5

Asset and liability management

Overview

With the establishment of an Asset and Liability Management branch in the Department of Finance, Government has brought an integrated approach to the management of the State's financial obligations, assets and risks.

Asset management

Normalisation of financial accounts of public enterprises

The protocol on corporate governance issued during 1996 provides a point of departure for normalising the financial accounts and tax and dividend policies of major state-owned enterprises. The principles in the protocol will be incorporated into regulations to be issued in terms of the Public Finance Management Act of 1999.

Proceeds of R6,9 billion in 1999/00

During 1999/00, proceeds from the restructuring of state-owned assets amounted to R6,9 billion, or R2,9 billion more than budgeted. This was mainly due to restructuring proceeds received from Sasria.

The restructuring of state-owned enterprises has gained momentum. The Department of Public Enterprises is currently finalising an integrated restructuring programme, in which priority will be given to the larger utilities and enterprises.

Liability management

Shift in focus to active debt management

Since the appointment of a panel of primary dealers on 1 April 1998, the focus of debt management has turned to the development of the South African securities market. The South African bond market has matured considerably, creating opportunities for more active management of the debt portfolio to reduce risks and debt servicing costs.

Net borrowing requirement of R12,0 billion in 1999/00

The net borrowing requirement during 1999/00 was substantially reduced to R14,3 billion, largely because of the receipt of a special restructuring dividend from Sasria. At the end of 1999/00, total government debt will amount to 46,4 per cent of GDP, down from a high of 48,2 per cent in 1996/97.

Declining debt-GDP ratio

The net borrowing requirement in the 2000/01 financial year is expected to be R20,3 billion. Of this amount, R13,6 billion will be financed in the domestic market and the balance (about US$ 1 billion) in foreign capital markets. The total outstanding debt is projected to decline steadily to 45,0 per cent of GDP at 31 March 2001 and 42,0 per cent by the end of 2002/03.

Debt costs lower than budgeted

The interest costs of servicing state debt will amount to R44,5 billion in 1999/00, which is R1,6 billion lower than budgeted mainly because of lower interest rates and debt reduction through state asset restructuring. State debt costs are estimated at R46,5 billion in 2000/01. Interest on debt is steadily falling as a percentage of GDP, thereby freeing up tax resources for other priorities.

Decline in contingent liabilities

Contingent liabilities reflected in the Statement of Financially Related Assets and Liabilities have declined from R148,5 billion at 31 March 1998 to R124,8 billion at 31 March 1999.

Improved credit ratings

During the past year, several international credit rating agencies acknowledged the positive political and economic developments in South Africa by raising their rating outlook for the country.

Asset management

Protocol on corporate governance

In consultation with the Department of Public Enterprises, a corporate governance protocol was developed in 1996 and approved by Cabinet. It provides a framework for financial performance, including tax and dividend policies, and a code of corporate practice and conduct. The principles of the protocol will be incorporated into regulations issued in terms of the Public Finance Management Act of 1999.

Adoption of tax and dividend policies for public enterprises

The principles in the protocol signal Government’s commitment to normalising the financial affairs of government business enterprises. To ensure transparency, the integrity of the budget and prudence in the management of public entities, any subsidisation of government business enterprises that may be warranted should be done through the budget allocation process and not through the retention of tax or dividends.

Dividend receipts of R610 million in 1999/00

In 1998/99 Government received dividend payments of R475,8 million and, in 1999/00, R610,2 million, excluding the special restructuring dividend received from Sasria.

During 1999, progress with the normalisation of tax and dividend payments was as follows:

- *Central Energy Fund (CEF)*: Consolidation of the group accounts and payment of a first dividend of R180 million.
- *Sasria*: The Conversion of Sasria Act of 1998 was enacted and a special restructuring dividend of R6,2 billion was paid. Sasria will in future pay normal dividends to Government, based on its profit levels.
- *Eskom*: The Eskom Amendment Act of 1998 is an important step in the restructuring of Eskom and forms the basis for negotiations on revoking its tax-exempt status and on dividend payments.
- *Development Bank of Southern Africa (DBSA)*: The Board of Directors accepted the principle of becoming a tax- and dividend-paying entity. Negotiations currently focus on appropriate mechanisms to implement the policy while protecting the capital base of this development finance institution.

Restructuring of state assets

The restructuring of public enterprises will gather pace in 2000 and beyond. The Department of Public Enterprises is developing an integrated programme for restructuring, for consideration by the Inter-Ministerial Cabinet Committee in March 2000. The restructuring of the larger public utilities – Telkom, Eskom, Denel and Transnet – will receive priority.

Proceeds from restructuring of state assets

During 1999/00 a further R43,9 million was received from the sale of the Airports Company, R6,2 billion from the restructuring of Sasria and R610 million from the sale of a 20 per cent stake in South African Airways, bringing total net asset restructuring proceeds to R6,9 billion. In addition, secondary tax on companies of about R800 million was paid into revenue as a result of the restructuring of Sasria.

Reinforcement of the restructuring programme

The restructuring programme is coordinated by the Ministry of Public Enterprises and is undertaken within the context of a National Framework Agreement. This agreement affords high priority to reducing state debt, recapitalising public enterprises and broadening economic participation. While the primary focus for restructuring will be the energy, transport, telecommunication and defence sectors, restructuring of other state-owned enterprises will occur concurrently. Various approaches are being adopted in the restructuring process, including corporatisation, concessioning, strategic equity partners, business re-engineering and divestiture. The capacity of the Department of Public Enterprises has been enhanced in order to reinforce the restructuring programme.

Proceeds of asset restructuring

Table 5.1 summarises the restructuring transactions that have been completed to date. A total investment of R8,6 billion has been raised, mainly from international equity partners, of which R3,3 billion has been paid to the exchequer to reduce debt. The conversion of Sasria into a state-owned company has allowed a further R6,2 billion in debt to be redeemed.

Table 5.1 Proceeds of the restructuring of state enterprises

R million	Date of transaction	Stake sold (%)	Proceeds from sale of assets	Proceeds paid to exchequer to reduce debt
Sun Air	November 1997	100	42,1	21,1
Telkom	May 1997	30	5 630,5	1 165,4
SABC radio stations	March 1997	100	510,4	510,4
Airports Company	June 1998	25	1035,1	1035,1
South African Airways	July 1999	20	1 400,0	610,5
Connex	August 1999	100	15,0	–
Sasria	February 2000	Special restructuring dividend		6 171,4
Total			**8 633,1**	**9 513,9**

Termination of sale of Aventura

The successful bidder for the Aventura holiday resorts did not meet the payment obligations and Government was forced to terminate the sale contract. Government has since appointed the Protea Group to manage and restructure the company.

Sun Air negotiations in progress

Government has received 50 per cent of the proceeds of the sale of Sun Air. The balance was to be paid in January 2000, but Sun Air has since been liquidated. Government is negotiating with the former shareholders, Rethabile/Consolidated Network Investments, regarding payment of the outstanding debt of R20 million and commitments under the employee share ownership programme.

Telkom 30% share sold

A 30 per cent stake in Telkom was sold to the SBC/Telekom Malaysia consortium in 1997. Government received US$961 million (R5,6 billion) for the initial sale, and invested US$700 million as its share of a US$1,0 billion recapitalisation programme. The net proceeds (R1,2 billion) were paid to the exchequer.

Radio stations

An amount of R510 million was received from the sale of six radio stations and was paid to the exchequer.

Airports Company empowerment and employee participation

A 20 per cent equity stake in the Airports Company was sold for R819 million to Aeroporti di Roma, which also has an option to acquire a further 10 per cent stake on the public listing of the company. A 10 per cent share has been reserved for black economic empowerment, of which 4,2 per cent was taken up for an amount of R173 million. Of the 9 per cent set aside for sale to management and employees, 1,2 per cent, valued at R43,8 million, was sold in October 1999.

South African Airways 20% stake sold

The sale has been finalised of a 20 per cent stake in South African Airways to Swissair for R1,4 billion. Government agreed to the disposal of a further 10 per cent equity stake to economic empowerment groups, the National Empowerment Fund and employees. In keeping with a burden-sharing agreement, Government will take over R1,3 billion of the shortfall in the Transnet Pension Fund attributable to South African Airways.

Proceeds from the sale of strategic oil stocks

Proceeds received by the exchequer from the sale of strategic oil stocks since 1995/96 are shown in Table 5.2.

Table 5.2 Proceeds from the sale of strategic oil stocks

R million	1995/96	1996/97	1997/98	1998/99	Total
Proceeds	1 336	1 603	2 947	1 730	7 616

Current public enterprise initiatives

Preparations are in progress for further equity partnerships or outright sales of government businesses. An amount of R5,0 billion is anticipated for the reduction of state debt from the proceeds of the restructuring of state assets during 2000/01.

Forestry restructuring to be finalised this year

Negotiations are proceeding for the finalisation of prices and conditions for the restructuring of SAFCOL and lease of forests managed by the Department of Water Affairs and Forestry. Preferred bidders for the forestry packages are reflected in Table 5.3. These transactions aim to achieve greater competition in the forestry and saw-milling industry, and black economic empowerment groups are expected to become significant players. The Mpumalanga and Northern Province packages have been re-offered on a stand-alone basis, and the process is to be completed by

June 2000. Government is reviewing its position on the Western Cape package with alternative land-use considerations. In addition to the proceeds of these transactions, Government will receive an annual income from the lease of the land and significant savings will be achieved in respect of forests currently managed by the Department.

Table 5.3 Government-approved bidders for SAFCOL and government forests

Package	Consortia
Southern Cape	Thesen consortium
Eastern Cape South	Amathole Timber Holdings
Eastern Cape North	Singisi Forest Products
KwaZulu-Natal	Siyaqhubeka packages

Alexcor under new management

With a view to putting Government's diamond mining concern on a sound footing, a 2-year strategic management contract has been awarded to Nabera, entailing the transfer of operational responsibility for Alexcor. A loan facility to the company to the value of R70 million has been approved, as has the withdrawal of Mmakau Mining from the Nabera consortium.

Division of Eskom into 3 entities

The Eskom Amendment Act of 1998 constitutes an important step in the restructuring of Eskom. The Act vests ownership of the equity in the state and establishes the legal basis for revoking Eskom's tax-exempt status and for the payment of dividends. Eskom is currently restructuring into separate generation, transmission and distribution corporate entities.

Sasria special dividend of R6,2 billion…

The Conversion of Sasria Act of 1998 provides for the conversion of the SA Special Risks Association into a public company owned by the state. At the time of the conversion, Sasria held reserves in excess of R10,0 billion. In terms of the Act, Government appointed an independent actuary to advise on the portion of the reserves that the converted Sasria would require to continue its business. Based on the actuarial report, a special restructuring dividend of R6,2 billion was declared from the excess reserves and applied to reduce public debt. R5,0 billion has already been received and the remainder is expected before the end of the fiscal year. The transaction also leads to a secondary tax on companies payment of R800 million.

…with privatisation to follow

The Act further provides for the full privatisation of Sasria, by the Minister of Finance, after consultation with the short-term insurance industry. This process has commenced and a transaction advisor will shortly be appointed.

Telkom empowerment sale of shares and initial public offer

Government has approved that 5 per cent of Telkom's equity, worth an estimated R970 million, should be sold to empowerment groups, employees and the National Empowerment Fund. Black economic empowerment groups were invited to submit applications for a 3 per cent stake and the transaction should be concluded by October 2000. Approval has also been granted for the purchase by Telkom employees of 2 per cent of shares, valued at R310 million. The Inter-Ministerial Cabinet Committee has endorsed a 20 per cent initial public offer of Telkom shares by 2001.

Sale of Transnet's non-core enterprises

The corporatisation, restructuring and sale of Transnet's non-core business units have been approved. The sale of Connex Travel for R15 million has been completed. The disposal of Autonet, Protekon, Air Chefs, Apron Service, Production House and Chemical Services is underway. Transwerk has been corporatised into four entities – Transwerk Rollstock, Transwerk Traction, Transwerk Foundries and Transwerk Perway. Work is in progress on outstanding issues, including contractual commitments, the funding of pension obligations and medical scheme arrangements.

Review of options for Transnet core entites

Structural options and restructuring strategies for core businesses Portnet, Petronet and Spoornet are currently being discussed, with due regard to the role of these entities in the broader transport sector.

Arms industry restructuring

Options for restructuring the arms industry are under review. The sale of Denel's non-core activities has been approved, as has the purchase of a 50 per cent shareholding in Debis IT Services.

Consolidation of IT interests

Government has approved the merger and consolidation into a single corporate entity of the information techonology service providers within Denel (Ariel Technologies), Eskom and Transnet (Datavia).

Telecommunications merger

The merger and corporatisation of the telecommunications divisions of Transnet (Transtel) and Eskom have also been approved. A steering committee comprising representatives of these entities and Government has been convened.

Sale of equity in Sentech

The Inter-Ministerial Cabinet Committee has approved the sale of a minority stake in signal distributor Sentech to a strategic equity partner to access capital, technology and expertise. Terms of reference have been drawn up for the appointment of a transaction adviser.

Restructuring of the SABC

Government has approved the appointment of advisers on the restructuring of the South African Broadcasting Corporation. The restructuring is aimed at corporatisating the SABC, achieving a separation of public broadcasting and commercial services, and implementing transparent mechanisms for cross-subsidisation of these services.

Management partner for the Post Office

The South African Post Office signed an agreement in September 1999 appointing New Zealand Post International as a strategic management partner.

Cash management

The Finance Department's asset management responsibilities include control of short-term investments and cash management.

Investment of surplus cash

Since February 1994, Government has invested surplus cash in tax and loans accounts at the four major clearing banks. This assists the Reserve Bank in managing the money market shortage and earns interest for the exchequer. Interest earned on tax and loans accounts since 1994/95 is set out in Table 5.4.

Table 5.4 Interest earned on tax and loan accounts, 1994/95–1999/00

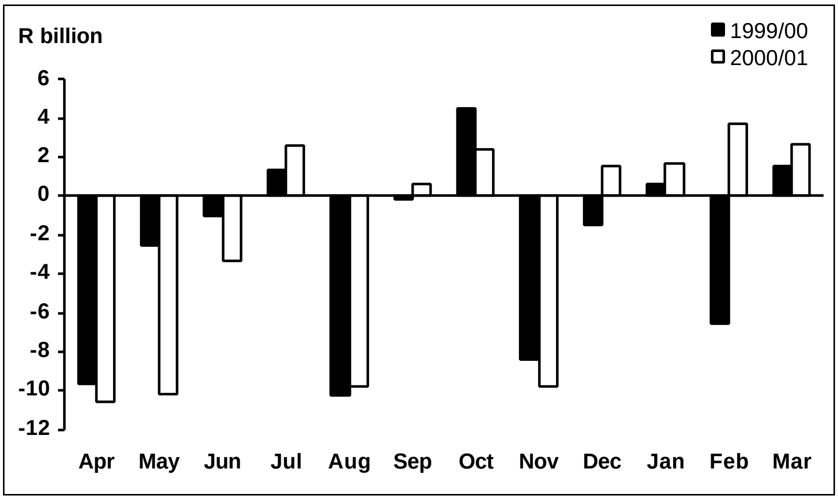
R million	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00 estimate	Total
Interest	309	779	943	452	750	500	3 733

Monthly peaks in cash flows

Cash flow requirements in 1999/00 are illustrated in Figure 5.1. Peaks arise from seasonally high expenditure during April, interest payments of about R10,0 billion in August and February and repayments of loans of R7,5 billion, R5,0 billion and R5,0 billion in November, December 1999 and March 2000 respectively.

For similar reasons, monthly cash requirements in 2000/01 are expected to be high in April and August, and February 2001. The repayment of domestic loans of R7,5 billion in May and R7,5 billion in November 2000 and a foreign loan of about R1,8 billion in June 2000 will also result in high cash flow requirements during the first half of the year.

Figure 5.1 Monthly surplus/deficit before borrowing, 1999/00–2000/01



Liability management

Increasingly liquid debt market

The South African securities market has become increasingly liquid, partly in response to the introduction of regular bond auctions to complement the weekly treasury bill auctions and the market-making role of the panel of primary dealers appointed in April 1998. The domestic capital market has evolved to a point where the focus of debt management can turn to strategies to reduce risks and debt servicing costs further.

Improved investor confidence

The soundness of the South African securities market is illustrated by its performance relative to other emerging markets during the financial crisis of 1997 and 1998. Investor confidence has improved, reflected by increased commitment of funds at the long end of the curve and active participation of foreign investors in the domestic securities market.

From capital market development…

Over the last two years, the priority has been the development of the domestic capital market, promoting a more balanced maturity structure and enhancing liquidity in Government's benchmark funding securities. The management of debt has largely been governed by the principle that debt service costs are minimised in a liquid, well-functioning market for government securities.

…to risk management and cost reduction

The matured securities market has created scope for Government to use a broader range of debt management techniques and strategies to reduce debt servicing costs:

- *Reduction of state debt cost*: Switch auctions, for example, will be used to manage redemptions of domestic government bonds. A switch is a repurchase of government securities before maturity, with payment in terms of more liquid securities. Alternatively, the treasury can repurchase securities for a cash settlement under suitable market conditions. This provides a low risk mechanism for reducing borrowing costs.
- *Debt consolidation*: Consolidation of bond issues can enhance market liquidity. The consolidation of several smaller outstanding government bond issues improves market liquidity by focusing trading activities on fewer instruments.
- *Risk management*: Recent international experience shows that countries that do not manage their liabilities properly become vulnerable to market shocks. The Department of Finance is exploring options for managing the risk exposure of both the domestic and foreign liabilities of government to possible market shocks.

Borrowing requirement and financing

Borrowing requirement

Budget deficit

The revised estimates of expenditure and revenue for 1999/00 yield a budget deficit of R19,7 billion, increasing to R23,1 billion in 2000/01, equivalent to 2,6 per cent of projected GDP. Table 5.5 shows the resulting borrowing requirements, with projections to 2002/03.

Sasria proceeds of R6,9 billion

In the 1999 Budget provision was made for restructuring proceeds of R4,0 billion. The revised estimate is R6,9 billion, mainly as a result of the conversion of Sasria to a state-owned public company. For the 2000/01 year, restructuring receipts of R5,0 billion are anticipated.

Extraordinary payments adding to debt

The borrowing requirement is also affected by extraordinary expenditure items. A payment of R152 million was made in 1999/00 as final settlement of outstanding obligations to the Closed Pension Fund for former political office-bearers. Government's burden-sharing agreement regarding Transnet Pension Fund shortfalls attributable to South African Airways amounted to R1,3 billion, and R2,2 billion is provided for the take-over of South African Rail Commuter Corporation debt during 2000/01.

Net borrowing requirement

After asset restructuring proceeds and extraordinary payments, the net borrowing requirement for 1999/00 is expected to be R14,3 billion. After similar adjustments for 2000/01, the net borrowing requirement is R20,3 billion.

Table 5.5 Budget deficit and net borrowing requirement, 1998/99–2002/03

	1998/99	1999/00		2000/01	2001/02	2002/03
R million	**Outcome**	**Budget**	**Revised**	**Budget**	**Forward estimate**	
Budget deficit[1]	**17 206**	**23 020**	**19 734**	**23 053**	**24 078**	**23 071**
Proceeds from the sale of state assets	-2 722	-4 000	-6 900	-5 000	-6 000	-10 000
Extraordinary payments	936	–	1 485	2 200	–	–
Net borrowing requirement	**15 420**	**19 020**	**14 323**	**20 253**	**18 078**	**13 071**

1. After excluding revaluation of maturing foreign loans of R657,7 million in 1998/99 and R2 110,3 million budgeted for 1999/00, revised to R1 982,5 million, from expenditure.

Reclassification of foreign loan revaluations

The revaluation of maturing foreign loans, previously reflected as a "management cost" in state debt cost, is now included in the redemption of foreign loans as part of financing, in line with international practice.

Redemptions of R20,4 billion in 1999/00

Total loan redemptions will amount to R20,4 billion in 1999/00, compared with the R19,4 billion projected at the time of the budget. The revised amount includes the following, not provided for in the original estimates:

- Early redemption of R1,4 billion government bonds held by Sasria
- Higher payments of R15 million on Development Board loans to former provincial administrations
- Payments of R73 million in respect of former Namibian debt
- R128 million lower rand value of maturing foreign loans.

Table 5.6 shows loan redemptions projected to 2002/03.

Table 5.6 Loan redemptions, 1998/99–2002/03

	1998/99	1999/00		2000/01	2001/02	2002/03
R million	**Outcome**	**Budget**	**Revised**	**Budget**	**Forward estimate**	
Government bonds	14 857	14 511	15 619	15 118[2]	22 404	17 061
Foreign loans:	–	–	–	–	–	–
Principal	1 067	2 696	2 696	1 328	12	–
Revaluation[1]	658	2 110	1 983	560[1]	33	–
Former Namibian debt	11	5	79	5	24	50
Former TBVC and self-governing territories debt	33	36	51	19	20	–
Total loan redemptions[2]	**16 626**	**19 358**	**20 427**	**17 031**	**22 493**	**17 111**

1. Valued at exchange rates prevailing at 31 January 2000.

2. Excludes R236,7 million of "book profit" on government bond transactions, regarded as "negative" loan redemptions for purposes of analysis as it does not represent an actual cash flow.

Financing the borrowing requirement, 1999/00

Table 5.7 shows the financing of the net borrowing requirement in 1999/00, with projections to 2002/03. These estimates and those for previous years are set out in Table B4, Annexure B.

Table 5.7 Financing of net borrowing requirement, 1998/99–2002/03

	1998/99	1999/00		2000/01	2001/02	2002/03
	Outcome	Budget	Revised	Budget	Forward estimate	
Domestic short-term loans (net)	**1 353**	**3 000**	**3 000**	**3 500**	**4 000**	**4 500**
Domestic long-term loans (net)	**18 215**	**14 826**	**4 985**	**10 141**	**7 124**	**1 071**
New loans	39 310	33 092	23 904	26 293	33 805	20 446
Discount on issue of new loans	-6 194	-3 713	-3 171	-1 009	-4 234	-2 265
Redemptions (net of book profit)	-14 901	-14 553	-15 749	-15 143	-22 447	-17 111
Foreign loans (net)	**-678**	**1 194**	**3 639**	**4 612**	**6 955**	**7 500**
New loans (net)	1 048	6 000	8 385	6 500	7 000	7 500
Discount on issues of new loans	–	–	-67	–	–	–
Redemptions (including revaluation of loans)[1]	-1 725	-4 806	-4 679	-1 888[1]	-46	–
Change in cash and other balances[2]	**-3 470**	**–**	**2 700**	**2 000**	**–**	**–**
Opening balance	3 230	2 000	6 699	4 000	2 000	2 000
Cash balance	2 610	1 287	4 436	4 000	2 000	2 000
Surrenders/Late requests	620	–	1 551	–	–	–
Own Affairs balances	–	713	713	–	–	–
Closing balance	6 700	2 000	4 000	2 000	2 000	2 000
Total financing (net)	**15 420**	**19 020**	**14 323**	**20 253**	**18 078**	**13 071**

1. Valued at exchange rates prevailing on 31 March 1999 and forward projections for other financial years.
2. A positive change indicates a reduction in cash balances.

Cash balances and surrenders of R6,7 billion

The initial exchequer cash balance at the beginning of 1999/00 amounted to R5,1 billion, including surplus balances of R713 million on the accounts of the former “own affairs” administrations. Departmental surrenders (net of late requests) of R1,6 billion brought the balances available for 1999/00 to R6,7 billion, of which some R2,7 billion is expected to contribute to the 1999/00 financing requirement.

To provide for the government’s forecast cash requirements in the first quarter of 2000/01, a 1999/00 year-end balance of R4,0 billion will be carried forward to the new year. End-of-year balances of R2,0 billion are projected over 2000/01 to 2002/03.

Short-term loans increase by R3,0 billion

Short-term borrowing in 1999/00 is expected to contribute about R3,0 billion to financing, at an average interest rate of 11,5 per cent (budgeted 14 per cent). Government will continue to promote liquidity at the short end of the market by increasing the volume of treasury bill issues during 2000/01 by R3,5 billion. The increase in short-term financing since 1994/95 is illustrated in Table 5.8.

Table 5.8 Short-term loans outstanding, 1994/95–2000/01

As at 31 March R million	1995	1996	1997	1998	1999	2000 Estimate	2001
Treasury bills:							
Shorter than 91 days	1 880	–	–	–	–	–	–
91 day	4 700	10 500	9 100	11 200	13 800	16 800	20 300
182 day	–	200	5 200	6 085	5 200	5 200	5 200
Bridging bonds	8 453	4 267	–	–	–	–	–
Public Investment Commissioners	1 220	–	–	–	–	–	–
Corporation for Public Deposits	600	600	2 567	1 497	1 117	1 117	1 117
Other[1]	32	14	12	12	10	10	9
Total	16 885	15 581	16 879	18 776	20 127	23 127	26 626

1. Loan levies and Bophuthatswana bonds.

Domestic bond issues raise R5,0 billion in 1999/00

Net finance raised through domestic bond issues in 1999/00 is projected to be R5,0 billion, which is R9,8 billion lower than the budgeted amount. Less finance was raised in the domestic market because foreign loan financing and asset restructuring proceeds were higher than envisaged.

Up to 31 January 2000, new domestic loans with a total nominal value of R16,3 billion were issued, at an average coupon rate of 11,3 per cent and an average yield of 14,2 per cent (budgeted 14,0 per cent). Details are set out in Table 5.9.

Table 5.9 Government bonds issued, 1999/00

As at 31 January 2000 R million	Bond issues	Finance raised	Discount	Average yield (%)
Medium-term:				
R193 (floating; 2003)	500	495	5	11,39
R175 (9,0%; 2003)	3 484	3 036	449	14,05
R150 (12,0%; 2005/06/07)	4 296	3 962	335	14,07
Long-term:				
R153 (13,0%; 2010/11/12)	1 859	1 714	145	14,44
R157 (13,5%; 2015/16/17)	1 947	1 780	168	14,91
R186 (10,5%; 2025/26/27)	4 201	3 085	1 116	14,42

Medium-term bonds comprised 50,8 per cent of issues and long-term bonds 49,2 per cent.

Floating rate and CPI-linked bond issues

A floating-rate bond (R193) maturing in March 2003 has been issued to replace the R192 bond redeeming in March 2000. In addition, an inflation-linked bond will be issued during the first quarter of 2000, its indexing based on headline CPI with a 3-month lag. The issuance of CPI-linked bonds will become a feature of Government's overall funding strategy.

Additional take-up of bonds by primary dealers

Primary dealers are permitted to take up a further 10 per cent of their allotted amounts at any auction, on a non-competitive basis, within 24 hours of the close of the auction. About 4,4 per cent of the total bond issues for 1999/00 were taken up in terms of this option.

Bond market turnover

Trading activity in the secondary bond market has continued to increase strongly. During 1999, gross turnover in government bonds amounted to an estimated R8 469 billion, compared to R8 071 billion in 1998 and R3 547 billion in 1997. Non-residents were net purchasers of R14 billion in government bonds, whereas they accounted for net sales of R10 billion in 1998 and net purchases of R15 billion in 1997.

Foreign issues of euro-bonds and US$ global bond

At the time of the 1999 Budget, it was envisaged that R6,0 billion would be raised through foreign loans. In April 1999, Government entered the euro-currency market with a 7-year E500 million eurobond launched at a spread of 328 basis points over German government bonds. This was followed by a 10-year US$500 million global bond in the same month, at a spread of 370 basis points over United States government treasuries. Both bonds showed continuous strong performance last year.

Foreign borrowing of US$1,3 billion

In October 1999, government entered the foreign market again with a 5-year E300 million bond based on solid demand for South African bonds, supported by strong economic performance. This was the first to be executed off the euro medium-term note programme established in March 1999, and it brought total borrowing to approximately US$1,3 billion, US$300 million more than budgeted.

Table 5.10 Foreign bond issues, 1999/00

Coupon (%)	Maturity	Size (million)	Spread at launch (basis points)	Current spread [1] (basis points)
6,750	19 May 2006	E500	328	175
9,125	19 May 2009	US$500	370	225
7,000	17 October 2004	E300	250	165

1. As at 15 February 2000

Financing the borrowing requirement, 2000/01

Domestic net borrowing in 2000/01 of R10,1 billion

The projected net borrowing in domestic government bonds will total R10,1 billion in 2000/01, while the gross borrowing requirement is projected to be R26,3 billion. To smooth the maturity profile, funding will be spread over the medium and long end of the curve, which includes the R150, R177, R153, R157 and R186 government bonds. In addition, the R193 (a floating-rate bond) will be included in the 2000/01 funding strategy, and a new inflation-linked instrument. To smooth the redemption curve and ensure liquidity throughout the yield curve, switch auctions will be conducted to repurchase bonds before maturity.

Foreign borrowing of US$1,0 billion

The projected foreign borrowing in 2000/01 is equivalent to US$1,0 billion. Of this amount, about US$300 million will finance the export credit agreements of the defence procurement programme, and the defence purchases will continue to be financed within the envisaged foreign financing programme. Government pursues the following broad foreign borrowing objectives:

- Establish liquid benchmarks in major currency markets
- Maintain a balanced portfolio of foreign currency denominated debt
- Broaden and improve the quality of the foreign investor base
- Borrow at the most cost-effective rates.

The financing of the foreign borrowing requirement will to a large extent depend on market conditions. Government will continue to use the flexibility of the euro medium-term note programme to access the market when favourable opportunities arise.

Government debt portfolio

Other factors affecting debt

Consolidation of RSA debt

In addition to financing the national budget deficit, government debt increased because R13,9 billion debt of the former TBVC-states and self-governing territories was converted to national debt during 1994/95, in terms of the 1993 Constitution. The consolidation of this debt into the national government's debt portfolio has largely been completed. Outstanding balances to be incorporated are summarised in Table 5.11. About R1,4 billion in obligations of the Republic of Namibia were also taken over by Government in 1998.

Table 5.11 Former regional authorities' debt incorporated into RSA debt instruments, 1994/95–1999/00

As at 31 March R million	1995	1996	1997	1998	1999	2000
Short-term loans	8 594	4 278	9	9	7	7
Capital market loans	732	685	572	106	37	–
RSA government (Foreign Affairs)	483	448	430	411	–	–
Industrial Development Corporation	130	117	103	86	74	62
Development Bank of Southern Africa	2 929	3 154	3 160	93	138	63
Other	3	1	–	–	–	–
Total	**12 872**	**8 683**	**4 273**	**705**	**255**	**132**

Bond issues to the Reserve Bank, pension funds and SAA

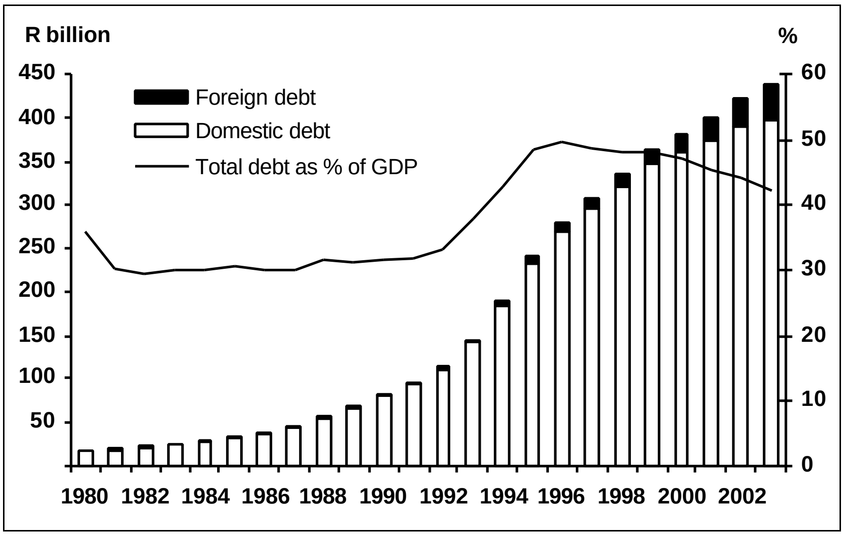
Loan debt also increased since 1993/94 because government bonds amounting to R10,6 billion were issued to the Reserve Bank to compensate for realised losses on the Gold and Foreign Exchange Contingency Reserve Account. In addition, a transfer of R7,4 billion was made to the government pension funds in 1993/94 to compensate for the impact of early retirement offers to civil servants. Government's burden-sharing of South African Airways' unallocable debt, amounting to R1,3 billion, was settled in 1999/00.

Total government debt

Decline in net loan debt as % of GDP

After taking into account the balances of the National Revenue Fund (government's accounts with the South African Reserve Bank and commercial banks), total net loan debt declined from 48,2 per cent of GDP at 31 March 1997 to a projected 46,4 per cent of GDP at the end of 1999/00, as illustrated in Figure 5.2.

Figure 5.2 Government debt, 1980–2003



Increase in total government debt

The projected increase in government debt of R14,1 billion in 1999/00 is explained in Table 5.12.

Table 5.12 Increase in government debt, 1999/00

	R million
Financing of the national budget	14 861
Unamortised discount on zero coupon bonds	178
Debt of the former regional structures/Namibia	94
Payments to Closed Pension Fund and SAA burden-sharing	1 485
Foreign loan revaluations and other adjustments	576
Increase in loan debt	**17 194**
Change in cash balances (decrease +)	1 166
Increase in net loan debt	**18 360**
Foreign exchange forward cover profits (-) realised by the SARB	-4 231
Total projected increase in government debt	**14 129**

Projected increase in government debt

Total net loan debt is projected to be R398,3 billion on 31 March 2001. This is 45,0 per cent of expected GDP, compared with the estimated 46,5 per cent of GDP on 31 March 2000. Total government debt may also be affected by:

- revaluation of foreign loans because of exchange rates movements
- forward cover losses or profits on the Gold and Foreign Exchange Contingency Reserve Account
- proceeds from the sale of state assets.

Based on the projected budget deficit, asset restructuring proceeds and discounts on bond issues for 2001/02 and 2002/03, total net loan debt will decline further to 42,0 per cent of GDP by 31 March 2003.

The composition of government debt since 1995/96 is summarised in Table 5.13. Table B8 of Annexure B sets out the figures since 1975.

Table 5.13 Total government debt, 1996–2003

As at 31 March	1996	1997	1998	1999	2000	2001	2002	2003
R billion						Forward estimate		
Marketable domestic debt	263,8	290,4	318,8	344,9	358,1	372,9	388,4	395,8
Non-marketable domestic debt	4,7	6,4	2,8	2,0	2,1	2,0	2,0	2,0
Total domestic debt	268,5	296,8	321,5	346,9	360,2	374,9	390,4	397,8
Total foreign debt[1]	11,0	11,4	14,6	16,3	20,2	25,4	32,3	39,8
Total gross loan debt	**279,5**	**308,2**	**336,1**	**363,2**	**380,4**	**400,3**	**422,8**	**437,6**
Percentage of GDP	*49,6%*	*48,6%*	*48,1%*	*48,1%*	*47,0%*	*45,2%*	*44,1%*	*42,2%*
Less: National Revenue Fund balance	-8,6	-2,8	-4,8	-5,2	-4,0	-2,0	-2,0	-2,0
Total net loan debt	**270,9**	**305,5**	**331,3**	**358,1**	**376,4**	**398,3**	**420,8**	**435,6**
Percentage of GDP	*48,0%*	*48,2%*	*47,4%*	*47,4%*	*46,5%*	*45,0%*	*43,9%*	*42,0%*
Gold and Foreign Exchange Contingency Reserve Account[2]	–	2,2	0,1	14,4	10,2	10,2	10,2	10,2
Total net government debt	**270,9**	**307,7**	**331,4**	**372,5**	**386,6**	**408,5**	**431,0**	**445,8**

1. Valued at exchange rates prevailing at 31 January 2000.

2. Mainly foreign exchange losses incurred through provision of forward cover by the Reserve Bank.

3. The total net government loan debt is calculated with due account of the balance of the National Revenue Fund (balances of government's accounts with the South African Reserve Bank and the Tax and Loans Accounts with commercial banks).

Forward cover losses

Total government debt includes the balance on the Gold and Foreign Exchange Contingency Reserve Account at the Reserve Bank. Over the past year profits made on forward contracts have brought the projected balance on this account to R10,2 billion on 31 March 2000, R4,2 billion lower than the balance a year ago.

Debt maturity profile

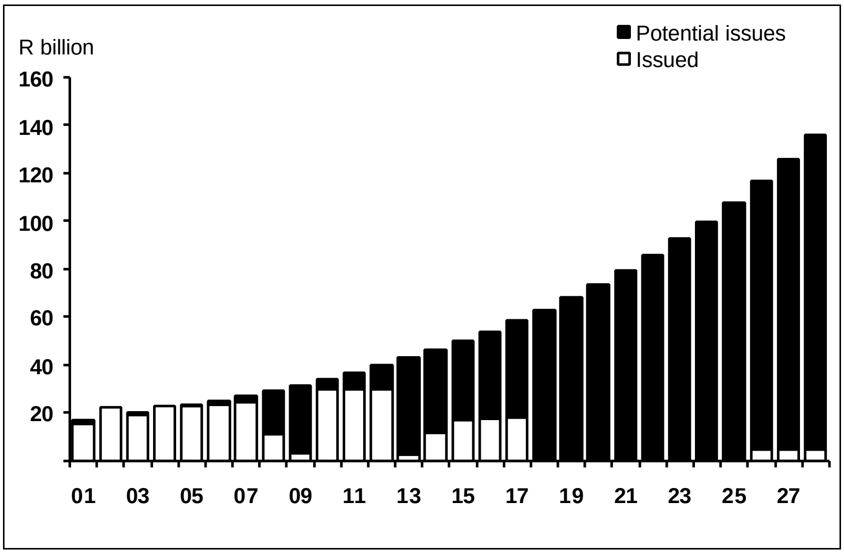
Maturity profile of domestic bonds

Government aims to keep annual bond redemptions at about R12,5 billion in 1997/98 prices, to prevent undue bunching. Table 5.14 and Figure 5.3 illustrate the scope for further issues within this limit.

Table 5.14 Further potential issues of government bonds

Bond code	R billion
R193 (floating TB; 2003)	0,7
R150 (12,0%; 2005/06/07)	2,4
R189 (floating CPI)	40,3
R177 (9,5%; 2008)	18,6
R153 (13,0%; 2010/11/12)	21,4
R157 (13,5%; 2015/16/17)	109,8
R186 (10,5%; 2026/27/28)	364,0

Figure 5.3 Maturity profile of domestic marketable bonds, 31 March 2000



Average maturity / duration of domestic marketable bonds

Bonds with an outstanding maturity of less than three years comprise 16,3 per cent of the total domestic marketable bonds in issue, 28,7 per cent lie between three and seven years, 4,1 per cent between seven and 10 years, 46,6 per cent between 10 and 19 years and 4,3 per cent are dated longer than 19 years ahead. The average maturity is nine years, and the average duration of domestic marketable bonds is five years.

Composition and ownership of domestic debt

Composition of domestic debt

On 31 March 2000 fixed-interest bonds are expected to comprise 91,2 per cent of total domestic debt, while treasury bills should account for 6,1 per cent, as shown in Table 5.15.

Table 5.15 Composition of domestic debt, 1993/94–1999/00

As at 31 March R million	1994	1995	1996	1997	1998	1999	2000 Estimate
Government bonds:							
Fixed interest	164 375	199 674	237 515	258 933	291 439	315 889	328 422
Floating	618	458	305	150	18	5	–
Zero coupon	10 517	10 517	11 362	17 191	10 049	10 049	7 711
Bridging Bonds	–	8 453	4 267	–	–	–	–
Treasury bills	6 568	6 580	10 700	14 300	17 285	19 000	22 000
Public Investment Commisioners	–	1 220	–	–	–	–	–
Corporation for Public Deposits	1 979	600	600	2 567	1 479	1 117	1 117
Namibian loans	–	–	–	–	680	669	591
Other	713	3 865	3 795	3 704	601	222	399
Total	**184 770**	**231 367**	**268 544**	**296 845**	**321 551**	**346 951**	**360 240**

Ownership of domestic government bonds

Based on provisional figures furnished by the Central Depository, the distribution of ownership of government bonds as at 31 July 1999 is set out in Table 5.16.

Table 5.16 Ownership distribution of domestic government bonds

As at 31 July 1999	% of total
Nominee companies	0,5
Government enterprises and public sector	1,6
Pension funds	3,8
Insurers	5,0
Private	5,6
Monetary authorities/institutions	12,7
Foreign	13,6
Other financial institutions	27,4
Public Investment Commissioners	29,8

Source: Central Depository

This classification is incomplete, as it excludes bonds held outside the central depository, and the “other financial institutions” category is a substantial share of the total. The Department of Finance, Central Depository, banks and their clients are considering revised processes to improve the accuracy of the classification of ownership.

Increase in foreign debt

Foreign debt has increased from 2,7 per cent of net loan debt at the end of March 1994 to 5,4 per cent at the end of January 2000. Table 5.17 shows a currency breakdown of foreign loan debt obligations as at 31 March, for 1994 to 2000.

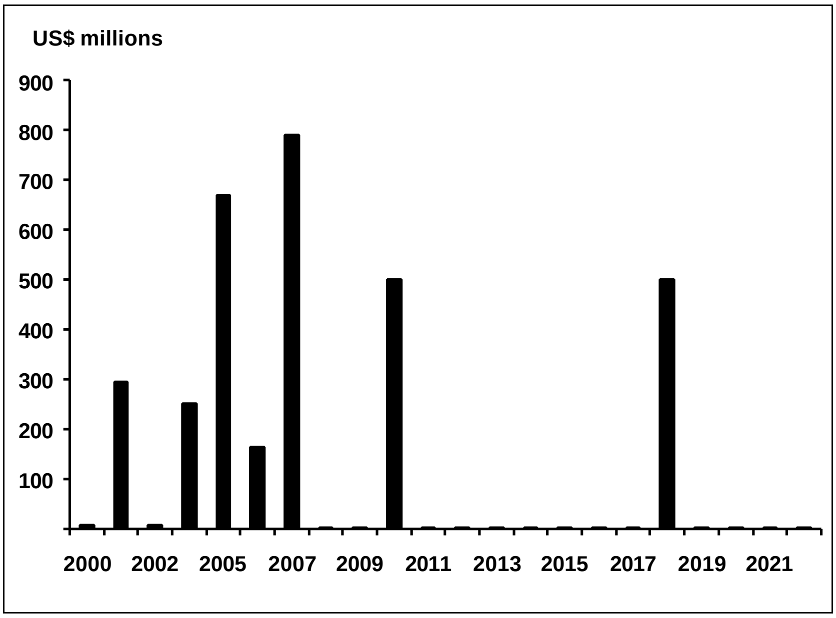
Table 5.17 Composition of foreign debt, 1993/94–1999/00

As at 31 March Percentage of total	1994	1995	1996	1997	1998	1999	2000 Estimate
United States dollar	4,42	39,1	29,33	36,77	49,02	60,35	41,52
ECU/Euro	18,24	11,2	10,76	6,59	0,62	–	24,52
Deutschmark	15,26	9,37	9,74	16,32	11,24	10,48	7,84
British pound	–	–	5,48	5,41	6,36	6,14	5,08
Austrian schilling	–	2,42	1,27	0,51	–	–	–
Japanese yen	–	–	11,74	9,79	22,24	23,03	21,04
Special Drawing Rights	62,08	37,91	31,68	24,61	10,52	–	–

Foreign debt maturity profile

South Africa’s foreign debt maturity profile is easily manageable, as illustrated in Figure 5.4.

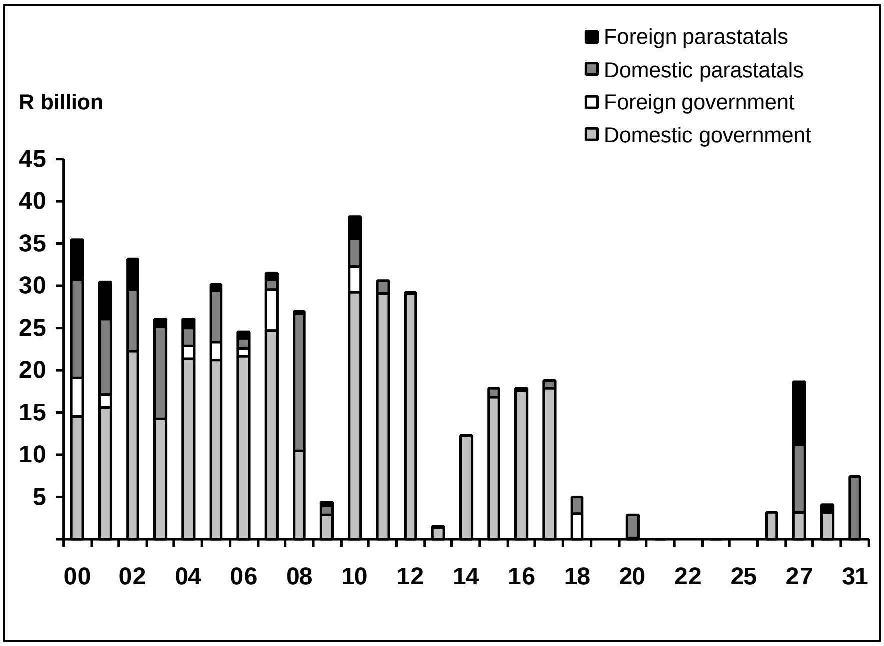
Figure 5.4 Maturity profile of foreign debt of Government



Consolidated debt maturity profile

The Department of Finance compiles a consolidated debt maturity profile of the domestic and foreign debt of the national government and general government bodies, to assist with the management and coordination of the borrowing activities of these entities. This profile is illustrated in Figure 5.5.

Figure 5.5 Consolidated maturity profile of domestic and foreign debt of the national government and parastatals, 30 June 1999



Contingent liabilities

Statement of Liabilities and Financially Related Assets

A Statement of Liabilities and Financially Related Assets of the national government is compiled annually by the Departments of Finance and State Expenditure. The statement includes information on off balance sheet items, including accrued unfunded commitments and other contingent liabilities. The statement as at 31 March 1999 (unaudited) appears in Table 5.18 below.

Table 5.18 Statement of liabilities and financially related assets

At 31 March:	1995	1996	1997	1998	1999
R billion					
Liabilities					
Long-term liabilities					
Bonds, debentures and loans	212,8	245,0	273,7	298,3	323,9
Domestic	204,1	236,3	262,2	285,4	312,3
Foreign	8,7	8,7	11,5	12,9	11,6
Closed pension fund	0,4	0,3	0,3	0,2	0,2
	213,2	**245,3**	**274,0**	**298,5**	**324,1**
Other liabilities					
Provisions	17,7	13,6	16,4	14,6	34,0
Short-term liabilities	32,4	38,8	34,8	34,7	36,8
Bonds, debentures and loans	26,2	33,1	33,1	34,9	36,7
Domestic	26,1	30,9	33,0	33,4	32,1
Foreign	0,1	2,2	0,1	1,5	4,6
Creditors	6,2	5,7	1,7	(0,2)	0,1
	50,1	**52,4**	**51,2**	**49,3**	**70,8**
Total liabilities	**263,3**	**297,7**	**325,2**	**347,8**	**394,9**
Financially related assets					
Investments	74,6	81,0	103,4	103,4	116,2
Loans	1,3	1,2	1,2	1,3	1,1
Debtors	9,8	11,4	11,6	15,2	36,1
Balances on hand	9,3	14,1	4,7	6,1	5,6
	95,0	**107,7**	**120,9**	**126,0**	**159,0**
Off balance sheet items					
Capital commitments	4,0	3,7	3,9	3,9	2,6
Contingent liabilities	129,7	135,9	138,7	144,6	122,2
	133,7	139,5	142,6	148,5	124,8

Contingent liabilities amounted to R122,2 billion on 31 March 1999. These include the following:

- Actuarially determined liabilities for post-retirement medical assistance amounted to R14,2 billion on 28 February 1999.
- An actuarial liability with respect to government pension funds amounted to R5,9 billion.
- R11,1 billion represents the underfunding of future claims against the Road Accident Fund.

- Guarantees to various institutions amounted to R85,8 billion in total, including an amount of R0,9 billion in respect of the guaranteed liabilities of the former TBVC-states and self-governing territories.

Post-retirement medical benefits

Post-retirement medical assistance liability of R14,2 billion

A first actuarial valuation of Government's contingent liability in respect of post-retirement medical assistance for civil servants was concluded in March 1999. The amount of R14,2 billion included in the Statement of Liabilities and Financially Related Assets as at 31 March 1999 represents the estimated present value of the Government's future commitment in respect of medical scheme subsidies to retired government employees (including former members of the National Defence Force, the Police Services and Correctional Services). The liability in respect of post-retirement medical assistance of current government employees is not included.

In last year's Statement of Liabilities and Financially Related Assets, an amount of R8,2 billion was included for retired employees who were members of the Medihelp medical scheme only, as at 31 March 1997.

Government's commitment on post-retirement medical assistance is provided for in the annual budget on the votes of the National Defence Force, the Police Services and Correctional Services for former services members, and on the Finance vote for other government employees.

Forward cover losses

Forward cover losses

Government is also liable for losses incurred as a result of the forward market operations of the Reserve Bank. The outstanding oversold forward book stood at US$11,5 billion at the end of January 2000. Potential future losses from this open position are not included in the statement of contingent liabilities, as unanticipated movements in the exchange rate limit the usefulness of such estimates.

Issue of guarantees to public entities

Guarantees and borrowing powers

The granting of borrowing powers to general government bodies and the issuing of government guarantees are managed within a set of guidelines. Consistent with these guidelines, during 1999/00 guarantees were largely restricted to concessionary loans to public enterprises, project finance for infrastructure development schemes and, in exceptional cases, facilities in support of public enterprise restructuring.

Average maturity of guarantees issued

During 1999/00 the average maturity of foreign loans for which government guarantees were issued was 9,8 years. This lengthening of the maturity was made possible largely by improved access to the euro-rand market and various sources of concessionary finance.

Guarantee fees of R2,5 million received

Guarantee fees were increased to 2,0 per cent per year on the nominal value of a loan; Government received fees to the amount of R2,5 million during 1999/00.

Total government guarantees on 31 March 1999 amounted to R85,8 billion. A detailed account of Government's exposure as at 31 March 1999 is set out in Table B9, Annexure B.

State debt cost

Debt cost

State debt cost is recorded on a cash basis, in keeping with current government accounting practice. Debt costs amounted to R44,5 billion in 1999/00, or R1,6 billion lower than budgeted because of:

- lower than anticipated interest rates
- state restructuring proceeds of R2,9 billion more than budgeted
- a change in cash balances of R2,7 billion
- lower average requirements for short-term bridging finance as a result of foreign loan proceeds of R6,5 billion during May 1999.

Projections of state debt costs to 2002/03 are set out in Table 5.19. For 2000/01 the cost of servicing state debt is expected to amount to R46,5 billion, or 5,3 per cent of GDP. This estimate assumes:

- a national budget deficit of R23,1 billion
- scheduled domestic and foreign loan redemptions of R17,0 billion
- an average coupon rate of 12,3 per cent on domestic bond issues
- average capital market yields of 13,6 per cent
- average short-term interest rates of 11,0 per cent.

Table 5.19 Projected state debt costs, 1998/99–2002/03

	1998/99	1999/00		2000/01	2001/02	2002/03
R million	**Outcome**	**Budget**	**Revised**	**Forward estimate**		
Interest:	42 664	46 062	44 278	46 425	49 480	50 945
Domestic debt	41 421	44 321	42 899	44 630	47 027	47 917
Foreign debt	1 243	1 741	1 379	1 795	2 452	3 028
Management cost	1	0	174	15	2	2
Cost of raising loans	5	50	31	50	50	50
Total state debt cost	**42 669**	**46 112**	**44 483**	**46 490**	**49 531**	**50 997**
Excludes:						
Revaluation of maturing foreign loans[1]	658	2 110	1 983	560	33	–
Discount on issues of government bonds	6 194	3 713	3 238	878	4 096	1 530

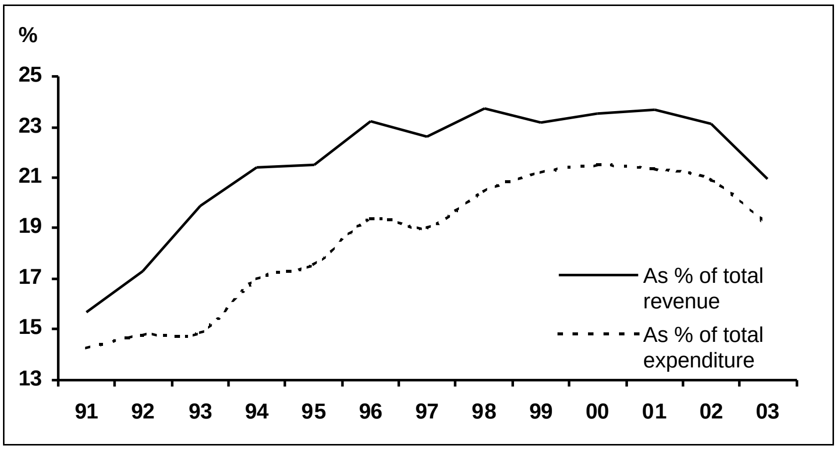
1. Valued at exchange rates of 31 March 1999 and forward estimates for other years.

Revaluation of maturing foreign loans

As announced in the 1999 *Budget Review*, internationally recognised practice in the treatment of foreign currency denominated debt has now been adopted. State debt cost therefore excludes the revaluation of maturing foreign loans, previously reflected as a management cost. The full redemption value of foreign loans is now shown in foreign loan financing.

The revaluation of the 1999/00 repayment of the $750 million global bond issue and other foreign loans amounted to R2,0 billion.

Figure 5.6 Cost to service debt as a percentage of total revenue/expenditure, 1990/91–2002/03



Declining burden of interest on debt

The tax burden that debt service costs impose on the economy continued to shrink, as illustrated in Figure 5.6. The ratio of interest payments to tax revenues declines from 23,1 per cent in 1998/99 to 20,9 per cent in 2002/03, freeing up resources for other priorities. Interest payments are projected to fall from 5,7 per cent of GDP to 4,9 per cent over the same period.

Discount on bonds R3,2 billion in 1999/00

Government bonds currently carry interest somewhat below anticipated market rates. The lower domestic financing requirement and lower than anticipated interest rates resulted in a projected discount on bond issues of R3,2 billion in 1999/00, compared with a budget estimate of R3,7 billion. The overall discount on the issue of new bonds is expected to amount to R0,9 billion in 2000/01.

Accounting for discount on bonds

In terms of current government accounting practice, the discount on government bonds is accounted for on a cash basis. Although the discount is recorded at the time of issue of a bond and forms part of outstanding government debt, it is not shown as part of government expenditure. However, since 1996 the discount on government bonds has been disclosed on an accrual basis in the *Budget Review*, in line with the recommendations of the revised international System of National Accounts of 1993. The amortisation of the discount over the term of the bond result in higher recorded state debt cost and government expenditure, a higher deficit and a lower aggregate measure of government debt. The adjustments for 1989/90 to 1999/00 are summarised in Table 5.20.

Table 5.20 Adjustment to state debt cost and total government debt to account for discount on an accrual basis, 1989/90–1999/00

	Amortised discount (R million)	Adjustments to state debt cost (% of GDP)	Nominal total debt at year-end (% of GDP)	Adjusted total debt at year-end (% of GDP)
1989/90	666	0,3	36,8	35,0
1990/91	686	0,2	35,3	32,7
1991/92	1 031	0,3	36,8	33,6
1992/93	1 269	0,3	40,4	36,9
1993/94	1 285	0,3	43,5	39,7
1994/95	1 961	0,4	49,1	44,0
1995/96	3 091	0,5	49,5	43,7
1996/97	3 201	0,5	49,0	42,9
1997/98	3 411	0,5	48,1	42,0
1998/99	3 589	0,5	50,0	43,8
1999/00	3 741	0,5	48,2	42,3

Developments on credit ratings

Credit ratings affected by financial volatility

South Africa's credit rating, like that of other emerging market sovereigns, was affected during the financial volatility of 1998. Moody's and Duff and Phelps adjusted their outlook on South Africa's credit rating from stable to negative. Both Moody's and Duff and Phelps subsequently readjusted their outlook from negative to stable and reconfirmed their investment grade rating status for South Africa.

On 7 February 2000 Moody's again raised South Africa's rating outlook to positive. This indicates that rating agencies are willing to acknowledge the positive developments on the economic front. Japan Rating and Investment Information also reconfirmed their investment grade rating for South Africa. Standard and Poor's credit rating agency completed its due diligence meetings in November 1999. Its review for 1999 is still outstanding. The current status of South Africa's credit rating is reflected in Table 5.21.

Table 5.21 Credit rating

	Foreign debt	Rand-denominated debt
Duff and Phelps International	BBB (Investment grade)	A (Investment grade)
Moody's Investors Service	Baa3 (Investment grade)	Baa1 (Investment grade)
Japan Rating and Investment	BBB (Investment grade)	
Standard and Poor's	BB+ (Stable)	BBB+ (Investment grade)