

FITCH AFFIRMS SOUTH AFRICA'S 'BBB-' RATING; OUTLOOK STABLE

Fitch-London-18 October 2001: Fitch, the international rating agency, has today affirmed South Africa's Long-term foreign currency rating at 'BBB-' (BBB minus), and the Short-term foreign currency rating at 'F3'. The Long-term local currency (rand) rating is also affirmed, at 'BBB+'. The Long-term rating Outlook is Stable.

The affirmation of South Africa's ratings reflects important progress on macro-economic policy during the past year, which has yielded improvements in fiscal, inflation, debt and liquidity indicators. The political environment also continues to be stable. The general government deficit, at 2% of GDP in fiscal year 2000/2001, outperformed the government's target for the third year in a row. Further out-performance is likely this year and fiscal deficits are expected to stabilise at the present level in the medium-term. Low fiscal deficits have, in turn, contributed to a falling public sector borrowing requirement, and lower debt servicing costs and expected privatisation revenues will reinforce this trend in coming years. The general government debt to GDP ratio, which peaked at 50.4% of GDP at the end of fiscal year 1998/1999 and fell to 46.6% of GDP at the end of 2000/2001, is expected to fall further and is in line with similarly rated credits.

In addition, the adoption of an inflation targeting monetary policy framework in early 2000 has been successful in lowering inflation. The benchmark CPIX at 5.8% year-on-year in September fell within the South African Reserve Bank's (SARB) inflation target of 3%-6% by 2002 and is expected to remain within this range. Cumulative rand depreciation of around 40% since January 2000, reflecting in part low external liquidity and a weak capital account, continues to be of concern. However, the move to exchange rate flexibility in 1998 and the SARB's commitment to closing its forward foreign exchange position bode well for improved external liquidity and ultimately reduced rand vulnerability in the future. In the meantime, success at containing inflation in the face of substantial rand depreciation is also resulting in an improvement in international competitiveness. External debt indicators remain moderate. Improvements in the macro-economic framework have led to lower interest rates, lower inflation and have made room for growth-oriented budgets starting in 2001/2002, which should all lift growth in the future.

However, owing to a combination of external shocks and structural constraints, South Africa has yet to achieve its medium-term growth potential of 3%-4%. Growth this year and next may be little more than 2%. Moreover, even 3%-4% growth, if achieved, is insufficient to make a substantial impact on high unemployment of 37%. Low investment rates of around 15% of GDP reflect inflexible labour markets, skills shortages, high crime levels, slow privatisation and increasingly the AIDS epidemic, which all deter domestic and foreign investment. The government is addressing these problems, yet many of them are medium- to longer-term challenges. A more effective response to the AIDS epidemic is also needed as the epidemic risks undermining progress on delivery of social services. The ratings outlook will depend on further improvement of external liquidity, including gross reserves, and progress on reducing structural constraints and speeding growth.

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