Moody's Investors Service
Global Credit Research

South Africa

December 2000

Ratings and Contacts

Category	Moody's Rating
Country Ceiling: Fgn Currency Debt	Baa3/—
Country Ceiling: Fgn Currency Bank Deposits	Ba1/NP
South Africa, Republic of	
Issuer Rating	Baa3
Government Bonds -Fgn Curr	Baa3
Government Bonds -Dom Curr	Baa1

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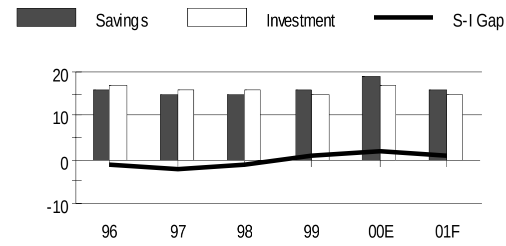
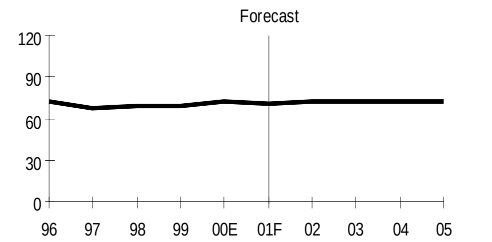
Savings and Investment (% of GDP)[1]



[1] Gross national saving includes foreign income/payments.

Foreign Currency Debt % Exports[1]



[1] Total Current Account Receipts.

Domestic Statistics

South Africa

	1996	1997	1998	1999	2000E	2001F
General Government Balance/GDP[1]	-5.6	-4.5	-2.5	-1.1	-1.8	-2.2
Real GDP Growth Rate	4.2	2.5	0.7	1.9	3.0	3.3
Inflation (CPI)	7.4	8.5	7.0	5.2	5.6	5.1
Manufacturing Production (%)	1.5	2.8	-3.1	0.2	5.1	6.0
Gross Investment/GDP	17.1	16.1	15.7	15.2	15.1	15.3
Short-term Interest Rate	15.0	15.3	16.5	13.0	10.5	—
General Government Debt/GDP	49.3	49.3	49.0	48.9	47.9	46.8

[1] Fiscal year beginning April 1.

International Statistics

South Africa

	1996	1997	1998	1999	2000E	2001F
Foreign Curr. Debt (US$ Bil.)	26.1	25.2	24.7	23.9	26.0	28.1
Foreign Curr. Debt/GDP	18.2	17.1	18.5	18.2	20.4	21.7
Foreign Curr. Debt/Exports[1]	71.6	66.6	69.2	68.8	71.5	71.4
Debt Service Ratio[2]	14.5	16.2	16.7	16.1	14.9	14.7
Current Acct. Bal./GDP	-1.3	-1.5	-1.6	-0.4	-0.1	-0.4
Trade Balance/GDP	1.9	1.6	1.4	2.9	3.2	2.9

[1] Total Current Account Receipts. [2] (Interest + Currently Maturing Long-term Debt)/Total Current Account Receipts.

Opinion

Rating Rationale

South Africa's Baa3 country ceiling for foreign currency debt and the Baa1 rating assigned to the government's rand-denominated debt reflect an increasingly disciplined macroeconomic policy framework and ultimately, the low risk of default on rated securities given the country's moderate public debt and debt service burden. A broadening of the tax base and rigorous enforcement has narrowed the fiscal deficit significantly, providing room for income tax rate cuts in the current and future budgets. Monetary policy also is increasingly transparent, with the introduction of inflation targets as a guide for interest rate decisions and little interference with market determination of the rand exchange rate.

The industrial restructuring and trade and financial liberalization of the last several years is now paying off in faster growth and a more resilient balance of payments, led by the rise of both commodity and manufactured exports. Lower barriers to trade with the European Union and the US should further strengthen exports and foreign direct investment over the medium term.

S. Africa's ratings also incorporate the formidable hurdles still facing the country, the most important being the lack of dynamic and sustained growth, high unemployment, and the problems posed by the HIV epidemic. Urgent efforts must be undertaken in order to address the country's vast social inequities, particularly the need to enhance delivery of social services, not just utilities and housing, but education and skills training. A serious improvement in the law and order situation is also crucial to increase private investment.

Rating Outlook

The outlook for South Africa's ratings is positive. The government has a strong electoral mandate that should allow it to eschew narrow political considerations in favor of policies that better serve the majority. Given a benign external environment, economic growth and jobs creation could accelerate in the years ahead.

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Rating Rationale

Moody's country ceiling for South Africa's foreign currency debt is Baa3 and the foreign currency bank deposit ceiling is Ba1. The government's rand-denominated debt securities are rated Baa1. The ratings reflect the prospective benefits of comprehensive macroeconomic policy reform, which has coincided with an improvement in the provision of social welfare benefits, housing facilities, and broader access to utilities. The country's developed urban infrastructure, well managed and profitable banking sector, and internationally-oriented development strategy strengthen expectations of an improvement in the country's ability to attract investment capital in the medium term. At the same time, Moody's analysis also takes into account the significant constraints that currently low investment spending and labor skills shortages – exacerbated by the AIDS epidemic – impose on South Africa's potential for job creation and growth.

Moody's believes that the economic and political developments that have occurred since South Africa's country rating was assigned in October 1994 largely substantiate its initial assessment. South Africa's majority-led democracy has offered a means for the population to express its aspirations while also providing legitimacy to its elected rulers, both inside and outside the country. The seamless transition from the Presidency of Nelson Mandela to that of Thabo Mbeki last year is an example of the successful implementation of the democratic process, as are the relatively high voter participation rates and orderly conduct of elections at the local, provincial and national levels. The dominance of the ANC, particularly at the national level, is an inevitable outcome of the party's historic role in the anti-apartheid struggle. Still, the emergence of a viable political opposition will be critical to assure government accountability in the long-term. The relatively strong, although geographically concentrated, showing of the Democratic Alliance in the December 2000 municipal elections should be viewed positively to the extent that the party is able to attract a more racially-mixed voter base.

In the immediate post-apartheid era, the government of Nelson Mandela focused on national reconciliation. While that process necessarily continues, President Mbeki has made his top priorities the attainment of faster economic growth and the enhancement of social welfare. This shift is crucial, because disparities between the races' access to health, education, water, electricity, roads and telecommunications services are still significant. Indeed, South Africa ranks 103rd in a list of 174 countries in the Human Development Index compiled by the United Nations Development Program.

In order to improve the social and physical infrastructure, the national government is making an effort to enhance the delivery capacity of local and provincial governments, which are mainly responsible for providing services to the general population. The Local Government Transformation Program (LGTP), initiated in March 1999, is part of the plan to redefine municipal structures in order to increase efficiency in governance. The other goal on the administration's agenda – rapid economic growth – still faces significant challenges. Only high and widespread growth offers the means to integrate South Africa's large pool of low-skilled unemployed into the economy.

Overall growth rates in the post-apartheid South Africa have been higher than in the previous decade, but lower than anticipated given the removal of international trade and capital sanctions. In some respects, the economy has responded remarkably to the opening of the economy to foreign competition.[1] The manufacturing industry has witnessed strong productivity gains. To cite one particularly successful example, motor vehicles and machinery account for almost 50% of manufactured goods exports. South Africa's economic progress, however, hit a major hurdle during the Asian and Russian crises of 1997/98. Interest rates were hiked dramatically to stem the fall in the rand exchange rate, significantly dampening private sector consumption and investment.

After interest rates were gradually lowered in 1999, growth was widely expected to accelerate. The environment was propitious at the start of 2000: macro-level reforms were well-established, the market was confident in the commitment of the government and central bank to control inflation and external debt exposure, and South African equities were at the top of the preferred lists of many international investment advisors. Part of the reason for the lagging growth relates to market contagion from the events in neighboring Zimbabwe. Although the nature of South Africa's political system and its laws protecting private property preclude land seizures, the initial reluctance of President Mbeki to criticize Zimbabwean President Mugabe's support of the seizures and associated violence shook business confidence throughout

[1] *Average tariffs on industrial products have been lowered from 14% in 1994 to 5% in 2000.*

the region. In addition, revelations regarding the extent of HIV infection in South Africa and the potential impact on economic growth have made investors hesitant.

Although this year's revival did not live up to expectations early in the year, growth for the full year is expected to top 3% after better results came in for the third quarter. Even so, growth still remains concentrated in particular sectors and sub-sectors such as transport, communications, electricity, car-manufacture, trading, and financial services. Economy-wide business and consumer confidence surveys suggest that a belief in a broad-based recovery has yet to take hold.

Rating Outlook

In February 2000, Moody's assigned a positive outlook to South Africa's Baa3 foreign currency debt ceiling, Ba1 foreign currency deposit ceiling, and the government's Baa1 local currency debt rating. Continuing improvements in the macroeconomic framework and the cohesion in economic development strategy prompted the outlook change. Significant progress has been reflected in the economy as a whole. Inflation is much reduced compared to the 1980s and early 1990s and productivity is improving. The South African Reserve Bank's management of its forward book has allayed concerns regarding external liquidity that arose in the aftermath of the 1998 crisis, when SARB intervention in the currency market increased its net open position. Furthermore, the Reserve Bank has increased the transparency of its decision making process and the inflation target range of 3 to 6 per cent for the year 2002 announced in the budget of 2000 is likely to be met, in the absence of significant external shocks.

Other factors supporting the positive outlook include declining government debt and debt service ratios, a trend that will be enhanced by substantial proceeds from sales of state-owned enterprises in the next two years. Past fiscal prudence and a favorable current account position have opened the door for mild fiscal easing this year and in the next few years, as indicated by the government's latest Medium-Term Expenditure Framework. Planned tax cuts and increased government investment and social spending are expected to support faster growth. During this period the current account deficit is expected to be low and easily financed and the public sector borrowing requirement will be further reduced, partly through privatization inflows.

In addition, considerable shifts have taken place in the two policy areas most criticized by investors. Preparations for the privatization of four major government enterprises are well underway and are being handled in a transparent and professional manner. The long-awaited Telkom IPO planned for next year should add a sizable amount to government coffers and improve the country's telecommunications infrastructure by inviting further private investment in the sector. The Telkom offer is also likely to underscore the government's desire to invite greater foreign and domestic private sector participation in economic development, and thus accelerate private investment in other sectors.

Secondly, amendments to the Conditions of Employment Act have been undertaken despite vociferous labor opposition. This determination reveals the government's view that its job creation objectives required changes in the extensive protections provided to the currently employed. However, business continues to feel constrained by the government's insistence on using racial quotas in hiring and employment, in both the public and private sector, as a means to alleviate racial inequality.

The above-mentioned policy changes have naturally placed a strain on the ANC's alliance with the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP). However, any COSATU threats of retaliation in the form of withdrawal or strikes would be tempered by the government's confidence in its policy objectives. In addition, strikes have been ineffective in mobilizing public opinion against government policies over the past two years, in fact, demand for improved social services such as education and health are more likely than labor discontent to rally political opposition. Recognizing this public priority, the government is trying to create the institutional conditions for enhancing provision of welfare services.

The South African government acknowledges the need to increase awareness of the reforms it has undertaken in the last six years and has invited dialogue with investors on policies to foster growth. Indeed, the authorities face the challenge of convincing domestic business, along with international investors, about the benefits of making long-term investments in the country. Their efforts could pay off if the public-private partnerships that have been initiated in recent years provide a platform to create and sustain a consensus regarding economic policy, while coming up with concrete growth-inducing investment projects.

In conclusion, the economic, political and institutional conditions seem to be in place for South African investment and growth to accelerate. However, it remains crucial not to underestimate the numerous obstacles that could stand in the way over the near to medium term. The most obvious in the near term is a global slowdown in demand on top of the increased investor risk aversion that has led to a slump in investment flows to emerging markets. Potentially more insidious is the lingering skepticism about Africa in general, which has been exacerbated by the Zimbabwe political situation and civil war elsewhere in the continent.

Longer-term issues that could impinge upon the attractiveness of South Africa as an investment destination concern the relatively low growth South Africa has witnessed compared to some other emerging markets. In addition, the prevalence of crime, the relative shortage of skilled labor and the worries about the impact of AIDS on the work force has created a vicious cycle in which these factors both discourage investment and in turn perpetuate the problems.

Another risk, but even more difficult to manage, is the impact that regional political instability and poor economic performance could have on South Africa. The post-apartheid South African government has been actively involved in peace efforts on the continent and in regional economic initiatives, even when, as the events in Zimbabwe have shown, combating risk perceptions based on events in neighboring countries may sometimes require distancing rather than engaging with those countries. Given the President's hopes of an African Renaissance as well as the clear benefits of regional trade and investment to South Africa, a strategy that is predicated in improving links between Africa and the rest of the world may ultimately prove to be the most rewarding. This, of course, would require considerable skill, energy and the cooperation of trading partners in Africa and on other continents.

HIV/AIDS infection rates in South Africa could also be a possible brake on economic growth. At present, estimates of infection and mortality rates as well as differences in these among various sections of the population vary widely. Although the most severe impact of AIDS will naturally be felt at the household level, the epidemic has clear implications for investment, competitiveness, GDP growth and the government's budget. President Mbeki's participation in the scientific debate regarding the causes of the disease created uncertainty regarding his government's approach to AIDS and healthcare policy. The Health Ministry, in conjunction with other related departments, is appropriately increasing its emphasis on health education and HIV prevention. An effort is also being made to quantify the prevalence, impact and future costs of the disease. Agreements regarding free or subsidized medication are being negotiated with international pharmaceutical companies. However, given the limited resources at the government's disposal and the constraints facing international drug corporations to provide medication free of cost, providing treatment for all those infected will be difficult.

In conclusion, and considering the balance of promising prospects and difficult hurdles facing South Africa, Moody's believes that the rating is under upward pressure. The general government deficit has been reduced from 9% of GDP in 1993/94 to a little over 1% in 1999/00, while inflation came down to the 5% range in 1999 from 9% in 1994. Regulations on investment and barriers to trade have been significantly reduced. GDP growth, which averaged 0.2% between 1990 and 1994, improved to 2.5% on an average annual basis between 1995 and 1999. We believe that the encouraging developments of the last six years will be reflected in an improvement in South Africa's creditworthiness in the medium term.

Rating History

Republic of South Africa

Date	Action	Foreign Currency Bonds and Notes	Foreign Currency Bank Deposits Long Term	Foreign Currency Bank Deposits Short Term	Domestic Currency Gov't Bonds
10/3/1994	Rating Assigned	Baa3	—	—	
10/2/1995	Rating Assigned	—	Ba1	NP	Baa1

South Africa

Key Statistics	1995	1996	1997	1998	1999	2000E	2001F
Economic Indicators							
Real GDP growth (%)	3.1	4.2	2.5	0.7	1.9	3.0	3.3
Nominal GDP (US$ Billions)	151.1	143.0	147.6	133.5	131.1	127.0	129.5
Manufacturing Production (% change)	9.1	1.5	2.8	-3.1	0.2	5.1	6.0
Consumer Price Index (% change)	8.6	7.4	8.5	7.0	5.2	5.6	5.1
M3 (% change)	15.2	13.6	17.2	19.4	7.5	10.0	10.0
Private Sector Credit (% change)	17.8	15.9	14.4	16.0	10.5	12.5	12.5
Treasury Bill Rates (%, annual average)	13.5	15.0	15.3	16.5	13.0	10.0	10.0
Exchange Rate, Rand/US$ (end of period)	3.6	4.7	4.9	5.9	6.2	7.3	7.7
Exchange Rate, Rand/US$ (average)	3.6	4.3	4.6	5.5	6.1	7.0	7.5
Real Effective Exchange Rate (1995=100)	100.0	92.2	98.7	89.5	86.0	—	—
External Debt (US$ Billions)							
Foreign Currency Debt	25.4	26.1	25.2	24.7	23.9	26.0	28.1
o/w Short Term	9.4	8.8	10.9	11.4	—	—	—
Rand-denominated debt	10.0	8.5	14.0	12.5	14.9	15.1	16.4
o/w Bonds	7.3	6.3	10.4	9.2	9.8	—	—
Total External Debt	35.3	34.5	39.2	37.2	38.8	41.0	44.5
Relative Size of External Debt (%)							
External Debt/GDP	23.4	24.1	26.6	27.9	29.6	32.3	34.4
External Debt/Exports	100.4	94.9	103.6	104.2	111.8	113.1	113.3
Foreign Currency Debt/GDP	16.8	18.2	17.1	18.5	18.2	20.4	21.7
Foreign Currency Debt/Exports	72.0	71.6	66.6	69.2	68.8	71.5	71.4
External Debt Service							
Amortization (US$ Millions)	2,343	2,848	3,359	3,207	2,864	2,521	2,653
Interest Payments (US$ Millions)	2,518	2,427	2,776	2,756	2,717	2,872	3,115
Debt Service (US$ Millions)	4,861	5,275	6,135	5,963	5,581	5,393	5,768
Debt Service % Current Account Receipts	13.8	14.5	16.2	16.7	16.1	14.9	14.7

South Africa

	1995	1996	1997	1998	1999	2000E	2001F
Balance of Payments (US$ Millions)							
Trade Balance	2,672	2,686	2,337	1,847	3,748	4,102	3,770
Exports excluding gold	23,871	24,170	25,610	24,430	24,386	26,241	28,934
Net Gold Exports	6,214	6,118	5,603	4,686	3,974	3,696	3,562
Imports	27,412	27,601	28,876	27,269	24,612	25,835	28,725
Services and Income Balance	-4,230	-3,831	-3,877	-3,213	-3,288	-3,385	-3,565
o/w Interest Payments	2,518	2,427	2,776	2,756	2,717	2,872	3,115
Transfers, net	-645	-746	-722	-737	-927	-791	-733
Current Account Balance	**-2,203**	**-1,891**	**-2,263**	**-2,104**	**-467**	**-74**	**-528**
As % of GDP	***-1.5***	***-1.3***	***-1.5***	***-1.6***	***-0.4***	***-0.1***	***-0.4***
Capital Transfers	-40	-47	-194	-56	-43	-22	-27
Foreign Direct Investment, net	-1,256	-226	1,466	-1,171	262	719	533
Liabilities	1,241	818	3,817	561	1,377	1,583	1,467
Assets	-2,498	-1,043	-2,350	-1,732	-1,115	-863	-933
Portfolio Investment, net	2,487	2,227	6,636	3,686	8,354	-863	2,080
Liabilities	2,937	4,183	11,190	9,126	13,484	3,165	5,999
Assets	-450	-1,956	-4,554	-5,441	-5,130	-4,029	-3,920
Other Investment, net	4,223	1,114	-2,232	662	-4,502	1,007	400
Liabilities	4,747	1,743	-289	1,182	-3,160	1,583	1,067
Assets	-524	-629	-1,944	-520	-1,342	-576	-667
Errors and Omissions, net	-844	-2,365	-1,057	-1,744	368	0	0
Change in Reserves (- = increase)	**-2,368**	**1,187**	**-2,357**	**727**	**-3,973**	**-768**	**-2,459**
Foreign Exchange Reserves							
Foreign Exchange Reserves (US$ Millions)	2,815	940	4,790	4,171	6,068	6,836	9,295
Import Cover [1]	0.9	0.3	1.5	1.4	2.2	2.4	2.9

[1] Relative to months of total current account payments.

Public Finances (% of GDP) [1]	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01B	2001/02F
Consolidated General Gov't Revenue	27.9	28.0	28.0	29.4	30.2	28.6	—
Consolidated General Gov't Expenditures	33.1	33.6	32.5	31.9	31.2	30.6	—
o/w Interest Payments	5.8	5.8	5.8	5.9	5.6	5.8	—
General Gov't Financial Balance [2]	-5.2	-5.6	-4.5	-2.5	-1.1	-1.8	-2.2
Primary Balance	0.6	0.2	1.3	3.4	4.5	3.8	—

[1] Fiscal years run from April to March.
[2] Includes net lending.

Government Debt (% of GDP)	1995	1996	1997	1998	1999	2000	2001
National Government Gross Debt	50.4	49.3	49.3	49.0	48.9	47.9	46.8
o/w in Domestic Currency	48.6	47.0	47.2	46.8	46.4	—	—
o/w in Foreign Currency	1.8	2.3	2.2	2.1	2.5	—	—

Sovereign

South Africa

Analysis

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