Sovereign

Republic of South Africa

Ratings

Foreign currency		
Long-term	BBB-	(7/00)
Previously	BB+	(5/00)
	BB	(9/94)
Short-term	F3	(7/00)
Local currency		
Long-term	BBB+	(7/00)
Previously	BBB	(9/94)

Outlook Stable

Peer Group

BBB	Estonia Latvia Malaysia
BBB-	Bahrain Egypt **South Africa** Thailand Tunisia Uruguay
BB+	Colombia Croatia El Salvador India Lithuania Mexico Panama Philippines Slovakia

Analysts

Jaime Sanz
Phone + 44 20 7417 4384
jaime.sanz@fitchratings.com

Chris Pryce
Phone + 44 20 7417 4342
chris.pryce@fitchratings.com

5 September 2000

Fitch's recent upgrade of South Africa's sovereign ratings reflects a marked improvement in the country's macroeconomic conditions, as tight fiscal and monetary policies underpinned a recovery of confidence in 1999. A strong inflow of foreign portfolio investment has allowed the South Africa Reserve Bank (SARB) to wind down its oversold forward book from USD26 bn in mid-1998 to just over USD16 bn in June 2000.

A reduction in the general government's deficit to 1.7% of GDP in 1999/2000 from 2.1% in the previous year has been aided by a reform of the tax system, including lower income and corporate tax rates, a broadening of the tax base and tougher penalties for evaders. A lower public sector borrowing requirement and the SARB's generally tight monetary policy have supported a reduction of inflation from 8.6% in 1997 to 5.2% in 1999. Inflationary pressures resurfaced in the first half of 2000, due mainly to high international oil prices, but the SARB's adoption of an inflation targeting system from 2002 should contribute to the long-term abating of inflation expectations. More importantly, fiscal and monetary discipline have supported an improvement in South Africa's debt ratios. Public debt, which peaked at 50.5% of GDP in 1998, is expected to decline to 47% in 2000 and further to 42% in 2003.

While the government's success on the macroeconomic front has been impressive, its record in the area of structural reforms is mixed. Domestic and foreign direct investment continues to lag behind that of most other investment-grade credits, as investors complain of the limited pool of skills in South Africa's labour market and the country's stubbornly high crime rates. Additionally, the spread of HIV/AIDS, with an expected marked increase in infection rates over the coming decade, has become a major social tragedy with serious, but difficult to quantify, ramifications in the South African economy.

The government recognises the constraint imposed by these structural deficiencies and has pledged to step up reforms in the areas of privatisation, labour market, health and education provision. Until these reforms yield results, growth potential appears limited to 3-4% a year, which is by and large insufficient to sustain employment creation. Official unemployment has continued to creep up, and is estimated at over 37% of the labour force. More significantly, a poor growth record continues to deny a majority of the population the benefits of South Africa's transition, and if not improved, could in time threaten the sustainability of the current policy environment.

■ Strengths

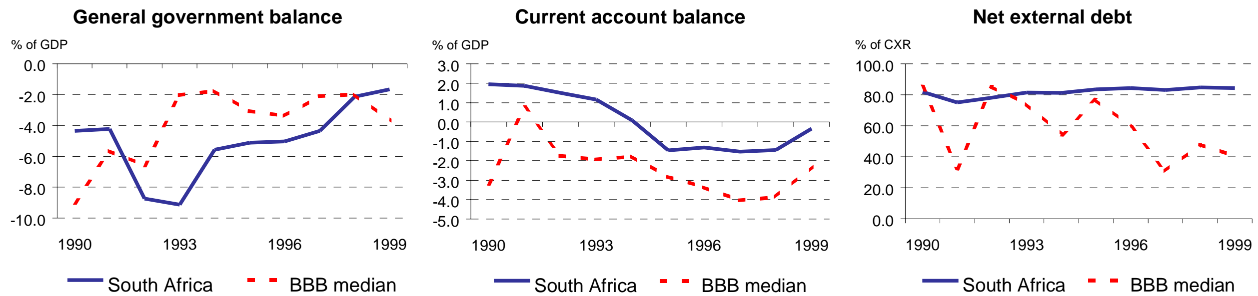
- Consistent and responsible fiscal and monetary policies
- A comparably modest external debt burden
- A stable and democratic political system
- A robust financial system and solid legal institutions

■ Weaknesses

- Structural deficiencies constraining growth
- Low external liquidity and dependence on foreign portfolio capital
- Social challenges including high crime and spread of AIDS
- Inadequate education system and poor labour skills set

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000



Key Indicators for South Africa (1)

Population (1998): 42.1mn **Population growth rate (1994-98):** 1.2% p.a.

GDP (1999): USD131.1bn **GDP per head at market exchange rates (1999):** USD3,078

GNP per head at purchasing power parity (1998): USD8,296 (= 28% of USA level)

Modern sovereign rescheduling history: none

	1995	1996	1997	1998	1999	2000[f]	2001[f]
Domestic economy and finance							
Real GDP growth (%)	3.1	4.2	2.5	0.6	1.2	3.4	4.0
Unemployment (% of labour force)	29.2	35.6	37.6	37.8	37.5	37.5	37.5
Consumer prices (CPI, annual average % chg)	8.7	7.4	8.6	6.9	5.2	4.4	5.7
Gross domestic savings/GDP (%)	19.1	18.3	17.1	17.4	18.2	17.7	17.5
General government balance/GDP (%)	-5.1	-5.0	-4.3	-2.1	-1.7	-2.4	-2.0
General government debt/GDP (%)	49.5	49.2	48.3	50.4	48.6	47.5	46.6
General government debt maturities/GDP(5) (%)	2.9	4.4	4.4	4.3	4.5	6.0	
Broad money (% change December to December)	16.0	14.3	17.8	13.7	10.1	10.4	9.8
ZAR per USD (annual average)	3.63	4.30	4.61	5.53	6.11	6.65	6.90
Real effective exchange rate(2) (1995=100)	100.0	92.2	98.7	89.4	84.6	80.0	78.0
Reer: % change (+ = appreciation)	-2.9	-7.8	7.0	-9.4	-5.4	-5.4	-2.5
Balance of payments							
Current receipts, CXR(3) (USDbn)	36.0	36.4	37.9	35.9	34.8	38.1	41.8
Current receipts (annual % change)	15.5	1.1	4.2	-5.4	-3.1	9.4	10.0
Current payments, CXP(3) (USDbn)	38.2	38.3	40.2	37.8	35.3	38.7	43.0
Current payments (annual % change)	23.0	0.2	5.0	-5.9	-6.8	9.7	11.2
Current account balance (USDbn)	-2.2	-1.9	-2.3	-1.9	-0.5	-0.6	-1.2
Current account balance/GDP (%)	-1.5	-1.3	-1.5	-1.4	-0.4	-0.5	-0.9
External assets and liabilities							
Gross external debt (USDbn)	35.3	34.5	39.2	38.8	41.7	43.5	44.9
Gross external debt/GDP (%)	23.4	24.0	26.4	29.0	31.8	34.0	33.6
Gross external debt/CXR (%)	98.1	94.8	103.3	108.2	119.8	114.3	107.2
Net external debt (USDbn)	30.1	30.7	31.5	30.4	29.3	29.3	28.2
Net external debt/GDP (%)	19.9	21.4	21.2	22.7	22.4	22.9	21.1
Net external debt/CXR (%)	83.5	84.3	83.0	84.8	84.3	77.1	67.3
Short-term debt/Gross external debt (%)	52.1	56.6	67.1	66.7	66.7	66.6	66.4
Debt service/CXR (%)	13.8	14.6	16.4	16.3	15.9	15.9	13.6
Interest service/CXR (%)	7.3	7.0	7.9	8.3	8.7	8.1	7.5
Liquidity ratio(4) (%)	18.0	17.1	12.1	18.4	20.6	27.6	30.8
Official reserves including gold (USDbn)	4.5	2.4	6.1	5.5	7.5	8.2	9.2
Official reserves in months of CXP cover	1.4	0.8	1.8	1.8	2.6	2.5	2.6
Official reserves/Broad money (%)	5.9	3.6	8.1	7.7	10.0	10.7	11.7

(1) Fitch estimates and forecasts.
(2) Based on consumer prices. (3) Exports/imports of goods, services, income, and current transfers.
(4) Official reserves incl. gold *plus* banks' foreign assets/ Debt service *plus* liquid external liabilities.
(5) Maturities of medium and long-term debt during year *plus* short-term debt outstanding at the beginning of the year.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Sovereign report

Republic of South Africa

Rationale

Ratings

Foreign currency Long-term	Short-term	Local currency Long-term
BBB-	F3	BBB+

Outlook Stable

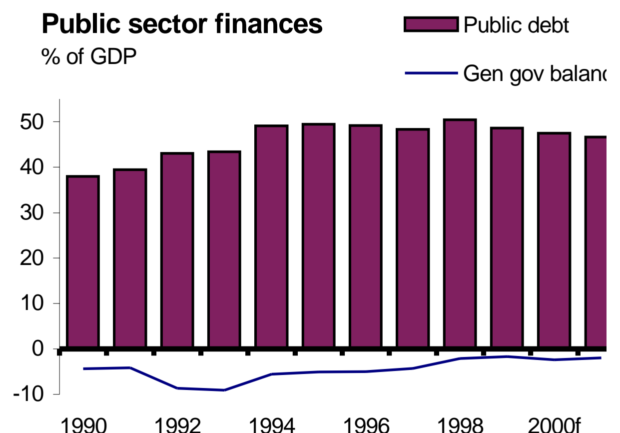
One year after the election that reaffirmed and strengthened the African National Congress (ANC) claim to power in South Africa and brought Thabo Mbeki to the presidency, the country's government continues to show a mixed record in terms of its long-term economic goals. On the one hand, macroeconomic stability has been reinforced by the adoption of a more transparent and effective monetary policy framework and by the continued over-performance of the fiscal authorities. On the other, the key long-term objectives of raising the country's savings and investment rates and ultimately achieving higher, sustainable growth have continued to elude policymakers. In our view, South Africa's poor recent growth record – averaging just over 2.3% per year since 1995 – reflects mainly the existence of structural deficiencies that have only been partially addressed by the successive ANC-led governments since 1994. Most critically, gross domestic investment, at just under 16% of GDP in 1999, appears constrained by the lack of skilled human capital, the still substantial presence of the public sector in economic activity and the rigidities present in the labour market. Ultimately, the direction of South Africa's sovereign rating hinges on the ability of the government to overcome these constrains and to create an environment for sustained social stability that would support the improving trend of macroeconomic and debt indicators.

While South Africa faces significant structural problems that will challenge the resilience of the policy environment and the resolve of the government to maintain economic discipline, in our view, recent improvements in fiscal, inflation, debt and liquidity indicators warrant an upgrade of the country's sovereign ratings.

Primarily, South Africa's ratings are supported by prudent fiscal and monetary policies and a coherent policy mix. In fact, the macroeconomic stance was tightened during the first year of the Mbeki administration, as the government overshot its fiscal targets in 1999/2000 and adjusted downwards its deficit targets for 2000/2001, while the South African Reserve Bank (SARB) introduced a strict inflation-targeting system. The general government (including local governments, social security funds and extra-budgetary institutions) registered a deficit of 1.7% of GDP in 1999/2000, down from 2.1% in the previous year. The SARB's new monetary policy framework calls for a reduction of CPIX inflation (a measure of consumer prices that excludes mortgage interest rates) to a range of 3-6% by 2002. Average CPIX inflation is expected to edge up to 7.6% in 2000 driven mainly by high international oil prices.

The steady reduction of the public sector's deficit has been accompanied by a rationalisation of the tax system and with significant gains in the area of tax compliance and enforcement. The reduction of income tax rates in the 2000/2001 budget follows a similar reduction in corporate tax rates in the preceding budget. Notwithstanding the lower tax rates, the South African Revenue Service (SARS) has achieved a steady improvement in tax yields through increases in the tax base and a reduction of tax evasion. A new capital gains tax will be introduced in the first quarter of 2001 at a single rate of 10.5%.

The SARB's success in reducing inflation rates and the shrinking levels of public sector borrowing have allowed a marked reduction of nominal and real interest rates which should underpin a recovery in economic activity this year and next. Real interest



Source: SARB. Fitch estimates and forecasts.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

rates have fallen steadily from a peak of 18% during the emerging market crisis of 1998 to 8% in the first half of 2000. Few analysts expect a further reduction in nominal interest rates in 2000, as high oil prices and a weak rand are likely to add pressure to the SARB's inflation targets. In the absence of any external shocks, the impact of substantially lower real interest rates on private investment and general business confidence indicators was expected to push GDP growth to 3.5-4% in 2000. In the event, the negative impact of political developments in neighbouring Zimbabwe and a new round of foreign sales of South African financial assets will likely take some lustre away from the growth statistics for 2000. Real GDP growth is now generally expected at 3-3.5%, still a significant improvement from the average 1% annual growth of 1998-99.

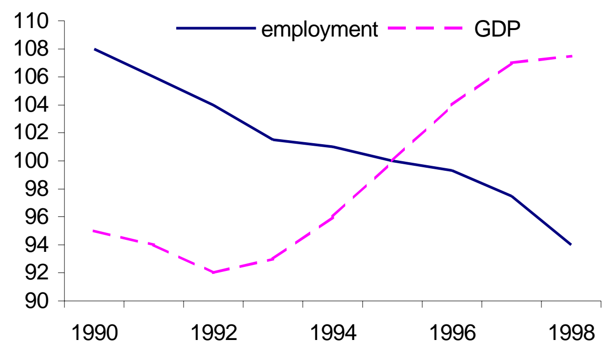
Critically, the process of fiscal consolidation has supported a stabilisation of South Africa's public debt ratios, which are central to the country's sovereign ratings. Public debt is expected to fall to 48.5% of GDP at year-end 2000, down from 50.5% of GDP in 1998. Furthermore, public debt ratios should continue to improve in line with the government's medium-term budgetary program, with public debt expected to fall to 42% of GDP in 2003.

At the same time, macroeconomic stability and the recovery of external confidence have allowed the SARB to substantially reduce it net open forward position. The forward risk position will continue to come down if the reserve bank maintains its present commitment to let the market determine the value of the rand without intervention.

The adoption of strict monetary rules by the SARB has been criticised in South African business circles as potentially damaging to the economy's chances of staging a prolonged recovery in the short term. Equally, some South African observers consider that the government's fiscal zeal is constraining the extent of the economic recovery and that the country's generally healthy public finances would allow for a more profligate spending policy. Although it is possible that stringent fiscal and monetary policies will reduce growth in the short term, we believe that prudent and consistent policies will reduce the volatility of the economy to shocks and should lead to more stable growth. A more widely held view is that medium-term growth is constrained by structural rigidities and by the sensitivity of the economy to domestic and external shocks.

The precarious situation of the labour market, with official unemployment at 37% of the labour force, is the most immediate reflection of the lack of adequate investment and growth in the economy. Lack of restructuring and liberalisation in the economy, and an inappropriate set of skills in the labour market partly explain this precarious situation. Ultimately, this structural mismatch reflects the failure of the education system under the apartheid regime, as well as the limited progress achieved by the Mandela and Mbeki governments in the area of education and skills development.

GDP and Employment
1995 = 100



Source: Department of Finance

Neither changes to the labour legislation, nor a more aggressive privatisation agenda are likely to boost growth rates in the short term. The conclusion is that growth is unlikely to exceed 3.5% per year on average in the short to medium-term. These are clearly insufficient levels, as it is estimated that sustained annual growth rates of 5-6% would be required in order for unemployment rates to start declining in any significant way. On the other hand, if current macroeconomic discipline is maintained, it is likely that the pattern of growth will become less volatile.

Popular support for the government's broad reconciliation agenda remained high throughout the Mandela administration, as evidenced by the strong ANC showing in the 1999 elections, where it obtained 66% of the vote, up from 60% in the 1994 election. However, political analysts in South Africa reckon that the reconciliation honeymoon that permeated Mandela's presidency is reaching its end. The government recognizes that to maintain political and economic stability it will have to find ways to deliver higher standards of living to a majority of the country's population. In this sense, the government's Growth, Employment and Redistribution (GEAR) agenda – a blueprint for the implementation of macroeconomic policies consistent with sustainable growth – alone does not ensure success.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

On virtually every front, the government's efforts to maintain stability will be challenged by the spread of the AIDS epidemic, with an estimated 10% infection rate already in 1999. While the bottom-line economic impact of AIDS is likely to be manageable, the social consequences will be dire, and will test the resilience of South Africa's civil and government institutions.

The political and social environment

Since the 1999 election, the administration of president Thabo Mbeki has ensured continuity in economic policy while emphasising a more efficient delivery of sorely needed social services and infrastructure. The list of social challenges facing the government is appalling, led by the spread of AIDS, high crime levels and income inequality. Still, signs of political discontent are hardly visible.

Political risk, or more explicitly the risk of a breakdown in the emerging democratic stability as a result of social or political tensions, has been a prominent factor in South Africa's sovereign debt ratings from the onset of the country's transition from apartheid to democracy. After the rupture of the apartheid regime, the transition to a regime of legitimate democratic political parties in 1994 entailed a number of risks that are critical in the sovereign rating process. First, there was the risk of a violent transition from the old to the new regime, which could have potentially led to civil war, and which was highlighted by the increase in political assassinations in the mid-1990s. Second, there was a latent risk of violent confrontation among newly legalised parties representing the new South Africa. This risk was highest in regions such as Natal, where the end of the rigid power control structures under apartheid revived traditional antagonisms between the Zulu and Xhosa peoples. More importantly, there was the risk associated with the lack of experience of the new political forces, which after decades of life in exile had scanty experience in running a government bureaucracy with the complexities exhibited by South Africa. In particular, the ratings assigned in 1994 took into account the risk that inexperienced politicians would yield to the many legitimate demands of South Africa's population to the extent of destabilising the country's fragile public finances and endangering the sovereign's creditworthiness. Finally, there was succession risk, which grew over time as president Mandela consolidated his personal grip on power. All these were meaningful real risks, which were at one point or another weighted in South Africa's sovereign rating.

In our view, these risks have greatly diminished over time, and therefore the country's ratings have benefited from a relatively more stable political environment, strengthened by the orderly conduct of presidential elections in 1999. The risk of a violent political outbreak has receded as democracy has consolidated. After six years of government experience, the African National Congress (ANC) party has gradually but skilfully revamped the public sector bureaucracy, which had deteriorated sharply in the last decade of apartheid. Not only have the ANC-led governments of the last six years avoided a marked deterioration of public finances and monetary conditions, but they have also steered economic policies to levels of discipline unheard of in South Africa's recent history, as it will be described in later sections of this report. However, corruption remains a major problem, especially at provincial levels.

At this stage, our main concern is with the durability of these improvements in the general political environment with a view to understanding how sustainable the current policy framework is in the medium-term. As is the case in so many other countries which have endured exceptional historical conditions, post-apartheid South Africa benefits from a reserve of patience emanating from its people's aspirations for better standards of living and their memories of the hardships of the past. This "reserve" of patience has facilitated the implementation of adjustment policies which have a positive impact on the rating but which erode the political capital of the government due to their unpopularity. The key question is, thus, how much political capital there is left and how quickly will it evaporate if the government pushes new controversial structural reforms or if its overall economic program doesn't deliver as expected.

In the 1999 elections, support for the ruling party-alliance – encompassing the ANC and the South African Communist Party with the support of the Congress of South African Trade Unions (COSATU) – obtained 66% of the votes, up from 62% in 1994. Unblemished popular support for the ruling alliance would seem to suggest that the ANC's popular honeymoon is far from over, but this is only partly true. Internal dissent within the alliance has been on the rise, with COSATU nagging about privatisation, changes to the tax system and other reform proposals and arguing for a more lax fiscal and monetary policy mix. More importantly, for all its success consolidating macroeconomic stability, the government's economic program has not translated into more equal or generally higher standards of living in South Africa. As a result, the risk remains that the people who have supported the ANC during

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

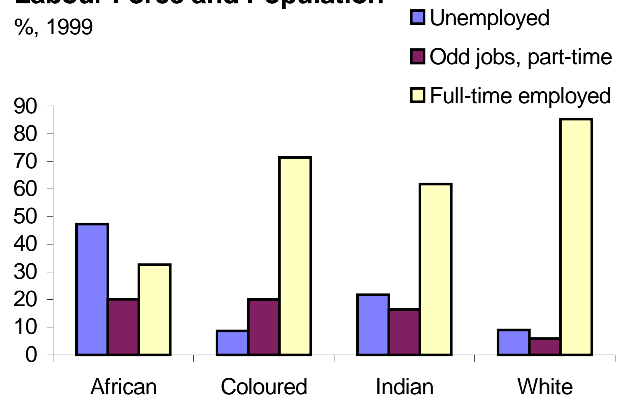
Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

the transition will become disenchanted and push for a change in the direction of economic policies.

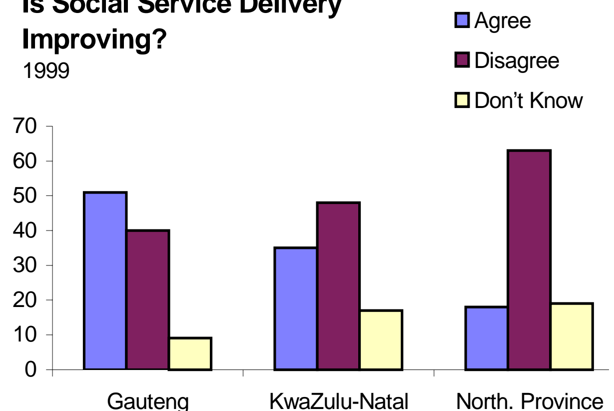
Two factors will determine, in our view, the likelihood of such an outcome. First, the ability of policymakers to translate the country's macroeconomic success into growth, jobs and better social services that will begin to address the extreme social inequalities in place in South Africa, and second, the emergence of a viable political alternative to the current alliance.

The reasons why economic stability and some measure of structural reform have not translated into a pick up in GDP growth and employment are difficult to ascertain. The growth conundrum will be discussed in more detail in the structural issues section of this report, but its solution will be central to the future direction of the ratings, as it will be difficult for the government to maintain a steady course if growth and employment deteriorate further. Ultimately, the government's success in raising standards of living will also determine the chances of possible political alternatives to the current ANC structure.

It is hard to see a real short-term alternative to the current government within the existing party structure. Most political analysts, in fact, agree that president Mbeki will be in power for two full terms – through April 2009 – given the continuous weakening of the main opposition parties. The 1999 elections led to a further fragmentation of the South African parliament vis-à-vis the 1994 poll, as key formations such as the New National Party and the Inkatha Freedom Party lost a significant share of their votes. Instead, any emerging opposition to the ANC leadership is likely to come from within the party itself in the near future. If the Mbeki generation is unable to deliver, a younger generation will take over with what could be more radical policy proposals.
Aware of this risk, the Mbeki government has made the delivery of basic social services and social infrastructure its key political priority. To achieve this, the government relies on an extended social budget, focused on education, health and housing spending and in the Public Finance Management Act (PFMA), introduced in April 2000. Social spending already takes up approximately half of all government spending, but the efficiency of welfare policies is not always satisfactory due mainly to poor targeting and lack of financial controls. The PFMA aims at introducing measures of financial control and accountability in the broad public sector – including parastatal enterprises – such as those successfully enforced on South Africa's regional finances in 1999. A more targeted effort to extend basic services to large segments of the population, coupled with a strict enforcement of spending controls is likely to strengthen the government's popular support and the direction of current economic policies, as it would satisfy the most immediate needs of poor South Africans.



Source: NEDLAC



Source: NEDLAC

One of the most critical examples of this strategy is the delivery of housing facilities. In 1997, the housing shortage in South Africa was estimated at 1.6 million units, with an additional nine million people living in shacks and severe overcrowding in much of the formal housing stock. Public housing, which tallied under 100000 units prior to the 1994 elections, has been a priority of the democratic administrations since then, with an estimated one million houses completed or under construction by end-1999 and an even larger number of subsidies already approved.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.
©Copyright Fitch Ratings Ltd 2000
Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

But, of all the social problems facing the government, the rapid spread of AIDS will surely be the most challenging in the future. Official statistics suggest that the rate of infection may have reached 10% of the population in 1999, and that it is projected to peak at about 23% before the end of this decade. It is hard to overestimate the social impact of an epidemic of such dimensions, and it will take a concerted effort of local and international authorities to overcome the sequels of the disease, which is expected to kill ten million South Africans over the next 15 years.

After a long period of denial, the South African authorities are beginning to come to terms with the social and economic ramifications of the AIDS epidemic. The economic aspects of AIDS will be discussed in more detail in following sections, but we feel that the epidemic principally poses a political risk, as lack of action on the part of the government would surely lead to social tensions of some sort in the future.

Another social issue of great political significance is crime. The efforts of the South African Police Service to deal with the crime problem have focused on better intelligence and better targeting of particularly bad pockets of crime related to poor or less-developed areas. Aligning crime-fighting efforts with development efforts has yielded some positive results. After an exponential increase since the end of apartheid, crime statistics began to stabilise in 1999, and some minor decreases have been registered in 2000 in the most violent of crimes, namely murder and attempted murder. Still, every South African, from the layman in the street to president Mbeki and members of his Cabinet, reckons that current crime levels are unsustainable, and that more needs to be done to reduce them. Moreover, crime has a discouraging effect on potential investors, and has been cited in some recent research studies as a key explanatory element for South Africa's limited inflow of foreign direct investment (FDI).

The crime problem is exacerbated by poverty levels which, to a large extent, still run along racial lines. Most black people continue to have a standard of living typical of low-income developing countries, reflecting the very unequal racial distribution of income. This is paralleled by a wide divergence in access to education, health, housing and water. The evidence of deteriorating standards of education is particularly worrying. The failure to maintain standards is likely to aggravate existing inequities at all levels of educational attainment. One of the legacies of apartheid is the relatively high level of illiteracy by comparison with other middle-income countries. This illiteracy is concentrated in the black population. As a result, the unemployment rate - those outside the employed, formal economy - among blacks is estimated at 40%, compared to around 4% among whites.

In this respect, "black empowerment" initiatives, directed at increasing the role of black entrepreneurs in the economy by a combination of affirmative action policies and the removal of racial barriers, have had only mixed success. However, we can note that black businessmen are extending their activities, some without the conscious support of officialdom, affirmative action or white business. It has recently been estimated for example that black business controls about 16% of the Johannesburg Stock Exchange, up from virtually zero four years ago.

Finally, recent events have also highlighted external political risks to South Africa's political and economic stability, summarised by some as the "bad neighbourhood" effect. Most critically, political and social unrest in Zimbabwe has to some extent affected domestic and foreign confidence in South Africa's economic prospects. While we don't think events in Zimbabwe would be replicated in South Africa, or even have the potential to destabilise the country's economy, they have added to a wave of afro-pessimism which has several implications. First, trouble in Zimbabwe has constrained the recovery underway in South Africa through lower exports and a dip in confidence. Second, it has distracted South Africa's political class from other, more pressing domestic matters. Lastly, Zimbabwe's crisis deals a further blow to the anticipated coming of age of the Southern African Development Community (SADC), to which policy makers in South Africa point as a source of future expansion of the country's economic area of influence. The continuing war in Congo, protracted crises in Angola and Rwanda, and sporadic problems in other areas of the continent have furthered regional concerns.

Structural issues

The apparent inability of the South African economy to generate sustainable growth that allows for a decline in massive unemployment rates is a major constraint on the sovereign rating. The key question is how likely is low growth to affect the government's ability to pursue a framework of macroeconomic discipline and debt reduction that will continue to enhance its creditworthiness in the future. If macroeconomic stability is preserved, the best chance of raising potential growth rates is by a substantial boost in the structural reform program. Most critical

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

of all are changes to labour legislation, improvements in education outcomes and the sale of state assets.

After a long slump due mostly to the effect of the international embargo in response to South Africa's apartheid policies of the 1980s, growth picked up considerably after the 1994 election, to average 3.5% per year in 1994-96. This encouraging recovery has not been sustained, however, and growth has averaged just 1.4% per year in 1997-99. Such disappointing growth rates represent a major failure in the government's GEAR economic strategy, which was supposed to elevate savings, investment and GDP growth rates via macroeconomic discipline and some measure of structural reform. As described in the economic policy sections of this report, the macroeconomic guidelines in GEAR have been followed rigorously by the South African authorities, and yet growth has failed to pick up. To some extent, the recent poor growth record reflects the vulnerability of South Africa's economy to external developments in the context of a very turbulent period for emerging markets in 1997-98. More importantly, it also reflects South Africa's limited competitiveness, related to its rigid labour markets, state control of economic assets and poor education and skills levels. Addressing these structural issues will take time (a discussion on labour markets and on privatisation follows), and they can only be expected to have a significant positive impact on growth in the long term. Concerns about the growth potential in the short to medium-term and on the impact of disappointing growth on the government's economic program are therefore justified.

Medium-term forecasts project average growth of 3-3.5% through 2005. This is clearly insufficient to reverse the employment loss that started in the mid-1990s, as most estimates suggest that sustained growth of more than 5% is needed to generate jobs in the formal sector. Although unemployment estimates are unreliable at best, it is widely accepted that total employment in the formal economy has fallen by some 500,000 since the ANC came to power in 1994.

If growth potential will remain subdued for the foreseeable future, there is a chance that actual growth will become less volatile in the short-term. More stable – if insufficient – growth would reduce economic distortions generated by sharp falls in output associated with an external or domestic shock. As such, we believe more stable growth could strengthen the social and political buffer the government counts on in support of its economic policies.

The historical volatility of South African output can be attributed mainly to the economy's vulnerability to external commodity and financial shocks, to the fragility of the domestic political environment and to at least some degree of policy volatility. Macroeconomic policies have become more predictable and mutually reinforcing in the last few years. To the extent that monetary and fiscal policies remain on "automatic pilot", output volatility associated with policy surprises is likely to decrease in the future.

Regarding politically induced volatility, we would also argue that South Africa is now less prone to confidence shocks of a political nature than it was during the initial years of the transition. On the other hand, we are likely to see a greater spillover of political shocks in other African countries into South Africa, as the situation in the region becomes more unpredictable.

Commodity and terms of trade shocks have been a major source of output volatility in South Africa, given the country's traditional strong reliance on the production and export of a limited number of commodities, mainly gold. This reliance and the volatility associated with it have lessened significantly overtime as a result of the government's trade liberalisation and export diversification policies. The tariff system has been streamlined significantly, with the average trade weighted tariff falling to 4.9 percent in 2000, down from 14 percent in 1995. Additionally, South Africa has established free trade agreements with its major trading partners, most notably the European Union, which suggest that export competitiveness is likely to accelerate going forward. These measures should result in higher and less volatile growth, as the export sector becomes more diversified and resilient. Exports to GDP have increased from 14% of GDP in 1991 to 18% in 1999 and the mix has improved significantly, with gold representing just 14% of total exports, down from over 50% just two decades ago.

More importantly, changes in the size and composition of capital flows associated with the gradual liberalisation of capital account transactions have highlighted South Africa's vulnerability to external financial shocks, as evidenced in a very dramatic way during the 1998 emerging market crisis. To a large extent, this vulnerability is outside the control of South African policymakers, as it originates in tensions in the financial markets of the G3 economies, trends in overall capital flows to emerging markets and the high liquidity and depth of South Africa's capital markets vis-à-vis comparable emerging markets.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

To some degree, however, the violence of the speculative attacks against the South African currency – the rand – in the recent past has been intensified by the fragile liquidity position of the SARB and by the bank's implicit commitment to defend the value of the rand in the foreign exchange market. Both elements of vulnerability have been greatly mitigated since the 1998 crisis. Strong net capital inflows since late 1998 have allowed the SARB to increase the level of its reserves to approximately $6.5 bn in July 2000, the highest level in over a decade.

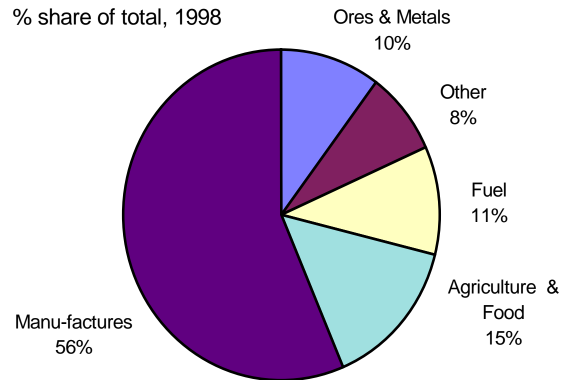
In our view, if all these factors result in a less volatile growth rate, the need to raise potential growth beyond its current 4% perceived ceiling in the short-term will subside. Moreover, the need to raise the potential rate of growth to strengthen popular support for economic reform and orthodox policies will also subside if the government becomes more efficient in the provision of basic services. In fact, it is possible that higher annual growth rates could undermine social stability and the government's support base if they don't result in a better delivery of basic public services or if they raise suspicions of government corruption.

The modest growth forecasts for coming years incorporate some degree of impact of AIDS on the labour force and population growth, although most analysts are just beginning to come to grips with the wider implications of the epidemic. Overall infection rates are expected to peak at a massive 23% of population. The distribution among different social groups, however, is likely to reflect their relative access to information and in general their literacy levels, which in turn are highly correlated with their labour market skills. Additionally, the disease will affect mostly rural areas where a majority of the population is unemployed or unskilled. The result is that estimates of peak infection rates fall to 13% for skilled workers and rise to 34% for the unskilled. For this reason, the impact of aids is likely to be more significant in terms of dislocation of communities than directly on growth. Yet, several estimates suggest that foregone GDP output due to the impact of aids on population and employment could be between 0.1% and 0.4% per year through 2015.

At the core of the structural constraints on growth is the precarious situation of the labour market, of which the official unemployment rate of 37 percent is but one indicator. The unemployment rate has been on a steady upward course since the early 1990s, reflecting partly the extent of restructuring and liberalisation in the economy, but mainly a significant mismatch between the skills required by the productive sector and those available in the labor market. South Africa's industrial and export sectors, largely controlled by the minority white population, are capital-intensive, technologically sophisticated and highly competitive. These mature industries, led by the automotive, chemical and industrial machinery sectors among others, face a permanent shortage of skilled workers, but can only absorb a very limited amount of the unskilled workers who fill up the unemployment ranks.

Composition of exports

% share of total, 1998



Source: World Bank

This structural mismatch reflects the failure of the education system under the apartheid regime, as well as the limited progress achieved by the Mandela government in the area of education and skills development. Ultimately, the structural deficiencies in the labour market reflect the broader social challenge of incorporating the majority black population into the country's vibrant but highly restricted private sector economy.

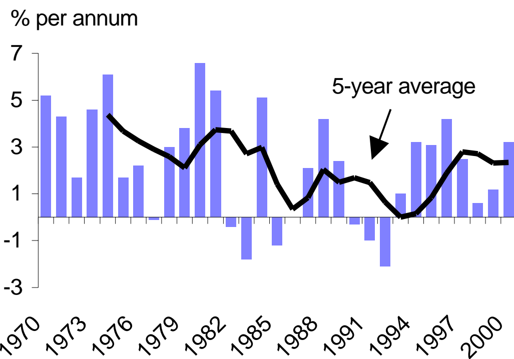
There is circumstantial evidence that at least part of the reduction in official employment figures has been picked up by South Africa's flourishing informal sector. The creation of employment in the informal sector – composed mainly of domestic services, taxis, street vendors and other menial jobs but increasingly also of essential service sectors which have been "outsourced" to avoid labour market regulations – is far from optimal. This type of unregulated employment creates an underclass of workers who enjoy little or no protection from the state and deprives the public sector of tax revenues. But at the same time, an active informal sector provides subsistence incomes to scores of families who are officially unemployed, and thus, in our view, official unemployment figures overstate the potential for social tensions in South Africa.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

The government introduced in 1999 a comprehensive package of labour regulations. The new legislation, centred on the Basic Conditions of Employment Law, the Employment Equity Act and the Skills Development Bill, seeks to reduce remaining inequalities in the labour market and to enhance the working conditions and skills levels of those who are currently employed. Although individual pieces of legislation are commendable, the whole package has upset the business community and could be detrimental to the overall flexibility of the South African labour market.



Source: IMF, Fitch

As a result of these criticisms, the government introduced several revisions to the package in late 1999 and early 2000, the most important of which is the exemption of small enterprises from the most stringent regulations. While the South African labour market is not particularly rigid in comparison to other emerging and developed economies, the new regulations are likely to compound the skills problem previously described, with an overall negative impact on official employment. Of particular concern is the extension of centralised collective bargaining practices, which could exacerbate the existing lack of downward flexibility in real wages and could undermine the incipient productivity gains in key exporting sectors.

Local business leaders and international investors agree that the existing labour market regulations are detrimental to the creation of employment and could hurt South Africa's long-term growth potential. Other structural issues that have discouraged local and foreign investment in the past include the state's extended presence in economic activity and South Africa's high crime rates.

The privatisation of state assets has been a particularly disappointing aspect of the government's program over recent years. The sale of a portion of the national telecom monopoly, Telkom, and of a minority stake in the national flag carrier, South African Airways, are among the few milestones in the government's privatisation program since 1997. It is fair to say, however, that the program has been revitalised significantly since the 1999 election, and that the Department of Public Enterprises is taking all the necessary steps to complete the privatisation of the four largest public enterprises before the end of the current administration in 2004. In August 2000 the government presented a blueprint to move the sales forward in order to meet this target, but few specific steps have been taken to date.

Aside from Telkom, key projected sales include Eskom, the electricity monopoly, Transnet, a conglomerate of transportation companies and Denel, an arms manufacturer. These steps, which include corporatising a number of enterprises, eliminating pension liabilities in the transport conglomerate and creating a modern regulatory framework for electricity and telecommunications could ultimately delay some of the sales. It is likely, however, that the bulk of the sales – perhaps excluding that of Transnet – will be completed during this administration, yielding net revenues to the state of a minimum of 0.5-1% of GDP per annum in 2001-2004. As in the past, the net proceeds from the sales will be used to reduce public debt.

The sale of key assets in the telecom and electricity sectors is expected to boost foreign direct investment in South Africa. Inward FDI has been slow in recent years, with net flows – inflows minus outflows – at close to zero in 1998-99. Foreign investors find it hard to break into South Africa's highly competitive business environment, as the number of hurdles that they have to overcome, from geographical location to high crime rates, is very discouraging. In this respect, the opening of large monopolist sectors to foreign private sector participation is expected to have a trickle down effect on other areas of foreign investment.

High crime rates are often cited as a discouraging factor by potential foreign direct investors, although it is unlikely that this is the most significant deterrent to foreign companies considering an investment in South Africa. Although overall crime rates remain at very high levels, a more targeted and efficient effort by the South African Police Service (SAPS) has started to make inroads into the most heinous types of crime. Recent SAPS statistics on reported crime for January-April 2000 indicate a substantial decrease in murder and attempted murder rates, a stabilisation of

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

rape and drug-related crimes and an increase in common assaults and thefts.

Finally, in discussing the structure of the South African economy and the underpinnings of growth, it is worth mentioning the countries unqualified success in reducing its dependency on mining and the export of mineral commodities, mainly gold. In contrast to gold, the output of many other minerals is increasing, notably of platinum, rhodium, chromite ore, palladium and titanium. South Africa's proven mineral reserves are impressive, and the region forms the richest single depository of minerals (excluding hydrocarbons) in the world. There may have been a temporary setback due to generally low commodity prices over the past few years, but the longer-term outlook for many of these minerals is brighter.

The banking system

South Africa's sophisticated, adequately capitalised and profitable banks, coupled with a comprehensive regulatory and supervisory system, are strong supporting factors to the country's creditworthiness.

South Africa's banking sector is reasonably well capitalised relative to most other emerging markets rated by Fitch. The capital adequacy ratio of the banking sector increased from 9.9% in 1997 to approximately 11.6% at yearend 1999. More importantly, the proportion of banks with a capital adequacy ratio below the 8% BIS guideline decreased from 9% in 1997 to 4% in December 1999 and will likely decrease further in 2000 with the expected consolidation amongst small banks after liquidity fears during 1999. This ensures higher protection against losses and systemic problems that may emerge during times of economic stress. In addition, South Africa's capital markets are deep, liquid and sophisticated, and match those of smaller developed economies, such as Portugal or Finland.

The non-performing asset ratio is comparatively low. At yearend 1999, only 4.9% of loans were classified as non-performing assets (NPA), but this increases to about 5.5% when properties in possession are included. Moreover, as the banks do not have large, unhedged positions, they are in a better position than other emerging markets to deal with currency fluctuations. Though modest, the NPA ratio increased sharply in 1999, as some of the effects of the September 1998 currency crisis filtered into banks' balance sheets. The effect of the crisis is estimated to have added 2% to the NPA ratio during 1999. The frustrated economic recovery in the first half of 2000 is not likely to prompt a fast decrease in the NPA ratio, but it should be enough to prevent further increases.

The net open foreign exchange position of the banking system, after hedging, remained well within the limit of 15% of net qualifying assets and reserves at about 2.5% in the first half of 2000. On a covered basis, the banking sector is in a net long foreign-exchange position. So in the aggregate, the financial sector benefited from the depreciation of the rand in 1998-1999. In addition, the liquidity structure of the banks' dollar position is not overly concentrated in the short-term -- a problem seen in some Asian countries during the recent crisis.

In Fitch's view, South Africa's bank supervision compares favourably against similarly rated countries. The banking supervision department has set priorities to further strengthen the regulatory environment after the 1998 crisis. Several are detailed below:

- Continued efforts to improve the extent of consolidated supervision
- Review of large exposure requirements and limitations on connected lending to bring them more in line with the Basle core principles
- Review of credit risk processes and capital adequacy risk weightings of loans and advances, such as mortgage loans and debts of local authorities and provincial governments

Bank supervision is currently the responsibility of the Office of the Registrar of Banks, which is part of the Reserve Bank. Non-bank institutions and the markets for debt and equity securities are the responsibility of the separate Financial Services Board, to which it is intended to transfer bank supervision as well. These plans have yet to be finalised. Meanwhile, the Bank and Registrar remain responsible for ensuring compliance with initial capitalisation and ownership rules, constraints on large exposures, liquidity (as opposed to minimum reserves, which are seen as an instrument of monetary policy) and capital requirements and other regulatory constraints.

The South African banking industry is heavily concentrated. Although almost 60 banks, mutual banks and branches of foreign banks were registered with the Reserve Bank at-end 1998 (and 57 foreign banks had authorised representative offices), the sector is dominated by four major banking groups, which together held 74.7% of total assets of the banking sector. As may be expected, the large banks offer a wide range of services from national retail networks. Between them, the 60 banks employ about

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.
©Copyright Fitch Ratings Ltd 2000
Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

140,000 people, and operate almost 4,000 branches. The IT infrastructure is advanced and undoubtedly "first world", as is the banking system itself. The domestic banks have had little difficulty in holding their own against international competition since the ending of sanctions in 1994.

The practice in South Africa is that banks have been self-regulating in respect of large exposures, although they were expected to report them to the Registrar. The system is now to be brought gradually into line with international practice, with large exposures exceeding 25% of qualifying capital and reserves requiring full capital impairment. The Basle guideline on total exposure to large credits will be similarly enforced. Here the total granted considerably exceeds the guideline maximum of 800% of capital and reserves, but the total actually utilised is less than half this amount, implying that in practise exposures were below 25% anyway. In addition the overdues in respect of large exposures fell substantially in 1998. The problem of large exposures arose for historical reasons, some related to sanctions, and now is expected to diminish. Most of the loans concerned are to parastatals and very large corporates. Connected lending as such is not regarded as a particular problem for the time being.

While local South African banks are reasonably profitable, they have been under pressure with increased domestic and foreign competition contributing to a margins squeeze. While considered wide by first world standards reflecting the risks they undertake, margins aren't wide when compared to other emerging markets. Margin pressures have been offset by growth in other income, particularly fees and commissions together with trading income, and improving efficiency ratios. The past few years have seen branch rationalisation, increased centralisation of risk management controls and technology-led productivity enhancements. It is worth noting that added to the high costs incurred by South African banks from a geographically spread branch network are the high incidence of crime, both robberies and white-collar.

Fiscal policy

With general government deficits in the range of 2% of GDP, we note that the authorities have succeeded in consolidating public finances along the lines proposed in their multi-annual budgets. Moreover, fiscal flexibility has been increased substantially via tax reform and more efficient and targeted spending. Public debt markets are increasingly sophisticated and deep, allowing the government to finance its deficits domestically with a degree of flexibility most other rated emerging markets lack.

It looks increasingly likely that fiscal results will outperform the government's budget for the third year running in 2000/01. This reflects mainly the conservative macroeconomic scenarios on which the national budget is constructed, as well as the impressive efforts made by the government on the revenue side of the budget. The 2000/01 budget projects a deficit of 2.6% of GDP for the national budget, slightly up from the 2000 fiscal year outcome. A smaller deficit of 2.4% of GDP is projected for the general government after adding the surpluses generated by the provincial governments and social security funds to the accounts of the national government. It is worth recalling that the ANC government inherited a fiscal mess from its National Party predecessor. Several years of slow growth, debilitated tax revenue, special outlays for drought relief and an enfeebled grip on other items of public expenditure took their toll of the public finances. The national budget deficit - the figure on which public attention focuses in South Africa, and which balances central government tax and spending - reached a record 7.3% of GDP in 1992/3.

The 2000/01 budget expands on the main theme of South Africa's policymaking: the promotion of long-term economic growth. The role of fiscal policy towards this aim has been rather limited in recent years, as the overriding goal of reducing fiscal deficits and reversing the trend in public debt has forced a severe reduction of public expenditures which has, if anything, pressured growth down. Since 1998, however, the government has made significant progress on both the expenditure and revenue sides, which leads us to believe that overall fiscal flexibility has improved in a meaningful and sustainable way. As a result, it is possible that the budgets for the next three years – according to the 3-year Medium-Term Expenditure Framework (MTEF) – will have a positive impact on growth.

Strict fiscal controls allowed the government to improve already in 1999/2000 the headline fiscal targets that had been laid-out for the end of this MTEF in 2003. Even though the emphasis will remain on further medium-term consolidation, this will in fact allow the government to pursue spending priorities that are entirely justified in terms of both their economic and social returns. Critically, these would include crime prevention and national security, social spending, mainly on health and fixed investment.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

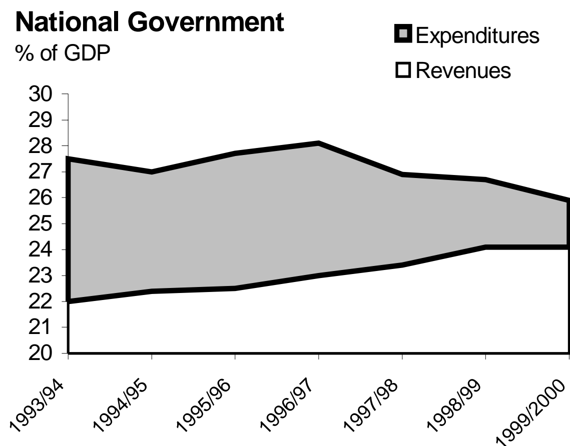
©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

The 2000/01 budget contained a sharp increase in defence expenditure as part of a R30 bn (3.5% of GDP) multi-year arms procurement package. Extra spending on police services and the justice system and additional health allocations, mainly HIV-related, can also be accommodated in the budget without putting headline targets under pressure due to the impressive performance of tax receipts. While it is difficult to ascertain what the impact of these programs will be on growth, estimates suggest that the defence program alone could add up to 0.2% to GDP growth over five years. Current spending programs will be supported by an increase in fixed investment expenditure, which is budgeted to grow by 5% per year through 2003.

At the same time, the wage bill has been largely contained, as the government has implemented piecemeal cuts in the public service, which accelerated in 1999 with a reduction of 35,000 public jobs, or about 3.3% of all state personnel. All in all, approximately 13% of public servants have been retrenched over the last five years, and estimates suggest that at least an additional 5% would lose their public jobs as a result of the privatisation of four large public companies through 2004. A reduction of the overall size of the public service is to be complemented by the introduction of a new pay system that seeks to reorganise pay scales to better reflect productivity trends as well as to link pay increases to future, rather than past, inflation. Further efforts will be needed to contain the wage drift – bonuses, promotions and other non-wage pay increases – which still adds approximately 2% to the annual wage settlement.

In order to strengthen public spending controls across the board, the government introduced in May 2000 Public Finance Management Act (PFMA). The PFMA, which applies not only to the national government, but also to provincial governments and state-owned enterprises, is the key piece of the "new face" of the state. More than pure fiscal savings, the



Source: SARB

A is designed to improve the efficiency of public spending – particularly on social services – by "setting out principles of accountability that devolve responsibility for service delivery to departmental managers". In other words, the PFMA is the tool that the government has designed to ensure that service delivery improves and that political support for the reform agenda stays strong (see political risk section).

Much of the government's success in consolidating public finances is due to the progress made by the South African Revenue Service (SARS) in narrowing the tax compliance gap. This compliance gap – a combined measure of tax evasion and tax avoidance – is considered to represent still approximately R20-30 bn. The foregone tax collection represents obligations of small taxpayers and thus it is increasingly costly to recover. This has not deterred SARS, which is keen on closing the gap for "democratic compliance" reasons. Partly due to this, two tax courts have been set up, and jail sentences for a total of 99 years have been imposed in 12 months on tax grounds – a record in any emerging market.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.
©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

But the main task of the SARS remains to steer the reform of the tax system that will remove current distortions and improve yields. In this respect, the 2000/01 budget incorporates a number of proposals that should go a long way towards the modernisation of the tax structure in South Africa, with the main aim of cutting tax rates and broadening the tax base to compensate. The overall tax reform launched in 1999 should remain broadly revenue neutral. Among the key changes introduced in the current budget we highlight a cut in personal income tax rates that has brought down the top marginal rate from 45% to 42% while rising the cut-off level. This is expected to provide a total tax relief of approximately R9.9 bn (1.2% of GDP) to the household sector. The evidence of other such windfalls, as in the de-mutualisation process last year, suggests that the tax relief will mainly reduce household debt, rather than lead to an immediate increase in private consumption. Other measures include a switch to residence-based taxation, a further lowering of corporate tax rates – following similar changes in 1999 – and changes to the interest income exemption scheme.

The tax reform will be completed in its key aspects in 2001 with the expected introduction from next April of a capital gains tax to be levied at a single rate of 10.5%. Some controversy has surrounded the introduction of a wealth tax, but the government is confident that the tax will be approved and introduced in time. The reforms should stabilise tax revenues at about 25% of GDP, as proposed in the MTEF.

The government has been particularly successful in bringing provincial finances under control after loose spending policies resulted in a 0.8% of GDP aggregate provincial deficit in 1997/98. The implementation of tight audit, treasury and expenditure control measures has reduced spending at the provincial level from 13.7% of GDP in 1997/98 to 12% in 1999/00. As a result, the provinces turned out a small fiscal surplus in 1998/99 and 1999/2000 (0.25% of GDP). Provincial governments are expected to remain in surplus in through the end of the current MTEF in 2003. Still, important rigidities remain at the provincial budgetary level, with nearly 90% of all spending going to health and wages.

To prevent public finances from going off track and to increase certainty surrounding the proposed allocations, a reserve is set up in the budget expenditure bill. The reserve consists of two parts: policy and contingency. A policy reserve has been set up to meet emergency policy priorities without jeopardising the budget headline. A contingency fund has been set up for unforeseen disasters.

A faster than expected closing of the fiscal deficit has facilitated a reversal of public debt to GDP trends in 2000, notwithstanding the modest growth record over the recent period. Indeed, gross public debt is expected to fall to 47% of GDP in the first quarter of 2001, after peaking at 50.5% of GDP in April 1999.

General government finances

% of GDP	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00[e]	2000/01[f]
General government revenue	**27.8**	**27.4**	**28.6**	**28.1**	**29.6**	**29.8**	**28.5**
O/w Taxes	24.0	23.6	24.9	24.7	25.9	26.8	26.0
General government expenditure	**33.4**	**32.6**	**33.6**	**32.4**	**31.7**	**31.5**	**30.9**
O/w Interest payments	5.1	5.8	5.8	5.8	5.9	6.1	5.8
Capital spending	2.8	2.8	2.4	2.5	2.8	2.8	2.4
General government balance	**-5.6**	**-5.1**	**-5.0**	**-4.3**	**-2.1**	**-1.7**	**-2.4**
Gross public debt	**49.1**	**49.5**	**49.2**	**48.3**	**50.4**	**48.6**	**47.5**
Public debt/revenue (%)	*176.6*	*180.4*	*172.1*	*172.0*	*170.6*	*162.9*	*166.7*
memo:							
primary balance	-0.4	0.7	0.8	1.5	3.8	4.4	3.5
interest/revenue, %	18.5	21.0	20.2	20.7	20.1	20.3	20.5

Source: South African Reserve Bank, Department of Finance and Fitch estimates

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.
©Copyright Fitch Ratings Ltd 2000

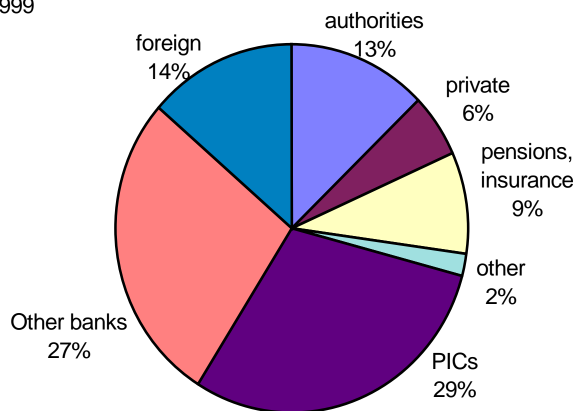
Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

Just as critically, the structure of the public debt is very favourable, with only 7% of the total maturing in one year or less and an average maturity of 9.2 years for the domestic debt. The government's debt is managed by the Asset and Liability Office of the Department of Finance, which has as its main objective the development of a liquid and flexible market based on a system of auctions and primary dealers. The government's yield curve in local currency (rand) is among the most sophisticated of any emerging market, with maturities spanning from 1 month to 30 years. The domestic funding strategy is based on four basic principles:

- Active debt management for existing portfolio
- Concentration around liquid benchmark bonds
- Diversification of investor profile (foreigners)
- Even spread of funding during the fiscal year

As of 1999, foreign ownership of domestic marketable debt represented approximately 14% of the total. Foreign holdings of public rand-denominated bonds have been very volatile during recent crises, and are partially responsible for the weakness of the rand in 1998 and early 2000. A majority of the debt, however, remains in the hands of relatively stable domestic institutions, including public investment commissioners, insurance companies and pension funds, as well as the Reserve Bank of South Africa and other official monetary institutions.

Ownership of Domestic Debt
1999



Source: ALM Office, Department of Finance

Monetary and exchange rate policy

The framework for the implementation of monetary policy is now determined by the adoption of an inflation targeting system by the SARB, with a target of 3-6% inflation by 2002. The bank expects a rules-based system to break inflationary expectations for good. After a rapid decline in 1999/2000, average CPIX inflation is expected to edge up to 7-8% at year-end 2000, outside the range set up by the SARB.

The government is committed to reducing inflation through a restrictive monetary policy implemented by the South Africa Reserve Bank (SARB). The SARB is widely known for its "hawkish" views on inflation, a reputation largely developed by Chris Stals, former governor of the bank and upheld by Tito Mboweni, the current governor. The bank's reputation was enhanced by its management of monetary and exchange rate policies during the currency attack of 1998. The SARB avoided then a collapse of the South African currency (the rand) via a combination of high interest rates and forward operations in the foreign exchange market.

The SARB's strong anti-inflationary credentials have evolved very naturally into a new framework introduced in January 2000, which will base monetary policy decisions on an inflation-targeting regime from 2002. The target, which will be defined on the basis of the CPIX index – CPI excluding mortgage interest rates – will become binding only in 2002, after an initial phase-in period during which the SARB will test the responsiveness of its models and of different tools under the new objectives. By then, the SARB has committed to maintain average CPIX inflation within a range of 3% to 6%. To decide on the practical implementation of policy decisions, the SARB has put in place a monetary policy committee (MPC) that will improve decision making within the bank and foster transparency over time. The MPC does not publish its voting records but it will be as explicit as possible in its clarification of monetary policy decisions.

Despite the numerous operational and institutional changes, the objectives of the SARB remain practically unaffected. According to recent statements, the primary objective of monetary policy will remain to protect the value of the currency in order to obtain balanced and sustainable growth in the South African economy. To achieve this, the bank will pursue both price stability and, more generally, financial stability, allowing the market to determine the proper exchange rate.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

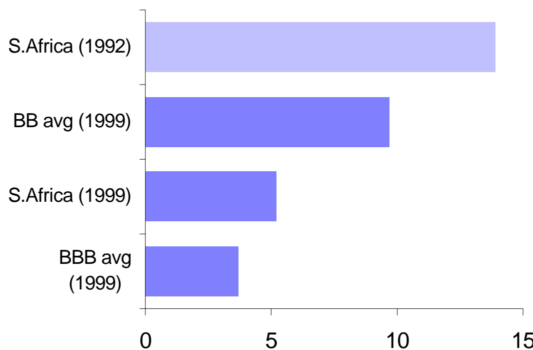
Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

Inflation has been relatively volatile over the last two years, reflecting the drastic swings in economic activity after the 1998 emerging markets crisis and to some extent the operational changes taking place in monetary policy. A strong fall in output after the crisis triggered a decline in inflation which bottomed at a rate of 1.7% in late 1999, the lowest rate for three decades. The fall in inflation has been supported throughout the last two years by a very restrictive monetary policy, driven in part by the need to maintain stability in the exchange rate in the face of external volatility.

As the rand stabilised in 1999 and the economy continued to slow down, interest rates took a sharp turn down, with the repo rate falling by approximately 1100 basis points, from 22% in September 1998 to 11% in March 2000.

Inflation

% per annum



Source: SARB, Fitch

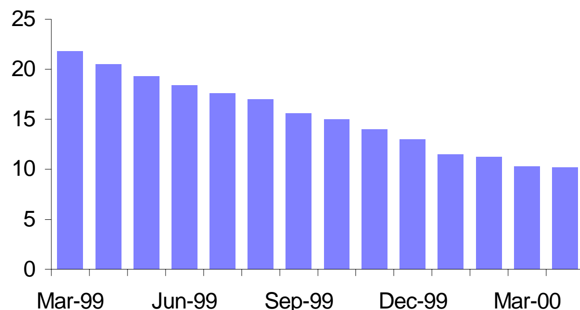
As a result, inflation expectations have resurfaced, and the CPI is expected to rebound to approximately 6.3% at yearend 2000. While there is some scepticism regarding the objectives set out under inflation targeting for 2002 – 3-6% for CPIX – for as long as economic output potential remains subdued, inflation is likely to return to a downward path early in 2001.

The SARB's international net reserves recovered significantly in 1999 following their severe depletion during the 1998 attack on the rand and in July 2000 stood at maximum historical levels of about US$6.5 billion, including gold holdings. Additionally, the SARB retains access to sizeable credit lines with foreign banks that, if necessary, would safeguard the current level of gross international reserves for a protracted period. At the same time, the SARB has achieved a rapid wind-down of its forward book, which decreased from an oversold position of $26 bn in September 1998 to approximately $16 bn in June 2000. As a result, the SARB's net open foreign exchange position (NOFP) – oversold forward position minus net reserves – fell to just over $10 bn in June 2000, from a peak of $25 bn during the crisis. The government remains committed to the gradual elimination of the forward book and, in accordance with the floating exchange rate regime, has pledged not to resort to the forward market in future episodes of financial instability. In addition, there is a possibility that the SARB's net forward position could be converted into a recognised debt of the government. The NOFP will continue to pose important challenges to South Africa's fiscal and monetary authorities, but the risk of fiscal losses was capped when the provision of long-term forward foreign-exchange coverage to exporters was discontinued in 1996. Total fiscal losses on the SARB's forward book as a result of the 1998 crisis are estimated at approximately 2% of GDP.

More importantly, the SARB has adopted a de facto free float exchange rate policy, supported by its commitment not to intervene in defence of the rand. The SARB has not intervened in the foreign exchange market since July 1998.

SARB's Net Open FX Position

(USD bn)



Source: Department of finance

There has been a substantial cumulative relaxation in the exchange control system the new government inherited in 1994. Briefly, the current provisions entail the virtual abolition of almost all quantitative limits on current account transactions and substantial inroads have been made into the restrictions on capital account. Remaining controls mainly refer to approvals of direct investment of South African corporates abroad and to quantitative limits on the extent of asset swaps by institutional investors.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

Short-term outlook and the balance of payments

As on previous occasions, the incipient recovery staged by the South African economy in the second half of 1999 has been frustrated by external events, in this case related at least in part to the crisis in Zimbabwe. Business confidence remains weak, and it is unlikely that GDP growth will exceed 3.5% in 2000, down from earlier forecasts of a 4.5% pick up.

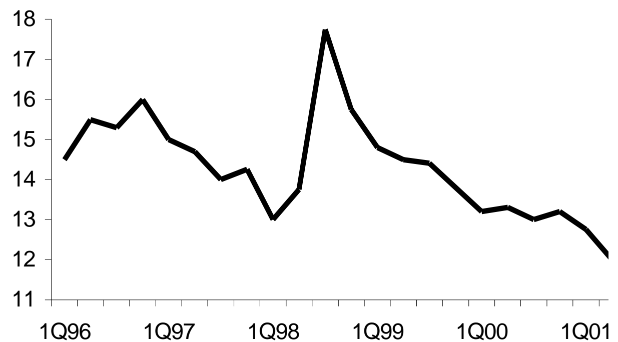
The year 2000 was poised for a strong recovery that could prove that the South African economy is getting over some of its vulnerabilities. Half way through the year, it looks unlikely that growth will live up to initial expectations. GDP growth forecasts for 2000 now average just under 3.5%. This will represent a nice recovery from meagre growth of just 1.2% in 1999, but it will be disappointing given previous projections of growth in excess of 4-4.5% for the year. Those initial projections were largely based on the upswing in commodity prices during the first part of 1999, as well as on the effect of sharply lower interest rates on private investment and consumption.

In the event, and with the only exception of oil, the recovery of commodity prices has been short-lived, particularly for those metals that constitute the bulk of South Africa's mining exports. The sharp decline in interest rates that fuelled the recovery after the 1998 crisis has been arrested, and if anything, interest rates could go up if inflationary pressures don't abate. Finally, the international environment, which had been supportive of the recovery in South Africa via high growth in Europe, Asia and the US, turned against the country when violence broke out in neighbouring Zimbabwe. The combination of all these factors affected domestic and foreign investor confidence sharply after the first quarter of 2000.

Considering the limitations on growth described in the structural section of this report, a key question regarding the current state of the economy is whether the coming year will look more like the buoyant fourth quarter of 1999 or the more subdued first half of 2000. Most domestic analysts reckon that the relative gloom experienced in the first half of 2000 is a temporary phenomenon, and that by the end of the year the outlook for growth will look somewhat brighter. In fact, growth forecasts for 2001 hover around 4%, with some upside potential depending on the behaviour of the emerging market assets class in the international capital markets.

At this stage, a sustained recovery is most likely to be led by an upswing in domestic demand, mainly via higher private sector fixed investment. Overall investment fell by nearly 7% in real terms in 1999, and started to recover in the second half of the year, as the impact of lower interest rates began to sink in. Despite the recent swing in confidence, gross fixed investment should still increase by close to 7% for 2000 as a whole, the fastest rate since 1996. About half of expected growth should come from a modest recovery in private consumption, which represents approximately 60% of GDP. Public consumption is expected to remain flat, as the government struggles to contain the fiscal deficit. Net external trade will also not contribute to growth this year, as a sharp increase in exports – upwards of 20% in 1Q00 – is more than compensated by rising imports. Exports of goods and services represent approximately 29% of GDP.

R150 Long-term Interest Rate
(quarterly averages and forecast)



Source:

The expected recovery will fall short of what is needed to generate sustainable employment. This means that the ranks of the unemployed will continue to grow this year, with official unemployment fast approaching 30% of the labour force. Employment has been negatively affected by the impact of the Asia crisis on external demand, the deep restructuring process initiated by South African businesses and the gradual fall in the price of gold, which has rendered an increasing number of projects uneconomic.

Domestic savings have remained in a range of 16-19% since 1991. Prior to 1991, the main reason for the falling domestic savings ratio was dissaving by the general government, which borrowed heavily to fund consumption. The considerable progress in reducing the government deficit since 1992 has not been sufficient to reverse the fall in savings, mainly

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

because personal saving has fallen even further. As a proportion of the disposable income of households, it has fallen from 7% in 1992 to less than 1% in 2000.

This secular decline in domestic savings renders South Africa highly dependent on foreign capital to support growth. For this reason, the current account deficit is a more binding constraint on growth than would appear from the headline deficit number. In order to attract much needed capital inflows the SARB needs to maintain comparatively high domestic interest rates, which in turn are highly correlated to GDP. This constraint is likely to become even more evident under a free-float foreign exchange regime, where interest rates take on a more prominent role in preventing sharp deviations of the exchange rate from its real equilibrium that could jeopardise the bank's inflation objectives.

For that reason, perhaps the most immediate trigger of a change in the GDP growth trend in South Africa is the reaction of foreign portfolio investors to domestic or external events. In that sense, the recent crisis in Zimbabwe is undoubtedly responsible for the weaker growth prospects in 2000, even though the political situation in Zimbabwe bears little resemblance to that in South Africa and despite the limited real economic link between both countries. As a result of the Zimbabwe crisis, R15 bn – the equivalent to 1.75% of GDP – left the South African bond market in the first half of 2000. Ultimately, the strength of the current recovery will depend on the extent to which foreign investors holding an estimated $16 bn in public domestic debt – more than 40% of the total – regain their confidence.
In any event, we don't expect the financing of the current account to be a problem in the immediate future. With current growth estimates, the current account deficit is expected to widen to 1.3% of GDP in 2000, up from a 0.4% deficit in 1999. In a moderate recovery scenario – with GDP growth of around 3.9% in 2001 – the current account deficit would widen further to approximately 1.6% of GDP. However, if commodity prices stage a stronger recovery, the current account deficit could easily widen to the region of 2.5% of GDP in the second half of 2001, at which point financing could become an issue depending on the mood of foreign portfolio investors.

Indeed, current account financing would benefit dramatically if government plans to kick-start the sale of state assets come through. On a conservative basis, a more decisive privatisation effort could attract capital inflows of $1-2 bn per year in 2001-2004, enough to finance between 50% and 100% of the expected aggregate current account deficits over the period.

External debt management

South Africa's external debt indicators compare favourably against other similarly rated countries. The net public external debt to exports ratio is on a declining trend and debt service is comparably light.

South Africa's total external debt of USD42 bn represented 120% of export receipts in June 2000. A good portion of that amount – approximately USD16 bn – is really rand-denominated debt held by foreigners. However, as in all other countries, we present the external debt data on a residency basis, since sales of rand debt by foreign holders tend to put pressure on the balance of payments and official reserves as foreign investors scramble for the exits at times of stress. About two thirds of the external debt is public sector, with the remaining split between banks and other private sector entities. Nearly all of the government's external debt is raised in the capital markets, with bank debt representing less than 1% of total debt outstanding. About half of the public foreign debt is denominated in US dollar, with the

Amortisation of foreign currency debt

USD mln at end-December 1999	2000	2001	2002	2003	2004	2005+
Bearer bonds and notes	507	343	401	257	1168	2139
Long-term loans	190	85	77	31	8	0
Other public sector	799	884	354	306	321	793
Other private sector	727	722	802	257	246	440
Renegotiated debt	742	743				
Total	**2965**	**2777**	**1634**	**851**	**1743**	**3372**

Source: South African Reserve Bank. This excludes short-term debt with an original maturity below one year, and Rand denominated debt.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.
©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

rest distributed between yen, euro, German mark and sterling.

At 16% of export receipts, South Africa's debt service ratio is comparably low. More importantly, this ratio has been very stable over the last decade, reflecting the favourable structure of the country's external debt and the absence of significant spikes in its amortisation profile. For the most part, this pattern will hold for the foreseeable future, as the maturity structure of foreign currency debt is evenly spread out, with no more than 11% of the debt maturing in any single year.

Despite a benign amortisation schedule and limited foreign currency short-term debt, external liquidity remains a key vulnerability to South Africa's sovereign ratings. The country's liquidity ratio stood at 25% in mid-2000, after recovering sharply from a critical situation in 1997. Still, South Africa's liquidity is among the lowest of rated emerging market sovereigns. On the numerator, external assets reflect gross external reserves without discounting the SARB's net open forward position, which remains significant, as described in the monetary policy section of this report. Indeed, these forward liabilities are also not included in the denominator for the sake of consistency with other countries that do not report their forward positions. In calculating this ratio, we include all local currency debt held by foreigners as short-term debt. This might be a conservative estimate, but it reflects the fact that a majority of the government's medium and long-term debt is marketable and could be sold by foreign holders on short notice. Indeed, foreign portfolio investors have been very volatile historically, closing off long-term positions on the basis of short-term developments. Straight foreign currency short-term debt, however, is negligible.

While South Africa did not escape the international debt crisis of the 1980s, it continued to service rescheduled debt in an orderly manner. It is also notable that throughout the period 1985-93 interest payments on all debt continued uninterrupted, while debt repayments to official creditors and bondholders were 'unaffected' by the standstill. The Government declared a debt moratorium in 1985, effectively freezing the repayment of all commercial bank debt including inter-bank credit lines. A series of interim agreements followed in which amortisation payments on the so-called 'affected debt' of USD13.6bn were steadily extended. Exit options were written into the agreements, which allowed banks to convert debt into equity or longer-term loans at higher interest rates. Largely as a result of banks exercising these options, the amount of affected debt caught in the standstill net had declined to USD4.4bn by December 1993, when a final agreement with banks was reached. This rescheduled the outstanding debt and stretched payments over the period 1994-2001.

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

Aggregate supply and demand balances

% of GDP	1995	1996	1997	1998	1999	2000[f]	2001[f]
Aggregate supply	**122.1**	**123.2**	**123.5**	**124.4**	**122.9**	**123.7**	**124.3**
Imports of goods and services	22.1	23.2	23.5	24.4	22.9	23.7	24.3
Aggregate demand	**122.1**	**123.2**	**123.5**	**124.4**	**122.9**	**123.7**	**124.3**
Exports of goods and services	23.0	24.5	24.6	25.7	25.4	25.9	26.1
Gross domestic expenditure	99.1	98.6	98.9	98.8	97.5	97.9	98.3
Consumption	80.9	81.7	82.9	82.6	81.8	82.3	82.5
Gross domestic investment	18.2	16.9	16.0	16.2	15.7	15.6	15.7
External balance	0.9	1.4	1.1	1.2	2.5	2.1	1.7
Gross domestic savings	19.1	18.3	17.1	17.4	18.2	17.7	17.5

Sources: South African Reserve Bank and Fitch estimates

Current account balance

USDbn	1995	1996	1997	1998	1999	2000[f]	2001[f]
Trade balance	**2.7**	**2.7**	**2.3**	**2.0**	**3.8**	**3.9**	**3.9**
Exports, fob	30.1	30.3	31.2	29.2	28.4	31.4	35.0
(annual % change)	14.2	0.6	3.0	-6.2	-3.0	10.7	11.5
Imports, fob	27.4	27.6	28.8	27.2	24.6	27.5	31.1
(annual % change)	25.4	0.6	4.6	-5.7	-9.6	11.7	13.1
Services, net	**-1.4**	**-0.7**	**-0.7**	**-0.2**	**-0.4**	**-0.4**	**-0.6**
Services, credit	4.6	5.0	5.3	5.3	5.0	5.1	5.3
Services, debit	6.0	5.7	6.0	5.5	5.4	5.5	5.8
Income, net	**-2.9**	**-3.1**	**-3.2**	**-3.0**	**-2.9**	**-3.1**	**-3.4**
Income, credit	1.1	1.1	1.3	1.3	1.4	1.5	1.5
Income, debit	4.0	4.2	4.5	4.3	4.3	4.6	4.9
o/w: interest payments	2.6	2.6	3.0	3.0	2.9	3.1	3.2
Current transfers, net	**-0.6**	**-0.8**	**-0.7**	**-0.7**	**-0.9**	**-1.0**	**-1.1**
Current transfers, credit	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Current transfers, debit	0.8	0.8	0.9	0.8	1.0	1.1	1.2
Current account balance	**-2.2**	**-1.9**	**-2.3**	**-1.9**	**-0.5**	**-0.6**	**-1.2**
% of GDP	*-1.5*	*-1.3*	*-1.5*	*-1.4*	*-0.4*	*-0.5*	*-0.9*
% of CXR	*-6.1*	*-5.2*	*-6.0*	*-5.4*	*-1.3*	*-1.7*	*-2.8*

Source: South African Reserve Bank and Fitch estimates

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

External debt and debt service

USDbn	1995	1996	1997	1998	1999	2000[f]	2001[f]
Gross external debt	**35.3**	**34.5**	**39.2**	**38.8**	**41.7**	**43.5**	**44.9**
% of GDP	*23.4*	*24.0*	*26.4*	*29.0*	*31.8*	*34.0*	*33.6*
% of CXR	*98.1*	*94.8*	*103.3*	*108.2*	*119.8*	*114.3*	*107.2*
By maturity:							
Medium- and long-term	16.9	15.0	12.9	13.0	13.9	14.5	15.1
Short -term	18.4	19.6	26.3	25.9	27.8	29.0	29.8
% total debt	*52.1*	*56.6*	*67.1*	*66.7*	*66.7*	*66.6*	*66.4*
Gross external assets*							
International reserves, incl. gold	4.5	2.4	6.1	5.5	7.5	8.2	9.2
Deposit money banks' foreign assets	0.8	1.4	1.6	2.9	4.9	6.0	7.5
Net external debt	**30.1**	**30.7**	**31.5**	**30.4**	**29.3**	**29.3**	**28.2**
% of GDP	*19.9*	*21.4*	*21.2*	*22.7*	*22.4*	*22.9*	*21.1*
% of CXR	*83.5*	*84.3*	*83.0*	*84.8*	*84.3*	*77.1*	*67.3*
Debt service (principal & interest)	**5.0**	**5.3**	**6.2**	**5.9**	**5.5**	**6.1**	**5.7**
Debt service (% of CXR)	*13.8*	*14.6*	*16.4*	*16.3*	*15.9*	*15.9*	*13.6*
Interest (% of CXR)	*7.3*	*7.0*	*7.9*	*8.3*	*8.7*	*8.1*	*7.5*
Liquidity ratio (%)	**18.0**	**17.1**	**12.1**	**18.4**	**20.6**	**27.6**	**30.8**
Excl. banks' foreign assets	13.8	14.7	7.7	14.7	13.7	16.9	17.9

* non-bank private sector external assets are not taken into account

Sources: South African Reserve Bank and Fitch estimates and forecasts

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com

External financing

USDbn	1995	1996	1997	1998	1999[e]	2000[f]	2001[f]
Non-debt creating flows, net	**1.3**	**0.4**	**3.1**	**2.8**	**4.8**	**3.0**	**4.8**
Direct investment, net	-1.2	-0.2	1.5	-1.0	0.3	0.5	0.8
Portfolio equity investment, net	2.5	0.6	1.6	3.9	4.5	2.5	4.0
External borrowing, net	3.5	2.9	6.8	2.2	-0.2	0.9	0.8
Multilateral, incl. IMF	0.0	-0.1	-0.9	-0.8	0.0	0.1	0.1
Bilateral, incl. Paris Club	-1.0	-0.2	0.1	-0.3	-0.2	-0.1	-0.2
Commercial banks	2.2	2.2	2.7	-0.2	-1.3	0.3	1.0
Medium- and long-term	1.8	-0.4	2.1	1.6	-0.7	1.2	1.2
Short-term	0.4	2.6	0.7	-1.8	-0.6	-0.9	-0.2
Debt securities (incl. Brady bonds)	0.0	2.1	5.9	1.3	5.0	2.7	3.3
Other creditors, not specified	2.2	-1.2	-0.9	2.1	-3.7	-2.1	-3.4
Net resident lending abroad	-0.6	-0.9	-2.7	-1.5	-2.5	-2.6	-3.4
Portfolio debt securities, assets	-0.1	-0.3	-0.7	-0.8	-1.1	-1.4	-1.8
Other investment assets	-0.5	-0.6	-2.0	-0.7	-1.3	-1.2	-1.6
Net errors and omissions	**-0.9**	**-2.4**	**-1.1**	**-2.0**	**0.4**	**0.0**	**0.0**
Overall balance = chg in reserves	**1.1**	**-1.9**	**3.9**	**-0.4**	**2.0**	**0.6**	**1.0**
Memo:							
Amortisation	2.4	2.8	3.2	2.9	2.5	3.0	2.5
Gross borrowing (incl. short-term)	5.7	-0.8	4.7	-0.4	2.9	1.8	1.4
Stock of International reserves, excl. gold	2.8	0.9	4.8	4.4	6.4	7.0	8.0

Sources: South African Reserve Bank, IMF, World Bank and Fitch estimates

Fitch Ratings Ltd has used due care in the preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. Fitch Ratings Ltd shall owe no liability whatsoever to any person for any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without Fitch Ratings Ltd's prior written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

©Copyright Fitch Ratings Ltd 2000

Tel: +44 (0)20 7417 4222 Fax: +44 (0)20 7417 4242 www.fitchratings.com