5

Asset and liability management

- Government's debt management policies have evolved from concentrating exclusively on financing the borrowing requirement to broader support for macroeconomic objectives.
- This sound policy stance has cushioned South Africa from external shocks in an increasingly volatile international environment. Given recent disquiet in global markets and a higher current account deficit, policy remains focused on managing external vulnerability. Budget surpluses, a growing level of official reserves, and active management of domestic and foreign debt support continued stability. As at the end of January 2008, gross foreign exchange reserves stood at US$33.6 billion, up from US$25.9 billion a year earlier.
- Debt management is directly supportive of stronger long-term economic growth. Declining public debt levels create space for greater borrowing on domestic and international markets by public enterprises to finance infrastructure development and capacity expansion. By March 2011, net government debt is projected to decline to 15.9 per cent of GDP, and the cost of servicing the debt to 1.9 per cent of GDP.
- The National Treasury continues to work to improve the financial performance and operational efficiency of state-owned entities and development finance institutions.

Overview

The credit crisis that began with the collapse of the US subprime housing market has unsettled global financial markets and lowered prospects for international growth. While the domestic economic outlook remains favourable, growth is expected to moderate over the coming period. In addition, risks associated with the growing current account deficit, higher inflation and rising interest rates require some rebalancing to ensure sustainable growth over the long term.

South Africa's growth prospects remain favourable, despite greater international uncertainty

Budget surplus and lower borrowing requirement maximise policy choices

The past several years of robust economic growth, together with prudent fiscal management, have resulted in South Africa enjoying a budget surplus. This lowers the government's borrowing requirement, providing greater flexibility in policy choices. Government's debt portfolio will be actively managed to minimise risks and external vulnerability in light of the high current account deficit.

Of a total gross borrowing requirement of R67.9 billion over the medium-term expenditure framework (MTEF), only R3.6 billion will be borrowed in international markets. Government does not plan to introduce any new domestic funding instruments during this period. To support the market, the volume of existing benchmark bonds will be increased, and opportunities to restructure the domestic debt portfolio through switches and buy-backs will be continued.

Net loan debt and debt service cost continue to decline

Over the medium term, government projects a net negative borrowing requirement of R42.1 billion, contributing to an increase in cash balances of R43.2 billion by March 2011. Surplus cash will be used to reduce the stock of debt and to achieve other macroeconomic objectives, such as further reducing external vulnerability. In addition, government's net negative borrowing requirement creates space in the market for state-owned entities to finance a large portion of their infrastructure investment programmes. Government's net loan debt will continue to decline from 22.3 per cent of GDP at the end of 2007/08 to 15.9 per cent of GDP at the end of 2010/11. Over the same period, the cost of servicing the debt will decline from 2.6 per cent to 1.9 per cent of GDP.

Positive revisions by Moody's and Fitch in 2007

During 2007, Moody's Investor Service and Fitch Ratings revised South Africa's sovereign credit ratings from "stable" to "positive". A key factor behind the revised outlook is the country's reduced external vulnerability, due in large measure to the prudent fiscal stance, the accumulation of reserves and the active management of external debt.

The National Treasury has completed financial modelling of the state-owned entities and assessed their treasury operations. This will contribute to better financial oversight and ultimately improved performance of these institutions.

This chapter discusses the developments in the domestic and international debt markets, government's debt portfolio, borrowing plans, contingent liabilities, credit risk and financial management of the state-owned enterprises.

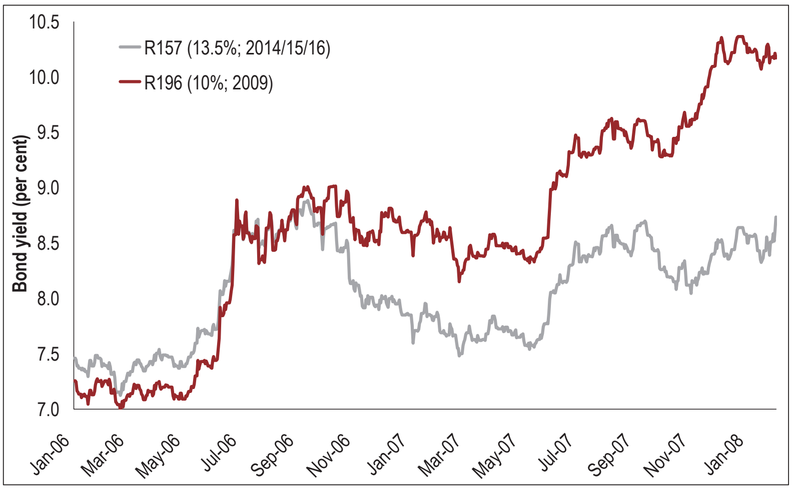
Developments in South Africa's debt markets

Domestic bond market

Bond yields were stable during first half of 2007

During the first half of 2007 government bond yields were fairly stable. Domestic government bonds were supported by a general shortage of liquid assets, cash flows resulting from redemptions, coupon payments and movements in the rand exchange rates.

Figure 5.1 Government bond yields, 2006 - 2008



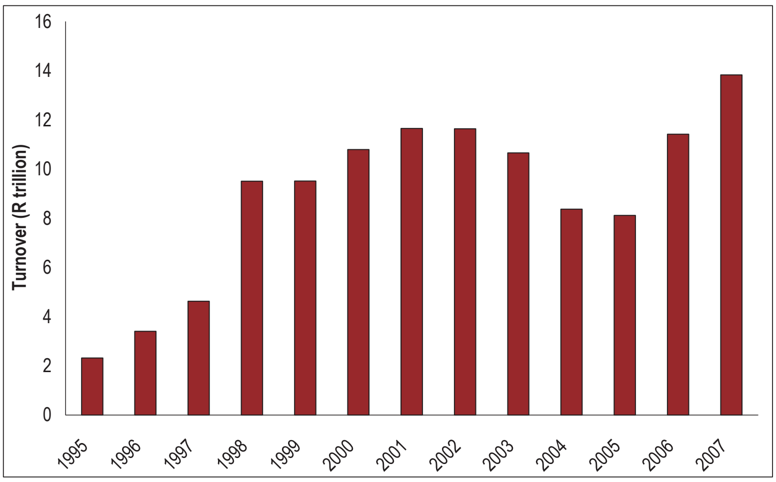
As monetary policy tightened, bond yields increased

From June 2006 to December 2007, the Reserve Bank increased the repo rate by a cumulative total of 400 basis points in response to inflationary pressures. As monetary policy tightened, bond yields increased, as shown in Figure 5.1. Between May and December 2007, the R196 (10%; 2009) bond yield increased by 328 basis points to 10.4 per cent and the R157 (13.5%; 2014/15/16) by 126 basis points to 8.6 per cent. Domestic bond yields were also influenced by global market volatility, which led to increased risk aversion.

Demand for inflation-linked bonds picked up during latter part of 2007

Inflation-linked bond yields generally trended lower during 2007, with demand for these bonds picking up in the light of the deteriorating inflation environment. Break-even inflation, which indicates projected inflation as measured by the difference in yields between the R153 (13%; 2009/10/11) fixed-income bond and the R189 (6.25%; 2013) inflation-linked bond, increased from 5.1 per cent in February to 6.6 per cent in December 2007.

Figure 5.2 Bond Exchange of South Africa turnover, 1995 – 2007

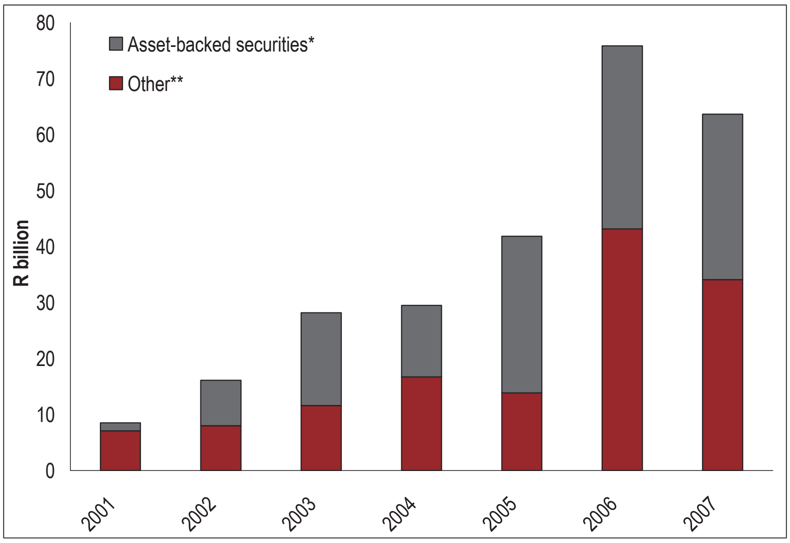


Total domestic bond liquidity reaches R23.3 trillion

Turnover on the Bond Exchange of South Africa (BESA) grew from R11.4 trillion in 2006 to R13.8 trillion in 2007, as shown in Figure 5.2 – an increase of 21.1 per cent. In addition total nominal trades recorded outside South Africa amounted to R9.5 trillion in 2007, bringing total nominal trades in domestic bonds to R23.3 trillion. The ratio of turnover to the total value of bonds listed on BESA was 30:1, making South Africa's market one of the most liquid in the world.

To date, the global credit crisis does not appear to have had a major impact on demand for South African bonds. After reaching an annual record high in 2006, net issuance in the corporate bond market slowed during 2007, as shown in Figure 5.3. The net issuance of corporate bonds declined from R76 billion in 2006 to R64 billion in 2007. In 2007 the net issuance of asset-backed securities accounted for about 46 per cent of total net issuance in the corporate bond market compared with 43 per cent in 2006. Total commercial paper funding declined from R14 billion in 2006 to R5 billion in 2007.

Figure 5.3 Net corporate bond issuance, 2001 – 2007



** Including commercial paper*
*** Including public corporations*

Lower turnover in municipal bonds

No municipalities raised funds in the primary bond market during 2007. As a result, turnover in municipal bonds declined from R9 billion in 2006 to R3.2 billion in 2007. Several municipalities have, however, expressed interest in entering the municipal bond market.

R153 and R157 bonds constitute 69 per cent of market turnover

Table 5.1 reveals a continued increase in the liquidity levels (turnover ratios) in domestic bonds. Turnover in 2007 was heavily weighted towards the R153 and R157 bonds, representing 69 per cent of the total.

Table 5.1 Turnover in domestic bonds, 2005 – 2007

Bond	2005	2006	2007
		Turnover ratio[1]	
Fixed-income			
R153 (13%; 2009/10/11)	*32.1*	*49.1*	*63.1*
R157 (13.5%; 2014/15/16)	*25.2*	*41.9*	*59.0*
R186 (10.5%; 2025/26/27)	*10.8*	*15.0*	*16.6*
R194 (10%; 2007/08/09)	*18.8*	*27.4*	–
R195 (10%; 2008)	–	–	*6.5*
R196 (10%; 2009)	–	–	*6.1*
R201 (8.75%; 2014)	*7.7*	*7.7*	*13.9*
R203 (8.25%; 2017)	*16.1*	*12.9*	*14.6*
R204 (8%; 2018)	*17.8*	*18.5*	*22.2*
R206 (7.5%; 2014)	*8.5*	*22.2*	*14.1*
R207 (7.25%; 2020)	*6.4*	*17.3*	*16.9*
R208 (6.75%; 2021)	–	*18.3*	*27.5*
R209 (6.25%; 2036)	–	*25.0*	*26.6*
Inflation-linked			
R189 (6.25%; 2013)	*0.6*	*1.3*	*1.8*
R197 (5.5%; 2023)	*0.8*	*1.0*	*1.9*
R198 (3.8%; 2008)	*8.1*	*3.1*	*3.3*
R202 (3.45%; 2033)	*1.8*	*2.6*	*1.9*
R210 (2.6%; 2028)	–	–	*3.3*

1. *The total turnover devided by the nominal outstanding issue of a bond.*

Issuance in international capital markets

As part of actively managing its foreign debt portfolio, government entered into buy-back and exchange transactions that included the issuance of a US$1 billion loan that matures in 2022. These transactions resulted in a net buy-back of US$218 million. The new bond was issued at a spread of 120 basis points over the 10-year US Treasury bond due in 2017 and has a coupon of 5.875 per cent.

During 2007, transactions resulted in a net buy-back of US$218 million

In recent months global credit conditions have tightened significantly, and as a result, sovereign risk premiums have increased throughout developing economies. Table 5.2 shows South Africa's foreign bond spreads.

Sovereign risk premiums have increased among developing economies

Figure 5.4 shows that the spread of the new 2022 bond is wider than at issue and has remained so since July 2007. Much of this widening can be attributed to the global credit crunch and the related decline in US Treasury yields.

Table 5.2 Performance of foreign bonds,[1] 2007

Bond	Coupon	Issue date	Maturity date	Issue spread	Average spread for 2007
Million	%			bps[2]	bps[2]
United States dollar					
612	*9.125*	*May 1999*	*May 2009*	*362/275*[3]	*78*
1 000	*7.375*	*April 2002*	*April 2012*	*240*	*104*
1 000	*6.500*	*June 2004*	*June 2014*	*195*	*106*
141	*8.500*	*June 1997*	*June 2017*	*183*	*101*
1 000	*5.875*	*May 2007*	*May 2022*	*120*	*144*[4]
Euro					
328	*7.000*	*April 2001*	*April 2008*	*272*	*37*
1 250	*5.250*	*May 2003*	*May 2013*	*142*	*77*
750	*4.500*	*April 2006*	*April 2016*	*81*	*84*

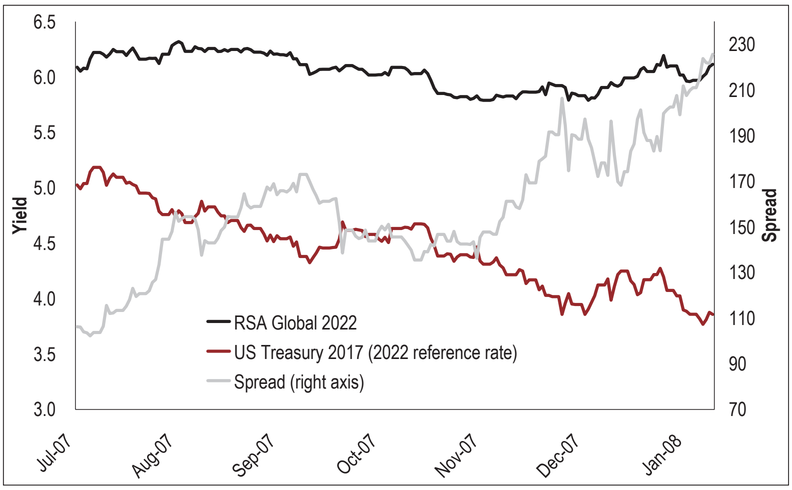
1. Excluding two yen-bonds, since these bonds are held by buy-and-hold investors and are therefore not trading.

2. Spread (percentages) are quoted relative to underlying international benchmark bonds. One basis point (bp) is 0.01 (1/100th) of a per cent.

3. This bond was issued at 362 bps over the US Treasury bond in 1999 and was reopened in 2000 at a spread of 275 bps over the US Treasury.

4. Average spread since May 2007.

Figure 5.4 Performance of US$1 billion 2022 RSA global bond, July 2007 – January 2008



Significant increase in demand for foreign rand-denominated issues

Activity in the Eurorand and Uridashi[1] markets picked up dramatically during 2007. In 2007 net issuance in the Eurorand bonds amounted to R15.2 billion compared to R5.5 billion in 2006, while there was a net R12.9 billion issued in the Uridashi market in 2007 compared to R5.2 billion in 2006. This can be attributed to a relatively stable macroeconomic environment and a higher interest rate differential.

[1] The Eurorand and Uridashi are foreign bonds issued in rands.

Borrowing requirement

Government borrows to meet its net borrowing requirement – the sum of the main budget balance, extraordinary receipts and extraordinary payments – and to refinance maturing debt.

R42.1 billion negative net borrowing requirement over medium term

Table 5.3 sets out the borrowing requirement for 2006/07, a revised estimate for 2007/08 and estimates for the period ahead. Over the medium term, government's total net borrowing requirement is negative R42.1 billion, meaning a decline in government's net loan debt.

Table 5.3 Net borrowing requirement, 2006/07 – 2010/11

	2006/07	2007/08		2008/09	2009/10	2010/11
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Budget balance[1]	-11 008	-10 728	-15 846	-14 257	-11 282	-14 286
Extraordinary receipts	-3 438	-1 250	-1 837	-850	-850	-600
Premiums on loan transactions[2]	*-909*	*-1 000*	*-260*	*-600*	*-600*	*-600*
Special dividends	*-1 496*	–	*-1 035*	–	–	–
Agricultural debt account surrender	*-200*	*-250*	*-250*	*-250*	*-250*	–
Foreign exchange amnesty proceeds	*-365*	–	–	–	–	–
Profits on GFECRA[3]	–	–	*-290*	–	–	–
Lebowa Minerals Trust abolition	*-467*	–	–	–	–	–
Other	*-2*	–	*-2*	–	–	–
Extraordinary payments	4 214	400	771	–	–	–
Premiums on loan transactions[2]	*422*	–	*677*	–	–	–
Defrayal of GFECRA losses[3]	–	–	*74*	–	–	–
Saambou Bank liability	*3 778*	*400*	–	–	–	–
Losses on conversion of foreign loans	*8*	–	*20*	–	–	–
Other	*7*	–	–	–	–	–
Net borrowing requirement	**-10 232**	**-11 578**	**-16 912**	**-15 107**	**-12 132**	**-14 886**

1. A negative number reflects a surplus and a positive number a deficit.
2. Premiums received or incurred on loan issues, bond switch and buy-back transactions.
3. Realised profits/losses on the Gold and Foreign Exchange Contingency Reserve Account.

Extraordinary receipts

R1.8 billion provided for extraordinary receipts in 2007/08

In 2007/08, R1.3 billion was provided for extraordinary receipts. This was composed of premiums of R1 billion on bonds issued to finance the borrowing requirement and the transfer of R250 million to the National Revenue Fund from the agricultural debt account held at the Corporation for Public Deposits.

These receipts are expected to increase due to a special dividend of R1 billion from Telkom and profits of R290 million on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) for 2005/06. However, these amounts will be partly offset by R740 million in lower premiums on new loan issues due to an increase in interest rates, bringing the total to R1.8 billion.

From 2008/09 to 2010/11, provision is made for premiums on bond issues of R600 million a year. Over the same period, transfers from the agricultural debt account will amount to R500 million.

Extraordinary payments

Extraordinary payments of R771 million in 2007/08

Extraordinary payments in 2007/08 amount to R771 million. This represents premiums paid on foreign debt liability management transactions (R697 million) and losses on the GFECRA during 2006/07 (R74 million). The R400 million provided for the settlement of the remaining liability relating to Saambou Bank will be paid out of the higher-than-anticipated positive balance in the curator's operational account.

Financing the borrowing requirement

Government's net borrowing requirement is financed through domestic short- and long-term loans, foreign loans and changes in cash balances.

Table 5.4 provides information on the funding of government's net borrowing requirement for 2006/07, revised estimates for 2007/08 and projections for 2008/09 to 2010/11.

Table 5.4 Financing of net borrowing requirement,[1] 2006/07 – 2010/11

	2006/07	2007/08		2008/09	2009/10	2010/11
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic short-term loans (net)	5 334	5 750	5 750	5 750	5 750	6 000
Treasury bills	*5 400*	*6 000*	*6 000*	*6 000*	*6 000*	*6 000*
Corporation for Public Deposits	*-66*	*-250*	*-250*	*-250*	*-250*	–
Domestic long-term loans (net)	892	-9 019	-4 001	5 309	-3 978	-3 911
Market loans	*36 938*	*24 000*	*25 306*	*30 000*	*30 000*	*30 000*
Redemptions	*-35 829*	*-33 019*	*-29 307*	*-24 691*	*-33 978*	*-33 911*
Buy-backs	*-218*	–	–	–	–	–
Foreign loans (net)	182	-2 587	-3 471	-3 496	-7 645	-2 671
Market loans	*5 509*	–	–	–	–	–
Arms procurement loan agreements	*3 690*	*3 533*	*3 691*	*2 614*	*438*	*532*
World Bank loans[2]	–	–	*20*	–	–	–
Redemptions (including revaluation of loans)	*-7 126*	*-6 120*	*-5 614*	*-6 110*	*-8 083*	*-3 203*
Buy-backs	*-1 891*	–	*-1 568*	–	–	–
Change in cash and other balances[3]	-16 640	-5 723	-15 190	-22 670	-6 259	-14 304
Opening balance	58 675	75 628	79 915	95 105	117 775	124 034
Cash balance	*58 187*	*74 128*	*75 315*	*95 105*	*117 775*	*124 034*
Surrenders/late requests	*3 685*	*1 500*	*4 600*	–	–	–
Cash flow adjustment[4]	*-3 197*	–	–	–	–	–
Closing balance	-75 315	-81 351	-95 105	-117 775	-124 034	-138 339
Sterilisation deposits[5]	*-45 667*	*-48 594*	*-62 075*	*-65 806*	*-70 830*	*-77 401*
Operational cash	*-29 648*	*-32 757*	*-33 030*	*-51 969*	*-53 204*	*-60 938*
Total	**-10 232**	**-11 578**	**-16 912**	**-15 107**	**-12 132**	**-14 886**

1. Full details are reflected in Table 1 of Annexure B.
2. Loans to provide financial and technical support for the municipal financial management project.
3. A negative change indicates an increase in cash balances.
4. Represents a reconciliation of actual revenue and actual expenditure against National Revenue Fund flows.
5. Deposits made with the Reserve Bank to regulate internal monetary conditions as provided for in Section 71(e) of the PFMA.

The net borrowing requirement excludes loan redemptions, which also need to be financed. Scheduled loan redemptions for 2006/07 and 2007/08 and medium-term estimates are set out in Table 5.5. Loan redemptions in 2007/08 amount to R36.5 billion. This is R2.7 billion lower than provided for, mainly due to domestic bond switch auctions of R3.9 billion and a net foreign debt buy-back of R1.6 billion.

For 2008/09, loan redemptions of R30.8 billion are anticipated, rising to R37.1 billion in 2010/11. Active debt management transactions could decrease redemptions over the medium term.

Projected redemptions of R30.8 billion in 2008/09

Table 5.5 Loan redemptions, 2006/07 – 2010/11

R million	2006/07 Outcome	2007/08 Budget	2007/08 Revised	2008/09	2009/10	2010/11
				Medium-term estimates		
Domestic loans	36 047	33 019	29 307	24 691	33 978	33 911
Foreign loans[1]	9 017	6 120	7 182	6 110	8 082	3 203
Principal	*7 256*	*5 647*	*5 244*	*4 264*	*7 419*	*2 235*
Revaluation	*1 761*	*472*	*1 938*	*1 846*	*663*	*968*
Total	**45 064**	**39 139**	**36 489**	**30 801**	**42 061**	**37 114**
Excludes: Source bonds in domestic switch auctions	–	–	*3 945*	–	–	–

1. *Includes the net amount of buy-backs.*

The funding strategy is underpinned by market-risk considerations, taking into account interest rates, liquidity, refinancing, inflation and currency fluctuations. These risk factors are managed by determining an optimal mix between fixed and non-fixed rate debt, and managing the level and composition of debt.

Domestic short-term loans

Short-term borrowing consists of marketable Treasury bill issuance and borrowing from the Corporation for Public Deposits. To date, Treasury bills with maturities of 3, 6, and 9 months have been issued.

In 2007/08 Treasury bills increased by a net R6 billion. The same annual net increase is provided for over the next three years. Treasury bills were issued at an average yield of 9.4 per cent in 2007/08.

Borrowing from the Corporation for Public Deposits will decrease by R250 million in 2007/08, and by R500 million over the first two years of the MTEF. Money borrowed from the Corporation for Public Deposits for bridging finance purposes and to sterilise the money market impact of flows on government's accounts with the Reserve Bank varies during the course of the year.

Borrowing from the Corporation for Public Deposits will decrease by R250 million in 2007/08

Domestic long-term loans

Domestic long-term loans consist of fixed-income bonds, inflation-linked bonds, floating rate notes and retail bonds. The 2007/08 domestic long-term loan issuance amounts to R25.3 billion, which is R4 billion lower than loan redemptions.

A net negative supply of R4 billion in government bonds in 2007/08

Table 5.6 provides a breakdown of the R20.8 billion in government bonds issued in 2007/08 up to 31 January 2008. Fixed-income bonds remain the major source of financing.

In 2007/08 fixed-income bonds were issued in maturities ranging from 2014 to 2036. Issuance was concentrated on the medium- to long-term maturity bonds, with 48 per cent in the 10 to 19 years maturity area.

The ultra-long R209 (6.25%; 2036) bond made up 21 per cent of total fixed-income bond issuance. Of the total amount of fixed-income bonds issued, primary dealers took up R769 million or 4.2 per cent under a non-competitive auction facility.

Table 5.6 Domestic long-term market loan issuance, 2007/08

As of 31 January 2008 R million	Cash value	Average yield %	Nominal outstanding
Fixed-income	17 401	8.01	
R186 (10.5%; 2025/26/27)	*500*	*7.29*	*39 025*
R201 (8.75%; 2014)	*1 339*	*8.53*	*36 928*
R203 (8.25%; 2017)	*1 674*	*8.10*	*22 289*
R204 (8%; 2018)	*3 093*	*7.96*	*23 499*
R206 (7.5%; 2014)	*2 164*	*8.22*	*12 022*
R207 (7.25%; 2020)	*3 016*	*8.02*	*15 308*
R208 (6.75%; 2021)	*1 747*	*8.02*	*4 198*
R209 (6.25%; 2036)	*3 654*	*7.75*	*9 448*
Retail	*214*	*8.91*	*1 355*
Inflation-linked	3 432	2.64	
R189 (6.25%;2013)	*604*	*2.81*	*25 938*
R197 (5.5%; 2023)	*1 006*	*2.70*	*23 814*
R202 (3.45%; 2033)	*1 273*	*2.51*	*10 036*
R210 (2.6%; 2028)	*548*	*2.67*	*2 658*
Retail	*1*	*2.84*	*1*
Total	**20 833**		

Reverse repurchase transactions of R13.2 billion

A total amount of R3.4 billion was issued in inflation-linked bonds, with 53.1 per cent concentrated in the longer maturity R210 (2.6%; 2028) and R202 (3.45%; 2033) bonds. The new R210 bond was well received by the market. To enhance efficiency in the primary and secondary inflation-linked bond market, reverse repurchase facilities with 7-, 14- and 28-day maturities were transacted mostly in the R189 (6.25%; 2013) bond. Transactions to the value of R13.2 billion were entered into as of 31 January 2008.

As shown in Table 5.4, net domestic long-term loan issuance in 2008/09 will be R5.3 billion. Over the next two years, domestic long-term loan redemptions will on average exceed new loan issues by R3.9 billion. In 2008/09 issuance will be in the existing bonds. The issuance strategy will be in line with government's support for a well-functioning financial market.

New retail bond sales channel to be launched

Issuance of 2-, 3- and 5-year fixed-income and 3-, 5- and 10-year inflation-linked retail bonds will continue in 2008/09. A new sales channel will be launched.

Switch auctions in inflation-linked bonds were conducted in 2007/08. An amount of R3.9 billion of the R198 inflation-linked bond was switched. Against a background of a relatively low supply of bonds by government, switches helped build the volume of inflation-linked benchmark bonds.

To facilitate the settlement risk in the capital market, government provides the primary dealers in benchmark government bonds with an overnight repurchase facility at zero per cent. As of 31 December 2007, repurchase transactions of R3.2 billion were entered into, mainly in the R153 and R157 bonds.

Foreign loans

Foreign loan redemptions total R13.8 billion more than new loans over MTEF

Over the MTEF, foreign loan redemptions total R13.8 billion more than new loans. Given the low borrowing requirement and government's ability to finance its total borrowing requirement in the domestic market, no new foreign capital market loans are planned to finance the medium-term borrowing requirement. However, government will maintain its presence in the international capital markets.

In 2007/08, a new US$1 billion 2022 maturity bond was issued as part of a foreign debt liability management transaction, resulting in a net buy-back of US$218 million, equivalent to R1.6 billion.

Reducing short-term foreign debt

As part of reducing external vulnerability, the National Treasury has worked to reduce short-term foreign debt. Consequently, government launched a bond buy-back offer and exchange in May 2007. This was structured as a "waterfall" package – in other words, a structure in which tendered bonds are accepted in order of priority, which in this case meant targeting the short-term bonds first, along with the highly illiquid 2017 bond.

Holders of Euro-denominated bonds were given the option of tendering for cash, while holders of US dollar-denominated bonds had the option to tender for cash or exchange existing bonds for new bonds due to mature in 2022. At the time of closing the book, there had been a total of US$2.8 billion in orders for exchanges and buy-backs.

Final order book for the exchange/buy-back offer

RSA foreign bonds Million	Buy-back	Exchange	Cumulative total in US$
US$ 2009	411	477	888
EUR 2008	172	–	1 121
US$ 2017	18	78	1 218

Total book US$ 3.4 billion

Total arms procurement drawdowns of R27.7 billion

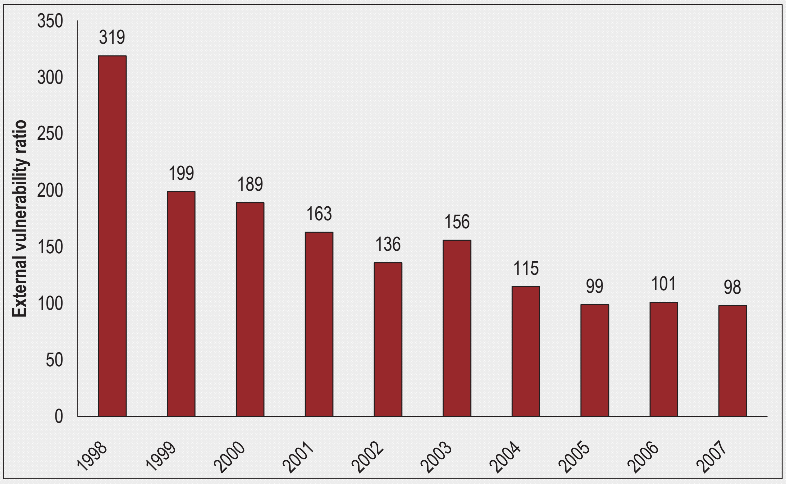
By 2007/08, government will have made total drawdowns of R27.7 billion, or 87.1 per cent of the total drawdowns in terms of the international arms procurement loan agreements. Drawdowns on these loans over the next three years total R3.6 billion. During 2007/08 government drew R20 million on a World Bank loan facility to provide financial and technical support for the municipal financial management project.

Managing external vulnerability [1]

With greater instability in global financial markets and a widening current account deficit, managing external vulnerability remains a priority. In recent years the external vulnerability indicator has declined sharply, from 156 in 2003 to 98 in 2007, as a combined result of foreign debt buy-backs and the accumulation of foreign exchange reserves.

Official reserves increased to US$33 billion in 2007 from US$25.6 billion in 2006, and foreign outstanding loans decreased by US$218 million in 2007 as a result of buy-backs. The Reserve Bank also prepaid US$1 billion of its syndicated loan.

External vulnerability trend, 1998 - 2007



1. External vulnerability is defined as the current account deficit plus short-term foreign currency denominated debt (including long-term debt maturing within 12 months), divided by gross official reserves.

Dialogue with investors

Government is strengthening relationships with foreign and domestic investors

Strengthening investor relations remains a key strategic intervention in the foreign and domestic markets. In 2007/08, the National Treasury conducted road shows for investors, setting out government's macroeconomic policy, debt management strategy and financing plans.

Cash balances

Government's total cash includes deposits held by the Reserve Bank and commercial banks. The Reserve Bank uses the deposits that it holds to "sterilise" the excess cash created in the money market when purchasing official reserves. Operational cash available to finance government's borrowing requirement is invested mainly with the commercial banks in line with credit risk principles.

Sterilisation deposits of R62.1 billion by the end of 2007/08

Sterilisation deposits with the Reserve Bank in 2007/08 are estimated to increase by R16.4 billion, from R45.7 billion to R62.1 billion, as a result of new sterilisation deposits of R13 billion and capitalised interest of R3.4 billion.

Over the MTEF, cash balances are projected to increase by R43.2 billion. The higher balances will be used to meet government's future cash requirements.

The losses and profits on the foreign exchange activities of the Reserve Bank are accounted for on the GFECRA. The balance on this account is split into transactions with a cash flow and a non-cash flow impact. Valuation gains and losses increased to a net R47.6 billion as of 31 January 2008, R21 billion higher than a year earlier. In 2007/08 a net cash flow profit of R216 million for 2005/06 and 2006/07 was transferred to the National Revenue Fund.

Government's debt portfolio

Total debt

Net loan debt consists of total domestic and foreign debt less the balances of the National Revenue Fund. Debt is affected by the net borrowing requirement, currency fluctuations and changes in cash balances.

In 2007/08, net loan debt is expected to decline by R20.7 billion to R456.1 billion, mainly due to increases in cash balances. This decline is projected to continue, resulting in net loan debt of R438 billion in 2010/11.

Net loan debt continues to decline over the MTEF, reaching R438 billion in 2010/11

Table 5.7 Total government debt, 2004/05 – 2010/11

End of period	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt	432.4	461.8	469.5	472.8	485.5	488.6	491.7
Foreign debt[1]	69.4	66.8	82.6	78.4	81.9	79.9	84.6
Gross loan debt	**501.8**	**528.6**	**552.1**	**551.2**	**567.4**	**568.5**	**576.3**
Less: National Revenue Fund bank balances	*-30.9*	*-58.2*	*-75.3*	*-95.1*	*-117.8*	*-124.0*	*-138.3*
Net loan debt[2]	**470.9**	**470.4**	**476.8**	**456.1**	**449.6**	**444.5**	**438.0**
As percentage of GDP :							
Net loan debt	*33.0*	*29.7*	*26.4*	*22.3*	*19.7*	*17.7*	*15.9*
Foreign debt	*4.9*	*4.2*	*4.6*	*3.8*	*3.6*	*3.2*	*3.1*
As percentage of gross loan debt:							
Foreign debt	*13.8*	*12.6*	*15.0*	*14.2*	*14.4*	*14.1*	*14.7*

1. Estimates are based on National Treasury's projections of exchange rates.

2. Net loan debt is calculated with due account of the bank balances of the National Revenue Fund (balances of government's accounts with the Reserve Bank and commercial banks).

As a percentage of GDP, net loan debt will decline to a projected 22.3 per cent at the end of 2007/08 from 26.4 per cent at the end of 2006/07. By 2010/11, net loan debt is expected to reach 15.9 per cent.

Government's foreign debt as a percentage of GDP is estimated to decline to 3.1 per cent over the same period. Foreign debt as a percentage of gross loan debt will average 14.4 per cent over the MTEF. This is well below the risk benchmark range of 20-25 per cent. South Africa's debt ratios compare favourably with those of its emerging-market peers (as shown in positive sovereign credit ratings) and some Organisation for Economic Cooperation and Development member countries.

A comprehensive presentation of government debt since 1983/84 is provided in Table 8 of Annexure B.

Maturity and composition of government debt

Average maturity of domestic bonds has declined to 8 years

Table 5.8 sets out the average maturity and duration of domestic marketable bonds. The average maturity has declined from 8.4 years in 2006/07 to 8 years in 2007/08. The weighted average term (duration) of interest and redemption cash flows has decreased from 5.4 years for 2006/07 to 5.1 years for 2007/08. This can be ascribed to the increase in interest rates. Government does not target a specific duration range, but an optimal debt portfolio.

Table 5.8 Maturity distribution of domestic marketable bonds, 2005/06 – 2007/08

Years to maturity	2005/06	2006/07	2007/08	
			Estimates	
Percentage of total	Portfolio[1]		Funding[2]	Portfolio[1]
0 – 3	21.9	21.7	–	28.4
3 – 7	25.2	24.7	18.2	29.7
7 – 10	24.1	23.6	8.8	14.8
10 – 19	18.8	20.8	44.6	20.1
Longer than 19	10.0	9.2	28.4	7.0
Years				
Average duration[3]	5.3	5.4	8.5	5.1
Average maturity	8.1	8.4	15.1	8.0

1. *The total bond portfolio as of the end of the period.*
2. *Bond issuances for the fiscal year.*
3. *The weighted average term (duration) of interest and redemption cash flows.*

Table 5.9 shows the composition of domestic debt, categorised by various funding instruments.

Table 5.9 Composition of domestic debt by instrument, 2004/05 – 2007/08

End of period	2004/05	2005/06	2006/07	2007/08
R billion		Outcome		Estimate
Bonds	395.8	419.4	421.9	419.6
Fixed-income	*338.7*	*349.2*	*351.5*	*352.2*
Floating rate	*8.8*	*11.4*	*4.8*	*4.8*
Zero coupon	*2.3*	*2.2*	*2.1*	*2.1*
Inflation-linked	*44.7*	*54.8*	*62.0*	*59.2*
Retail	*1.3*	*1.8*	*1.5*	*1.3*
Treasury bills	36.1	41.9	47.1	52.9
Shorter than 91-days[1]	*1.6*	*1.4*	*1.3*	*1.1*
91-days	*29.3*	*28.0*	*29.7*	*31.6*
182-days	*5.2*	*7.8*	*9.0*	*10.4*
273-days	*–*	*4.7*	*7.1*	*9.8*
Other[2]	0.5	0.5	0.5	0.3
Total	**432.4**	**461.8**	**469.5**	**472.8**

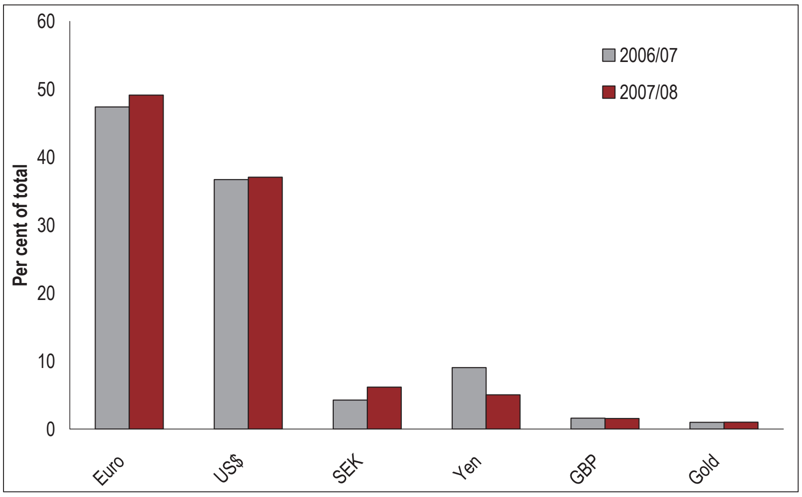
1. *Mainly 1-day bills issued to the Corporation for Public Deposits.*
2. *Loan levies, former regional authorities and Namibian debt.*

For purposes of risk management, the domestic debt portfolio is classified as fixed and non-fixed debt. At the end of 2007/08, the ratio of fixed to non-fixed debt is projected at 75:25 against a risk benchmark of 70:30.

Figure 5.5 shows that the foreign debt portfolio is concentrated in Euro- and US dollar-denominated instruments, which account for 86.2 per cent of the total foreign debt.

Dollar- and Euro-based debt is up, and yen-based debt is down

Figure 5.5 Currency composition of foreign debt, 2006/07 and 2007/08



Contingent liabilities

Contingent liabilities of R184.7 billion as of 31 March 2007 are summarised in Table 5.10. The increase of R24.7 billion since 2005/06 is mainly due to a new actuarial valuation of the post retirement medical aid assistance to government employees. Net loan debt and contingent liabilities as a percentage of GDP amount to 36.6 per cent, which is in line with the National Treasury's risk management guideline of 50 per cent of GDP.

Debt and contingent liability are well below the risk management guideline

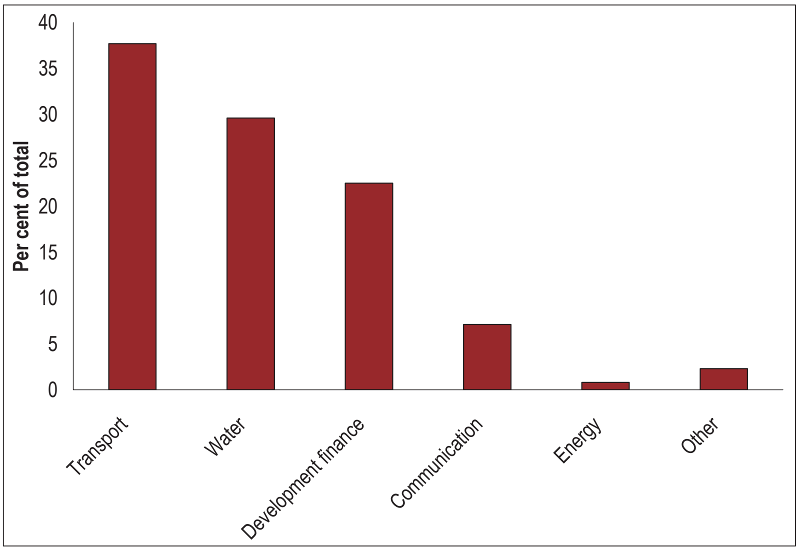
Table 5.10 Composition of contingent liabilities, 2004/05 – 2006/07

End of period R billion	2004/05	2005/06	2006/07
Guarantees	74.1	67.9	67.8
Domestic	*55.4*	*49.8*	*49.1*
Foreign	*18.7*	*18.1*	*18.7*
Post-retirement medical assistance[1]	37.0	37.0	56.0
Road Accident Fund[1]	20.1	21.4	23.9
Government pension funds[1]	9.8	12.8	12.8
Claims against government departments	6.0	9.1	11.0
Export Credit Insurance Corporation	8.7	7.2	10.9
Unemployment Insurance Fund[1]	2.3	2.3	2.0
SASRIA reinsurance cover	1.0	1.0	–
Other[2]	2.1	1.3	0.3
Total	**161.1**	**160.0**	**184.7**

1. *The Road Accident Fund, post-retirement medical assistance to government employees, government pension funds and Unemployment Insurance Fund are subject to actuarial valuation periods varying from one year to four years.*
2. *Represents a liability to Reserve Bank in respect of old coinage in circulation and other unconfirmed balances by departments.*

Figure 5.6 shows the sectoral classification of government guarantees, which provide surety for state-owned entities borrowing. Guarantees in the transport, water and development finance sectors account for 89.9 per cent of total guarantees.

Figure 5.6 Sectoral classification of guarantees, 2006/07



Government's guarantee exposure increased by R1 billion in 2007/08

Government's guarantee exposure in 2007/08 increased by R1 billion, mainly as a result of further drawdowns on existing loans by Transnet and SA National Road Agency. Guarantee fees of R40.9 million were received from state-owned entities in 2007/08. Details of government's guarantee commitments from 2003/04 to 2006/07 are set out in Table 9 of Annexure B.

State debt cost

The volume of debt, new borrowing requirements, interest rates and the value of the currency influence the cost of state debt. Table 5.11 summarises trends and projections to 2010/11.

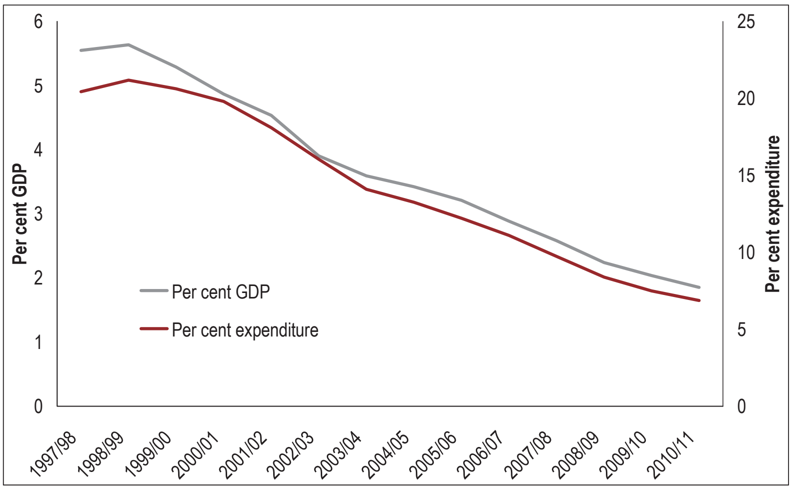
Table 5.11 State debt cost, 2006/07 – 2010/11

	2006/07	2007/08		2008/09	2009/10	2010/11
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic	47 672	48 052	48 123	46 637	46 765	46 814
Foreign	4 520	4 864	4 706	4 599	4 360	4 342
State debt cost	**52 192**	**52 916**	**52 829**	**51 236**	**51 125**	**51 156**
State debt cost as percentage of :						
GDP	*2.9*	*2.7*	*2.6*	*2.2*	*2.0*	*1.9*
GDP-accrual [1]	*3.1*	*2.9*	*2.7*	*2.4*	*2.2*	*2.0*
Revenue	*10.8*	*9.7*	*9.5*	*8.2*	*7.4*	*6.7*

1. State debt cost adjusted for the amortisation of discount on bond issues and expressed as a percentage of GDP.

In 2007/08, state debt cost is estimated to be R87 million lower than the budgeted amount of R52.9 billion, due to a stronger-than-budgeted currency and the positive effect of the foreign debt liability management transactions. State debt cost will average R51.2 billion over the next three years.

Figure 5.7 State debt cost, 1997/98 – 2010/11



State debt cost as a percentage of GDP is projected to decline from 2.6 per cent in 2007/08 to 1.9 per cent in 2010/11. Measured as a percentage of revenue and expenditure, debt service cost will decline to 6.7 per cent and 6.9 per cent by 2010/11, respectively.

Debt service costs continue to fall

State-owned entities

State-owned entities and development finance institutions (DFIs)[2] play an important role in supporting economic growth and development, job creation and poverty reduction. In addition to measures to improve the performance of these entities, government has undertaken a number of restructuring and capitalisation initiatives.

Government is taking steps to improve the performance of state-owned entities

Infrastructure investment plans

Government's improved fiscal position creates the space for state-owned entities and the private sector to increase their borrowing, without placing undue pressure on capital markets and interest rates.

Capital investment by the state-owned entities is a mainstay of government's infrastructure investment programme, which aims to increase the productive capacity of the economy, supporting accelerated growth and job creation in the years ahead. The bulk of financing requirements can be obtained in the capital markets.

Bulk of capital for infrastructure investment can be sourced in the markets

In specific cases, government will also make a contribution to the investment needs of these entities. Government will provide Eskom with finance of up to R60 billion on terms structured to assist in meeting medium-term cash requirements. An estimated R20 billion of this will flow during the MTEF period, provided for in the contingency reserve.

[2] The DFIs are the Development Bank of Southern Africa, the Industrial Development Corporation, the Land Bank, the National Housing Finance Corporation, Khula Enterprise Finance, the National Empowerment Fund, the Independent Development Trust, the Umsombovu Youth Fund, the National Urban Reconstruction and Housing Agency, the Rural Housing Loan Fund, the Micro Agricultural Financial Institute of South Africa and the South African Micro-finance Apex Fund.

As shown in Table 5.12, the state-owned entities have increased their estimated capital investment plans from R313.4 billion (2007/08 to 2011/12) to R494.5 billion (2008/09 to 2012/13). The principal investments are made to strengthen energy and transport. Over the next five years the main investments are:

- Eskom's provisional capital investment plans, estimated at R342.9 billion, of which 74% is earmarked for electricity generation
- Transnet's provisional capital investment plans, estimated at R78 billion, most of which is to be invested in rail infrastructure and rolling stock.

Government and the state-owned entities are reviewing these provisional capital investment figures to ensure that the financial sustainability of the relevant entities is not jeopardised.

Table 5.12 Provisional capital investment plans by state-owned entities, 2008/09 – 2012/13[1]

R billion	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Capex	82.5	124.2	115.9	95.4	76.5	494.5
Of which :						
Eskom	*46.9*	*80.8*	*79.7*	*70.3*	*65.2*	*342.9*
Transnet	*16.9*	*21.5*	*17.5*	*12.7*	*9.4*	*78.0*

1. These provisional figures will be reviewed.

Improving financial performance

New financial model for all state-owned entities will improve performance

During 2006/07 the National Treasury completed an integrated strategic financial model for all state-owned entities listed under Schedule 2 of the PFMA. The model will be used to monitor financial performance and manage financial risks.

Government has also developed a capital structure and dividend policy. This is particularly important in the light of large capital investment programmes under way at a number of state-owned entities. The integrated strategic financial model will aid in setting realistic capital structure targets and assessing funding alternatives.

A best-practice template for benchmarking treasury operations has been developed

The National Treasury has also developed a best-practice template for benchmarking treasury operations, and 15 state-owned entities have been reviewed against this benchmark. Reports and recommendations have been issued to each respective entity. Monitoring the execution of these recommendations will enhance overall treasury standards.

Together with other government departments, the National Treasury is completing a review of the DFIs. The main objective of the review is to ensure that these institutions use economic resources more effectively and efficiently in support of government's social and economic policy objectives, minimising wasteful competition and overlap with the private sector.