditure. Households continue to struggle with finances in an environment of high interest rates and elevated inflation – especially that of food and fuel – the impact of loadshedding on the cost of living, lower real disposable income, and higher household debt. See Figure 2.

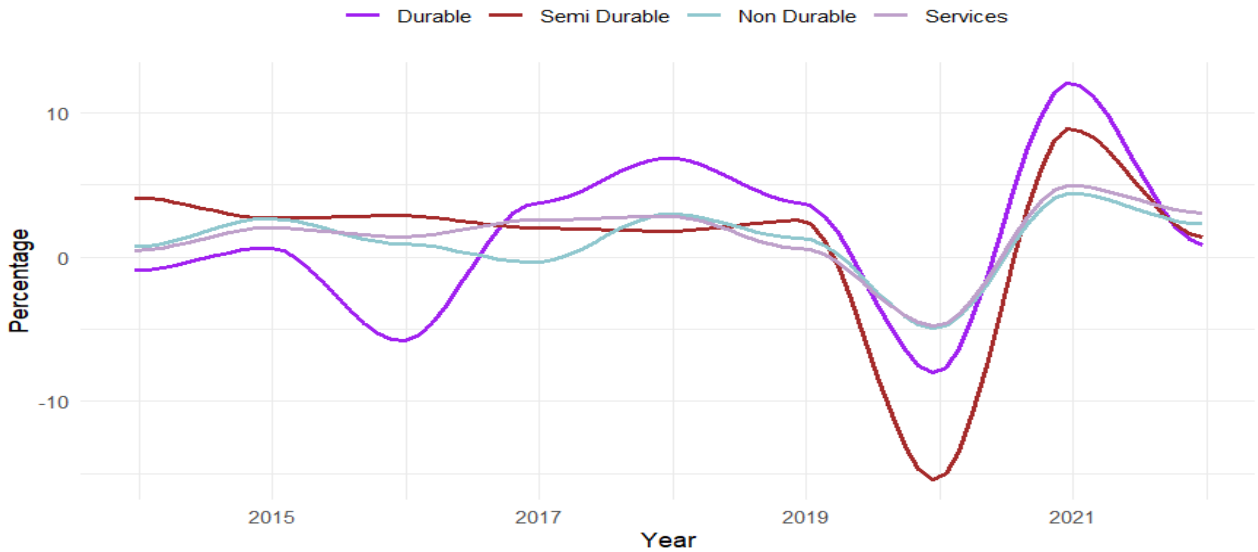
Figure 2: Government and Household Debt, 2010-2023



Source: SAR's calculations based on SARB data.

The financial pressure remains despite reducing expenditures in the first and second quarters of 2023. All categories of household expenditure have been affected, with non-durables taking the hardest hit (See Figure 3).

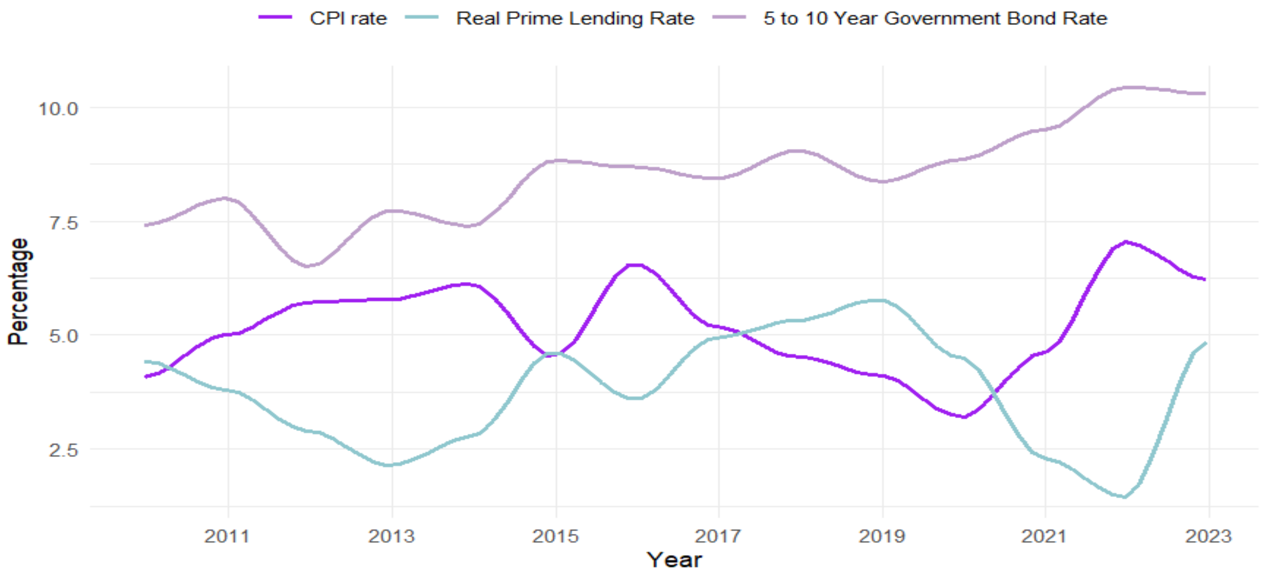
Figure 3: Change in Private Consumption Expenditure, 2014-2022



Source: SAR's calculations based on SARB data.

The economic performance outlook, and thus employment creation, remains gloomy. The expectation is that the economy will continue a subdued trend, consumer price inflation will remain at somewhat lower levels, unemployment to remain high, and household finances will remain vulnerable to interest rates. See Figure 4.

Figure 4: Consumer Inflation and Interest Rate, 2010-2023



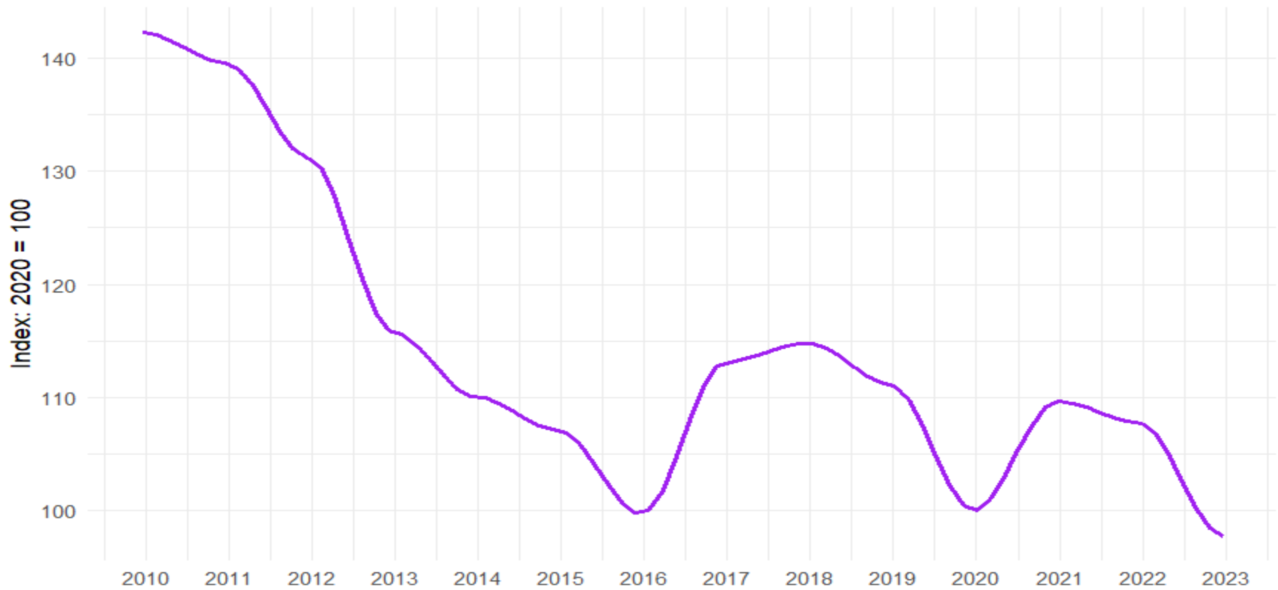
Source: SAR's calculations based on SARB data.

The South African economy realized a negative and declining output in terms of real GDP growth in the third quarter of 2023. The most recent data indicate that the economy contracted by 0.7% y/y in the third quarter versus 2022. In the first three quarters of 2023 compared to the corresponding period of 2022, the economy grew by 0.3% y/y. This falls short of expected growth for 2023 by the National Treasury, the SA Reserve Bank, private sector economist forecasts hosted by the Bureau of Market Research, and forecasts by the International Monetary Fund.

The effect of subdued growth in major employment-intensive sectors like manufacturing, construction, and agriculture in the third quarter of 2023 is a serious concern when considering the high unemployment rate in South Africa. Growth is further curtailed by insufficient real fixed investment driven by low investor confidence and inhibited real household demand mainly caused by unsustainable unemployment and debt servicing. The most worrying factor is the lack of adequate levels of fixed investment. Capital outflow due to negative international political and economic relations and subdued local economic performance remains a cause for concern.

The external competitiveness of the South African economy is represented by the movements in terms of the real effective exchange rate from 2010 to 2023 (See Figure 5).

Figure 5: The real effective exchange rate for South Africa, 2010-2023



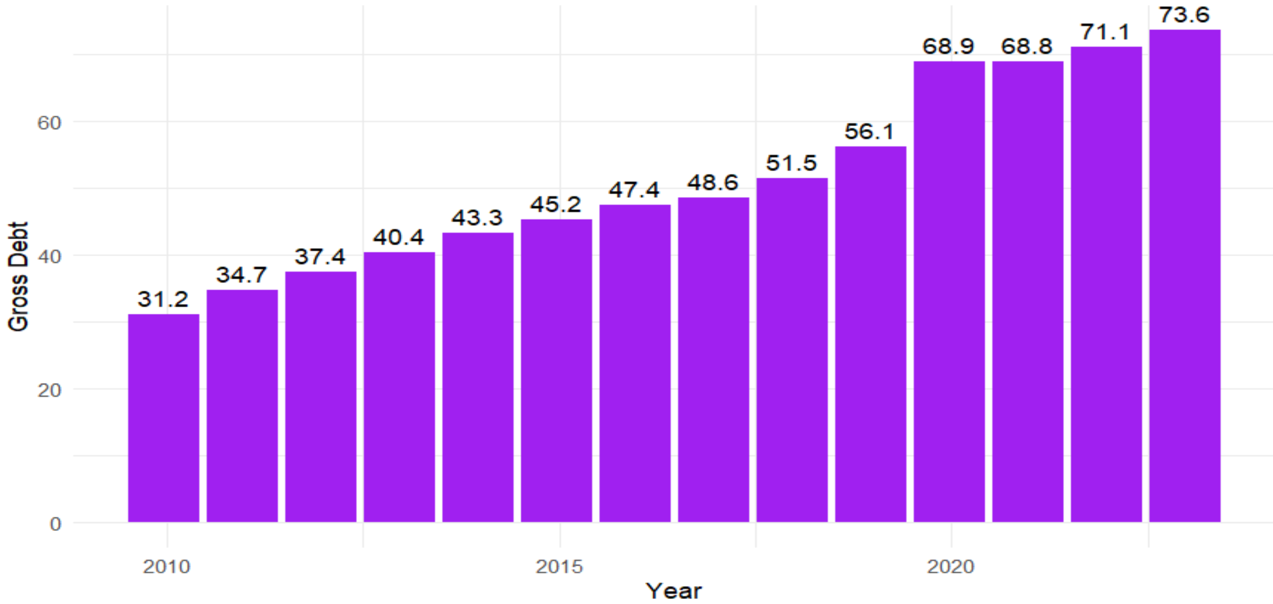
Source: SAR's calculations based on IMF data.

A decrease in South Africa's real effective exchange rate from 2010 to 2016 and from 2022 to 2023 is an indication that its exports are becoming cheaper, and its imports are becoming expensive. These events result in imported inflationary pressure which affects the country's citizens. On the other hand, this is regarded as a credit positive in relation to trade competitiveness.

DEBT PROFILE

South Africa currently faces a debt-to-GDP ratio of 73.6%, amounting to approximately R5 trillion in nominal terms. The fiscal deficit for the year is projected to be around 6% of GDP, leading to a deficit of R143.8 billion in July 2023. The country's debt has sharply risen over the years, growing from R500 billion in 2006 to R4.7 trillion in 2022, and is expected to approach R6 trillion by 2025. While South Africa's foreign currency-denominated debt is low, high debt-service costs, accounting for 20% of tax revenue, hinder crucial investments in sectors like infrastructure, healthcare, and education. Despite the ability to repay current bonds and a limited number of debt crisis symptoms, there is a crucial need for economic strengthening, fiscal consolidation, and growth-enhancing reforms to ensure long-term debt sustainability.

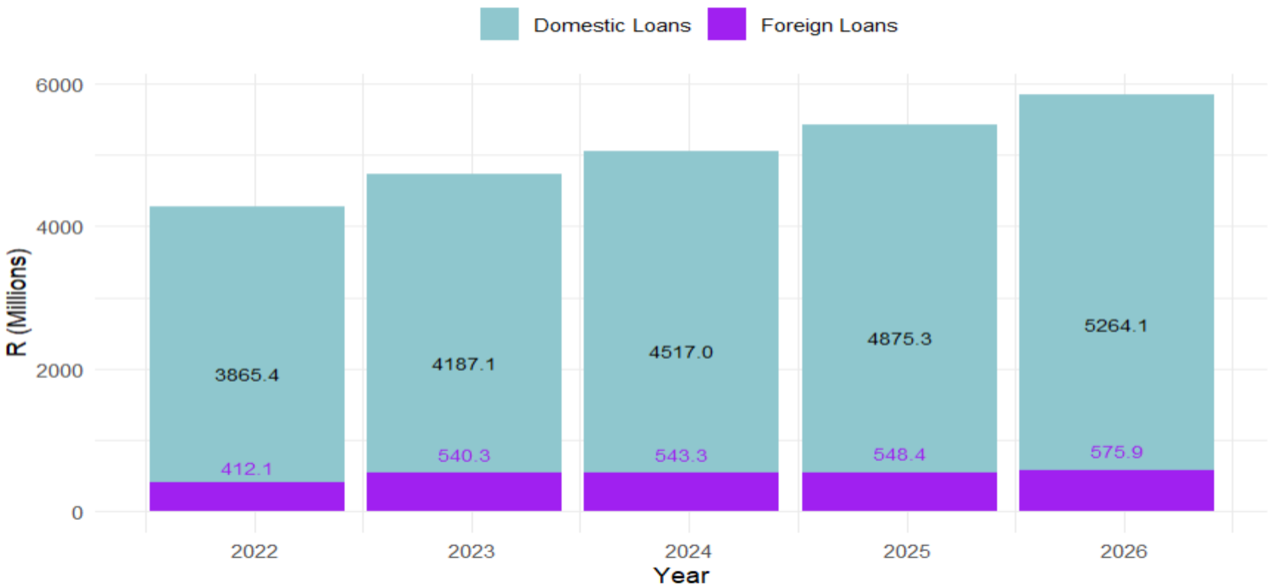
Figure 6: General Government Gross Debt as a Percentage of GDP, 2010-2023



Source: SAR's calculations based on IMF data.

South Africa's debt composition consists mainly of domestic debt (nearly 80%), primarily denominated in rand with extended maturities, reducing vulnerability to interest rate and currency risks. Although the country can currently meet bond repayments and lacks significant signs of a debt crisis, addressing issues such as fiscal consolidation, governance improvements in state-owned entities (SOEs), and implementing growth-focused structural reforms is imperative. The government relies heavily on long-term bonds for borrowing, with foreign investors being the largest holders of domestic government bonds, while insurers, pension funds, and monetary institutions hold the remainder. The distribution of national government debt reveals that domestic loans constitute approximately 89.6%, with foreign loans making up the remaining 10.4%.

Figure 7: Distribution and Stock of National Government Debt



Source: SAR's calculations based on National Treasury data.

KEY RATING INDICATORS

Indicator	2019	2020	2021	2022	2023 (f)	2024 (f)
GDP growth rate (%)	-6.34	4.91	2.04	1.70	1.90	2.00
GDP per capita (USD) nominal prices	5661.0	6965.2	6694.4	6423.5	6152.6	5881.8
Current account balance as a percentage of GDP (%)	2.0	3.7	-0.4	1.4	2.7	3.6
General government revenue (% of GDP)	23.3	25.9	24.7	25.4	25.3	25.3
Contingent liabilities (% of GDP)	1.04	3.21	3.18	2.38	2.63	2.90
Inflation rate (%)	3.2	4.6	7.0	4.8	4.6	4.6
Foreign currency reserves (% of total external debt)	0.021	0.021	0.022	0.019	0.018	0.016

RATING DISCUSSION

Economic Strength Pillar

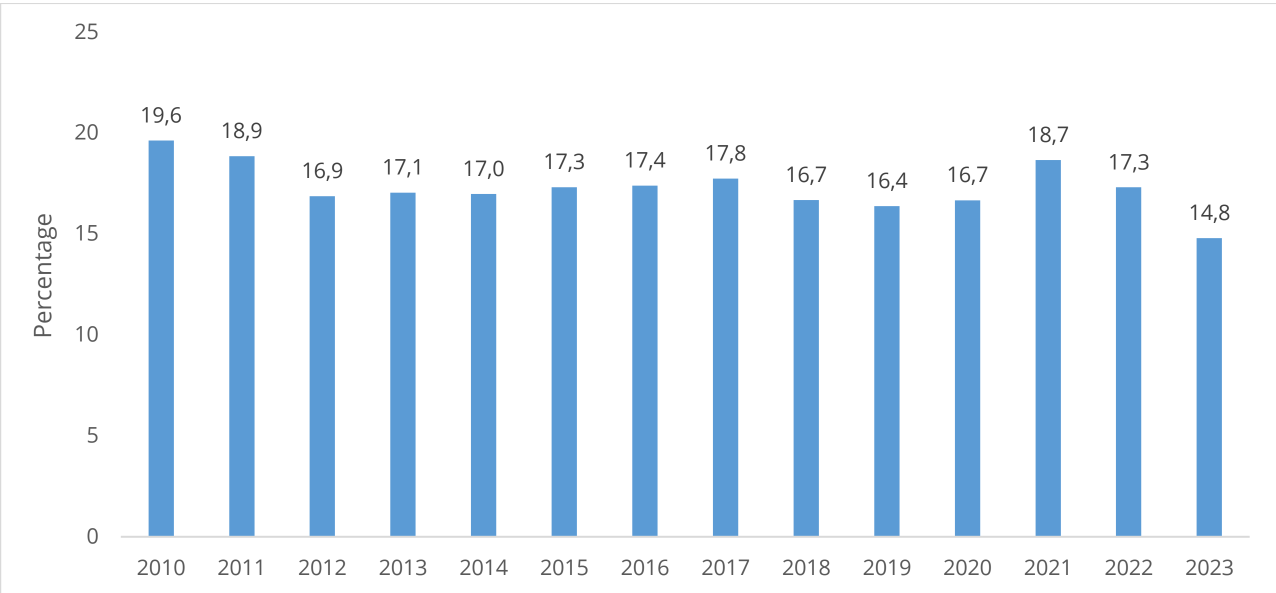
Economic strength variables are critical in determining the economic outlook score. GDP growth trends, GDP per capita, and GDP growth volatility are key metrics upon which the South African economic outlook was evaluated. These metrics are assessed in terms of whether their levels and growth trajectories are above or below thresholds compared to peers with the same economic structure.

South Africa’s growth outlook has been revised from 0.9% for 2023 to 0.8%. The growth outlook for the coming years has been revised from 1.5% in 2024 to 1%, and from 1.8% in 2025 to 1.6%; and now it is expected to average only 1.4% over the 2024 to 2026 period. This does not compare well with the 4% projection for emerging and developing economies and notably falls below advanced economies’ growth outlook of 1.7% over the same three-year period as projected by the IMF.

Negative growth rates and economic contraction are also marked by a decrease in real income, higher unemployment, and lower levels of industrial production, and this leads to credit challenges in the South African economy.

South African lawmakers decided to allow savers early access to their pension funds from next year, March 2024, referred to as a two-pot retirement system. Pension savings can be depleted to such an extent that inadequate retirement incomes are provided, thereby placing more pressure on social grant expenditure. This will have direct implications for the tax system. Pension contributions receive a tax exemption to incentivize long-term savings. Any withdrawal from the savings pot will be taxed at the member's marginal tax rate if accessed before retirement. Withdrawing money from retirement savings will have a negative financial impact on retirement. South Africa has a low savings-to-GDP ratio (see Figure 8) averaging 17.8% over the years.

Figure 8: Savings to GDP Ratio (2010-2023)



Source: SAR's calculations based on World Bank data

Pension funds contribute to the total pool of savings of the South African economy. The early access to pension funds will also affect the savings levels as well as the economic strength of the South African economy to some extent. Achieving economic growth requires governments to adopt different types of policies such as promoting savings, stimulating investment, and increasing internal production.

The state should maintain well-funded pensions. A deterioration in funding levels would raise long-term liabilities for the state, decrease future operating flexibility, and put downward pressure on its credit ratings.

The economic strength of the South African economy is also evaluated by SAR based on its external performance. In this regard, SAR took note of the announcement made by the Department of Trade, Industry, and Competition on 5 December 2023 regarding the White Paper on Electric Vehicles. This document marks South Africa's inaugural comprehensive policy statement on the manufacturing, sale, and utilization of electric vehicles (EVs). The White Paper represents a significant milestone in the transformation of the South African automotive industry, recognizing the imperative for the country to transition towards producing EVs and their components. This strategic shift is crucial for maintaining South Africa's global prominence as an exporter of vehicles and automotive parts.

Failing to act in this direction would have had adverse effects on South Africa's Terms of Trade Stability and External Competitiveness. Moreover, it would have increased South Africa's external vulnerabilities, as indicated by the country's current account balance. The recent development is viewed as a positive credit outcome for the South African Economy.

Furthermore, ongoing scrutiny by SAR is being directed towards the government's ban on scrap metal exports. An extension of this ban could inflict additional harm on the South African economy, exacerbate job losses, and prove ineffective in mitigating cable theft and damage to network infrastructure. The automotive industry and export market are anticipated to suffer adverse consequences as well. The situation is recognized as a credit challenge.

Financial Strength Pillar

The Fiscal Flexibility score is encapsulated in the Financial Strength Pillar and provides an overall assessment of the debt sustainability and affordability of South Africa's public finances. The Financial Pillar Strength considers both short- and long-term dynamics with regard to debt stocks and flows related to public finances, the sustainability of the current situation, and the projected path. The ability of a government to service its debt depends on various factors beyond the budget deficit and debt level themselves.

The basis for the Fiscal Flexibility score is the overall gross debt level. Currently, South Africa's debt-to-GDP ratio stands at 73%. This is viewed as an indicator of the stability of the current debt load and the government's ability and willingness to take steps to limit debt increases and as a proxy for the credibility of any fiscal projections.

Also considered in short-term debt dynamics is the volatility of the government's revenues, which can affect its ability to finance operations. South Africa's revenue collection falls short of set targets and is inadequate to sustain the debt. The debt level is then cross-referenced with the debt-servicing costs associated with this debt level. An over-accumulation of debt limits the flexibility of government policy and has been identified as a factor that increases sovereign default risk.

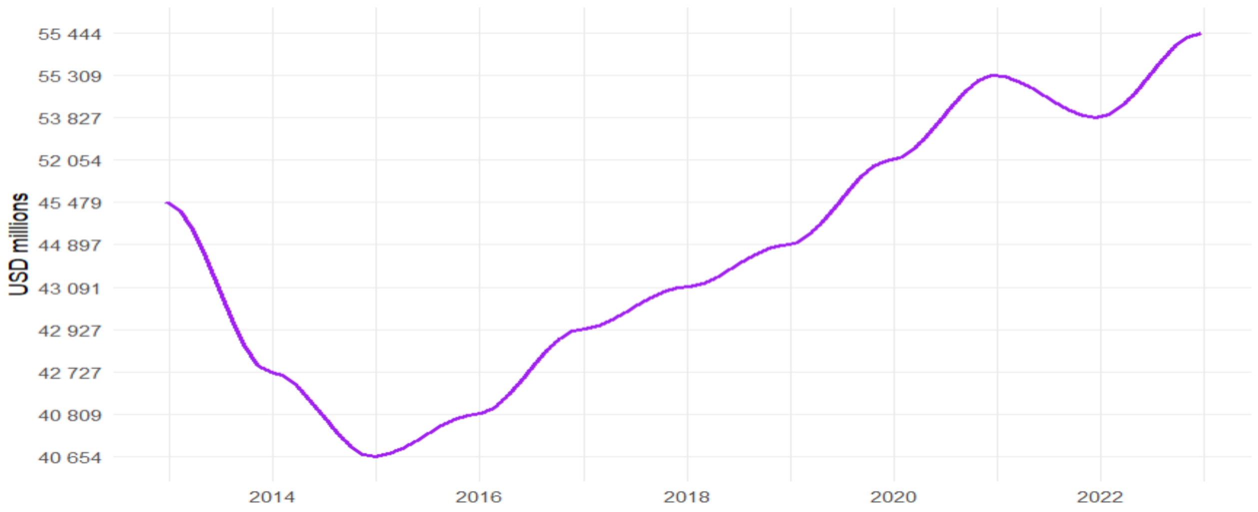
SAR has examined the general government interest payments as a ratio to general government revenues. South Africa's interest payments as a ratio of revenue have ranged between 15% to 19% from 2020 to 2023 and are projected to remain on the higher end through 2025.

South Africa is not regarded as experiencing debt stress, as its foreign-denominated debt is less than the 40% high-risk benchmark. The risk, however, associated with contingent liabilities, government guarantees, as well as fiscal imbalances remains heightened, and this might lead to credit challenges. The main challenges are posed by SOE bailouts as well as climate change impacts.

South Africa demonstrates monetary policy stability as the independence of the central bank is intact and the SARB has been effective in the implementation of monetary policy noting the average inflation rate of 4.8% from 2020 to 2023. The central bank also maintains adequate foreign currency reserves to enhance liquidity and minimize exchange rate volatility. The degree of flexibility and sophistication of monetary authorities as well as their demonstrated ability to contain inflation in South Africa is a credit positive.

The National Treasury's intentions to use the Central Bank's foreign currency reserves for government expenditure represent an elevated risk in terms of South Africa's capacity and ability to cover and finance import payments. The level of international foreign exchange reserves accumulated by the South African Reserve Bank represents a buffer to external shocks. The level of international reserves serves as an important factor in determining South Africa's exchange rate policy and requires a certain level of foreign exchange reserves to be credible. Foreign exchange reserves are not reserves for fiscal policy but for monetary policy. Any move by the National Treasury to tamper with foreign currency reserves will have consequences for liquidity and currency stability, thus exacerbating South Africa's external vulnerabilities in the process. Figure 9 below provides a picture of levels of the Central Bank's liquidity position from 2013 to September 2023. Currently, the reserves provide cover for imports for five months.

Figure 9: International Liquidity Position of the SARB, USD Millions (2013 – 2023)



Source: SAR's calculations based on SARB data.

Prudent use of reserves is anticipated, but a sustained deterioration in reserve levels would be a credit negative.

Institutional Strength Pillar

The Institutional Strength score captures South Africa's institutional features, the effectiveness and ability of the civil service and policymakers to respond to events that could affect a sovereign's creditworthiness. This includes the sovereign's ability and its willingness to meet current financial obligations, as well as to make decisions that further economic, fiscal, and political stability and support its ongoing ability to meet financial obligations.

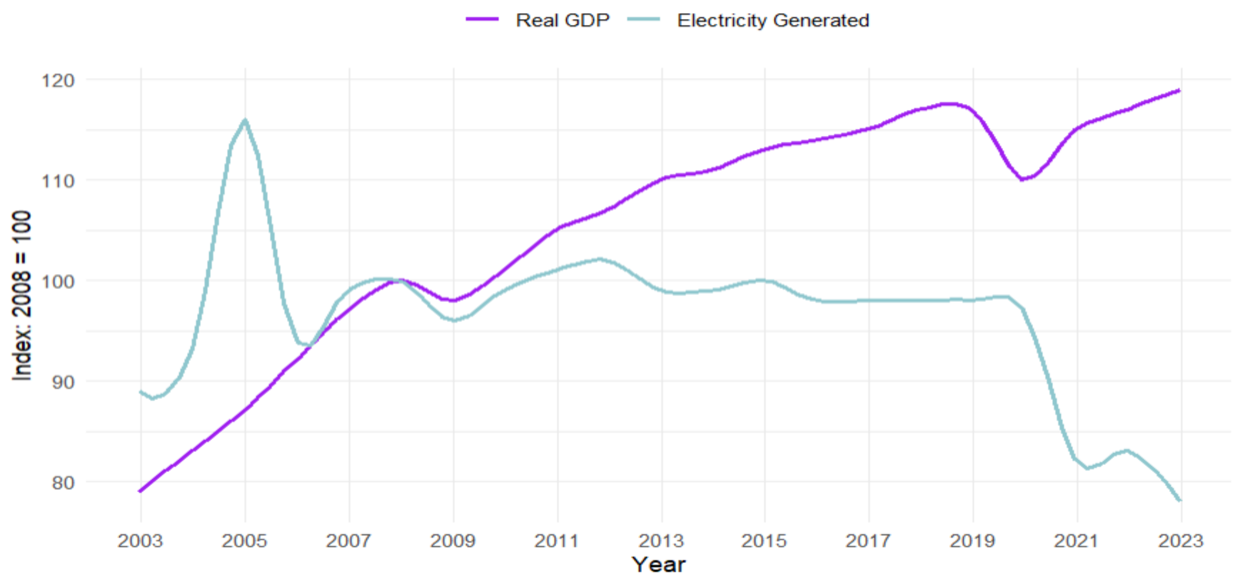
SAR views South Africa as a country with a predictable policy environment that has strong and effective institutions supportive of economic growth, which, in turn, also enhances creditworthiness. Financial sector oversight is strong, reflecting a commitment to independent supervision and the implementation of international standards.

The increase in inefficiencies in state-owned enterprises such as Transnet, Eskom, South African Airways, The South African Post Offices etc. continues to put pressure on the country's fiscus due to continual bailouts and government guarantees. This is viewed as a credit challenge for the South African economy.

South Africa has experienced sporadic incidents of load shedding since 2007, with a significant escalation in the last two years (largely caused by unplanned breakdowns at power plants). The year 2022 was the worst year of load shedding to date, with the country experiencing 3 776 hours (about 157 days) of load shedding. This is significantly higher than the 2021 record of 1 153 hours (48 days) and the 844 hours (35 days) lost in 2020. Load shedding has remained elevated in 2023, with the country already having experienced 2 434 hours, or 101 days, of power outages, as of 16 April. By mid-February of 2023, load shedding had already exceeded the cumulative totals of 2019 and 2020. Load shedding has severe negative implications for production and overall confidence in the economy.

Figure 10 demonstrates the important relationship between real output (real GDP) and electricity supply as shown for the period 2008 and 2023, with indices 2008=100 (2008 being the year when load shedding was announced by Eskom).

Figure 10: GDP and Energy Supply in South Africa in Tons (2003 - 2023)



Source: SAR's calculations based on Eskom and SARB data.

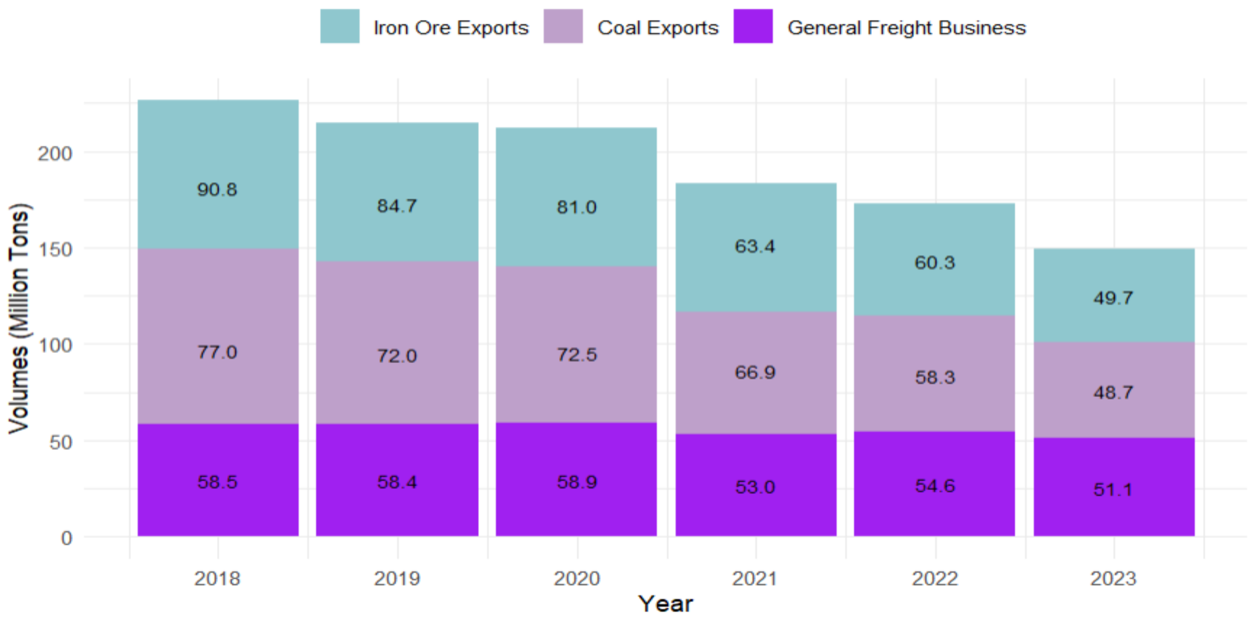
Towards year-end in 2022, South Africa was heading for serious electricity shortages caused by persistent and more frequent incidents of load shedding. As 2023 began, the electricity demand became critical with serious implications – not only for households but across all sectors of the economy. The availability of energy, specifically electricity, is of critical importance for the functionality of the economy and production processes.

It is most evident that a consistent electricity supply is a critically important input in the economy. Before 2008, real GDP growth and electricity demand moved in tandem. After 2008, it appears that GDP per unit of electricity increased with the economy becoming more energy efficient. From 2018 onwards, however, GDP growth declined, indicating that the earlier efficiency gains may have been negated. This also implies that the severity of load shedding, notably at its present levels, has a stark direct adverse impact on real GDP growth and the functioning of the economy. Key impacts include reduced production output, delayed orders and an overall decrease in productivity, supply chain disruptions leading to delayed deliveries of raw materials, components and finished products, lower profitability, and loss of competitiveness. This, in turn, affects the entire ecosystem and leads to financial losses.

Eskom is likely to need more state support, further pushing up state borrowing because of just transition costs. This poses a serious threat to the government's fiscal balances and policy priorities. Government guarantees to state-owned enterprises could swell to over R700 billion. These bailouts have weighed heavily on the fiscus, pushing government debt into unsustainable territory, and having the potential to increase contingent liabilities. The contingent liabilities exposure from Eskom is set to be reduced by debt-relief arrangements by the National Treasury. It is also expected that the President Energy Action Plan might provide much needed relief.

Ports run by Transnet are in a dire state and are currently ranked among the world's worst as they are far behind in terms of efficiency attributed to container loading and waiting times. Furthermore, Transnet's rail network is a crucial cog in South Africa's economy, responsible for moving most of the strategic commodities produced in the country such as coal, iron ore, chrome, and manganese to foreign markets. Transnet trains are often delayed due to poor management of rail systems, cable theft, and vandalism. Transnet rail volumes have declined by 77 million tons between 2017/18 and 2022/23 (See Figure 11). This translates to a decline of approximately 7% over the period.

Figure 11: Transnet Rail Volumes, Million Tons (2018-2023)



Source: SAR's calculations based on Transnet General Freight data

Inefficiencies at Transnet are costing the economy billions on an annual basis, most of this through lost sales of strategic commodities such as coal and iron ore. This situation has far-reaching implications for achieving optimal levels of economic growth in South Africa. The inefficiencies at SA ports also present a constraint on foreign trade (import and export volumes). The inability to enhance international trade as a result of Transnet's inefficiencies results in elevated external risks because they directly impact not only the sovereign's external debt repayment capacity but also the revenue generation of the financial and business sectors.

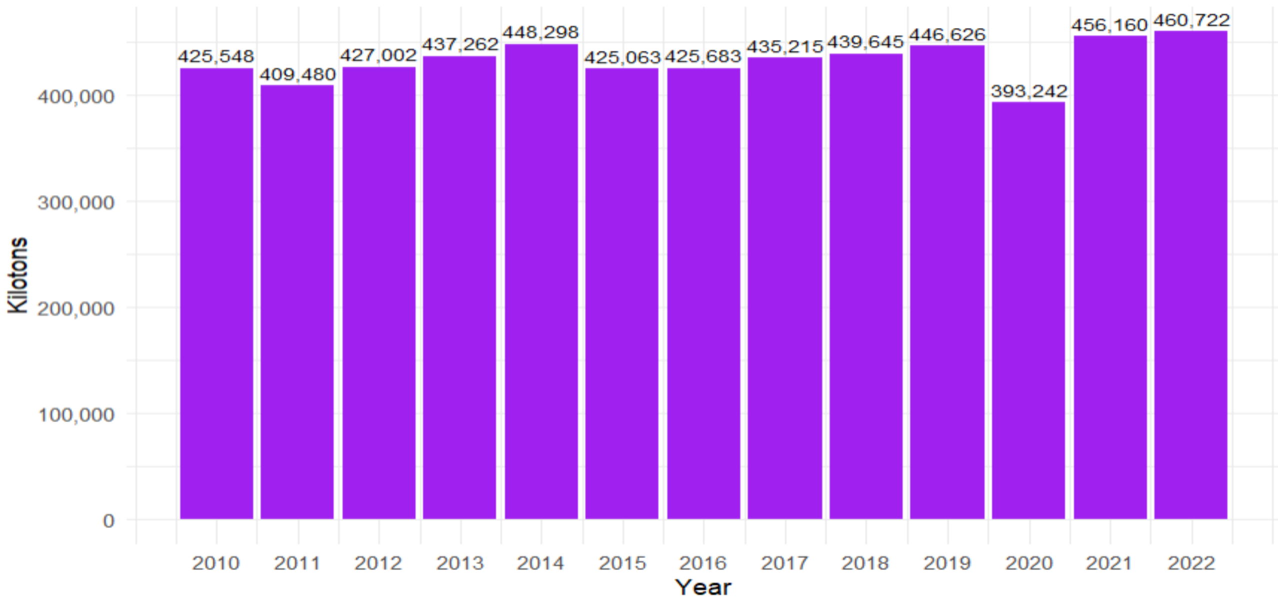
External imbalances and vulnerability to external shocks have often resulted in sharp currency depreciation or devaluation. This makes the repayment of foreign currency-denominated debt and the import of goods and services – including food, energy, capital goods, and inputs in supply chains – more expensive. Other risks created by this situation include terms of trade volatility as well as inferior external competitiveness of South African international trade. SAR view this situation as a credit challenge.

Environmental, Social, and Governance Pillar (ESG)

Environmental

ESG factors are incorporated into the credit analysis in the same manner as all other credit-relevant factors. For South Africa, climate change entails risk from the economic and social costs of both climate events and transition initiatives, including programmes for reducing emissions (e.g., transitioning away from carbon-based industry) and investing in adaptation measures to address potential vulnerabilities. Significant uncertainty remains about both the nature and magnitude of climate change impacts. At the same time, current decisions being made at COP 28 relating to climate change (including transition risks) have some credit implications for the South African economy as they come with significant trade-offs as well as sacrifices in trying to achieve potentially unrealistic objectives. It will cost South Africa R535 billion per year for the next seven years to meet its nationally determined contributions to reduce greenhouse gas emissions. Figure 12 below represents South Africa's levels of carbon emissions.

Figure 12 : RSA Carbon Emissions (Kilotonnes), 2010-2022



Source: SAR's calculations based on IMF data.

Under the environmental factor, as the effects of climate change escalate and become more severe, issuers increasingly face an array of challenges and opportunities that can influence financial assets, operations, and capital planning. As per COP 28, there were strong views expressed to phase out fossil fuels as well as oil and gas. This presents an opportunity cost for economies that generate revenues and royalty taxes from fossil fuels. On the other hand, funding for new energy projects will be tilted more toward green energy projects. In South Africa, the Just Energy Transition would add a huge cost burden to Eskom, thus placing further strain on the fiscus. This would be a credit challenge given South Africa's main resource of coal. Concerns are that countries like South Africa are sacrificing their economy and energy sovereignty at the expense of ambitions and costs of climate change goals. South Africa at COP

28 supported ending the use of fossil fuels and coal. This poses serious economic growth and employment creation risks.

Social

South Africa faces elevated risk associated with the erosion of social cohesion due to high levels of unemployment, inequality, and poverty, which lead to a scrambling of resources and, to some extent, corruption, and escalating crime levels. South Africa's economic and social challenges are mounting, risking stagnation amid an unprecedented energy crisis, increasingly binding infrastructure and logistics bottlenecks, a less favourable external environment, and climate shocks. This presents a credit negative for the South African economy.

According to the latest Quarterly Labour Force Survey published by StatsSA, the total number of officially unemployed persons in the second quarter of 2023 comprised 44.5% new entrants, 26.7% job losers, 22.2% having last worked five years ago, 3.6% reentrants, and 3.0% job leavers. The proportion of long-term unemployment (being unemployed for one year or longer) to total unemployment remained elevated and has increased steadily over the past decade, from 66.7% in the second quarter of 2013 to 77.3% in the second quarter of 2023. Youth aged 15-24 years and 25-34 years recorded the highest unemployment rates of 60.7% and 39.8% respectively. Approximately 3.5 million (34.2%) out of 10.2 million young people aged 15-24 years were not in employment, education, or training (NEET). Employment remains below pre-pandemic levels and unemployment is close to record highs – this is on the back of already high poverty and inequality.

The elevated public debt significantly limits the fiscal space available to respond to economic and climate shocks and meet social and developmental needs. Long-standing rigidities in product and labour markets as well as governance and corruption vulnerabilities also weigh on growth and employment prospects, threatening social cohesion.

The heightened levels of inequality and unemployment have underscored the necessity for the Basic Income Grant (BIG) as a mechanism to offer economic assistance. As the 2024 elections draw near, there will likely be a push to introduce or extend the Social Relief of Distress Grant (SRDG) to alleviate the challenges faced by low-income and impoverished households, including elevated food prices, increased household debt, and a higher cost of living. Implementing such support will necessitate the allocation of billions of rands from national resources, which can be funded through options like introducing a wealth tax, increasing VAT, or through budget reprioritisation and funding from other state programmes or possibly more borrowing. SAR is actively monitoring this developing situation.

Governance

SAR is currently closely monitoring critical governance risk factors for the South African economy, particularly in the lead-up to and aftermath of the 2024 national elections. These factors include concerns related to the rule of law, political stability, succession, and the control of corruption. It is essential to highlight that South Africa's credit strength is positively influenced by its political stability, adherence to the rule of law, and regulatory quality. However, challenges persist in managing corruption both in the private and public sectors.

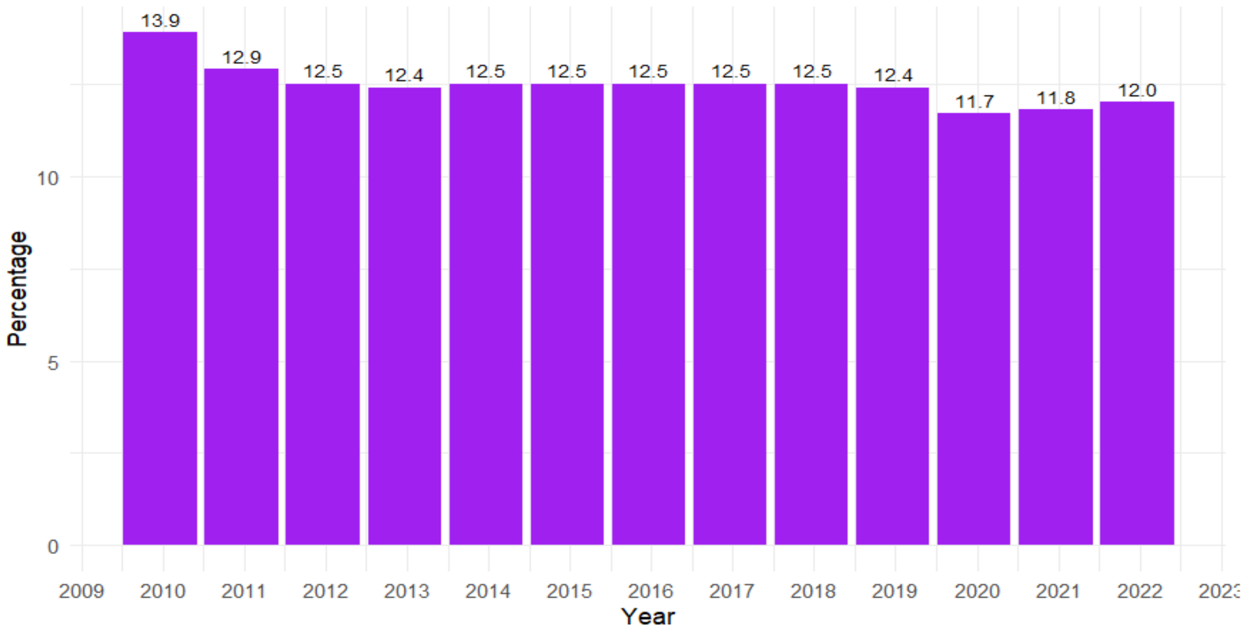
A notable worry is the existence of energy and construction mafia, posing obstacles to much-needed investment and capital formation. Additionally, there are instances of coordinated sabotage affecting key infrastructure, such as cable theft. The creditworthiness of South Africa is also contingent on addressing state capture decisively. Strengthening criminal prosecution and enforcing sanctions against corruption offenses are crucial, requiring the establishment of credible and effective deterrence mechanisms. Anti-corruption agencies must be endowed with adequate legal power, capacity, and operational autonomy to prevent political interference. The forthcoming procurement legislation and regulations present a significant opportunity to rectify deficiencies in the public procurement process. These risks are identified as credit challenges that need careful consideration.

Natural Resource Pillar

The Natural Resource pillar and factors impacting the economic outlook score capture the mineral wealth and economic prospects of a country, which are reflective of the financial resources upon which sovereigns can draw to repay financial obligations. Wealthy, diversified, and flexible economies typically provide a sovereign with a greater potential tax base and therefore a more stable and predictable source of income.

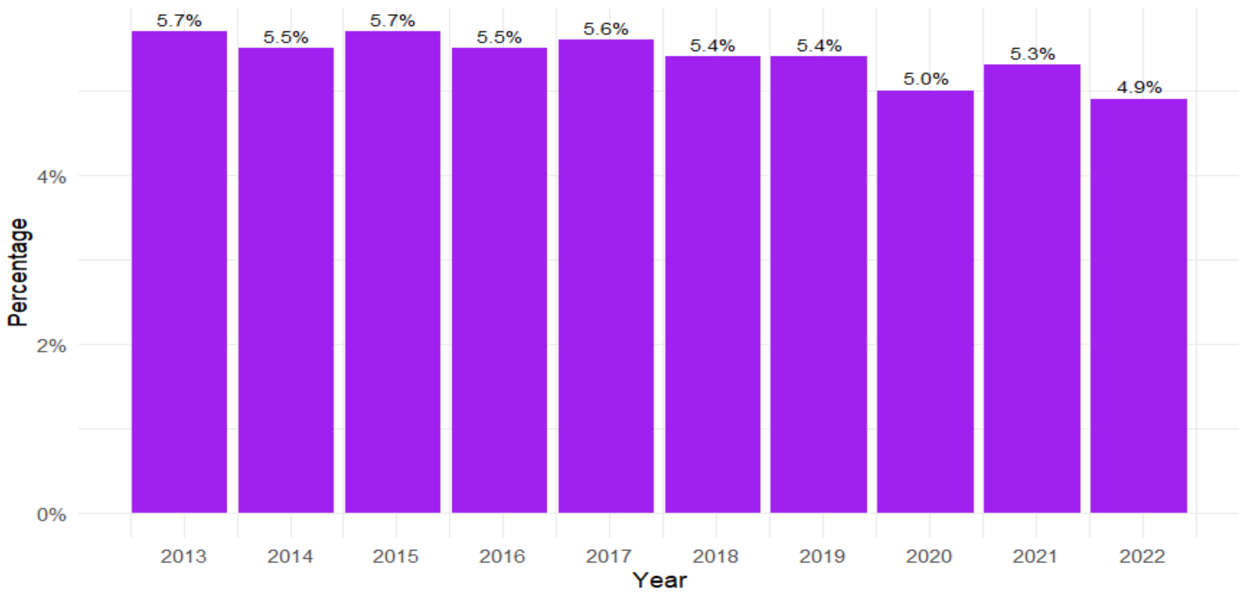
The extractive industry sector plays an important role in promoting and sustaining growth by contributing to a more efficient reallocation of resources. Beneficiation is therefore a significantly important consideration for assessing a sovereign's ability to withstand commodity price volatility and the general expansion of the secondary and tertiary sectors of its economy. Figure 13 provides levels of manufacturing value added relative to GDP in South Africa.

Figure 13: Manufacturing Value Added as a percentage of GDP, 2010-2022



Source: SAR's calculations based on IMF data.

Figure 14: Mining Sector Contribution to GDP, 2013-2022



Source: SAR's calculations based on SARB data.

Beneficiation

An area where South Africa can increase its potential for economic growth, development, and job creation is the beneficiation of its extracted minerals. South Africa has the wealthiest mining jurisdiction in the world, with mineral resources valued at $2.5 trillion. Despite these assets, the level of value-added mineral beneficiation undertaken in South Africa is low, which denoted the low levels of manufacturing value added per GDP, with activities in the mining industry dominated by primary production and exports of raw or partially processed minerals. As deduced from Figure 14, the contribution of mining to GDP is insignificant. However, mining beneficiation will enhance economic growth and employment creation as it will lead to more diversification, industrialization, and increased tax revenue. This will be viewed as a credit positive.

The level of mineral beneficiation was found to be low considering the country's mineral endowment, and this resulted in the country foregoing the opportunity to earn more from exports of finished products, create employment (especially in the low-to-semi-skilled sector, which makes up the bulk of unemployed individuals), and address the problems of inequality and poverty. Amongst the factors found to constrain beneficiation were the country's labour laws, lack of adequate skills, corruption, unstable labour force, research and development, the lack of entrepreneurship activity, inadequate infrastructure, and energy problems. The African Continental Free Trade Area's (AfCFTA) strategic intervention is also key to unlocking Africa's agriculture and mining intra-trade challenges for enhanced intra-regional industrialization and beneficiation. Should key constraints be dealt with, beneficiation will present significant credit positive for the South African economy.

Another consideration in assessing the country's external vulnerability is the diversification of its export base. Countries with a concentrated export base, such as commodity exporters, are also vulnerable to terms-of-trade shocks from sudden declines in the global prices of key export commodities. Additionally, a significant deterioration or improvement in external competitiveness would also affect local companies' ability to compete with foreign firms and impact the current account balance.

Rating Methodology

The principal methodology used in this rating methodology is available at:

Sovereign Rating Methodology

Credit Rating Update

Unsolicited credit rating review.

SAR confirms that the credit rating has been disclosed to the rated entity.

Rating Definitions

SAR Rating Definitions

Rating History

Initial Rating Date	**23 September 2022**	**Current Rating Date**	**22 December 2023**

Information and Data

SAR confirms that data and information adequacy were sufficient to conduct this credit rating. Data and information from reputable sources were used during the credit rating process. The quality of the data and information has been validated via cross-referencing against various data sources for consistency.

APPENDIX 1: DETAILED RATING INDICATORS

Variable	2020	2021	2022	2023	2024	2025
Economic Strength Pillar						
GDP growth rate (%)	-6.34	4.91	2.04	1.70	1.90	2.00
GDP growth volatility (using business cycle leading indicator as proxy) [% Change]	3.5	16.9	-1.6			
GDP per capita (US$)	5661.0	6965.2	6694.4	6423.5	6152.6	5881.8
Share in peer-group GDP	6.18	6.08	5.90	5.78	5.62	5.46
Share in world GDP	0.183	0.184	0.185	0.186	0.186	0.188
Structural Nature						
Export diversification index	0.6	0.6	0.6	0.6	0.6	0.6
Current account balance (% of GDP)	2.0	3.7	-0.4	1.4	2.7	3.6
General government revenue (% of GDP)	23.3	25.9	24.7	25.4	25.3	25.3
Financial Strength Pillar						
Gross government debt (% of GDP)	69.00	68.98	71.02	73.16	77.03	81.00
Gross government debt (% of revenue)	296.27	266.16	287.51	288.56	303.95	319.98
General government interest payments (% of revenue)	15.49	15.14	16.80	19.40	19.40	19.80
General government fiscal balance (% of GDP) fiscal balance/GDP	-0.06	-0.10	-0.05	-0.06	-0.07	-0.07
Gross foreign currency-denominated debt (% of GDP)	6.80	7.00	6.60	4.12	4.92	6.29
Gross local currency-denominated debt (% of GDP)	50.40	63.20	61.50	45.16	50.07	58.59
Contingent liabilities (% of GDP)	0.01	0.03	0.03	0.02	0.03	0.03
Debt repayment record (years since default or restructuring event)	35	36	37	38	39	40
Domestic Currency and Financial Markets						
Inflation rate	3.2	4.6	7.0	4.8	4.6	4.6
Exchange rate stability (GDP based on purchasing power parity)	0.6	0.6	0.6	0.6	0.6	0.6
Domestic market capitalisation (% of GDP)	311.5	277.3	317.7	323.2	327.4	333.8
Broad money supply growth rate (%)	9.4	5.7	8.7	7.7	7.6	7.4
Foreign currency reserves (% of total external debt)	0.021	0.021	0.022	0.019	0.018	0.016
Institutional Strength Pillar						
Independence of central bank (transparency and independence index)	8.50	8.50	8.50	8.50	8.50	8.50
Regulatory effectiveness	37.90	37.90	37.90	37.90	37.90	37.90
Fiscal policy effectiveness (public sector expenditure to GDP) (%)	24.90	23.40	23.30	23.30	23.30	23.30
Monetary policy effectiveness (money supply, R millions - measure of liquidity)	4 118 602	4 353 021	4 729 841	4 729 841	4 729 841	4 729 841
SOE institutional effectiveness	40.48	40.69	40.90	40.90	40.90	40.90
Transparency and accountability	44.38	44.59	44.80	44.80	44.80	44.80
Environmental, Social and Governance Pillar						

Environmental						
Environmental regulations and enforcement (Environmental Projection Index)	37.100	37.150	37.20	37.20	37.20	37.20
Climate and natural disaster risk exposure (Climate Change Policy)	115.76	115.88	116.00	116.00	116.00	116.00
	2020	**2021**	**2022**	**2023**	**2024**	**2025**
Social						
Unemployment rate (%)	24.34	28.77	28.84	28.28	29.04	29.83
Income inequality (Gini coefficient)	66.64	63.00	66.97	65.99	66.13	66.35
Social and environmental impact of natural resource extraction (%)	83.94	84.78	85.63			
Labour rights and standards (average production/labour ratio)	196 787	201 728	203 626	203 626	203 626	203 626
Human Development Indicators (HDI)	0.425	0.427	0.429	0.429	0.429	0.429
Governance						
Political effectiveness (Political Stability Index)	8.00	7.00	7.00	7.00	7.00	7.00
Governance practices (Government Effectiveness Index)	38.000	38.050	38.10	38.10	38.10	38.10
Natural Resource Pillar						
Natural resource extraction (ores and metals as % of exports)	31.44	37.78	31.55	32.17	33.85	35.32
Natural resource beneficiation (manufacturing value added as % of GDP)	11.66	11.79	12.04	11.87	11.83	11.73
Energy generation and availability	88.30	82.60	85.80	84.98	83.64	82.43

Glossary of Terms

Term	Definition
The African Continental Free Trade Area (AfCFTA)	The African Continental Free Trade Area (AfCFTA) is a landmark trade agreement among African countries aimed at promoting intra-Africa trade and economic integration. It was established with the goal of creating a single market for goods and services on the continent, removing trade barriers, and fostering economic cooperation among African nations.
Credit Rating Action	Any of the following is a credit rating action: 1. The process through which a credit rating is given to a rated entity or obligation, including credit ratings given during a subsequent rating process. 2. When relevant conditions are thought to have been satisfied in the anticipated rating process, a provisional note is removed from a credit rating. 3. A change to a credit rating (i.e., upgrade or downgrade). 4. Placing a credit rating under review, reconfiguring an active review, or removing a credit rating from review (i.e., Credit Rating Confirmation), the assignment of, or modification of, an Outlook linked to a Rated Entity or several Credit Ratings. 5. A Credit Rating Affirmation. 6. A Credit Rating Withdrawal.
Current Account Balance	Exports of goods and services minus imports of the same plus net factor income plus official and private net transfers.
Default	The definition of default includes both payment default, where the issuer fails to make principal or interest payments on the due date or within a grace period, and distressed exchanges, where the issuer offers new debt for old debt on terms (e.g. coupon maturity) that are less favourable than those of the original instrument.
Employee(s)	An employee is any full-time or part-time employee of SAR or any of its subsidiaries and associated companies.
Foreign Direct Investment (FDI)	Direct investment conducted by non-residents.
Gross Domestic Product (GDP)	Total market value of goods and services produced by resident factors of production.
GDP per capita	GDP divided by population.
Issuer	An issuer is any entity that issues debt, a credit commitment, debt-like obligations, or securities. Examples of such entities include special-purpose vehicles, companies, governments, and local governments.
Lead Rating Analyst (Lead Analyst)	Lead rating analyst is a term used to describe an analyst who is primarily responsible for providing details about a credit rating and/or for communicating with the issuer(s) regarding a specific credit rating or regarding the credit rating of a financial instrument issued by that issuer, as well as, when appropriate, for creating recommendations for the rating committee in relation to that credit rating.
Manager(s)	Managers are employees who oversee managing personnel.
Net General Government Debt	General government debt minus general government liquid financial assets.
Net External Liabilities	Total public- and private-sector liabilities to non-residents minus total external assets.
Outlook	An outlook is an opinion regarding the likely path an issuer’s rating could take over the medium term.
Prohibited Recommendation	Any proposals or recommendations made either formally or informally, regarding the design of financial instruments on which a CRA is envisioned to issue a credit rating, may be made by an employee to a rated entity or its agent to improve the rated entity's rating. This includes suggestions about the rated entity's corporate or legal structure, assets, liabilities, or activities.

Rated Entity(ies)	A rated entity is any entity rated by a credit rating agency (CRA).
Review	A review is an indication that a rating may be changing in the not-too-distant future.
SAR	Sovereign Africa Rating (Pty) Ltd is authorised to conduct business as a credit rating agency as per the Credit Ratings Services Act of 2012 of the Republic of South Africa.
Special Drawing Rights (SDR)	The SDR is an international reserve asset, created by the International Monetary Fund in 1969 to supplement its member countries' official reserves.
Security	Security refers to any type of financial instrument, including stocks, bonds, debentures, notes, options, equity securities, convertible securities, warrants, derivative securities (derivative), and warrants.
Total Debt Service (TDS)	Total Debt Service (TDS, current US$) refers to the total amount of money paid by a country to cover the principal and interest payments on its external debt. External debt includes loans and financial obligations owed to foreign creditors, such as other governments, international organizations, or private entities, by the country in question.

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