7

Government's borrowing requirement and other obligations

In brief

- Government's gross borrowing requirement is expected to be R243.4 billion in 2016/17, increasing to R284.4 billion in 2019/20.
- Debt-service costs are estimated to be R146.3 billion in 2016/17, or 3.3 per cent of GDP, increasing to R197.3 billion, or 3.6 per cent of GDP in 2019/20.
- Deep and liquid domestic capital markets will remain the main source of borrowing.
- Despite volatile market conditions, debt remains within strategic risk benchmarks.
- Eskom, independent power producers and the Road Accident Fund account for the majority of government's contingent liabilities.

Overview

Government borrows money to finance the difference between revenue and expenditure, and to pay debt that is due. In 2016/17, the budget deficit amounts to an estimated R170.5 billion. Debt repayments amount to R72.9 billion, bringing the total borrowing requirement to R243.4 billion.

Government needs to borrow at sustainable levels to fund its policy agenda

Government cannot always balance its budget through tax increases and spending cuts. It therefore needs to borrow at sustainable levels to fund expenditure. Borrowing at reasonable cost depends on the lender's perception of the borrower's ability to repay. In bond markets, lenders consider the credibility of a government's macroeconomic framework, the integrity of state institutions, the political environment and the country's economic growth prospects. These assessments are captured in sovereign credit ratings. In South Africa's case, rating agencies are concerned by low economic growth rates, political risk, policy uncertainty, and the weak balance sheets of state-owned companies.

Global developments can translate into financial market risks, affecting borrowing costs. During 2016, the UK's vote to leave the European Union

and policy uncertainty in the wake of the presidential election in the US resulted in market volatility and increased risk, which negatively affected some bond and Treasury bill auctions.

Financing strategy

Issuance of Treasury bills to decline and long-term bonds to increase over medium term

In 2017/18, the gross borrowing requirement will be R220.9 billion. Government also expects to borrow R21.2 billion to increase its cash reserves to meet future commitments.

The financing strategy focuses on mitigating risks presented by the increase in loan redemptions over the next several years. To manage maturing debt, the bond-switch programme, which exchanges bonds with shorter maturities for longer-dated bonds, will continue. Issuance of Treasury bills will be reduced to manage refinancing risk associated with low demand at auctions, and to minimise the impact of adverse interest-rate movements. Treasury bill issuance will average R21.5 billion per year. Gross domestic long-term bond issuance will grow from R173.1 billion in 2016/17 to an annual average of R194.5 billion to meet the higher borrowing requirement. As a result, weekly bond auction amounts will increase. Foreign-currency borrowing will average US$2 billion per year.

The increase in debt stock, the issuance of longer-dated bonds that attract higher interest payments, and the exchange of short- for longer-dated instruments, will put some upward pressure on debt-service costs.

The sources of government borrowing

Government has three main sources of borrowing:

- Short-term borrowing consists of Treasury bills issued with maturities of up to a year and borrowing from the Corporation for Public Deposits. These instruments are used to cover part of the borrowing requirement and short-term cash-flow needs. The Corporation for Public Deposits, administered by the Reserve Bank, is where provinces and state-owned companies invest their surplus cash.
- Domestic long-term borrowing consists of fixed-rate bonds, inflation-linked bonds and retail savings bonds. Long-term debt minimises refinancing risk – the probability that government will not be able to pay loans as they come due – by curbing short-term repayment pressures.
- Foreign-currency borrowing is denominated mostly in US dollars and euros. Government uses this type of borrowing partly to meet foreign-currency commitments.

The main risks to government's financing strategy are:

- Macroeconomic and fiscal risk. Persistently weak economic growth, a deterioration in the fiscal position and/or demands for additional guarantees or capital injections for state-owned companies would likely increase debt and borrowing costs.
- Financial market risk. Policy uncertainty and political noise ahead of the governing party's elective conference in December 2017 could add to market volatility. Lack of clarity on the policy trajectory of the US administration may lead to capital flow volatility.
- Inflation and exchange rate risk. Rising inflation and persistent rand depreciation could increase the stock of outstanding inflation-linked and foreign-currency debt, resulting in higher debt-service costs.

- Ratings risk. A downgrade to sub-investment grade ratings would increase borrowing costs and narrow the range of institutions that can invest in South African government debt.

Government's approaches to macroeconomic, fiscal and state-owned company risks are discussed in Chapters 2, 3 and 8 respectively. To manage risks directly linked to the financing strategy (inflation, exchange rate, interest rate and refinancing), government applies a series of strategic benchmarks, presented in Table 7.1 below. All debt metrics are expected to remain within their ranges or limits over the medium term.

Strategic benchmarks in place to manage inflation, exchange rate, interest rate and refinancing risk

Table 7.1 Performance against strategic portfolio risk benchmarks

Description	Benchmark range or limit	2016/17	2017/18	2018/19	2019/20
		Estimate	Medium-term estimates		
Benchmark[1]					
Treasury bills as % of domestic debt	15	13.1	12.7	12.6	12.2
Long-term debt maturing in 5 years as % of fixed-rate bonds and inflation-linked bonds	25	15.0	14.5	15.5	14.1
Inflation-linked bonds as % of domestic debt	20-25	22.3	23.4	24.0	24.2
Foreign debt as % of total debt	15	11.3	11.1	11.5	11.6
Weighted term-to-maturity of fixed-rate bonds and Treasury bills (years)	10-14	12.7	13.2	13.4	14.0
Weighted term-to-maturity of inflation-linked bonds (years)	14-17	15.5	14.7	14.4	15.0
Other indicators (weighted average)[2]					
Term-to-maturity of total debt (years)		14.7	14.8	14.9	15.4
Term-to-maturity of foreign debt (years)		10.1	9.2	9.8	9.9

1. Excludes borrowing from the Corporation for Public Deposits, retail savings and zero-coupon bonds
2. Indicators without specific benchmarks
Source: National Treasury

Government debt and debt-service costs

Table 7.2 summarises national government debt.

Table 7.2 Total national government debt[1]

End of period	2015/16	2016/17	2017/18	2018/19	2019/20
R billion	**Outcome**	**Estimate**	**Medium-term estimates**		
Domestic loans[2]	**1 819**	**2 016**	**2 215**	**2 415**	**2 616**
Short-term	237	278	299	320	342
Long-term	1 582	1 738	1 916	2 095	2 275
Fixed-rate	*1 173*	*1 299*	*1 411*	*1 522*	*1 631*
Inflation-linked	*409*	*439*	*505*	*573*	*644*
Foreign loans[2]	**200**	**222**	**263**	**298**	**288**
Gross loan debt	**2 019**	**2 238**	**2 478**	**2 713**	**2 905**
Less: National Revenue Fund bank balances	-214	-232	-251	-271	-235
Net loan debt[3]	**1 805**	**2 006**	**2 226**	**2 442**	**2 670**
As percentage of GDP:					
Gross loan debt	*49.4*	*50.7*	*52.3*	*52.9*	*52.4*
Net loan debt	*44.2*	*45.5*	*47.0*	*47.6*	*48.1*

1. A longer time series is given in Table 10 of the statistical annexure at the back of the Budget Review
2. Estimates include revaluation based on National Treasury's projections of inflation and exchange rates
3. Net loan debt is gross loan debt minus the bank balances of the National Revenue Fund
Source: National Treasury

Debt portfolio is well structured, with 88 per cent of debt stock in longer-dated bonds

Net government debt is expected to increase to R2.7 trillion over the medium term. The debt portfolio remains well structured. Instruments with a maturity of more than one year make up 88 per cent of debt stock and foreign-denominated bonds account for 10 per cent of debt stock.

In 2016/17, the stock of debt increased by R218.7 billion. The main budget deficit accounted for R170.5 billion of this increase. Upward revaluation of inflation-linked bonds was offset by the appreciation of the exchange rate, which led to a downward revision in the value of foreign-currency debt.

Table 7.3 Analysis of annual increase in gross loan debt

R million	2015/16 Outcome	2016/17 Estimate	2017/18	2018/19	2019/20
			Medium-term estimates		
Budget deficit	168 389	170 532	166 798	171 153	180 678
Discount on loan transactions	8 491	12 706	8 900	5 468	5 887
Revaluation of inflation-linked bonds[1]	19 306	26 745	27 476	28 515	32 215
Revaluation of foreign-currency debt[1]	36 888	-14 053	15 512	7 772	6 960
Change in cash balances and other balances[2]	-13 021	22 757	21 224	22 739	-34 381
Total	**220 053**	**218 687**	**239 910**	**235 647**	**191 359**

1. Revaluation based on National Treasury projections of inflation and exchange rates
2. A positive value indicates an increase in cash and other balances. A negative value indicates that cash is used to finance part of the borrowing requirement
Source: National Treasury

The cost of servicing government debt is influenced by the volume of debt, new borrowing and market variables such as interest, inflation and exchange rates. In 2016/17, debt-service costs are expected to be R1.4 billion lower than the 2016 Budget estimate of R147.7 billion, owing to favourable exchange rate movements, and adjustments to domestic and foreign-debt issuance plans. However, debt-service costs have been revised up substantially over the medium term due to growth in debt stock.

Table 7.4 summarises debt-service cost projections. Debt-service costs as a share of GDP will average 3.5 per cent over the medium term. A growing share of revenue goes to service debt. This ratio is projected to increase from 12 per cent of revenue in 2015/16 to 13.4 per cent in the outer year.

Table 7.4 National government debt-service costs

R million	2015/16 Outcome	2016/17 Budget	2016/17 Revised	2017/18	2018/19	2019/20
				Medium-term estimates		
Domestic loans	118 437	134 175	135 288	148 078	164 359	179 673
Short-term	16 162	19 674	21 321	22 983	25 578	28 692
Long-term	102 275	114 501	113 967	125 095	138 781	150 981
Foreign loans	10 359	13 545	10 993	14 275	16 293	17 647
Total	**128 796**	**147 720**	**146 281**	**162 353**	**180 652**	**197 320**
As percentage of:						
GDP	*3.2*	*3.4*	*3.3*	*3.4*	*3.5*	*3.6*
Expenditure	*10.3*	*11.2*	*11.2*	*11.5*	*11.9*	*11.9*
Revenue	*12.0*	*12.7*	*12.9*	*13.1*	*13.4*	*13.4*

Source: National Treasury

Borrowing performance and projections

This section reviews outcomes of the borrowing strategy in 2016/17, and outlines the mix of instruments needed to meet financing needs over the medium term.

Gross borrowing requirement for 2016/17 is R13.9 billion higher than projected in 2016 Budget

In 2016/17, government's gross borrowing requirement – the sum of the main budget balance and maturing debt – will total R243.4 billion, R13.9 billion higher than projected in the 2016 Budget. During the first half of the year, borrowing remained within projected levels. In September 2016, government increased Treasury bill issuance in anticipation of a higher budget deficit and to cover short-term cash flow pressures expected in December 2016 and January 2017. The bond-switch programme successfully reduced refinancing risk in both domestic and foreign loans. Government also funded its foreign-currency commitments and raised nearly US$1.2 billion in advance for future commitments (prefunding), despite difficult market conditions.

Table 7.5 Financing of national government gross borrowing requirement[1]

	2015/16	2016/17		2017/18	2018/19	2019/20
R million	Outcome	Budget	Revised	Medium-term estimates		
Main budget balance[2]	**-168 389**	**-156 342**	**-170 532**	**-166 798**	**-171 153**	**-180 678**
Redemptions	**-32 023**	**-73 194**	**-72 912**	**-54 078**	**-53 008**	**-103 763**
Domestic long-term loans[3]	-28 144	-57 800	-57 222	-49 514	-50 622	-55 634
Foreign loans[3]	-3 879	-15 394	-15 690	-4 564	-2 386	-48 129
Total	**-200 412**	**-229 536**	**-243 444**	**-220 876**	**-224 161**	**-284 441**
Financing						
Domestic short-term loans	**13 075**	**25 000**	**41 000**	**21 000**	**21 500**	**22 000**
Treasury bills[4]	7 252	25 000	41 000	21 000	21 500	22 000
Corporation for Public Deposits	5 823	–	–	–	–	–
Domestic long-term loans	**174 316**	**174 000**	**173 132**	**191 500**	**195 000**	**197 000**
Market loans	176 795	174 000	174 000	191 500	195 000	197 000
Loans issued for switches	-2 479	–	-868	–	–	–
Foreign loans	**–**	**23 205**	**52 069**	**29 600**	**30 400**	**31 060**
Market loans	–	23 205	50 958	29 600	30 400	31 060
Loans issued for switches	–	–	1 111	–	–	–
Change in cash and other balances[5]	**13 021**	**7 331**	**-22 757**	**-21 224**	**-22 739**	**34 381**
Cash balances	11 698	3 230	-29 179	-25 443	-27 077	30 102
Other balances[6]	1 323	4 101	6 422	4 219	4 338	4 279
Total	**200 412**	**229 536**	**243 444**	**220 876**	**224 161**	**284 441**

1. A longer time series is presented in Table 1 of the statistical annexure at the back of the Budget Review
2. A negative number reflects a deficit
3. Net of loans issued and redeemed in switch transactions
4. Treasury bills are disclosed on a net basis (gross issuance less redemptions)
5. A negative value indicates an increase in cash and other balances. A positive value indicates that cash is used to finance part of the borrowing requirement
6. Net movement in national departments' bank balances due to differences between funds requested and actual cash flows
Source: National Treasury

Debt redemptions increase to R104 billion in 2019/20

The gross borrowing requirement is projected to increase from R220.9 billion in 2017/18 to R284.4 billion in 2019/20. The main budget deficit constitutes the bulk of this requirement. Debt redemptions of R54 billion are expected in 2017/18, increasing to R104 billion in 2019/20, mainly as a result of large foreign loan redemptions. Most of this requirement will be met by domestic long-term bond issuance, which will increase gradually to R197 billion in the outer year. The value of short-term issuance will remain broadly stable over the three-year period.

Domestic short-term borrowing

Short-term loans make up about 12 per cent of government's debt stock. During 2016/17, in response to short-term funding pressures and to make up for the higher borrowing requirement, government increased net issuance of Treasury bills by R16 billion to R41 billion. Of the R358.5 billion on auction up to 31 January 2017, R5.4 billion, or 1.5 per cent, could not be allotted during periods of market volatility.

Table 7.6 Treasury bill auction under-allotments, 2016/17

As at 31 January 2017	Maturity				Total
R million	91-days	182-days	273-days	364-days	
Under-allotments	4 526	111	810	–	5 447
Gross issuance	124 244	87 043	75 570	71 672	358 529
% under-allotments	3.6	0.1	1.1	–	1.5

Source: National Treasury

Government also borrows from the Corporation for Public Deposits to manage cash shortfalls. In 2016/17, this worked out to a gross daily average of R48.8 billion, up from R30.7 billion and R36.6 billion in 2014/15 and 2015/16 respectively. No net change is anticipated in 2016/17 and 2017/18.

Government will reduce short-term refinancing risk in line with benchmarks

In 2017/18, R21 billion of the net borrowing requirement will be met through Treasury bills. The 91-day Treasury bill issuance and borrowing from the Corporation for Public Deposits will be used to manage in-year cash flows. At the end of 2017/18 the outstanding stock of Treasury bills is expected to increase from R277.7 billion to R298.7 billion. During 2018/19 and 2019/20, Treasury bill issuance will average R21.8 billion a year, reducing short-term refinancing risk.

Table 7.7 Domestic short-term borrowing

	2016/17			2017/18		2016/17	2017/18
R million	Opening balance	Net change	Closing balance	Net change	Closing balance	Weekly auction estimates	
Corporation for Public Deposits	**27 194**	**–**	**27 194**	**–**	**27 194**		
Treasury bills	**209 468**	**41 000**	**250 468**	**21 000**	**271 468**	**8 275**	**8 915**
91-days	32 884	5 300	38 184	-4 979	33 205	2 555	2 555
182-days	45 955	8 794	54 749	3 900	58 649	2 110	2 260
273-days	59 210	10 870	70 080	9 360	79 440	1 860	2 100
364-days	71 419	16 036	87 455	12 719	100 174	1 750	2 000
Total	**236 662**	**41 000**	**277 662**	**21 000**	**298 662**		

Source: National Treasury

Domestic long-term borrowing

Longer-dated, rand-denominated debt accounts for about 78 per cent of government debt stock. In the 10 months ending 31 January 2017, government raised R141.5 billion by issuing domestic long-term debt. Of this amount, R110.8 billion was raised in fixed-rate bonds, R27.2 billion in inflation-linked bonds and R3.5 billion in retail savings bonds.

Longer-dated, rand-denominated bonds account for about 78 per cent of government debt stock

Fixed-rate bond auctions performed as expected. During the year, bond yields decreased, making it cheaper for government to borrow. In contrast, take-up of inflation-linked bonds declined. During the second half of 2016/17 there were six under-subscribed and three under-allotted inflation-linked bond auctions.

Global interest in South African bonds remains strong. International investors held 36 per cent of rand-denominated bonds as at end-December 2016, up from 32.4 per cent in 2015. These holdings amounted to R558 billion, an increase of R107 billion from the previous year.

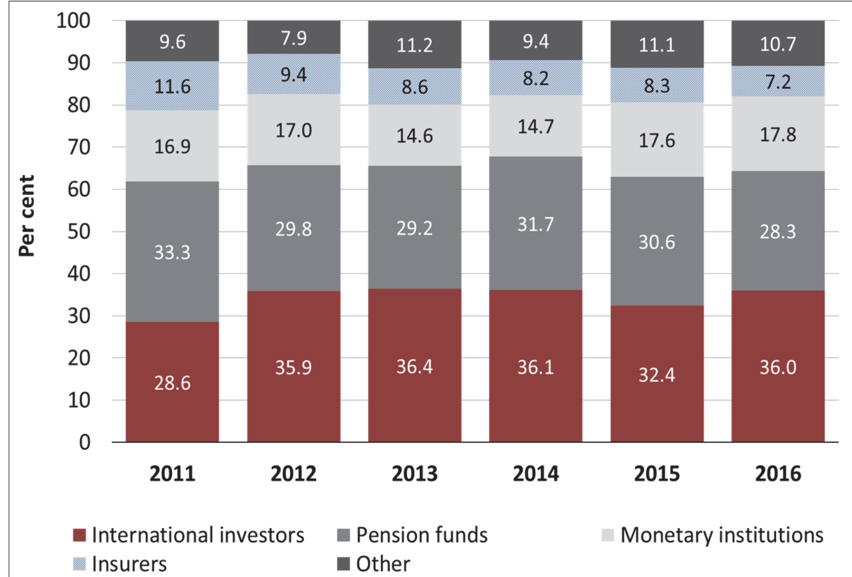
International investors have increased their holdings of rand-denominated bonds to 36 per cent of total

Table 7.8 Domestic long-term borrowing, 2016/17

As at 31 January 2017 Bond code (coupon rate; maturity)	Cash value (R million)	Average yield (%)	Average bid-to-cover ratio (times)
Fixed-rate[1]	**114 255**	**9.4**	
R2023 (7.75%; 2023)	2 934	8.7	3.4
R186 (10.5%; 2025/26/27)	2 931	9.0	4.3
R2030 (8%; 2030)	4 112	9.5	3.3
R213 (7%; 2031)	2 849	9.1	3.3
R2032 (8.25%; 2032)	4 367	9.6	2.9
R2035 (8.88%; 2035)	18 232	9.3	2.9
R209 (6.25%; 2036)	1 862	9.3	4.4
R2037 (8.5%; 2037)	16 524	9.5	3.2
R2040 (9%; 2040)	18 144	9.5	2.2
R214 (6.5%; 2041)	3 212	9.5	2.3
R2044 (8.75%; 2043/44/45)	17 474	9.6	2.7
R2048 (8.75%; 2047/48/49)	18 190	9.6	2.9
Retail	3 424	8.5	
Inflation-linked	**27 278**	**2.0**	
I2025 (2%; 2025)	1 414	1.7	1.9
I2029 (1.88%; 2029)	5 589	2.0	1.7
I2033 (1.88%; 2033)	6 266	1.9	2.1
I2046 (2.5%; 2046)	5 497	2.0	2.7
I2050 (2.5%; 2049/50/51)	8 442	2.0	2.1
Retail	70	2.0	
Total	**141 533**		

1. Includes non-competitive auction allocations of R22.7 billion
Source: National Treasury

Figure 7.1 Ownership of domestic government bonds



Source: Share Transactions Totally Electronic

Between February 2015 and January 2017, government's bond-switch programme exchanged a total of R130.4 billion in short-dated debt for long-dated debt, reducing pressure on the loan portfolio over the next four years. Table 7.9 shows which bonds have been switched and the bonds they have been exchanged for.

Over the medium term, fixed-rate bonds, which account for 80 per cent of domestic bond issuance, will anchor the portfolio, allowing government to manage interest rate risk. Issuance of inflation-linked bonds will be limited to 20 per cent to minimise the effect of revaluation on debt stock. New issuance in domestic capital markets will increase from R173.1 billion in 2016/17 to R191.5 billion in 2017/18, reaching R197 billion in 2019/20. Retail savings bonds, which encourage household savings, will provide funding of about R3.5 billion.

Table 7.9 Domestic bond-switch programme as at 31 January 2017[1]

Source bonds Bond code (coupon rate; maturity)	Value R million	Destination bonds	
R203 (8.25%; 2017)	36 780	R186 (10.5%; 2025/26/27)	31 914
R204 (8%; 2018)	32 975	R2030 (8%; 2030)	27 846
R207 (7.25%; 2020)	30 150	R2032 (7%; 2031)	13 117
R208 (6.75%; 2021)	30 480	R2035 (8.88%; 2035)	2 696
		R2037 (8.5%; 2037)	17 942
		R2040 (9%; 2040)	3 462
		R214 (6.5%; 2041)	654
		R2044 (8.75%; 2043/44/45)	9 261
		R2048 (8.75%; 2048)	19 812
Total[2]	**130 385**	**Total[2]**	**126 704**

1. Domestic bond-switch programme as of February 2015
2. Difference due to the net of premiums, discounts and interest paid/received on source and destination bonds
Source: National Treasury

International borrowing

Global debt issuances help diversify borrowing

Government issues debt in global capital markets to meet part of its foreign-currency commitments, set benchmarks and diversify funding sources. The rand equivalent of these loans and interest payments changes with the exchange rate. To manage this risk, portfolio benchmarks limit foreign-currency debt to 15 per cent of the portfolio. Over the medium term, borrowing in global markets will average US$2 billion per year.

Government's foreign-currency financing levels were revised upwards in 2016/17, partly to cater for large redemptions, which reach US$3.1 billion in 2019/20. Government issued bonds of US$1.25 billion in April 2016 and US$3 billion in September 2016. The latter transaction consisted of US$2.3 billion of new issuance and US$710 million in bond exchanges. About US$1.2 billion of the new issuance will be used as pre-funding to manage medium-term loan redemptions.

US and UK investors were largest purchasers of international bonds, with growing interest from Asia

US and UK investors were the largest participants in South Africa's recent international issuance, taking up 37 per cent and 33 per cent respectively of the US$3 billion of bonds on offer. Participation by Asian investors reached 10 per cent, the highest level since South Africa re-entered global capital markets in 1994. Table 7.10 shows government's foreign-currency commitments and financing.

Table 7.10 Foreign-currency commitments and financing

US$ million	2015/16	2016/17	2017/18	2018/19	2019/20
	Outcome	Estimate	Medium-term estimates		
Commitments					
Redemptions	-304	-1 079	-308	-157	-3 099
Interest	-744	-714	-961	-1 068	-1 133
Departmental	-652	-840	-753	-749	-748
Total	**-1 700**	**-2 633**	**-2 022**	**-1 974**	**-4 980**
Financing					
Loans	–	3 600	2 000	2 000	2 000
Purchases	717	256	666	666	606
Interest	119	86	82	82	82
Change in cash balances[1]	864	-1 309	-726	-774	2 292
Total	**1 700**	**2 633**	**2 022**	**1 974**	**4 980**

1. A negative value indicates an increase in cash balances. A positive value indicates that cash is used to finance part of the borrowing requirement

Source: National Treasury

Cash balances

Total operational cash balances stood at R45.1 billion at the beginning of 2016/17. As Table 7.11 shows, these balances will increase sharply over the medium term to prefund large redemptions due in 2019/20, before returning to R45 billion in the outer year.

Table 7.11 Change in cash balances

R million	2015/16 Outcome	2016/17 Budget	2016/17 Revised	2017/18 Medium-term estimates	2018/19 Medium-term estimates	2019/20 Medium-term estimates
Rand currency						
Opening balance	**120 304**	**115 657**	**112 249**	**112 157**	**112 157**	**116 157**
Closing balance	**112 249**	**112 157**	**112 157**	**112 157**	**116 157**	**112 157**
of which:						
Tax and loan accounts	*45 092*	*45 000*	*45 000*	*45 000*	*49 000*	*45 000*
Change in rand cash balance[1] (opening less closing balance)	**8 055**	**3 500**	**92**	**–**	**-4 000**	**4 000**
Foreign currency[2]						
Opening balance	**69 428**	**81 730**	**65 785**	**95 056**	**120 499**	**143 576**
Closing balance	**65 785**	**82 000**	**95 056**	**120 499**	**143 576**	**117 474**
US$ equivalent	*7 364*	*7 633*	*8 673*	*9 399*	*10 172*	*7 880*
Change in foreign currency cash balance[1] (opening less closing balance)	**3 643**	**-270**	**-29 271**	**-25 443**	**-23 077**	**26 102**
Total change in cash balances[1]	**11 698**	**3 230**	**-29 179**	**-25 443**	**-27 077**	**30 102**
Total closing cash balance	**178 034**	**194 157**	**207 213**	**232 656**	**259 733**	**229 631**
of which:						
Operational cash[3]	*45 092*	*45 000*	*56 344*	*66 525*	*82 452*	*45 000*
Official reserves[4]	*132 942*	*149 157*	*150 869*	*166 131*	*177 281*	*184 631*

1. A negative value indicates an increase in cash balances. A positive value indicates that cash is used to finance part of the borrowing requirement
2. Rand values at which foreign currency was purchased or borrowed
3. Deposits in rands and US dollars made with commercial banks and the Reserve Bank to meet government's commitments
4. Deposits in rands and US dollars made with the Reserve Bank from 2005 to 2010 to increase the level of official foreign exchange reserves. The increase is due to accrued interest and the rand book value of the portfolio increasing
Source: National Treasury

Contingent liabilities

Main contingent liabilities are from state-owned companies, independent power producers and RAF

Government closely monitors the status of its contingent liabilities – commitments that may give rise to financial obligations in future – and other fiscal obligations. Aside from debt, government's major obligations are guarantees to state-owned companies and independent power producers (IPPs), and provisions to multilateral institutions. The substantial underfunding of the Road Accident Fund (RAF), according to its actuarial valuation, also constitutes an obligation. Levels of risk vary, as do the likelihood of default and callability (when creditors call on the guarantee). Details of contingent liabilities and other obligations are shown in Table 11 of the statistical annexure.

Government guarantees

A guarantee is a commitment to take responsibility for a loan in the event of default; it enables the beneficiary to access funding that would otherwise be unavailable or to borrow at rates that reflect lower risk premiums. High levels of contingent liabilities can lead to an increase in the risk premium on sovereign debt. As a result, government seeks to maintain these liabilities within prudent levels.

Guarantees to public institutions

Additional guarantees made to SAA and Land Bank during 2016

Changes in government's guarantee profile in 2016 were as follows:

- In September, government granted South African Airways (SAA) an additional going-concern guarantee of R4.7 billion, increasing its total guarantees to R19.1 billion.
- In October, government granted the Land Bank an additional R4.5 billion guarantee to lengthen the maturity profile of its debt. This will bring its total guarantees to just over R11 billion.
- The R7 billion guarantee to the Reserve Bank for the bailout of African Bank expired in February 2016 without being called on. It has been replaced with a R3 billion guarantee.

Guarantees to state-owned companies remain major risk to fiscus

As a result of these changes, guarantees to public institutions are expected to increase by R7.8 billion, from R469.9 billion in 2015/16 to R477.7 billion in 2016/17. Over the same period, exposure (the amount that the state-owned companies have borrowed against their guarantee) is expected to rise by R52.5 billion. The main changes to guarantees were:

- Eskom is expected to use R43.6 billion of its guarantee in 2016/17 and R22 billion annually over the medium term.
- SAA has used R3.5 billion of a R4.7 billion going-concern guarantee, with the remainder likely to be used in 2017/18.
- The South African National Roads Agency Limited used R2.9 billion of its guarantee in 2016/17, increasing exposure to R30.1 billion. The full guarantee is expected to be used by 2018/19.
- The South African Post Office increased its exposure by R2.6 billion in 2016/17, utilising nearly all of its R4.4 billion guarantee.

Guarantees to some state-owned companies remain a major risk to the fiscus.

Guarantees to independent power producers

Last year, in line with global standards, government began to categorise power-purchase agreements between Eskom and IPPs as contingent liabilities.

These liabilities can materialise in two ways. If Eskom runs short of cash and is unable to buy power as stipulated in the power-purchase agreement, government will have to loan the utility money to honour its obligations. If government terminates power-purchase agreements because it is unable to fund Eskom, or there is a change in legislation or policy, government would also be liable. Both outcomes are unlikely.

Exposure to IPPs, now at R125.8 billion, declines to R104.1 billion in outer year

Government has committed to procure up to R200 billion in renewable energy from IPPs. As at March 2017, exposure to IPPs – which represents the value of signed projects – is expected to amount to R125.8 billion. Exposure is expected to decline to R104.1 billion in 2019/20.

Table 7.12 Government guarantee exposure[1]

R billion	2014/15 Guarantee	2014/15 Exposure[2]	2015/16 Guarantee	2015/16 Exposure[2]	2016/17 Guarantee	2016/17 Exposure[2]
Public institutions	**469.6**	**220.9**	**469.9**	**255.8**	**477.7**	**308.3**
of which:						
Eskom	*350.0*	*149.9*	*350.0*	*174.6*	*350.0*	*218.2*
SANRAL	*38.9*	*27.4*	*38.9*	*27.2*	*38.9*	*30.1*
Trans-Caledon Tunnel Authority	*25.6*	*20.8*	*25.8*	*21.2*	*25.7*	*20.7*
South African Airways	*14.4*	*8.4*	*14.4*	*14.4*	*19.1*	*17.9*
Land and Agricultural Bank of South Africa	*6.6*	*2.1*	*6.6*	*5.3*	*11.1*	*5.4*
Development Bank of Southern Africa	*12.9*	*4.1*	*13.9*	*4.4*	*12.7*	*4.2*
South African Post Office	*1.9*	*0.3*	*4.4*	*1.3*	*4.4*	*3.9*
Transnet	*3.5*	*3.8*	*3.5*	*3.8*	*3.5*	*3.8*
Denel	*1.9*	*1.9*	*1.9*	*1.9*	*1.9*	*1.9*
South African Express	*1.1*	*0.5*	*1.1*	*0.5*	*1.1*	*1.0*
Industrial Development Corporation	*1.6*	*0.3*	*2.0*	*0.2*	*1.9*	*0.2*
South African Reserve Bank	*7.0*	*–*	*3.0*	*–*	*3.0*	*–*
Independent power producers	**200.2**	**96.2**	**200.2**	**114.0**	**200.2**	**125.8**
Public-private partnerships[3]	**10.1**	**10.1**	**10.3**	**10.3**	**10.9**	**10.9**

1. A full list of guarantees is given in Table 11 of the statistical annexure
2. Total amount of borrowing and accrued interest for the period made against the guarantee
3. This amount only includes the national and provincial PPP agreements
Source: National Treasury

Guarantees to public-private partnerships

Contingent liability exposure from public-private partnerships (PPPs) arises mainly from government's obligation to a private party in the case of a contract termination (referred to as the maximum likelihood exposure). It also occurs if government has agreed to top up a shortfall if the project does not generate the minimum revenue set out in a contract with the private party. During 2016/17, contingent liabilities from PPPs increased by about R600 million, mainly due to the R1.5 billion project to construct a new building for Statistics South Africa. Total exposure is expected to decline from R10.9 billion in 2016/17 to R7.5 billion in 2019/20 as the contract comes to a close. Annexure E provides details on PPPs.

Provisions for multilateral institutions

Provisions for multilateral institutions to grow as South Africa increases stake in New Development Bank

South Africa subscribes to shares in multilateral institutions such as the International Monetary Fund and the World Bank. Government has an obligation to recapitalise these institutions, in the unlikely event that they run into financial difficulty, by paying for shares that are subscribed but not paid for. Given that the rand has depreciated less than forecast in the 2016 Budget, provisions for multilateral institutions have declined from a projected R240 billion to R218 billion for 2016/17. Provisions are expected to increase to R300 billion in 2019/20 as South Africa increases its stake in the New Development Bank.

Other obligations

Government's other obligations are shown in Table 11 of the statistical annexure. Government's commitments to the Export Credit Insurance

Corporation of South Africa amounted to R16.4 billion in 2015/16. This reflects the net underwriting exposure of the company and its total assets. The contingent liability for post-retirement medical assistance to government employees amounted to R69.9 billion. This reflects the estimated present value of government's future commitment for state employees. Legal claims against government departments were estimated at R61.4 billion. Obligations for the RAF amount to R143.3 billion, reflect the provision on the fund's books for claims incurred but not yet reported. The finances of the RAF are discussed in more detail in Chapter 8.

Net valuation profits and losses

Government's largest contingent asset is the Gold and Foreign Exchange Contingency Reserve Account. This account reflects profits and losses on gold and foreign exchange reserves, held by the Reserve Bank to meet foreign exchange obligations and maintain liquidity in the presence of external shocks. The balance on this account is split into transactions with cash flow and non-cash flow valuations. Due to the appreciation of the rand, unrealised gains are expected to amount to R242 billion by end-March 2017, a decline of R63 billion compared with 2015/16. Government will settle R388 million in losses.

Summary

Resilient fiscal and debt management policies enabled government to finance borrowing

Over the last year, notwithstanding volatility in global markets, threats of a sovereign rating downgrade, political uncertainty and weak domestic growth, government's resilient fiscal and debt management policies enabled it to continue raising the finance needed to meet its spending commitments. The medium-term financing strategy will focus on refinancing risks and maintaining the quality of the debt portfolio, in line with best-practice benchmarks.

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