6

Asset and liability management

Overview

Government expenditure is financed through revenue and borrowing, with state-owned entities and development finance institutions complementing delivery capacity. In 2011/12, government's net borrowing requirement will amount to R157.9 billion, while state-owned entities and development finance institutions will borrow R106.3 billion. Over the next three years, development finance institutions are expected to expand their loan books by about R115 billion.

In 2011/12, government's net borrowing requirement will amount to R157.9 billion

Owing to sound economic and fiscal policies, deep and liquid capital markets, and the availability of international funding, government was able to finance the 2010/11 budget deficit at a lower cost than anticipated. As a result, debt-service costs for 2010/11 are R4.8 billion lower than expected. Lower debt-service costs create more space to sustainably fund investment in economic infrastructure, which creates jobs, and to increase spending on social priorities such as education and health.

Lower debt-service costs allow for greater capital investment and spending on education and health

While the gap between expenditure and revenue is projected to narrow in line with the economic recovery, government borrowing in the current year remains substantial at 5.3 per cent of GDP, declining to 4.2 per cent of GDP in 2013/14.

During 2010, global capital surged into emerging markets. South Africa attracted net inflows of R92 billion into bonds and equities (inflows of R224 billion, outflows of R132 billion) from non-resident investors, whose holdings of government bonds grew by 58 per cent. Government's strategy of reserve accumulation has markedly reduced the external vulnerability of the economy. In 2010, government purchased official foreign exchange reserves of US$3.7 billion.

Reserve accumulation has markedly reduced the economy's external vulnerability

The Reserve Bank will continue to accumulate foreign exchange reserves

Over the medium term, government will work with the Reserve Bank to continue accumulating foreign exchange reserves and prefunding forex spending commitments. Taking these steps contributes to achieving a more competitive currency and strengthens South Africa's ability to respond to sudden changes in market conditions, such as a reversal in capital flows.

Credit ratings: a stable outlook for South Africa

All major credit rating agencies rate South Africa at investment grade. In January 2011, both Fitch Ratings (BBB+) and Standard & Poor's (BBB+) affirmed South Africa's sovereign credit rating, while revising the rating outlook from negative to stable. Moody's Investor Services (A3) and Rating and Investment Information, Inc. (A-), maintained a stable outlook.

These ratings reflect sound management of the economy and the public finances, and the underlying attractiveness of the country as an investment destination.

Since February 2010, rating agencies have downgraded their outlook for five developed countries and nine developing countries.

South Africa's positive credit outlook reflects relatively low levels of public debt and government's intention to contain debt over the long term.

The borrowing requirement is estimated at R141 billion in 2010/11

Government's borrowing requirement, estimated at R141 billion in 2010/11, is projected to be R148.7 billion by 2013/14. Net government debt will reach R822.4 billion by the end of this fiscal year, and is set to rise to R999 billion in 2011/12, peaking at R1.4 trillion or 39.3 per cent of GDP by 2013/14. Debt-service costs will amount to R66.6 billion in 2010/11, rising to R104 billion in 2013/14.

The primary source of funding remains domestic borrowing through a combination of Treasury bills, and fixed-income and inflation-linked bonds. No new domestic bonds are anticipated and current weekly auction levels in existing fixed-income and inflation-linked bonds will be maintained over the short term. Refinancing risk will be actively managed by switching R26.8 billion of debt that matures over the forecast period into longer-term debt instruments.

Enhanced oversight of state-owned entities and development finance institutions

The New Growth Path highlights the need for development finance institutions and state-owned entities to support infrastructure development, economic growth and job creation. These institutions are expected to seek out opportunities to cooperate with the private sector in co-financing infrastructure investment in South Africa and the region over the medium term. Government will increase oversight of these entities to ensure that they become more effective and financially sustainable. As the economy improves, the criteria for issuing government guarantees will be tightened.

Developments in South African debt markets

Domestic bond market

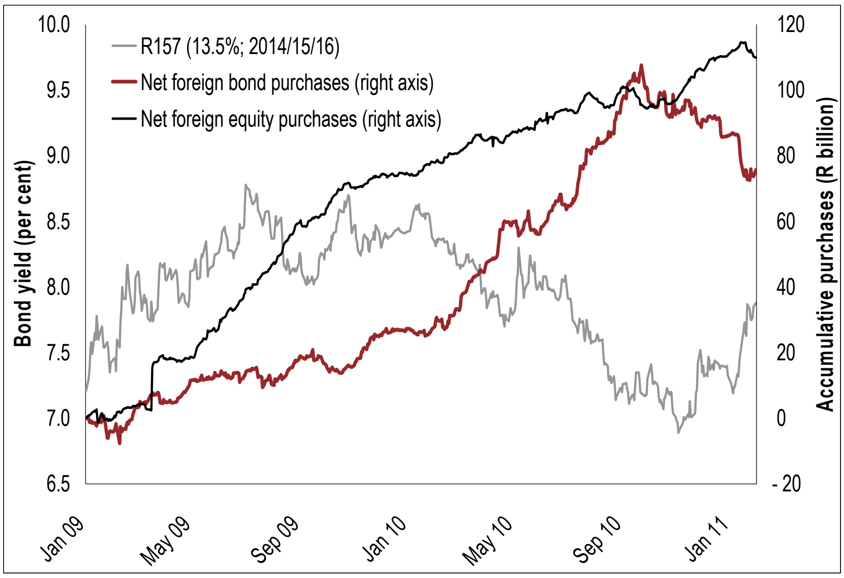
South Africa benefited from a wave of capital inflows, and government bond yields declined to record lows

Over the past year, emerging markets experienced a wave of capital inflows, driven by the expectation of higher returns and favourable interest rate differentials. In South Africa's case, this surge included unprecedented demand for debt, and yields on government bonds declined to record low levels.

Debt at government's weekly auctions was easily absorbed despite higher issuance by both the public and private sector. The short-dated R157 (13.5 per cent; 2014/15/16) bond yield declined 6 per cent year-on-year as at 31 January 2011, reaching a record low level of 6.89 per cent in November 2010. The spread between short- and long-term bond yields widened in anticipation of higher GDP growth and long-term inflation expectations.

Spread between short- and long-term bond yields widened in anticipation of higher growth and long-term inflation expectations

Figure 6.1 Bond yields and net purchases by non-residents of bonds and equities, 2009 – 2011



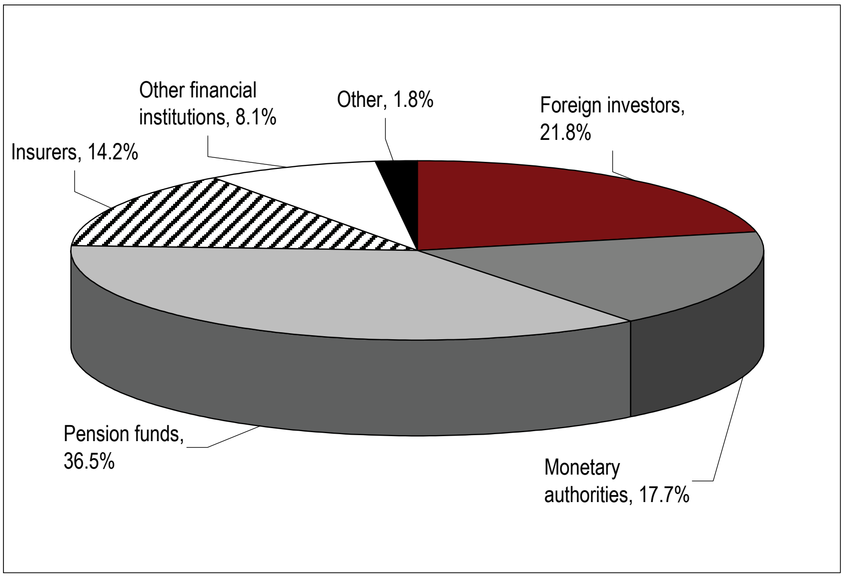
Source: Bloomberg

The strength of South Africa's macroeconomic indicators and higher global demand for emerging market debt has led to rising international interest in South African government bonds. Non-residents' purchases of domestic bonds more than doubled from a net R27 billion in 2009 to a net R56 billion in 2010. In the first nine months of 2010, non-residents purchased a net of R73 billion worth of domestic bonds, leading to a decline in bond yields. In the fourth quarter, yields rose as investors shifted into equities.

Non-residents more than doubled their purchases of government bonds in 2010

Domestic pension funds own the largest share (36.5 per cent) of government's bond portfolio, followed by non-resident investors (21.8 per cent). Government expects that it will be able to manage the impact of a sudden moderation in global capital flows should it occur.

Figure 6.2 Domestic government bond ownership, 31 December 2010

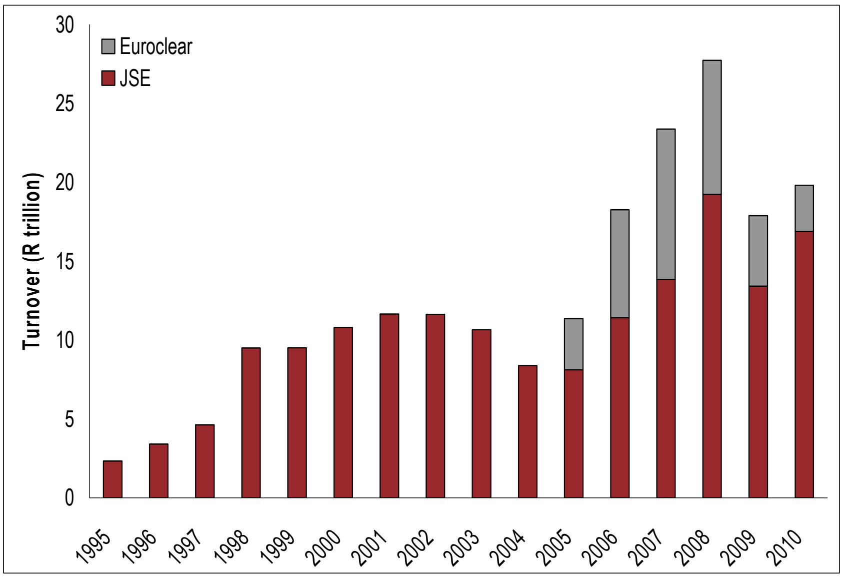


Source: STRATE

Turnover in municipal debt fell from R27.5 billion in 2009 to R24 billion in 2010

The annual turnover of bonds registered on the Johannesburg Stock Exchange increased from R13.4 trillion in 2009 to R16.9 trillion in 2010, and trades in RSA bonds abroad were R2.9 trillion, bringing total trades in domestic bonds to R19.8 trillion. Turnover in municipal debt declined from R27.5 billion in 2009 to R24 billion in 2010. The largest municipal bond issuers were Johannesburg (R3.4 billion), Cape Town (R2 billion) and Ekurhuleni (R815 million).

Figure 6.3 Turnover on domestic and international bond exchanges, 1995 – 2010



Source: Johannesburg Stock Exchange

The R157 is the most liquid government bond, followed by the R206

The R157 (13.5 per cent; 2014/15/16) bond remains government's most liquid debt instrument, with a turnover ratio of 74 times its outstanding amount. The R206 (7.5 per cent; 2014) bond has replaced the

R186 (10.5 per cent; 2025/26/27) as the second most liquid fixed-income bond. Turnover on inflation-linked bonds remains low due to the buy-and-hold nature of the investor base.

Domestic money market

In 2010, South Africa's three-month money market benchmark rate – the Johannesburg Interbank Acceptance Rate (JIBAR) – declined by 168 basis points to 5.55 per cent in response to the 1.5 percentage point decline in the repurchase rate. Over the same period, the 91-day Treasury bill rate followed other money market rates, declining from 7.27 per cent to 5.6 per cent. The 91-day Treasury bill continues to reflect supply pressures in the short end of the money market, remaining at higher average rates than the repo and JIBAR rates.

Global capital markets

Nearly US$908 billion in capital flows surged into emerging markets during 2010

During 2010, fears of a sovereign debt crisis in Europe, exceptionally low interest rates in developed countries and currency volatility drove sentiment in global capital markets. Nearly US$908 billion of capital flows surged into emerging markets. Foreign currency issuance by emerging markets amounted to more than US$75 billion.

Emerging market bond spreads have been narrowing, and South Africa's bond spreads traded below those of many of our peers. On 15 November 2010, the RSA global bond maturing in 2020 reached a spread of 95 basis points over the underlying US Treasury bond.

Higher sovereign debt issuance in world markets and non-resident purchases of domestic bonds reduced demand for rand-denominated debt issued in Europe (Eurorand bonds) and in Japan (Uridashi bonds), with negative net issuances of R10.5 billion and R7 billion respectively in 2010.

Consolidated borrowing and financing

The consolidated government borrowing requirement includes the financing requirement of national and provincial government, the social security funds and national extra-budgetary institutions.

Consolidated borrowing will increase to R153.6 billion in 2011/12 and decline to R134.6 billion in 2013/14

Consolidated borrowing in 2011/12 will increase to R153.6 billion before declining to R134.6 billion in 2013/14. The consolidated borrowing requirement is lower than that of the national government – mainly because of large investments held by the social security funds and capital reserves held by extra-budgetary institutions, which constitute prefunding for infrastructure investment.

Extra-budgetary institutions also raise loans to finance large-scale infrastructure investment, including South African National Roads Agency Limited and Trans Caledon Tunnel Authority project loans, which amount to about R22 billion over the medium term.

Table 6.1 Financing of consolidated government net borrowing requirement, 2007/08 – 2013/14

R billion	2007/08	2008/09 Actual	2009/10	2010/11 Estimate	2011/12	2012/13 Medium-term estimates	2013/14
Budget balance	**35.2**	**-27.5**	**-161.1**	**-142.4**	**-154.8**	**-152.9**	**-134.6**
Extraordinary receipts and payments	1.1	3.9	5.8	2.3	1.2	–	–
Net borrowing requirement	**36.3**	**-23.6**	**-155.3**	**-140.0**	**-153.6**	**-152.9**	**-134.6**
Domestic loans	6.1	46.0	177.1	188.1	175.3	158.5	144.8
Foreign loans	-4.7	-4.0	23.3	-2.3	5.0	-3.5	-9.6
Change in cash and other balances	-37.6	-18.5	-45.0	-45.9	-26.7	-2.1	-0.6
Financing	**-36.3**	**23.6**	**155.3**	**140.0**	**153.6**	**152.9**	**134.6**

National borrowing requirement

Net borrowing requirement is expected to peak at R161.7 billion in 2012/13

The net borrowing requirement for 2009/10, the revised estimate for 2010/11 and estimates for the medium term are set out in Table 6.2. In 2010/11, the net borrowing requirement is expected to amount to R141 billion, increasing to R161.7 billion in 2012/13 before declining to R148.7 billion in 2013/14. Changes in cash balances also affect the borrowing requirement.

Table 6.2 National government net borrowing requirement, 2009/10 – 2013/14

R million	2009/10 Outcome	2010/11 Budget	2010/11 Revised	2011/12	2012/13 Medium-term estimates	2013/14
National budget balance[1]	**-167 518**	**-174 904**	**-143 360**	**-159 066**	**-161 714**	**-148 715**
Extraordinary receipts	**6 435**	**–**	**3 148**	**1 350**	**–**	**–**
Premiums on loan transactions[2]	1 631	–	1 850	1 300	–	–
Special dividends	538	–	362	–	–	–
Vodacom / Vodafone transaction	3 934	–	–	–	–	–
Revaluation profits on foreign currency transactions[3]	212	–	86	–	–	–
Liquidation of SASRIA investment	104	–	150	50	–	–
Equalisation Fund account transfer	–	–	700	–	–	–
Other	16	–	–	–	–	–
Extraordinary payments	**-671**	**–**	**-802**	**-150**	**–**	**–**
Premiums on loan transactions[2]	–	–	-230	–	–	–
Revaluation losses on foreign currency transactions[3]	-435	–	-400	–	–	–
Defrayal of GFECRA losses[4]	-181	–	-172	-150	–	–
Settlement of Saambou Bank liability	-55	–	–	–	–	–
Borrowing requirement	**-161 755**	**-174 904**	**-141 014**	**-157 866**	**-161 714**	**-148 715**

1. A negative number reflects a deficit.
2. Premiums received or incurred on new loan issues, bond switch and buy-back transactions.
3. Revaluation profits or losses on government's foreign exchange deposits at the Reserve Bank when used to meet government's foreign exchange commitments.
4. Realised losses on the Gold and Foreign Exchange Contingency Reserve Account.

Extraordinary receipts and payments

Extraordinary receipts of R3.1 billion included R1.9 billion premiums on bond transactions

A total of R3.1 billion in extraordinary receipts is expected in 2010/11, consisting of premiums of R1.9 billion on bond transactions, proceeds of R150 million from government's liquidation of its investments in the

South African Special Risk Insurance Association (SASRIA), a special dividend of R362 million from Telkom, revaluation profits of R86 million on foreign currency transactions and a transfer of R700 million from the petroleum products equalisation fund.

In 2011/12, provision is made for the receipt of R50 million from SASRIA and R1.3 billion of premiums on bond transactions. No further receipts are projected over the medium term. Additional proceeds may be generated if non-strategic assets are identified and liquidated. Such proceeds could be used to buy back debt and to support state-owned entities and development finance institutions.

Extraordinary payments of R802 million in 2010/11

Extraordinary payments of R802 million are expected in 2010/11. These consist of losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) of R172 million, revaluation losses of R400 million on foreign currency transactions and premiums of R230 million paid on bond transactions. In 2011/12 provision is made for losses of R150 million on the GFECRA.

Financing the national borrowing requirement

Domestic borrowing levels maintained to support foreign exchange accumulation

Table 6.3 provides information on the funding of government's net borrowing requirement for 2009/10, revised estimates for 2010/11, and projections for 2011/12 to 2013/14. Although there has been a measured decline in the borrowing requirement, government maintained the 2010 Budget funding levels, using the surplus cash to buy foreign currency.

Table 6.3 Financing of national government net borrowing requirement, 2009/10 – 2013/14[1]

	2009/10	2010/11		2011/12	2012/13	2013/14
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic short-term loans (net)	**49 770**	**22 000**	**35 100**	**22 000**	**22 000**	**21 000**
Treasury bills	49 540	22 000	21 610	22 000	22 000	21 000
Corporation for public deposits	230	–	13 490	–	–	–
Domestic long-term loans (net)	**118 856**	**137 740**	**139 150**	**135 367**	**124 240**	**111 839**
Market loans	132 395	151 344	152 614	150 400	150 676	143 450
Redemptions[2]	-13 539	-13 604	-13 464	-15 033	-26 436	-31 611
Foreign loans (net)	**23 258**	**11 564**	**-2 267**	**4 999**	**-3 546**	**-9 630**
Market loans	30 873	14 439	–	7 150	7 870	8 690
Arms procurement loan agreements	800	352	512	1 009	26	–
Redemptions (including revaluation of loans)	-8 415	-3 227	-2 779	-3 160	-11 442	-18 320
Change in cash and other balances[3]	**-30 129**	**3 600**	**-30 969**	**-4 500**	**19 020**	**25 506**
Rand	-4 953	3 600	1 096	10 496	3 600	3 600
Foreign currency	-25 176	–	-32 065	-14 996	15 420	21 906
Financing	**161 755**	**174 904**	**141 014**	**157 866**	**161 714**	**148 715**

1. A longer time series is presented in Table 1 of Annexure B.
2. Redemption figures are net of anticipated switches, reducing redemptions by R7.8 billion in 2011/12 and by R35 billion in 2012/13.
3. A negative change indicates an increase in cash balances.

Lower-than-projected loan redemptions as a result of favourable exchange rates

The net borrowing requirement excludes loan redemptions – the repurchase of bonds at or before maturity – which also need to be financed. Scheduled loan redemptions are set out in Table 6.4. Loan redemptions in 2010/11 amount to R16.2 billion – R588 million lower than anticipated, mainly due to redemption of foreign loans at favourable rates. Loan redemptions are projected to reach R49.9 billion in 2013/14. Government actively manages refinancing risk through the domestic switch programme, which has already reduced the redemption value of the R189 (6.25 per cent; 2013) bond by R16 billion.

Table 6.4 Loan redemptions, 2009/10 – 2013/14

R million	2009/10 Outcome	2010/11 Budget	2010/11 Revised	2011/12	2012/13	2013/14
				Medium-term estimates		
Domestic loans	**13 539**	**13 604**	**13 464**	**15 033**	**26 436**	**31 611**
Foreign loans	**8 415**	**3 227**	**2 779**	**3 160**	**11 442**	**18 320**
Principal	7 608	2 387	2 439	2 998	13 967	13 466
Revaluation	807	840	340	162	-2 525	4 854
Total	**21 954**	**16 831**	**16 243**	**18 193**	**37 878**	**49 931**
Excludes: Source bonds in domestic switch auctions	–	–	–	*7 805*	*35 000*	–

Managing refinancing risk

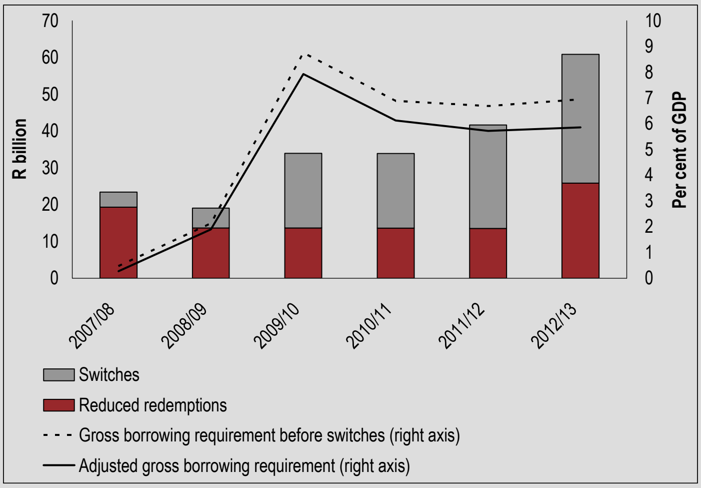
An excess of short-term debt increases refinancing risk. Short-dated debt must be regularly refinanced, raising the risk that this will be done at higher interest rates than planned, leading to higher costs. Government has reduced this risk by exchanging maturing debt before due date for longer-dated bonds, in what are referred to as switch auctions.

In 2008/09, government switched R66.3 billion of domestic debt maturing over the subsequent three years into longer-dated bonds. This reduced domestic bond redemptions to an average of 8.2 per cent of the gross borrowing requirement over the period 2009/10 to 2011/12, lowering costs and making more funds available to fund a countercyclical response to the recession.

Domestic bond redemptions as a percentage of gross domestic borrowing will remain low compared with those of most Organisation for Economic Cooperation and Development member countries. In 2010/11, a new switch programme was launched to reduce the redemption values of the R205 (floating; 2012) and R189 (6.25 per cent; 2013) bonds by R42.8 billion.

The redemption values of the R157 (13.5 per cent; 2014/15/16) and R201 (8.75 per cent; 2014) bonds, amounting to over R100 billion, will also have to be reduced.

Impact of bond switches on domestic maturity profile



The domestic switch programme will continue. The funding strategy takes into account risk benchmarks of 70/30 fixed-rate versus non-fixed-rate domestic debt, and a 20 per cent maximum exposure to foreign debt as a percentage of total gross debt.

Domestic short-term loans

Short-term borrowing consists of Treasury bill issuance and borrowing of surplus cash from the broader public sector. Provinces and some public entities are required to invest their surplus cash with the Corporation for Public Deposits, and government borrows from the Corporation to finance a portion of its borrowing requirement.

In 2010/11, domestic short-term loans increased by R35.1 billion, comprising R21.6 billion of Treasury bill issuance and R13.5 billion of borrowing from the Corporation for Public Deposits. As shown in Table 6.5, issuance of Treasury bills was concentrated in 9- and 12- month maturities, increasing the weighted average term to maturity of the Treasury bill portfolio from 186 days in 2009/10 to 204 days in 2010/11.

Domestic short-term loans increased by R35.1 billion in 2010/11

Table 6.5 Treasury bill issuance, 2010/11 – 2011/12

Maturity	2010/11			2011/12		2010/11	2011/12
R million	Opening balance	Net increase	Closing balance	Net increase	Closing balance	Weekly auction estimates	
91-day	48 225	1 500	49 725	–	49 725	3 825	3 825
182-day	24 275	3 675	27 950	7 930	35 880	1 075	1 380
273-day	27 865	6 260	34 125	4 100	38 225	875	980
364-day	14 175	10 175	24 350	9 970	34 320	475	660
Total	**114 540**	**21 610**	**136 150**	**22 000**	**158 150**	**6 250**	**6 845**

Over the medium term, Treasury bill net issuance is expected to average R22 billion a year. Currently no provision is made for further borrowing from the Corporation for Public Deposits.

Domestic long-term loans

Government's funding strategy in domestic long-term loans makes use of fixed-income bonds, inflation-linked bonds, floating-rate notes and retail bonds. Domestic long-term loan issuance amounts to R152.6 billion in 2010/11. Fixed-income bond issuance was concentrated in the medium-term maturities as shown in Table 6.6. These bonds constitute 78 per cent of total bond issuance. Fixed-income bonds were issued at a weighted average nominal yield of 8.3 per cent, while inflation-linked bonds were issued at a weighted average real yield of 2.9 per cent.

Fixed-income bonds account for 78 per cent of total bond issuance

The new fixed-income bonds, R213 (7 per cent; 2031) and R214 (6.5 per cent; 2041), were well received. As at 31 January 2011, issuance in the R213 bond reached R10.7 billion and R5.5 billion in the R214 bond, showing high demand for ultra-long benchmarks. Demand for inflation-linked bonds remained high, with 61 per cent of issuance in the longer maturity R202 (3.45 per cent; 2033) and R210 (2.6 per cent; 2028) bonds.

Current weekly auction levels in domestic bonds will be broadly maintained in the year ahead

Over the next two years, domestic long-term loan issuance will average R150.5 billion, decreasing to R143.5 billion in 2013/14. In 2011/12, issuance in fixed-income and inflation-linked bonds will be in existing benchmark bonds. It is anticipated that the current weekly auction levels in domestic bonds will be broadly maintained in 2011/12.

The non-competitive auctions in domestic fixed-income bonds, which provide primary dealers a 48-hour option of taking up an additional 30 per cent of their allocation at the auction clearing yield, will remain a source of funding.

Table 6.6 Domestic long-term market loan issuance, 2010/11

As of 31 January 2011 R million	Cash value	Average yield %	Nominal outstanding
Fixed-income[1]	**96 441**	**8.32**	**396 108**
R203 (8.25%; 2017)	17 684	8.13	61 750
R204 (8%; 2018)	15 581	8.39	60 968
R207 (7.25%; 2020)	15 100	8.19	69 949
R208 (6.75%; 2021)	18 539	8.34	58 341
R186 (10.5%; 2025/26/27)	4 512	8.53	79 684
R213 (7%; 2031)	9 251	8.43	10 719
R209 (6.25%; 2036)	6 678	8.54	40 325
R214 (6.5%; 2041)	4 330	8.52	5 534
Retail	4 766	8.25	8 838
Inflation-linked	**27 771**	**2.87**	**126 752**
R211 (2.5%; 2017)	3 278	2.51	17 138
R212 (2.75%; 2022)	5 953	2.82	7 763
R197 (5.5%; 2023)	1 541	3.14	57 478
R210 (2.6%; 2028)	7 189	2.95	14 100
R202 (3.45%; 2033)	9 776	2.91	30 110
Retail	34	2.35	163
Total	**124 212**		

1. Includes non-competitive auction allocations of R13 billion.

Total investment in retail bonds amounts to R9 billion

Retail bonds consist of 2-, 3- and 5-year fixed-rate and 3-, 5- and 10-year inflation-linked bonds. During 2010/11, investment in retail bonds amounted to R4.8 billion, of which R220 million was reinvestment of maturing bonds and capitalised interest. Total investment in retail bonds amounts to R9 billion. The interest rates on retail bonds are shown in Table 6.7.

Table 6.7 Interest rates on government retail bonds

Effective from Percentage	Bond maturity		
Fixed-rate	**2-year**	**3-year**	**5-year**
1 May 2010	8.50	8.75	9.00
1 Oct 2010	8.00	8.25	8.50
1 Dec 2010	7.50	7.75	8.00
Inflation-linked	**3-year**	**5-year**	**10-year**
1 Dec 2009	2.25	2.50	3.00
1 Dec 2010	2.00	2.25	2.75

As at 31 January 2011, R217 million of benchmark bonds were made available to primary dealers as an overnight facility at zero per cent interest to facilitate settlements in the bond market.

Foreign loans

Awards for a US$2 billion bond issuance, which was three times oversubscribed

Government did not issue any bonds in the international market in 2010/11. The US$2 billion issuance planned for 2010/11 took place in 2009/10 in response to favourable market conditions. The bond issue was more than three times oversubscribed. *Euroweek* named this instrument the emerging market bond of 2010, and *Credit Magazine* called it the best bond for Africa in 2010.

Drawdowns on the arms procurement loan agreements in 2011/12 amount to R1 billion, with final drawdowns of R26 million in 2012/13.

Global borrowing of US$1 billion a year to maintain foreign currency benchmarks

Over the medium term, government intends to borrow about US$1 billion a year in global markets to maintain benchmarks in major currencies and meet part of its foreign currency commitments. The balance of these commitments will be met from foreign currency bank balances and purchases in the domestic market.

Cash balances

Government's total cash consists of deposits in rand and in foreign currency. These deposits are held with commercial banks and the Reserve Bank, as shown in Table 6.8.

Table 6.8 National government cash balances, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R billion		Actual		Estimate	Medium-term estimates		
Reserve Bank							
Sterilisation deposits	63.1	66.1	67.2	67.2	67.2	67.2	67.2
Foreign currency deposits	–	–	25.2	57.1	72.2	56.8	34.9
Corporation for Public Deposits	0.2	4.0	1.0	–	–	–	–
Commercial banks							
Tax and loan accounts	30.5	31.3	38.4	41.9	35.0	35.0	35.0
Foreign currency deposits[1]	–	–	–	0.1	–	–	–
Total	**93.8**	**101.4**	**131.8**	**166.3**	**174.4**	**159.0**	**137.1**
Of which:							
Rand	*93.8*	*101.4*	*106.6*	*109.1*	*102.2*	*102.2*	*102.2*
Foreign currency	*–*	*–*	*25.2*	*57.2*	*72.2*	*56.8*	*34.9*

1. Amounts drawn on the arms procurement loan agreements and deposited into an interest bearing escrow account until actual expenditure takes place.

Foreign currency deposits with Reserve Bank to increase to R72.2 billion in 2011/12

Government's foreign exchange deposits with the Reserve Bank are made from money borrowed in the international markets and from purchases of foreign currency in the local market. These deposits are used to meet government's foreign currency commitments. The rand equivalent of foreign currency deposits with the Reserve Bank is expected to rise to R72.2 billion by 2011/12 and will decrease to R34.9 billion in 2013/14 after large scheduled foreign loan redemptions and interest payments.

In view of their role in managing money market liquidity, sterilisation deposits are only available for short-term cash management.

Operational cash in the tax and loan accounts is used to meet government's rand expenditure. Total cash balances will rise to R174.4 billion in 2011/12, declining to R137.1 billion in 2013/14. The losses and profits on the foreign exchange activities of the Reserve Bank are accounted for on the Gold and Foreign Exchange Contingency Reserve Account. The balance on this account is split into transactions with a cash flow and non-cash flow impact. Due to a stronger currency, the balance of valuation gains and losses decreased to a net R18.3 billion as of 31 December 2010, R17.5 billion lower than a year earlier.

National government's debt portfolio

Total debt

At 4.6 per cent of net loan debt, foreign net loan debt is well below risk benchmark

Net loan debt consists of total domestic and foreign debt, less the cash balances of the National Revenue Fund. In 2010/11, lower foreign issuance and a higher foreign currency cash balance are expected to reduce foreign net loan debt to 4.6 per cent of total net loan debt. Gross foreign loan debt exposure as a percentage of total gross loan debt is expected to remain well below the National Treasury's 20 per cent risk benchmark, declining from 9.6 per cent in 2010/11 to 7.2 per cent in 2013/14.

Table 6.9 Total national government debt, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R billion		Outcome		Estimate	Medium-term estimates		
Domestic debt							
Gross loan debt[1]	480.8	529.7	705.5	893.4	1 072.8	1 250.2	1 415.3
Cash balances	-93.8	-101.3	-106.6	-109.1	-102.2	-102.2	-102.2
Net loan debt[2]	387.0	428.4	598.9	784.3	970.6	1 148.0	1 313.1
Foreign debt							
Gross loan debt[1]	96.2	97.3	99.5	95.3	100.4	108.5	110.1
Cash balances	–	–	-25.2	-57.2	-72.2	-56.8	-34.9
Net loan debt[2]	96.2	97.3	74.3	38.1	28.2	51.7	75.2
Total gross loan debt	**577.0**	**627.0**	**805.0**	**988.7**	**1 173.2**	**1 358.7**	**1 525.4**
Total net loan debt	**483.2**	**525.7**	**673.2**	**822.4**	**998.8**	**1 199.7**	**1 388.3**
As percentage of GDP:							
Total gross loan debt	*27.8*	*27.1*	*33.0*	*37.1*	*40.2*	*42.4*	*43.1*
Total net loan debt	*23.2*	*22.7*	*27.6*	*30.8*	*34.3*	*37.5*	*39.3*
Foreign debt as percentage of:							
Gross loan debt	*16.7*	*15.5*	*12.4*	*9.6*	*8.6*	*8.0*	*7.2*
Net loan debt	*19.9*	*18.5*	*11.0*	*4.6*	*2.8*	*4.3*	*5.4*

1. Forward estimates are based on projections of exchange and inflation rates.
2. Net loan debt is calculated with due account of the cash balances of the National Revenue Fund (bank balances of government's accounts with the Reserve Bank and commercial banks).

By the end of 2010/11, financing of the net borrowing requirement, the impact of currency movements and inflation are expected to increase net loan debt to R822.4 billion. Net loan debt is projected to rise to R1.4 trillion or 39.3 per cent of GDP at the end of the forecast period.

Maturity distribution and composition of government debt

Table 6.10 shows the weighted average maturity distribution of the domestic bond portfolio. The average maturity of the portfolio will increase marginally to 10.2 years in 2010/11. The short-term end of the portfolio increased to 11.9 per cent as the R189 (6.25 per cent; 2013) inflation-linked bond approached its redemption date.

Table 6.10 Maturity distribution of domestic marketable bonds, 2008/09 – 2010/11

Percentage of total	2008/09	2009/10	2010/11	
			Estimates	
Years	Portfolio[1]		Funding[2]	Portfolio[1]
0 – 3	8.4	5.7	–	11.9
3 – 7	32.2	31.5	17.0	25.6
7 – 10	17.5	24.4	25.5	18.9
10 – 19	34.3	29.6	31.9	31.0
Longer than 19	7.6	8.8	25.6	12.6
Weighted average years to maturity	*10.2*	*10.1*	*13.1*	*10.2*

1. The total bond portfolio as at the end of the period.
2. Bond issuances for the fiscal year.

Non-fixed portion of domestic debt portfolio exceeds benchmark

The non-fixed component of the domestic portfolio, comprising floating-rate notes, inflation-linked bonds and short-term loans, will grow from 30 per cent in 2008/09 to 38 per cent in 2010/11, exceeding the National Treasury risk benchmark of 30 per cent non-fixed debt.

The deviation was necessary to fund government's large borrowing requirement and in response to greater demand for inflation-linked bonds and Treasury bills. Over the medium term, government will seek to move closer to the non-fixed debt benchmark.

Table 6.11 Composition of domestic debt by instrument, 2007/08 – 2010/11

End of period	2007/08	2008/09	2009/10	2010/11
R billion		Outcome		Estimate
Short-term loans	**52.9**	**65.0**	**114.9**	**149.9**
Shorter than 91-days[1]	1.0	–	0.3	13.7
91-days	31.7	37.7	48.2	49.7
182-days	10.4	13.8	24.3	28.0
273-days	9.8	12.9	27.9	34.1
364-days	–	0.6	14.2	24.4
Long-term loans	**427.9**	**464.7**	**590.6**	**743.5**
Fixed-income	350.8	369.0	445.6	556.3
Floating rate	4.8	7.8	7.8	7.8
Zero coupon	2.2	2.1	2.1	1.0
Inflation-linked[2]	68.6	83.9	130.4	168.7
Retail	1.3	1.7	4.6	9.6
Other[3]	0.2	0.2	0.1	0.1
Total	**480.8**	**529.7**	**705.5**	**893.4**

1. Mainly borrowing from the Corporation for Public Deposits.
2. Includes revaluation as a result of changes in CPI.
3. Loan levies, former regional authorities and Namibian debt.

The foreign debt portfolio consists mainly of US dollar-denominated (57 per cent) and euro-denominated (30 per cent) debt.

Debt-service costs

Debt-service costs are influenced by the volume of debt, new borrowing and market variables such as interest rates, inflation and exchange rates. Table 6.12 summarises trends and projections to 2013/14.

Table 6.12 National government debt-service costs, 2009/10 – 2013/14

	2009/10	2010/11		2011/12	2012/13	2013/14
R million	Outcome	Budget	Revised	Medium-term estimates		
Domestic	52 170	65 549	61 084	70 797	84 551	97 061
Foreign	4 959	5 809	5 486	5 782	6 257	6 975
Total	**57 129**	**71 358**	**66 570**	**76 579**	**90 808**	**104 036**
As percentage of:						
GDP	*2.3*	*2.6*	*2.5*	*2.6*	*2.8*	*2.9*
GDP-accrual [1]	*2.4*	*2.9*	*2.8*	*2.9*	*3.1*	*3.2*
Expenditure	*7.6*	*8.7*	*8.2*	*8.6*	*9.4*	*9.9*
Revenue	*9.9*	*11.1*	*10.0*	*10.5*	*11.3*	*11.5*

1. Debt-service costs adjusted for the amortisation of discount on domestic bond issues.

In 2010/11, revised debt-service costs are expected to be R4.8 billion lower than projected, mainly due to favourable interest and exchange rates.

State-owned entities' capital programmes

Government works with state-owned entities to ensure low-cost financing for capital investments

The state-owned entities are mandated to give effect to government's priorities. The main entities are in energy, rail, roads, ports, water and sanitation. For several years the largest entities have been investing in key economic infrastructure necessary to support long-term economic growth. During the recession, these infrastructure investments helped to stimulate the economy. To support the capital infrastructure programme, government provided cash injections, loans and guarantees to ensure the continued availability of funding at the lowest possible cost. To function sustainably, however, state-owned entities need to borrow mainly on the strength of their balance sheets.

Government will continue to help Eskom raise funding for its infrastructure commitments

Government support has reduced borrowing costs and eased pressure on the domestic capital market. The average spread between guaranteed and nonguaranteed domestic debt of state-owned entities amounted to 80 basis points in 2010/11. In the case of Eskom, this translates into an estimated saving of R1.3 billion over the period 2009/10 to 2014/15. In January 2011, Eskom issued 10-year unsecured notes amounting to US$1.8 billion in the global capital market. Government will continue to explore mechanisms to support Eskom in raising funding for its infrastructure commitments through 2017.

State-owned entities will continue to pursue funding opportunities in domestic and foreign capital markets. Multilateral agencies (the World Bank, European Investment Bank, African Development Bank, Agence Française de Développement and Kreditanstalt für Wiederaufbau) that provide cost-effective long-term loans will also continue to be sources of finance.

Between 2010/11 and 2014/15, capital expenditure by the major state-owned entities is projected at R623.6 billion (2010: R699.6 billion). This estimate is 10.9 per cent lower than previously published figures as a result of revisions to capital expenditure estimates. Contract prices have fallen somewhat and some projects have been delayed as a result of a slowdown in demand due to the recession.

In the five years to 2014/15, capital expenditure by the major state-owned entities is projected at R623.6 billion

Table 6.13 Major state-owned entities' capital expenditure programmes, 2009/10 – 2014/15

R billion	2009/10 Outcome	2010/11 Budget	 Revised	2011/12 Medium-term estimate	2012/13	2013/14	2014/15
Capital expenditure	88.6	149.5	136.2	136.5	122.7	104.3	123.9
Of which:							
Eskom	*48.4*	*96.3*	*86.8*	*93.7*	*85.2*	*67.0*	*88.9*
Transnet	*18.4*	*19.4*	*22.8*	*21.9*	*17.1*	*16.2*	*15.2*
Central Energy Fund	*1.4*	*5.8*	*6.8*	*4.3*	*8.2*	*10.1*	*5.5*
South African National Roads Agency Limited	*11.6*	*13.5*	*8.4*	*2.6*	*2.0*	*1.5*	*1.5*
Trans-Caledon Tunnel Authority	*0.4*	*7.1*	*5.0*	*9.0*	*4.8*	*4.8*	*2.9*
Airports Company of South Africa Limited	*5.2*	*1.6*	*1.3*	*0.8*	*1.1*	*–*	*–*

Over the same five-year period, the capital expenditure programmes and refinancing needs of major state-owned entities will be financed through internally generated resources (42 per cent), government funding (5 per cent) and a combination of long-term and short-term borrowing in the domestic (28 per cent) and foreign markets (25 per cent).

Table 6.14 Projected major sources of funding for state-owned entities and development finance institutions, 2009/10 – 2014/15

R billion	2009/10 Outcome	2010/11 Budget	 Revised	2011/12 Medium-term estimates	2012/13	2013/14	2014/15
Domestic loans (gross)	**110.6**	**75.9**	**81.3**	**59.2**	**51.6**	**52.9**	**65.7**
Short-term	29.6	11.7	20.2	17.9	13.5	11.3	12.7
Long-term	81.0	64.2	61.1	41.3	38.1	41.6	53.0
Foreign loans (gross)	**6.9**	**50.4**	**66.2**	**47.1**	**30.5**	**32.0**	**12.9**
Long-term	–	9.8	20.8	22.1	17.0	25.1	9.6
Multilateral institutions	4.6	32.6	28.0	18.1	7.9	3.5	1.2
Export credit agencies	2.3	8.0	17.4	6.9	5.6	3.4	2.1
Total	**117.5**	**126.3**	**147.5**	**106.3**	**82.1**	**84.9**	**78.6**
As percentage of total:							
Domestic loans	*94.1*	*60.1*	*55.1*	*55.7*	*62.9*	*62.3*	*83.6*
Foreign loans	*5.9*	*39.9*	*44.9*	*44.3*	*37.1*	*37.7*	*16.4*

Contingent liabilities

Contingent liabilities may be incurred depending on future events. In 2010/11, new guarantees were issued to Eskom (R174 billion) and the existing guarantee to Denel (R1.9 billion) was extended by a year. Fees of R43.9 million were received in 2010/11 on various guarantees provided. The major public entities that hold guarantees are shown in Table 6.15. Details of guarantee commitments are set out in Table 9 of Annexure B.

Table 6.15 Guarantee exposure against major state-owned entities and development finance institutions, 2009/10 – 2010/11

Institution	2009/10		2010/11	
R billion	Guarantee	Exposure	Guarantee	Exposure
Total	**298.4**	**129.1**	**470.5**	**159.8**
Of which:				
Eskom	*176.0*	*46.7*	*350.0*	*71.3*
South African National Roads Agency Limited	*38.9*	*12.3*	*38.9*	*23.7*
Development Bank of Southern Africa	*29.3*	*26.6*	*29.3*	*25.7*
Trans-Caledon Tunnel Authority	*25.4*	*20.7*	*25.4*	*18.8*
Transnet	*11.4*	*11.6*	*9.5*	*9.9*
Land Bank	*3.8*	*2.6*	*3.8*	*1.8*

Eskom

State support led to cancellation of Eskom's credit watch

In February 2009, government approved guarantees totalling R176 billion to support construction of new power plants; the guarantee was increased by R174 billion in October 2010, bringing the total to R350 billion. The additional state support has led to the cancellation of an Eskom credit watch. Part of the increase in the guarantee was precautionary, aimed at ensuring more rapid progress on urgent projects through 2017, including the completion of the Kusile power plant. Eskom is now able to borrow with a mix of unsecured and secured debt instruments.

Trans-Caledon Tunnel Authority

As at 31 March 2011 the Trans-Caledon Tunnel Authority will have borrowed a total of R18.8 billion against an authorised guaranteed amount of R25.4 billion for the Lesotho Highlands Water Project. Income from water sales is proving adequate to service debt.

South African National Road Agency Limited

SANRAL will continue to source finance to fund expansion of toll roads in Gauteng and Western Cape

In 2009/10, SANRAL received a guarantee of R31.9 billion and raised R11.4 billion. SANRAL will continue to source finance over the medium term to fund the expansion and upgrade of toll roads as part of the Gauteng Freeway Improvement Project and the N1/N2 Winelands project.

Transnet

Guarantees to Transnet were provided in 1998 (R3.5 billion) and 2004 (R6 billion) to enable financing of capital expenditure projects. Since then Transnet's financial position has improved and it can fund its capital expenditure programme on the strength of its balance sheet.

Denel

Government extended Denel's R1.9 billion of existing guarantees to 2011. Of the eight business units, four are profitable. Government is working with Denel to find a way for loss-making entities such as Denel Saab Aerostructures, Denel Dynamics and Rooivalk to become sustainable.

South African Airways

SAA's R1.6 billion guarantee was restructured

Although no additional support was required during 2010, government restructured the R1.6 billion perpetual guarantee provided to South African Airways (SAA) in 2009 to provide security required by international air services licensing councils for tickets purchased in advance.

South African Broadcasting Corporation

Task team is working to ensure SABC's adherence to conditions of guarantee

In 2009/10, government approved a R1.5 billion guarantee for the South African Broadcasting Corporation (SABC). A R1 billion term loan facility was concluded in December 2009 and issuance against the remaining guarantee is contingent on approval by government. The Ministers of Communications and Finance have established a task team to oversee a turnaround at the SABC and ensure adherence to guarantee conditions.

Passenger Rail Agency of South Africa

The 2010 Budget included a recapitalisation of the Passenger Rail Agency of South Africa to the value of R797 million. This transfer supported repayment of a loan under the R1.4 billion guarantee for the acquisition of buses for the 2010 World Cup. The rail agency is working with government to ensure that the remainder of the loan will be repaid.

Provisions and contingent liabilities

Projections for provisions and contingent liabilities are shown in Table 6.16. Provisions are liabilities for which the payment date or amount is uncertain. The provisions for the multilateral institutions are the unpaid portion of subscriptions to these institutions, payable on request.

As at 31 March 2010, net loan debt, provisions and contingent liabilities amounted to 41 per cent of GDP, and are projected to reach 51 per cent of GDP by 2013/14. This is well below the Southern African Development Community's macroeconomic convergence target of 60 per cent of GDP, and compares favourably with many developed countries.

Table 6.16 Composition of provisions and contingent liabilities[1], 2009/10 – 2013/14

End of period R billion	2009/10 Outcome	2010/11 Estimate	2011/12 Medium-term estimates	2012/13	2013/14
Net loan debt	**673.2**	**822.4**	**998.8**	**1 199.7**	**1 388.3**
Provisions	**58.4**	**58.5**	**75.2**	**79.4**	**84.0**
Special drawing rights	0.8	0.8	0.8	0.8	0.8
International Monetary Fund[2]	23.6	23.6	23.6	23.6	23.6
International Bank for Reconstruction and Development[2]	11.2	11.0	10.9	12.0	13.3
Multilateral Investment Guarantee Agency[2]	0.1	0.1	0.1	0.1	0.1
African Development Bank[2]	8.1	7.9	24.1	26.6	29.3
Development Bank of Southern Africa Limited[3]	4.8	4.8	4.8	4.8	4.8
Government employees leave credits	9.8	10.3	10.9	11.5	12.1
Contingent liabilities	**267.9**	**298.2**	**316.6**	**327.4**	**331.9**
Guarantees	129.1	159.8	175.8	188.0	193.5
Post-retirement medical assistance	56.0	56.0	56.0	56.0	56.0
Road Accident Fund	45.4	44.1	46.2	45.6	45.3
Government employees pension funds	–	–	–	–	–
Claims against government departments	24.2	24.2	24.2	24.2	24.2
Export Credit Insurance Corporation	9.2	9.9	10.0	8.9	7.7
Unemployment Insurance Fund	3.7	3.9	4.1	4.4	4.9
Other[4]	0.3	0.3	0.3	0.3	0.3
Total	**999.5**	**1 179.1**	**1 390.6**	**1 606.5**	**1 804.2**
Total as percentage of GDP	*40.9*	*44.2*	*47.7*	*50.2*	*51.0*

1. Medium-term forecasts of some figures are not available and are kept constant.
2. Represents the unpaid portion of government's subscription to these institutions.
3. Represents callable capital provided for in terms of the Development Bank of Southern Africa Act.
4. Represents a liability to Reserve Bank in respect of old coinage in circulation and other unconfirmed balances by departments.

Development finance institutions

Development finance to support infrastructure and industrial development in South Africa and region

South Africa's development finance institutions are well placed to deliver on government's development priorities. The asset base of the major development finance institutions amounted to R153 billion as at 31 March 2010, and over the next three years their lending capacity will be an estimated R115 billion. Over the period ahead, these institutions will focus on infrastructure and industrial development, low-cost housing, rural development and land reform, financing small businesses and black economic empowerment enterprises, and supporting regional development.

Development finance institutions require adequate resources to deliver on their mandates. Government works with these institutions and other state-owned entities to ensure orderly participation in bond auctions, and to make use of favourable market conditions to extend their debt maturities to reduce refinancing risk. To ensure better coordination, guidance and monitoring, and a more cost-effective approach, government has established the Development Finance Institutions Council, made up of Cabinet ministers responsible for the various entities.

Review of development finance institutions

In 2008 government commissioned a review on the role of development finance institutions. The purpose of the review was to ensure that these institutions were effectively supporting South Africa's social and economic policy objectives, and working within a well-coordinated policy and governance framework.

The review focused on the 12 main institutions.* Its key findings were as follows:

- **Mandates**: The mandates are broad and lack focus. There is considerable overlap and duplication in the purpose and function of these entities, leading to wastage of resources.
- **Governance**: A uniform legal and regulatory framework is required for these institutions.
- **Coordination**: Development finance institutions are not well coordinated at central government level. Improved coordination would support efficiency in service delivery.
- **Risk management**: More emphasis must be placed on risk management to contain losses. Staff technical skills should be improved, boards trained and risk management programmes developed.
- **Development effectiveness**: Monitoring and evaluation frameworks are weak or absent, making it difficult for government to assess the real impact of development finance activities.
- **Financial sustainability**: The institutions should be able to cover their costs with their own income. While maintaining commercial loans, a growing proportion of funds should be directed towards development.

The review recommended that government introduce a more meaningful performance monitoring and evaluation system to assess and guide delivery on development interventions. It also proposed the establishment of a Development Finance Council to coordinate and guide the activities of these entities. The council is now in place and is overseeing the implementation of the recommendations made in the review.

**Development Bank of Southern Africa, Independent Development Trust, Industrial Development Corporation, Khula Enterprise Finance, Land Bank, Micro Agricultural Finance Institute of South Africa, National Empowerment Fund, National Housing Finance Corporation, National Urban Reconstruction and Housing Agency, Rural Housing Loan Fund, South African Micro Finance Apex Fund and Umsobomvu Youth Fund.*

Development Bank of Southern Africa

Government and the Development Bank of Southern Africa (DBSA) have agreed that the bank should step up its support for municipalities and expand its support to provinces and other priority programmes.

DBSA to step up support for municipalities in services and infrastructure

The DBSA will work to improve delivery of services, operations and infrastructure maintenance, with spinoffs for local employment. The Bank is also encouraged to champion a model that involves private-sector co-financing of such projects. To support these initiatives, government committed to raise the Bank's callable capital by R15.2 billion to R20 billion, increasing its lending capacity to R140 billion. A legislative amendment will effect this change. Government is also exploring ways to reduce the DBSA's exposure when lending to municipalities that are credit risks. This will help to accelerate municipal infrastructure programmes.

Land Bank

The Land Bank is refocusing to prioritise support for emerging farmers, and to increase South Africa's production of food and fibre. The Bank is working with the relevant national departments to implement a support programme for emerging farmers, starting with those who cannot service their Land Bank loans. The Bank has improved its financial performance, moving from a profit of R168.1 million in 2008/09 to R379 million in 2009/10. During 2011/12, the Bank will receive a tranche amounting to R750 million, reducing its extended guarantee to R1 billion. The intention is to complete the recapitalisation over the next two years, eliminating the

Land Bank has refocused to provide support for emerging farmers and boost agricultural production guarantee. During 2010, the Land Bank successfully issued a 3-year floating rate note. Government will help the Bank to access longer-term multilateral funding to extend its debt-maturity profile.

National Housing Finance Corporation

NHFC has borrowed from international agencies

Government approved NHFC requests to borrow equivalent of €50 million from European agencies

In March 2010, government approved a request by the National Housing Finance Corporation (NHFC) to borrow the rand-denominated equivalent of €30 million from the European Investment Bank and €20 million from the Agence Française de Développement. The Department of Human Settlements and the NHFC are investigating a mortgage default insurance programme, backed by a R1 billion government guarantee. The National Treasury is considering a reclassification under the Public Finance Management Act that would allow the NHFC to borrow.

Industrial Development Corporation

IDC plans to invest more than R70 billion over the next five years

The Industrial Development Corporation (IDC) plans to invest more than R70 billion to fund industrial and business development over the next five years, with R10 billion set aside for projects with high job-creation potential. The IDC will also continue to assist selected businesses that are in distress as a result of the recent recession through the R6.1 billion fund announced in 2009 (R2.9 billion in 2009/10 and R3.2 billion in 2010/11). By the end of 2010, the IDC had committed R3.6 billion to 66 businesses under this programme, with 23 322 jobs saved as a result.

Conclusion

Deep and liquid capital markets have supported the borrowing programme

During 2010/11, South Africa's deep and liquid capital markets facilitated the financing of the elevated public-sector borrowing requirement of R281.2 billion, including the main budget deficit of R143.4 billion. Government has strengthened the development finance institutions through guarantees and capital injections to help them to leverage more resources in support of the development agenda.