5

Asset and liability management

In brief

- Government's debt management strategy is intended to keep the cost of debt as low as possible, ensure access to global and domestic markets, diversify funding instruments and encourage the growth of South Africa's liquid capital market. Fiscal policy works to ensure that debt levels remain sustainable.
- Net loan debt is projected to reach 38.6 per cent in 2013/14. Debt-service costs are expected to stabilise at 2.8 per cent of GDP in 2012/13. Total contingent liabilities, net loan debt and provisions will stabilise at 53.4 per cent of GDP in 2014/15.
- Government's gross borrowing requirement of R215.5 billion in 2013/14 will be financed by domestic bond issuance of R165.6 billion, net short-term loans of R23 billion, cash balances of R15.8 billion and borrowing of US$1.5 billion on global markets. Five new domestic bonds will be introduced in 2013/14.
- State-owned companies plan to spend R377.5 billion on infrastructure over the medium term. Government supports these companies to ensure that they can borrow at reasonable cost. Those facing persistent difficulties may be restructured to ensure that resources can be more productively applied to finance policy priorities. Government's holdings of equity and cash in various entities are therefore under review.

Overview

When its spending exceeds its income, government has a budget deficit. The deficit has to be financed by borrowing on the domestic and international financial markets. These loans add to government's overall debt.

Government debt is financed by borrowing on financial markets

The debt, which is also known as the principal, has to be repaid by an agreed date. Government also pays interest on the debt. To the degree that public funds are absorbed by interest payments, the state has less money for social and economic programmes. In other words, high and growing levels of debt mean that a rising portion of tax revenue must be spent on servicing the debt.

Increase in state debt over last several years was in line with countercyclical fiscal policy

In response to the global financial crisis of 2008 and the recession that followed, government allowed for budget deficits to increase as revenue declined. This was in line with countercyclical fiscal policy and supported the economy by maintaining investment in infrastructure and core social expenditure. Because government has maintained a prudent approach to managing its financial affairs – and because South Africa has well-developed financial markets – the state has been able to secure borrowing from investors to cover these deficits at a reasonable cost.

As a consequence of increased borrowing, net government debt rose from R483 billion in 2007/08 to R1.2 trillion in 2012/13, or from 23.3 per cent to 36.3 per cent of GDP. Over the next three years, government needs to borrow an additional R497 billion, increasing debt to R1.7 trillion or 40.3 per cent of GDP. As a result, interest costs will rise from R52.9 billion in 2007/08 to R88.3 billion in 2012/13, and to R118.2 billion in 2015/16.

Government is committed to managing its debt in a manner consistent with the principles of sustainability and intergenerational equity.

Government plans to borrow R215.5 billion in 2013/14

In 2013/14 government plans to borrow R215.5 billion, which includes the refinancing of R37.5 billion of debt scheduled for repayment during 2013/14. This borrowing requirement will be financed mainly in the domestic market through issuing fixed-rate and inflation-linked government bonds and Treasury bills, and making use of surplus cash. In keeping with government's commitment to develop the market, new fixed-rate and inflation-linked bonds will be issued. South Africa will also borrow in global capital markets to finance part of its foreign currency commitments.

Financing strategy and financing instruments

Government's debt management strategy is intended to keep the cost of debt as low as possible, ensure access to domestic and international financial markets, diversify funding instruments and encourage the continued development of liquid capital markets in South Africa.

The main instruments that government uses to finance its debt include the following:

- **Fixed-rate bonds** offer a fixed rate of interest, known as the "coupon", which is paid periodically during the life of the bond – usually twice a year.
- **Inflation-linked bonds** provide investors with cover against inflation, adjust the principal in line with movements in the consumer price index, and pay a fixed rate of interest on the adjusted principal.
- **Treasury bills** are debt instruments with maturities of less than a year. They are issued at a discount, which represents the interest.

Other instruments available to finance debt include cash balances, which can be drawn down, and cash borrowings from the Corporation for Public Deposits.

Capital investments by state-owned companies need to be financed from the strength of their own balance sheets

State-owned companies are at the centre of South Africa's infrastructure expansion. Government continues to support these companies to ensure that they are able to borrow at reasonable cost, while seeking ways to increase their efficiency. Some state-owned companies facing persistent difficulties will require restructuring to become financially sustainable, and to ensure that they are playing their mandated roles.

This chapter provides an overview of developments in South Africa's debt markets, the 2013/14 funding strategy and the state debt portfolio. It also reviews the challenges and opportunities facing state-owned companies and development finance institutions.

Developments in South Africa's debt markets

Domestic bond market

Demand for South African domestic bonds remained strong during 2012/13, anchored by a global search for higher yield and positive growth prospects in emerging markets. Domestic bonds also benefited from South Africa's listing in Citigroup's World Government Bond Index in October 2012, exposing government paper to a new set of investors. International investors purchased a net R92.4 billion of domestic bonds, taking their holdings of local currency government debt from 29.1 per cent in 2011 to 35.9 per cent in 2012. This marks the first time that holdings by global investors exceed those of local pension funds.

Strong demand for South African bonds reflects global search for higher yield

Table 5.1 Ownership of domestic government bonds, 2008 – 2012

Percentage of total	2008	2009	2010	2011	2012
Pension funds	43.9	39.9	36.5	33.0	29.8
International investors	12.8	13.8	21.8	29.1	35.9
Monetary institutions	18.0	18.3	17.7	16.3	17.0
Insurers	13.7	12.4	14.1	11.6	9.4
Other financial institutions	10.2	13.2	8.1	8.0	5.8
Other	1.4	2.4	1.8	2.0	2.1

Source: Share Transactions Totally Electronic Ltd

These capital inflows have helped to finance government's infrastructure investments. They have also helped to keep borrowing costs at historic lows. The funding costs on long-term fixed-rate bonds, for example, have fallen by an average of 2.34 percentage points since 2010.

Capital inflows have helped to finance infrastructure and kept borrowing costs low

Government recognises the risks associated with increased investment from overseas, including currency volatility and the potential for rapid withdrawal of capital.

Listing on World Government Bond Index: a vote of confidence in South Africa

In October 2012, South Africa became the first African country listed on Citigroup's World Government Bond Index.

The index includes bonds from 22 countries, including Australia, Canada, Germany and the United States. It is used by global investors as a benchmark for allocating about US$2 trillion of assets under management. To be included in the index, countries must have a minimum market capitalisation of US$50 billion equivalent in outstanding local currency debt, an investment-grade rating from Standard and Poor's, or Moody's Investor Services, and no barriers to entry for international investors.

Inclusion in the index is a vote of confidence in South Africa's commitment to prudent fiscal and monetary policy, and reflects the depth of the rand-denominated bond market.

International bond market

During 2012 global financial markets benefited from low interest rates resulting from moves by central banks to provide liquidity. Assets that major global investors often perceive as risky, such as emerging market equities and high-yield sovereign bonds, outperformed lower-yielding developed-country assets.

From January to December 2012, emerging market governments issued US$375 billion in bonds, surpassing the US$306 billion issued in 2011. Reflecting the popularity of emerging market bonds, new issuances have been characterised by lower interest rates, oversubscribed order books and

During 2012, emerging market governments issued US$375 billion in bonds a record number of issuers. This trend supports government's continued access to global finance for its foreign currency commitments.

Sovereign credit ratings

During 2012/13, three rating agencies downgraded South Africa's credit ratings. Moody's Investor Services downgraded the rating to Baa1 from A3, and Standard and Poor's and Fitch Ratings each downgraded their ratings to BBB from BBB+. Both Moody's and S&P have maintained South Africa's credit outlook at negative while Fitch has assigned a stable outlook. The downgrades also affected the ratings of state-owned companies and development finance institutions.

Factors cited for the downgrades included:

- A weaker business and investment climate
- Infrastructure bottlenecks
- Policy uncertainty
- A deteriorating growth outlook, which could affect the fiscus and raise social and political tensions.

Government views these observations in the context of persistent uncertainty about the strength of the global economic recovery. Europe, for example, which accounts for 21 per cent of South Africa's exports, is undergoing a debt crisis that has sharply reduced trade with South Africa.

At the same time, government is mindful of risks posed by sluggish economic growth to the sustainability of its fiscal accounts, and has taken measures to contain spending and stabilise the growth of debt over the medium term. Prudent macroeconomic policies and the country's sound institutional environment should continue to support a positive long-term rating outlook. The National Development Plan provides a broad strategic framework to eliminate poverty and reduce inequality, focusing in part on massive infrastructure and skills investment to boost long-term growth potential.

Consolidated borrowing requirement

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

Consolidated borrowing stood at an estimated R159.8 billion in 2012/13

Consolidated borrowing is estimated to increase to R159.8 billion in 2012/13, before declining to R131.3 billion in 2015/16. This requirement is lower than that of the national government – mainly because of large investments held by the social security funds and capital reserves held by extra-budgetary institutions, which constitute prefunding for infrastructure investment. Extra-budgetary institutions also raise loans to finance large-scale infrastructure investment. These include the South African National Roads Agency Limited (SANRAL), Trans-Caledon Tunnel Authority and water board project loans, which will amount to about R17.9 billion over the medium term.

Table 5.2 Financing of consolidated government net borrowing requirement, 2009/10 – 2015/16

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
R billion		Actual		Estimate		Medium-term estimates	
Budget balance[1]	**-159.6**	**-120.4**	**-117.3**	**-168.0**	**-163.7**	**-153.2**	**-134.4**
Extraordinary receipts and payments	5.8	2.2	3.8	8.2	4.1	2.9	3.1
Net borrowing requirement	**-153.8**	**-118.2**	**-113.5**	**-159.8**	**-159.6**	**-150.3**	**-131.3**
Domestic loans	177.6	176.5	160.1	148.1	169.8	164.5	167.4
Foreign loans	24.2	4.7	11.6	-8.1	-3.3	3.1	8.9
Change in cash and other balances[2]	-48.0	-63.0	-58.2	19.9	-6.9	-17.3	-45.0
Financing	**153.8**	**118.2**	**113.5**	**159.8**	**159.6**	**150.3**	**131.3**

1. A negative number reflects a deficit
2. A negative change indicates an increase in cash balances

National government borrowing requirement

Government's net borrowing requirement is the sum of the main budget balance and the net of extraordinary receipts and extraordinary payments. In addition, government borrows to refinance its redeeming debt.

Net borrowing requirement of R178 billion in 2013/14

As Table 5.3 shows, the net borrowing requirement is expected to amount to R176.3 billion in 2012/13, increasing to R178 billion in 2013/14 before declining to R151.9 billion in 2015/16.

Table 5.3 National government net borrowing requirement, 2011/12 – 2015/16

R million	2011/12 Outcome	2012/13 Budget	2012/13 Revised	2013/14	2014/15	2015/16
				Medium-term estimates		
National budget balance[1]	**-148 439**	**-170 025**	**-184 493**	**-182 109**	**-170 058**	**-155 000**
Extraordinary receipts	**5 209**	**1 200**	**10 780**	**4 992**	**2 900**	**3 100**
Premiums on loan transactions[2]	3 483	1 200	9 975	4 740	2 900	3 100
Saambou Bank curatorship	30	–	–	–	–	–
Revaluation profits on foreign currency transactions[3]	641	–	755	252	–	–
Liquidation of SASRIA investment[4]	228	–	50	–	–	–
Profits on GFECRA[5]	794	–	–	–	–	–
Other[6]	33	–	–	–	–	–
Extraordinary payments	**-1 388**	**-24**	**-2 584**	**-930**	**–**	**–**
Premiums on loan transactions[2]	–	–	-2 170	-930	–	–
Revaluation losses on foreign currency transactions[3]	-448	–	-262	–	–	–
Defrayal of GFECRA losses[5]	-940	-24	-152	–	–	–
Borrowing requirement	**-144 618**	**-168 849**	**-176 297**	**-178 047**	**-167 158**	**-151 900**

1. A negative number reflects a deficit
2. Premiums received or incurred on new loan issues, bond switch and buy-back transactions
3. Revaluation profits or losses on government's foreign exchange deposits at the Reserve Bank when used to meet government's foreign currency commitments
4. Liquidation of government's investments in the South African Special Risk Insurance Association
5. Realised profits/losses on the Gold and Foreign Exchange Contingency Reserve Account
6. Mainly penalties on early withdrawal of retail bonds

Extraordinary receipts and payments

Extraordinary receipts of R10.8 billion, extraordinary payments of R2.6 billion expected in 2012/13

Premiums on loan transactions and revaluations of foreign currency transactions, and substantial once-off capital transactions, are reported as extraordinary payments and receipts. Extraordinary receipts of R10.8 billion and extraordinary payments of R2.6 billion are expected in 2012/13. Over the medium term, extraordinary receipts of R11 billion and extraordinary payments of R930 million are projected.

Government is reviewing its substantial investments in state-owned companies. Some of these companies hold cash, excess financial reserves or assets that are not associated with public service delivery. Where such resources can be more productively applied to support policy priorities, the sale of such assets – or the return of surplus funds to the fiscus – will be considered.

Financing the national borrowing requirement

The net borrowing requirement is financed through loans made in the domestic and global markets and by using surplus cash. Table 5.4 outlines the financing of the net borrowing requirement for 2011/12, revised estimates for 2012/13 and projections over the medium term. Loan redemptions in 2012/13 amount to R42.9 billion. Over the medium term domestic and foreign loan redemptions of R113 billion are projected.

Table 5.4 Financing of national government net borrowing requirement,[1] 2011/12 – 2015/16

R million	2011/12 Outcome	2012/13 Budget	2012/13 Revised	2013/14	2014/15	2015/16
				Medium-term estimates		
Domestic short-term loans (net)	**18 725**	**22 000**	**22 000**	**23 000**	**24 000**	**24 000**
Treasury bills	19 009	22 000	20 897	24 103	24 000	24 000
Corporation for Public Deposits	-284	–	1 103	-1 103	–	–
Domestic long-term loans (net)	**138 501**	**119 998**	**126 448**	**143 610**	**132 292**	**137 032**
Market loans (gross)	154 861	151 367	161 557	165 648	165 405	165 119
Loans issued for switches[2]	-753	–	-3 790	-1 310	–	–
Redemptions[3]	-15 607	-31 369	-31 319	-20 728	-33 113	-28 087
Foreign loans (net)	**9 135**	**-7 492**	**-7 379**	**-4 335**	**964**	**9 724**
Market loans (gross)	12 025	4 035	4 190	12 390	12 435	12 630
Arms procurement loan agreements (gross)	569	183	61	–	–	–
Redemptions (including revaluation of loans)	-3 459	-11 710	-11 630	-16 725	-11 471	-2 906
Change in cash and other balances[4]	**-21 743**	**34 343**	**35 228**	**15 772**	**9 902**	**-18 856**
Cash balances	-21 270	30 743	26 728	11 272	5 402	-23 356
Other balances[5]	-473	3 600	8 500	4 500	4 500	4 500
Financing	**144 618**	**168 849**	**176 297**	**178 047**	**167 158**	**151 900**

1. A longer time series is presented in Table 1 of Annexure B
2. Net of loans issued and redeemed in switch transactions
3. Domestic loan redemption figures in 2014/15 are net of anticipated switches of R11.9 billion
4. A negative change indicates an increase in cash balances
5. Net movement in national departments' bank balances due to differences between funds requested and actual cash flows

Domestic short-term borrowing

Domestic short-terms loans increased by R22 billion in 2012/13

Short-term borrowing consists of Treasury bill issuance and borrowing of surplus cash from the public sector through the Corporation for Public Deposits, into which provinces and some public companies are required to invest their surplus cash. Government borrows from the corporation to finance a portion of its borrowing requirement. In 2012/13, short-term loans will increase by an estimated R22 billion to R190.4 billion.

Table 5.5 Domestic short-term borrowing, 2012/13 – 2013/14

R million	2012/13 Opening balance	2012/13 Net change	2012/13 Closing balance	2013/14 Net change	2013/14 Closing balance	Weekly auction estimates 2012/13	Weekly auction estimates 2013/14
Corporation for Public Deposits	**13 256**	**1 103**	**14 359**	**-1 103**	**13 256**		
Treasury bills	**155 159**	**20 897**	**176 056**	**24 103**	**200 159**	**7 210**	**7 770**
91-day	46 909	996	47 905	–	47 905	3 685	3 685
182-day	35 880	2 929	38 809	4 481	43 290	1 515	1 665
273-day	38 220	5 640	43 860	6 840	50 700	1 130	1 300
364-day	34 150	11 332	45 482	12 782	58 264	880	1 120
Total	**168 415**	**22 000**	**190 415**	**23 000**	**213 415**		

Of the total amount of Treasury bills issued, 73.4 per cent is held by domestic commercial banks to partly meet their prescribed liquid asset requirements and 3.4 per cent is held by international investors. Over the medium term, Treasury bill net issuance is expected to average R24 billion a year, concentrated in longer maturities.

Domestic long-term borrowing

Long-term domestic loan issuance reached R161.6 billion in 2012/13

Domestic long-term loans consist of fixed-rate bonds, inflation-linked bonds and retail bonds. In 2012/13, the budgeted domestic long-term loan issuance increased by R10.2 billion to R161.6 billion. This increase was financed by higher-than-anticipated take-up of non-competitive auctions. Domestic long-term loan issuance is expected to increase to an average of R165 billion a year over the medium term. As a result, current weekly auction levels will increase in 2013/14. Table 5.6 shows that fixed-rate bond issuance in 2012/13 was concentrated in longer maturities.

Table 5.6 Domestic long-term market loan issuance, 2012/13

As of 31 January 2013 R million	Cash value	Average yield %	Outstanding value
Fixed-rate[1]	**114 746**	**7.7**	
R157 (13.5%; 2014/15/16)	14 445	6.5	71 949
R203 (8.25%; 2017)	5 232	7.0	85 272
R204 (8%; 2018)	5 240	7.2	81 854
R208 (6.75%; 2021)	4 986	7.6	87 220
R2023 (7.75%; 2023)	20 128	7.2	20 495
R186 (10.5%; 2025/26/27)	6 484	7.7	121 605
R213 (7%; 2031)	15 030	8.2	48 828
R209 (6.25%; 2036)	7 594	8.6	63 319
R214 (6.5%; 2041)	12 974	8.1	45 991
R2048 (8.75%; 2047/48/49)	19 487	8.5	19 500
Retail	3 146	6.9	11 113
Inflation-linked[2]	**33 113**	**1.9**	
R211 (2.5%; 2017)	1 438	0.7	24 044
R212 (2.75%; 2022)	5 171	1.6	31 128
I2025 (2.0%; 2025)	4 160	1.5	4 029
R210 (2.6%; 2028)	4 372	2.4	36 869
R202 (3.45%; 2033)	1 938	2.4	61 158
I2038 (2.25%; 2038)	7 442	2.0	7 278
I2050 (2.5%; 2049/50/51)	8 521	2.1	7 830
Retail	71	1.5	250
Total	**147 859**		

1. Includes non-competitive auction allocations of R19.5 billion
2. Outstanding value is revalued using the relevant reference consumer price index

Government will continue to hold competitive auctions in domestic fixed-rate bonds, followed by non-competitive auctions to broaden participation.

Five new bonds will be introduced in 2013/14, as shown in Table 5.7.

Table 5.7 New domestic government bonds, 2013/14

Fixed-rate		Inflation-linked	
Bond code	**Maturity date**	**Bond code**	**Maturity date**
R2030	31 January 2030	I2046	31 March 2046
R2032	31 March 2032		
R2037	31 January 2037		
R2044[1]	31 January 2043		
	31 January 2044		
	31 January 2045		

1. Bond with a maturity value split equally over three years

Government bond auctions

Domestic bonds are sold in weekly auctions. Both fixed-rate and inflation-linked bond auctions start with competitive bidding, where bidders offer to buy specific amounts at a specific yield or rate. The auction is settled on the basis of highest yield and available amount, with the highest rate accepted for all successful bidders. The fixed-rate competitive bid auction is followed by a non-competitive bid auction, which gives successful bidders a 48-hour option of taking up an additional 30 per cent of their competitive bid auction allocations at the same yield.

An important part of the debt strategy is managing refinancing risk – the risk that government will not be able to raise the money to repay debt at any scheduled redemption point, or will have to do so at very high cost. To manage this risk and improve liquidity, government will continue to issue bonds with the maturity split over three years – and introduce new bonds along the existing curve, extending the curve when required.

Switch programme reduces refinancing risk

Government's bond-switch programme mitigates refinancing risk by switching short-term for longer-term debt. In 2012/13, domestic loan redemptions for 2013/14 and 2014/15 were reduced by R37.4 billion, as shown in Table 5.8. Switch auctions in 2013/14 will reduce 2014/15 loan redemptions by a further R11.9 billion. Government also plans to increase cash balances to meet redemptions beyond the medium term, reducing dependence on switches.

Government will also work to ensure a smooth schedule of repayments over the long term that avoids sharp swings in redemptions.

Table 5.8 Domestic bond switch programme, 2012/13

As of 31 January 2013 R million	Source bonds		Destination bonds[1]
R206 (7.50%; 2014)	15 335	R157 (13.5%; 2014/15/16)	8 711
		R186 (10.5%; 2025/26/27)	4 363
R201 (8.75%; 2014)	22 072	R208 (6.75%; 2021)	1 894
		R2023 (7.75%; 2023)	366
		R186 (10.5%; 2025/26/27)	13 448
		R213 (7.0%; 2031)	2 131
		R209 (6.25%; 2036)	478
		R214 (6.5%; 2041)	2 169
Total	**37 407**	**Total**	**33 560**

1. Excludes discount on destination bonds

A total of R11.4 billion is invested in retail savings bonds

Since they were launched in 2004, government's retail bonds have helped to promote household savings and finance the borrowing requirement. During 2012/13, investments in retail bonds amounted to R3.2 billion, of which R1.3 billion were reinvestments of maturing bonds and capitalised interest. A total of R11.4 billion is currently invested in these bonds. More retail bond products are under consideration to cater for younger savers and to allow for regular deposits into existing investments.

Foreign borrowing

To diversify funding options, government is preparing to enter the sukuk market

Over the medium term, government intends to borrow about US$1.5 billion a year in global markets to maintain benchmarks in major currencies and meet part of its foreign currency commitments. To diversify funding options, government is preparing to enter the sukuk (Islamic bond) market and is identifying assets to structure these certificates.

The final drawdown on the arms procurement loan agreements took place in 2012/13.

Cash balances

Table 5.9 shows the projected change in cash balances over the medium term. Government's total cash consists of deposits in rands and in other currencies held with commercial banks and the Reserve Bank.

Table 5.9 Change in cash balances, 2011/12 – 2015/16

	2011/12	2012/13		2013/14	2014/15	2015/16
R million	Outcome	Budget	Revised	Medium-term estimates		
Rand currency						
Opening balance	**111 413**	**129 425**	**130 450**	**100 041**	**102 657**	**97 157**
Used for domestic funding	21 481	-13 013	-10 706	2 616	2 685	23 000
Foreign exchange purchases[1]	-2 444	-7 352	-19 703	–	-8 185	–
Closing balance	**130 450**	**109 060**	**100 041**	**102 657**	**97 157**	**120 157**
of which:						
Tax and loan accounts	*63 293*	*41 903*	*32 884*	*35 500*	*30 000*	*53 000*
Sterilisation deposits[2]	*67 157*	*67 157*	*67 157*	*67 157*	*67 157*	*67 157*
Change in rand cash balance[3] (opening less closing balance)	**-19 037**	**20 365**	**30 409**	**-2 616**	**5 500**	**-23 000**
Foreign currency[4]						
Opening balance	**62 143**	**65 287**	**64 376**	**68 057**	**54 169**	**54 267**
Foreign exchange purchases[1]	2 444	7 352	19 703	–	8 185	–
Interest on foreign exchange balances	995	1 000	1 006	1 000	998	1 000
International borrowing	12 594	4 218	4 251	12 390	12 435	12 630
Used for foreign funding	-13 800	-22 948	-21 279	-27 278	-21 520	-13 274
Closing balance	**64 376**	**54 909**	**68 057**	**54 169**	**54 267**	**54 623**
US$ equivalent	*8 804*	*7 624*	*9 236*	*7 524*	*7 536*	*7 578*
Change in foreign currency cash balance[3] (opening less closing balance)	**-2 233**	**10 378**	**-3 681**	**13 888**	**-98**	**-356**
Total change in cash balances[3]	**-21 270**	**30 743**	**26 728**	**11 272**	**5 402**	**-23 356**
Total closing cash balance	**194 826**	**163 969**	**168 098**	**156 826**	**151 424**	**174 780**

1. Foreign currency purchased in the spot market and obtained from the settlement of forward exchange contracts entered into by the Reserve Bank to sterilise sizable foreign direct investment flows
2. Deposits made with the Reserve Bank to increase the level of official foreign exchange reserves
3. A negative value indicates an increase in cash balances and a positive value indicates that cash is used to finance part of the borrowing requirement
4. Rand values at which foreign currency was purchased or borrowed

Foreign exchange deposits held by the Reserve Bank are made from money borrowed in global markets and from purchases of foreign currency in the local market.

Some cash will be used to finance part of the gross borrowing requirement

Total cash with the Reserve Bank and commercial banks reached a high of R194.8 billion in 2011/12. Cash balances are projected to decline to R151.4 billion in 2014/15 as cash is used to finance part of the gross borrowing requirement. In 2015/16, cash balances will increase to R174.8 billion to provide for large redemptions beyond the medium term. Of government's total cash balances, R121 billion are deposits made with the Reserve Bank to increase the level of official foreign exchange reserves and are not available to finance government expenditure.

Debt-service costs

Debt-service costs as a percentage of GDP are set to stabilise in 2012/13

The costs of servicing government debt are influenced by the volume of debt, new borrowing and market variables such as interest, inflation and exchange rates. Table 5.10 summarises trends and projections to 2015/16. Debt-service costs as a percentage of GDP are expected to stabilise in 2012/13.

Table 5.10 National government debt-service costs, 2011/12 – 2015/16

	2011/12	2012/13		2013/14	2014/15	2015/16
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic loans	70 478	82 563	81 471	92 596	102 340	111 525
Short-term	12 764	10 864	9 722	10 971	12 121	13 321
Long-term	57 714	71 699	71 749	81 625	90 219	98 204
Foreign loans	5 982	6 825	6 854	7 145	6 378	6 638
Total	**76 460**	**89 388**	**88 325**	**99 741**	**108 718**	**118 163**
As percentage of:						
GDP	*2.6*	*2.7*	*2.8*	*2.8*	*2.8*	*2.8*
Expenditure	*8.6*	*10.0*	*9.1*	*9.5*	*9.6*	*9.6*
Revenue	*10.3*	*12.2*	*11.3*	*11.4*	*11.2*	*11.0*

Government's debt portfolio

Total loan debt

Net loan debt consists of total domestic and foreign debt, less cash balances. Net loan debt is expected to be R1.2 trillion by the end of 2012/13, or 36.3 per cent of GDP, increasing to 40.3 per cent of GDP in 2015/16.

Table 5.11 Total national government debt,[1] 2009/10 – 2015/16

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
R billion	**Outcome**			**Estimate**	**Medium-term estimates**		
Total gross loan debt[2]	**805.0**	**990.6**	**1 187.8**	**1 342.5**	**1 522.1**	**1 704.1**	**1 903.8**
Total net loan debt[3]	**673.1**	**820.4**	**989.7**	**1 165.1**	**1 357.3**	**1 544.5**	**1 719.8**
As percentage of GDP:							
Total gross loan debt	*32.8*	*36.2*	*39.9*	*41.8*	*43.2*	*43.9*	*44.6*
Total net loan debt	*27.4*	*30.0*	*33.3*	*36.3*	*38.6*	*39.8*	*40.3*
Foreign debt as percentage of:							
Gross loan debt	*12.4*	*9.9*	*9.8*	*8.7*	*7.4*	*6.7*	*6.7*
Net loan debt	*11.0*	*4.8*	*5.0*	*3.5*	*3.7*	*3.3*	*3.6*

1. A longer time series is presented in Table 9 of Annexure B
2. Forward estimates are based on projections of exchange and inflation rates
3. Net loan debt is calculated with due account of the cash balances of the National Revenue Fund (cash balances of government's accounts with the Reserve Bank and commercial banks)

Composition of government loan debt

Average term-to-maturity of government bonds to reach 11.7 years in 2012/13

The average term-to-maturity of government bonds – the time remaining until a bond is repaid – is expected to increase marginally from 11.1 years in 2011/12 to 11.7 years in 2012/13. The longer the average term to maturity, the lower the refinancing risk. The non-fixed rate debt component of the domestic portfolio will increase from 29.6 per cent in 2008/09 to 35.5 per cent in 2012/13. Over time, government will return the domestic debt portfolio to the current risk benchmark of 70/30 fixed-rate versus non-fixed rate debt.

Government's exposure to loans raised in the international market will be 8.7 per cent of total debt in 2012/13, well below the 20-25 per cent risk limit established by the National Treasury.

Provisions and contingent liabilities

Projections for provisions and contingent liabilities are shown in Table 5.12. Provisions are liabilities for which the payment date or amount is uncertain. Contingent liabilities are obligations, such as government guarantees, that only result in expenditure when a specific event occurs.

As at 31 March 2013, net loan debt, provisions and contingent liabilities are expected to amount to 51.3 per cent of GDP, and are projected to reach 53.4 per cent of GDP by 31 March 2015, before falling to 52.8 per cent in 2015/16. This remains below the Southern African Development Community's macroeconomic convergence target of 60 per cent of GDP.

Net loan debt, provisions and contingent liabilities remain well below the SADC macroeconomic convergence target

Table 5.12 Composition of provisions and contingent liabilities,[1] 2011/12 – 2015/16

End of period R billion	2011/12 Outcome	2012/13 Estimate	2013/14	2014/15 Medium-term estimates	2015/16
Net loan debt	**989.7**	**1 165.1**	**1 357.3**	**1 544.5**	**1 719.8**
Provisions	**98.6**	**106.4**	**117.0**	**117.9**	**120.1**
International Monetary Fund[2]	43.4	46.9	57.5	57.7	58.6
International Bank for Reconstruction and Development[2]	11.7	12.8	12.6	12.6	12.8
Multilateral Investment Guarantee Agency[2]	0.1	0.1	0.1	0.1	0.1
African Development Bank[2]	27.3	29.8	29.4	29.5	30.0
Development Bank of Southern Africa Limited[3]	4.8	4.8	4.8	4.8	4.8
Government employee leave credits	11.3	12.0	12.6	13.2	13.8
Contingent liabilities	**335.4**	**373.2**	**399.0**	**409.1**	**413.3**
Guarantees	153.9	182.9	207.7	218.8	225.8
Post-retirement medical assistance	65.3	65.3	65.3	65.3	65.3
Road Accident Fund	53.9	56.7	56.7	54.0	50.7
Government Employees Pension Fund	–	–	–	–	–
Claims against government departments	43.0	43.0	43.0	43.0	43.0
Export Credit Insurance Corporation of SA Limited	10.0	15.7	16.1	17.1	16.8
Unemployment Insurance Fund	3.4	3.7	4.3	5.0	5.8
Other[4]	5.9	5.9	5.9	5.9	5.9
Total	**1 423.7**	**1 644.7**	**1 873.3**	**2 071.5**	**2 253.2**
Percentage of GDP	*47.9*	*51.3*	*53.2*	*53.4*	*52.8*

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

The major public entities that hold guarantees are shown in Table 5.13. Details of guarantee commitments are set out in Table 10 of Annexure B. Fees of R40.1 million were received in 2012/13 on these guarantees.

Table 5.13 Guarantee exposure to major state-owned companies and development finance institutions,[1] 2011/12 – 2012/13

Institution R billion	2011/12 Guarantee	 Exposure[2]	2012/13 Guarantee	 Exposure[2]
Total	**464.2**	**153.9**	**470.8**	**182.9**
of which:				
Eskom	*350.0*	*77.2*	*350.0*	*103.5*
SANRAL	*40.0*	*19.4*	*40.0*	*19.4*
Development Bank of Southern Africa	*28.9*	*25.7*	*28.9*	*25.7*
Trans-Caledon Tunnel Authority	*25.5*	*19.9*	*25.5*	*19.9*
South African Airways	*2.9*	*1.3*	*7.9*	*2.9*
Transnet	*3.5*	*4.0*	*3.5*	*3.8*
Land Bank	*3.6*	*1.1*	*4.6*	*1.9*

1. A longer time series is presented in Table 10 of Annexure B
2. Includes accrued interest

Monitoring guarantees to state-owned companies

The National Treasury monitors the status of contingent liabilities. Requests for guarantees by state-owned companies are subject to thorough risk assessment, both for the individual entity and to assess the impact on the overall guarantee portfolio. Where a guarantee is issued, the National Treasury works with other departments to monitor the financial commitments of the company and to take action where necessary. All state-owned companies are required to adhere strictly to the guarantee conditions. The risk associated with the overall guarantee portfolio remains moderate.

New guarantees in 2012/13 totalled R6.5 billion

During 2012/13, government issued new guarantees totalling R6.5 billion:

- South African Airways (SAA) received an additional R5 billion, two-year guarantee for its going-concern and liquidity requirements, which enabled its board of directors to sign off on the carrier's 2011/12 annual financial statements.
- South African Express (SAX) has been granted a R539 million two-year guarantee to enable the company to raise funding pending the finalisation of its restated annual financial statements.
- The Land Bank received an additional guarantee of R1 billion for a loan from the African Development Bank to support small farmers.

Denel's three guarantees were consolidated into a single guarantee of R1.9 billion for administrative purposes and renewed for five years, enabling the company to take advantage of low interest rates by issuing longer-term debt.

SAA, SAX and Denel are required to report each month to a monitoring team

SAA, SAX and Denel are required to report each month to a monitoring team and to deliver turnaround strategies with associated funding plans, which must be approved by government.

State-owned companies

Capital expenditure and financial plans

Over the medium term, capital expenditure by state-owned companies is projected at R377.5 billion. The majority of this investment will take place in energy and transport (Eskom and Transnet account for 87 per cent of this amount) and in the water sector.

Table 5.14 Major state-owned companies' capital expenditure programmes, 2011/12 – 2015/16

	2011/12	2012/13		2013/14	2014/15	2015/16
R billion	Outcome	Budget	Revised	Medium-term estimate		
Capital expenditure	**92.6**	**137.6**	**108.2**	**125.3**	**123.5**	**128.7**
Of which:						
Eskom	*58.8*	*64.9*	*59.9*	*72.1*	*68.0*	*64.9*
Transnet	*21.8*	*31.2*	*29.7*	*37.3*	*38.8*	*48.0*
Central Energy Fund	*1.2*	*23.3*	*4.8*	*3.7*	*2.0*	*0.4*
SANRAL	*8.2*	*8.9*	*9.6*	*8.3*	*9.5*	*11.6*
Trans-Caledon Tunnel Authority	*1.2*	*3.6*	*1.5*	*1.2*	*3.1*	*1.9*

In delivering on their infrastructure commitments, state-owned companies improved their performance, spending R92.6 billion of a budgeted R131.7 billion (70 per cent) in 2011/12, compared with R82 billion of a budgeted R132 billion (62.1 per cent) in the prior year. The shortfall against budget, however, was substantial, resulting largely from procurement and project implementation delays.

Large share of state-owned companies' infrastructure investments to be funded from debt markets

Over the next three years, 43 per cent of the funding required for infrastructure development by state-owned companies is expected to be raised in the debt markets, with the remainder coming from internally generated cash. Funding has also been diversified to reduce borrowing costs. State-owned companies are benefiting from concessional funding opportunities presented by multilateral financial institutions such as the African Development Bank, Agence Française de Développement and Kreditanstalt für Wiederaufbau.

Table 5.15 Funding sources for state-owned companies, 2011/12 – 2015/16

	2011/12	2012/13		2013/14	2014/15	2015/16
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic loans (gross)	**31.5**	**30.1**	**36.7**	**40.5**	**35.0**	**36.4**
Short-term	11.3	9.5	13.1	18.9	12.0	12.7
Long-term	20.2	20.6	23.6	21.6	23.0	23.7
Foreign loans (gross)	**17.1**	**41.2**	**35.4**	**21.0**	**14.1**	**13.6**
Long-term	17.1	41.2	35.4	21.0	14.1	13.6
of which:						
Multilateral institutions	*8.9*	*19.3*	*15.0*	*13.2*	*10.5*	*9.8*
Export credit agency financing	*8.0*	*12.9*	*9.7*	*5.8*	*3.6*	*3.8*
Total	**48.6**	**71.3**	**72.1**	**61.5**	**49.1**	**50.0**
As percentage of total:						
Domestic loans	*64.8*	*42.2*	*50.9*	*65.9*	*71.3*	*72.8*
Foreign loans	*35.2*	*57.8*	*49.1*	*34.1*	*28.7*	*27.2*

To sustain their infrastructure plans, state-owned companies need strong balance sheets. Government is reviewing its holdings of these entities to direct capital to investment priorities. It will also be necessary to forge strategic partnerships with private firms to co-invest and bring technical expertise to large public infrastructure projects. An example of this approach has been the renewable energy independent power producer programme, which attracted R46.6 billion worth of investments from the private sector in 2012/13.

Asset base of state-owned companies reached R707 billion in 2011/12

Large-scale capital investments have led to a steady increase in the asset base of state-owned companies, from R382.5 billion in 2007/08 to R707 billion at the end of 2011/12. Eskom and Transnet collectively account for about 79 per cent of the total net asset value. In 2011/12, the average return on equity improved to 9.3 per cent from 6.7 per cent in the prior year.

Table 5.16 Consolidated balance sheets of state-owned companies,[1] 2007/08 – 2011/12

R billion	2007/08	2008/09	2009/10	2010/11	2011/12
Total assets	382.5	450.1	517.8	639.4	707.0
% growth in assets	*22.0%*	*17.7%*	*15.0%*	*23.5%*	*10.7%*
Total liabilities	229.0	290.6	341.6	422.9	469.7
% growth in total liabilities	*22.0%*	*26.9%*	*17.6%*	*23.8%*	*11.1%*
Net asset value	153.5	159.5	176.2	216.5	237.3
% growth in asset value	*22.0%*	*3.9%*	*10.5%*	*22.9%*	*9.6%*
Return on equity	4.7%	-4.0%	3.8%	6.7%	9.3%

1. Major state-owned companies listed in Schedule 2 of the PFMA

During 2011/12, Airports Company and Eskom recorded profits, but SAA, Alexkor and Armscor lost money

In 2011/12 the Airports Company of South Africa (ACSA), Eskom, and Air Traffic and Navigation Services registered returns in excess of 10 per cent. SAA, Alexkor and Armscor lost money. Reasons for the poor performance of these three companies included policy uncertainty, costs associated with non-commercial activities, operational inefficiencies, management instability, and lack of adequate coordination between boards and the shareholder. In the case of SAA, fundamental changes in the global airline industry also played a role.

Over time, the equity of entities that persistently lose money is gradually eroded, which eventually requires that they be recapitalised. Over the next year, government will work with SAA, SAX, Denel, the South African Broadcasting Corporation and the South African Post Office to develop sustainable long-term strategies, which may include some form of restructuring.

Government will also review the developmental activities carried out by state-owned companies. Where such activities are mandated, they should be funded sustainably through explicit fiscal allocations, transparent cross-subsidies from other users or by government accepting a lower return on equity than would be expected if they were operating on commercial principles.

Reforms to improve regulation and operation of public infrastructure and draw in private capital

Government is working on a series of reforms to improve regulation and operation of public infrastructure and facilitate greater private-sector participation:

- Parliament is considering the Independent System and Market Operator Bill to establish an independent procurer of electricity.
- A single transport economic regulator is to be established, encompassing regulation of ports, aviation, rail and possibly roads.
- The review of the national broadband policy will clarify the roles of the public and private sectors in rolling out broadband infrastructure. During 2013/14, government will finalise the strategy and implementation plan.
- Government will review the Integrated Resources Plan 2010, assessing the trade-offs to be considered between nuclear and other technologies.

Development finance institutions

Aggregate assets of development finance institutions reached R201.5 billion in 2012

Aggregate assets of development finance institutions at 31 March 2012 amounted to R201.5 billion, of which the Industrial Development Corporation (IDC) holds 56 per cent (R112.2 billion), the Development Bank of Southern Africa (DBSA) 26 per cent (R52.3 billion) and the Land Bank 13 per cent (R25.4 billion). Growth in the asset base has enabled these institutions to borrow against their balance sheets to extend loans to the value of R81.1 billion.

A balance is needed between sustainable lending and non-revenue-generating activities

Development finance institutions are expected to maintain financial sustainability, and care has to be taken to balance sustainable lending and non-revenue-generating activities. Over the next three years, these institutions will concentrate on financing infrastructure and industrial development, low-cost housing, rural development and land reform, small business growth and black economic empowerment enterprises, and regional development.

Development Bank of Southern Africa

DBSA is recapitalised by R7.9 billion over medium term

The DBSA's mandate is to provide financial and technical support for infrastructure to extend basic service delivery among municipalities and promote economic growth in South Africa and the region. The bank is restructuring to reduce costs, increase efficiency and sharpen focus on its core mandate. Support to government departments will be undertaken strictly on a cost-recovery basis.

After a profit of R29.4 million in 2010/11, the DBSA reported a net loss of R371 million for 2011/12. The loss stemmed mainly from revaluation of equity investments, which led to unrealised losses. The bank disbursed loans of R8.1 billion, of which R4.9 billion were in South Africa and R3.2 billion in the southern African region.

The bank will be recapitalised by R7.9 billion over the medium term. This recapitalisation will support the DBSA's refocused mandate on core infrastructure, with increased lending to municipalities, state-owned companies, regional lending and public-private partnerships. Rebuilding of the bank's capital base will allow it to increase loan disbursements from R8.1 billion to R21 billion per year.

Land Bank

Land Bank recorded profit of R187.2 million in 2011/12 and is stepping up developmental loans

The Land Bank's profits declined by 34 per cent from R284.6 million in 2010/11 to R187.2 million in 2011/12. Over the same period, the performing loan book grew by 54.4 per cent to R21 billion, and non-performing loans decreased by 15 per cent to R1.4 billion as the bank increased collections and improved operational efficiency. The Land Bank has stepped up its developmental assistance by establishing a dedicated division for emerging farmers, which approved loans worth R112 million to 260 farmers between April and December 2012.

Industrial Development Corporation

IDC recorded a R3.3 billion profit in 2011/12 and has approved R31.6 billion in funding over past three years

The IDC's mandate is to promote and finance industrial projects in South Africa and the African continent. During 2011/12, the IDC made a profit of R3.3 billion – a 22 per cent increase from the prior year, largely as a result of increased dividend income and gains from the disposal of mature investments.

A resilient balance sheet enabled the IDC to approve a net R31.6 billion funding in the form of loans and equity over the past three years. This funding supported the objectives of the New Growth Path and the Industrial Policy Action Plan.

Human settlement institutions

The Department of Human Settlements is rationalising the three housing institutions to improve efficiency and effectiveness. During 2012/13, government capitalised the National Urban Reconstruction and Housing Agency to the value of R100 million, and the Rural Housing Loan Fund to the value of R51.9 million, to expand their capacity to support subsidised housing.

Since inception, the Rural Housing Loan Fund has distributed 197 291 loans worth about R1 billion through its intermediary network. The National Urban Reconstruction and Housing Agency has distributed 1 348 loans to the value of R2.3 billion for 265 000 completed houses. Since 2008, the National Housing Finance Corporation has disbursed R664 million.

Conclusion

Government's debt management strategies will ensure that the borrowing requirement is financed at the lowest possible cost, while minimising repayment risk. The strategy complements the fiscal guidelines, which emphasise long-term debt sustainability. Government will continue to support state-owned companies and, through prudent financial oversight, ensure that they remain financially sound and contribute to the rollout of economic infrastructure.