5

Asset and liability management

- As a consequence of the global economic downturn and consistent with countercyclical fiscal policy, South Africa will once again become a net issuer of debt in 2009. A sound debt management record, in combination with deep and liquid domestic capital markets, will enable government to sustain expenditure growth while maintaining a sustainable level of borrowing.
- The funding strategy for the next three years takes account of both government's borrowing requirement and the R787 billion public-sector infrastructure programme. In an environment of tightening credit, government will coordinate and sequence debt issuance in the broader public sector to minimise pressure on interest rates. Over the next three years government's net borrowing requirement amounts to R90 billion, R82 billion and R67 billion, with debt service costs averaging 2.2 per cent of GDP.
- To ensure that state-owned entities can contribute to South Africa's development mandate during the downturn, government will provide guarantees and recapitalise selected development finance institutions. The state is providing a loan and guarantees to Eskom.

Overview

Conditions in financial markets have become significantly tougher

The consequences of the world financial crisis for South Africa include a slowdown in the real economy, heightened risk aversion, a reversal of capital flows and higher sovereign risk premiums. Prior to 2008, global capital markets thrived on the basis of abundant liquidity. During the second half of last year, conditions in financial markets became significantly tougher.

Given the freezing up of global credit markets during 2008 and the much higher costs of international borrowing, South Africa's deep and liquid domestic bond market is crucially important to finance growth. Steps taken over the past 15 years to strengthen the capital market –

the introduction of primary dealers, the diversification of debt instruments, the creation of benchmark bonds and active management of the state debt portfolio – enable government to finance a major portion of the borrowing requirement in the domestic market.

In line with the changed economic environment and the countercyclical fiscal stance, government's net borrowing requirement grows from a negative position to a projected borrowing of R239 billion over the next three years.

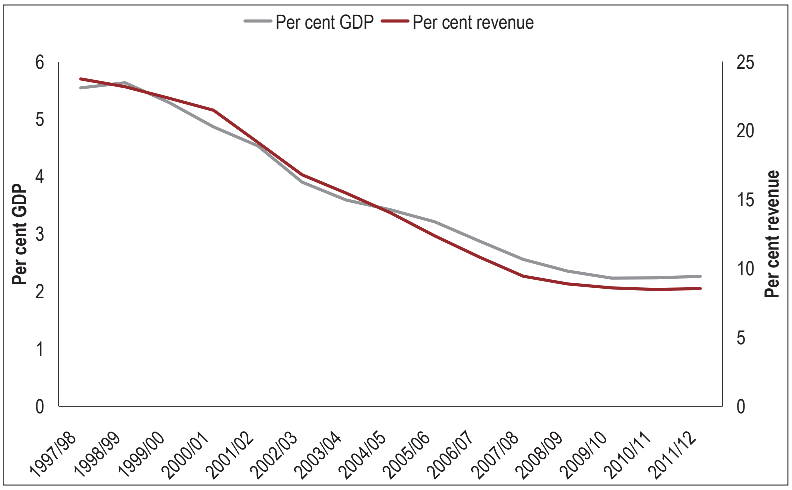
Much of government's borrowing requirement will be financed in existing domestic bonds

Government's borrowing requirement will be financed in large part through existing domestic bonds, supported by Treasury bills, along with enhanced coordination and sequencing of domestic and foreign issuance programmes. Borrowing in the international capital markets, and from multilateral or bilateral institutions, will be considered. A bond-switch programme and a reduction in operational cash balances will lower the gross borrowing requirement over the medium term.

The debt outlook remains sustainable

The debt outlook is sustainable. While the gross stock of government debt is expected to increase from R628.7 billion in 2008/09 to R918.5 billion in 2011/12, the level of debt service costs as a percentage of revenue will be maintained as maturing debt is refinanced and new debt is issued in a more favourable interest rate environment. As a percentage of GDP, the cost of servicing debt averages 2.2 per cent over the medium term. Figure 5.1 shows the projected trend in the cost of state debt over the next three years.

Figure 5.1 State debt cost, 1997/98 – 2011/12



Government will provide guarantees to state-owned entities on a case-by-case basis

As part of its support for state-owned entities, government is providing Eskom with a R60 billion loan and guaranteeing R176 billion of the utility's debt. Guarantees for other state-owned entities will be considered based on merit and strategic factors. As the economic outlook and stability of these enterprises improves, government will reduce its contingent liability exposure by issuing fewer guarantees and refinancing debt without such guarantees.

South Africa's investment grade rating is supported by strong investment growth, low external debt and a robust macroeconomic policy framework. During 2008, as the effects of the financial crisis spread to emerging markets, Moody's Investors Service affirmed South Africa's rating outlook as positive, but three other rating agencies revised their ratings outlook from stable to negative.

A record of sound debt management

Sound debt management has contributed to South Africa's relative financial health amid global turmoil. Over the past 15 years, debt management strategies reduced borrowing costs and risk while building credibility in the markets. Key elements of the debt management strategies included:

- The introduction of primary dealers in 1998
- Diversifying funding instruments, from fixed-income bonds and short-dated Treasury bills to inflation-linked bonds, variable rate bonds, retail bonds and longer-dated Treasury bills
- Extending demand for government debt to longer-term (30-year) debt
- Supporting domestic market liquidity by maintaining issuance at levels to refinance maturing domestic and foreign debt, despite budget surpluses
- Eliminating the net open forward position and using surplus cash to build forex reserves.

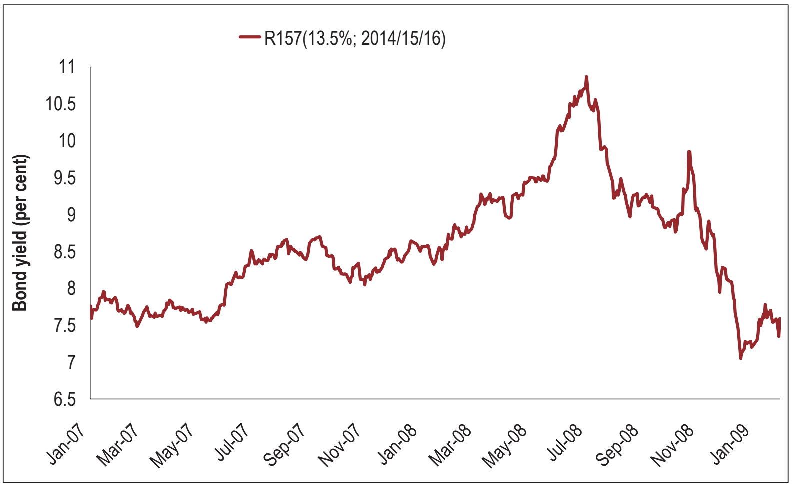
Developments in South Africa's debt markets

Domestic bond market

2009 began with bond yields on the decline

The domestic bond market entered 2009 with yields falling, reflecting expectations of lower inflation and lower interest rates. During the first half of 2008 yields on government bonds increased in line with tighter monetary policy, as the Reserve Bank increased the repo rate by 100 basis points to 12 per cent. The yield on the R157 bond increased by 240 basis points to 10.7 per cent.

Figure 5.2 Government bond yields, 2007 – 2009



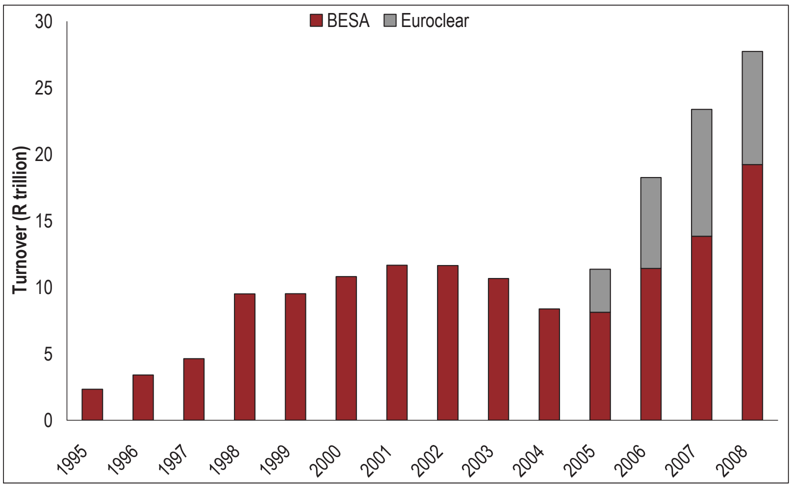
Expectation of further interest rate cuts supported downward trend in yields

The upward trend in yields reversed in mid-2008 on expectations that inflation was approaching a peak. The Reserve Bank reduced the repo rate to 10.5 per cent in February 2009. Expectations of further interest rate cuts in 2009 give additional momentum to the downward trend in yields. By end-December 2008, the R157 bond yield traded at 7.2 per cent. The yield on the R189 (6.25%; 2013) inflation-linked bond rose from 1.7 per cent in June 2008 to 3.1 per cent in December 2008.

Average daily turnover on the Bond Exchange of South Africa rose to R80 billion in 2008

Turnover on the Bond Exchange of South Africa (BESA) more than doubled from R8 trillion in 2005 to R19.2 trillion in 2008, reflective of the depth and liquidity of the domestic bond market. Total nominal trades in RSA bonds recorded abroad amounted to R8.5 trillion in 2008, bringing total trades in domestic bonds to R27.7 trillion. During 2008 average daily turnover rose from about R60 billion to R80 billion.

Figure 5.3 Turnover on Bond Exchange of South Africa, 1995 – 2008



Non-residents sold a net R12.8 billion of bonds during 2008

With the reversal of investment flows to emerging markets, non-residents, who were net buyers of about R20 billion in South African bonds during 2007, sold a net R12.8 billion worth of bonds during 2008.

Global economic developments, a weaker domestic growth outlook, higher inflation and high interest rates contributed to a more cautious approach to bond issuance by private firms in 2008. Net issuance of corporate bonds fell from R64 billion in 2007 to R28 billion in 2008. Net issues of asset-backed securities in 2007 reversed, becoming net redemptions in 2008, while the net issuance of commercial paper by non-bank corporations escalated due to a preference for shorter-term exposure to risk. Net issuance of bonds by public corporations increased in 2008 to support their growing infrastructure budgets.

Cape Town issued its first bond in 2008 and Johannesburg added two bonds to its portfolio

Turnover in municipal bonds reached R18.3 billion in 2008. Two municipalities raised funds in the primary bond market. Cape Town's inaugural bond issue raised R1 billion and Johannesburg added two new bonds worth R3.2 billion to its existing portfolio. Municipal bond issuance remains moderate compared with the metropolitan revenue base.

Table 5.1 shows a continued increase in the liquidity levels (turnover ratios) in domestic government bonds.

Table 5.1 Turnover in domestic bonds, 2006 – 2008

Bond	2006	2007	2008
		Turnover ratio[1]	
Fixed-income			
R153 (13%; 2009/10/11)	49.1	63.1	153.9[2]
R157 (13.5%; 2014/15/16)	41.9	59.0	73.2
R186 (10.5%; 2025/26/27)	15.0	16.6	23.3
R196 (10%; 2009)	–	6.1	7.3
R201 (8.75%; 2014)	7.7	13.9	22.8
R203 (8.25%; 2017)	12.9	14.6	22.6
R204 (8%; 2018)	18.5	22.2	21.8
R206 (7.5%; 2014)	22.2	14.1	22.1
R207 (7.25%; 2020)	17.3	16.9	14.7
R208 (6.75%; 2021)	18.3	27.5	21.6
R209 (6.25%; 2036)	25.0	26.6	40.5
Inflation-linked			
R189 (6.25%; 2013)	1.3	1.8	1.8
R197 (5.5%; 2023)	1.0	1.9	1.4
R202 (3.45%; 2033)	2.6	1.9	1.3
R210 (2.6%; 2028)	–	3.3	3.6

1. *The total turnover divided by the nominal outstanding issue of a bond at year-end.*
2. *High turnover ratio partly due to bond switch programme reducing the nominal value outstanding of the R153 bond.*

Issuance in global capital markets

Spread between RSA global bonds and US Treasury notes narrowed after peaking in October 2008

Financial market turmoil has increased risk premiums and reduced capital flows to emerging markets, leading to a sharp reduction in the yield of US Treasury securities. During late 2008, at the height of the crisis, South Africa's bond spreads widened to record levels, as shown in Figure 5.4. The spread between the 2022 RSA global bond and US Treasury notes widened to 829 basis points in October 2008, returning below 500 basis points in January 2009.

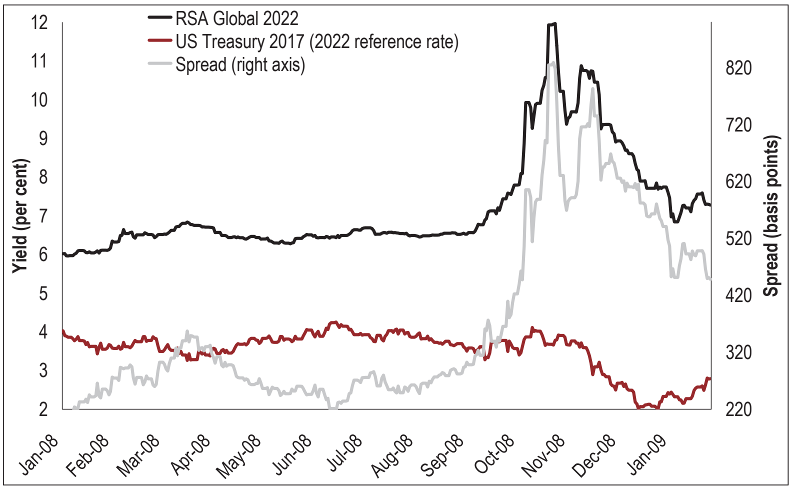
Towards the end of 2008 financial instrument risks were repriced and access to global capital markets began opening up for higher-rated government debt and high-grade US and European corporations. Capital market activity is picking up, but issuance spread levels remain high compared with recent years. In this context, many developing countries will require financial assistance from multilateral and bilateral institutions to finance higher borrowing requirements.

International funding opportunities will be considered

The 2008 Budget projected no new foreign capital market loans given a low borrowing requirement. Foreign financing was limited to further drawdowns on the arms procurement loans. However, government maintained a presence in global markets, and over the medium term, international funding opportunities will again be considered.

Eurorand bond issuance slowed during 2008 as the rand exchange rate became more volatile, aggravating currency risks in these rand-denominated foreign bonds. Net issuance nearly halved to about R7.8 billion from R14.1 billion in 2007. In contrast, net issuance in Uridashi bonds (rand-denominated bonds issued in Japan) remained robust for most of 2008, but activity in this market has ground to a halt since the collapse of Lehman Brothers.

Figure 5.4 Performance of US$1 billion 2022 RSA global bond, January 2008 – January 2009



Borrowing requirement

Net borrowing requirement to increase to R90.4 billion in 2009/10

Government borrows to meet its net borrowing requirement – the sum of the main budget balance, extraordinary receipts and extraordinary payments – and to refinance maturing debt. Table 5.2 sets out the net borrowing requirement outcome for 2007/08, a revised estimate for 2008/09 and estimates for the medium-term expenditure framework (MTEF) period. In 2008/09 the net borrowing requirement is expected to amount to R19.9 billion, increasing to R90.4 billion in 2009/10 before declining to R66.7 billion in 2011/12.

Table 5.2 Net borrowing requirement, 2007/08 – 2011/12

	2007/08	2008/09		2009/10	2010/11	2011/12
R million	Outcome	Budget	Revised	Medium-term estimates		
Budget balance[1]	**18 275**	**14 257**	**-22 783**	**-95 573**	**-83 280**	**-67 745**
Extraordinary receipts	**2 871**	**850**	**8 123**	**6 100**	**1 000**	**1 000**
Premiums on loan transactions[2]	245	600	5 282	2 100	1 000	1 000
Special dividends	1 035	–	–	–	–	–
Agricultural debt account surrender	250	250	250	150	–	–
Telkom / Vodacom transaction	–	–	–	3 500	–	–
Profits on GFECRA[3]	319	–	–	–	–	–
Liquidation of SASRIA investment	–	–	2 150	350	–	–
Penalties and forfeits	1 021	–	–	–	–	–
Wound up of Diabo Share Trust	–	–	436	–	–	–
Other	1	–	5	–	–	–
Extraordinary payments	**-776**	**–**	**-5 246**	**-900**	**–**	**–**
Premiums on loan transactions[2]	-677	–	-4 868	-900	–	–
Defrayal of GFECRA losses[3]	-81	–	-328	–	–	–
Losses on conversion of foreign loans	-18	–	-50	–	–	–
Borrowing requirement (-)	**20 370**	**15 107**	**-19 906**	**-90 373**	**-82 280**	**-66 745**

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

Extraordinary receipts and payments

Extraordinary receipts are expected to increase to R8.1 billion in 2008/09, composed of R5.3 billion of premiums on bond switches, proceeds of R2.2 billion from government's investment in the South African Special Risks Insurance Association and R436 million from the Diabo Share Trust liquidation. In 2009/10 provision is made for a transfer of R150 million from the agricultural debt account at the Corporation for Public Deposits, premiums on bond transactions of R2.1 billion and proceeds of R3.5 billion from Telkom's sale of a 15 per cent share in Vodacom to Vodafone (government still owns 39.4 per cent of Telkom).

Extraordinary receipts in 2008/09 from premiums on bond switches and investment disposals

Provision of R900 million is made for premiums on bond transactions in 2009/10. No extraordinary payments are expected over the remainder of the MTEF. In 2008/09 losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) of R328 million were settled. Premiums paid on bond switches amounted to R4.9 billion.

Financing the borrowing requirement

Table 5.3 summarises the funding of government's net borrowing requirement over the medium term.

Table 5.3 Financing of net borrowing requirement,[1] 2007/08 – 2011/12

	2007/08	2008/09		2009/10	2010/11	2011/12
R million	Outcome	Budget	Revised	Medium-term estimates		
Domestic short-term loans (net)	**5 673**	**5 750**	**13 200**	**15 400**	**12 400**	**6 000**
Treasury bills	5 923	6 000	13 450	15 550	12 400	6 000
Corporation for Public Deposits	-250	-250	-250	-150	–	–
Domestic long-term loans (net)	**-2 448**	**5 309**	**20 675**	**61 522**	**61 589**	**51 947**
Market loans	26 820	30 000	39 946	70 500	70 500	68 600
Redemptions	-29 268	-24 691	-19 271	-8 978	-8 911	-16 653
Foreign loans (net)	**-4 746**	**-3 496**	**-3 955**	**3 837**	**8 291**	**7 798**
Market loans	–	–	–	9 800	9 600	9 900
Arms procurement loan agreements[2]	2 427	2 614	3 039	3 872	2 350	1 980
World Bank loans	20	–	2	–	–	–
Redemptions (including revaluation of loans)	-5 624	-6 110	-6 996	-9 835	-3 659	-4 082
Buy-backs	-1 568	–	–	–	–	–
Change in cash and other balances[3]	**-18 849**	**-22 671**	**-10 014**	**9 614**	–	**1 000**
Opening balance	74 960	95 104	98 009	111 623	105 609	109 209
Cash balance	*75 315*	*95 104*	*93 809*	*108 023*	*102 009*	*105 609*
Surrenders/late requests	*4 703*	–	*4 200*	*3 600*	*3 600*	*3 600*
Cash flow adjustment[4]	*-5 058*	–	–	–	–	–
Closing balance	93 809	117 775	108 023	102 009	105 609	108 209
Sterilisation deposits[5]	*63 109*	*65 806*	*66 409*	*69 009*	*71 609*	*74 209*
Operational cash	*30 700*	*51 969*	*41 614*	*33 000*	*34 000*	*34 000*
Total	**-20 370**	**-15 107**	**19 906**	**90 373**	**82 280**	**66 745**

1. *Full details are reflected in Table 1 of Annexure B.*
2. *Includes R5.3 billion in new export credit agency financing for purchase of 8 Airbus A400Ms over the MTEF.*
3. *A negative change indicates an increase in cash balances.*
4. *Represents a reconciliation of actual revenue and actual expenditure against National Revenue Fund flows.*
5. *Deposits made with the Reserve Bank to regulate internal monetary conditions as provided for in Section 71(e) of the PFMA.*

Most of the R153 bond will be switched this year

Government's net borrowing requirement is financed through domestic short- and long-term loans, foreign loans and changes in cash balances. To manage refinancing risk, government entered into domestic bond switches, reducing domestic loan redemptions in 2008/09 and over the medium-term by R57.8 billion, as shown in Table 5.4. It is anticipated that most of the R153 bond maturing in tranches over the next three years will be switched before August 2009, reducing redemptions by a further R22.6 billion over the MTEF period.

Table 5.4 Domestic bond switch programme, 2008/09

As of 4 February 2009 R million	Source bonds		Destination bonds[1]
R196 (10%; 2009)	5 395	R205 (variable; 2012)	2 997
		R207 (7.25%; 2020)	1 897
		R209 (6.25%; 2036)	501
R153 (13%; 2009/10/11)	52 390	R157 (13.5%; 2014/15/16)	1 900
		R186 (10.5%; 2025/26/27)	24 738
		R207 (7.25%; 2020)	14 657
		R208 (6.75%; 2021)	11 140
Total	**57 785**	**Total**	**57 830**

1. *Excludes discount on destination bonds.*

The net borrowing requirement excludes loan redemptions, which also need to be financed. Scheduled loan redemptions for 2007/08 and 2008/09 and medium-term estimates are set out in Table 5.5. Total loan redemptions amounted to R26.3 billion in 2008/09, R4.5 billion lower than provided for, mainly due to the net of domestic bond switches reducing redemptions and a higher rand value of foreign loans redeeming at weaker-than-predicted exchange rates. For 2009/10, loan redemptions of R18.8 billion are anticipated, rising to R20.7 billion in 2011/12.

Table 5.5 Loan redemptions, 2007/08 – 2011/12

	2007/08	2008/09		2009/10	2010/11	2011/12
R million	Outcome	Budget	Revised	Medium-term estimates		
Domestic loans	**29 268**	**24 691**	**19 271**	**8 978**	**8 911**	**16 653**
Foreign loans[1]	**7 192**	**6 110**	**6 996**	**9 835**	**3 659**	**4 082**
Principal	7 311	4 264	4 304	7 544	2 349	2 791
Revaluation	-119	1 846	2 692	2 291	1 310	1 291
Total	**36 460**	**30 801**	**26 267**	**18 813**	**12 570**	**20 735**
Excludes: Source bonds in domestic switch auctions	*4 121*	*–*	*5 395*	*25 000*	*25 000*	*25 000*

1. *Includes the net amount of buy-backs for 2007/08.*

Domestic short-term loans

New 1-year maturity Treasury bill to be considered

Short-term borrowing consists of marketable Treasury bill issuance and borrowing from the Corporation for Public Deposits. To date, Treasury bills with maturities of 3, 6, and 9 months have been issued. To further develop the yield curve, a 1-year maturity Treasury bill will be considered.

In 2008/09 short-term loans increased by R13.2 billion, at an average yield of 11.1 per cent, compared with a projected 9.6 per cent.

Treasury bills increased by a net R13.5 billion, while borrowing from the Corporation for Public Deposits decreased by R250 million. Treasury bill net issuance will increase by R15.6 billion in 2009/10, decreasing to R6 billion in 2011/12. Borrowing from the Corporation for Public Deposits will decrease by R150 million in 2009/10.

Domestic long-term loans

Domestic long-term loan issuance in 2008/09 amounts to R39.9 billion

Government's portfolio of domestic long-term loans consists of fixed-income bonds, inflation-linked bonds, floating rate notes and retail bonds. Domestic long-term loan issuance in 2008/09 amounts to R39.9 billion, R9.9 billion higher than projected in the 2008 Budget.

Table 5.6 provides a breakdown of the R30.4 billion in government bonds issued in 2008/09 up to 31 January 2009. Fixed-income bonds remain the major source of financing, constituting 78.5 per cent of total issuance. Inflation-linked bonds account for the remaining 21.5 per cent.

Table 5.6 Domestic long-term market loan issuance, 2008/09

As of 31 January 2009 R million	Cash value	Average yield %	Nominal outstanding
Fixed-income	**23 867**	**9.01**	
R186 (10.5%; 2025/26/27)	9	8.41	63 772
R201 (8.75%; 2014)	1 505	8.72	38 471
R203 (8.25%; 2017)	3 672	9.47	26 259
R204 (8%; 2018)	3 935	9.33	29 469
R206 (7.5%; 2014)	3 788	8.83	16 934
R207 (7.25%; 2020)	4 075	9.00	37 911
R208 (6.75%; 2021)	2 762	8.30	21 963
R209 (6.25%; 2036)	3 741	8.89	15 764
Retail	380	10.26	1 306
Inflation-linked	**6 554**	**2.59**	
R189 (6.25%;2013)	2 261	2.33	36 363
R197 (5.5%; 2023)	2 251	2.91	28 147
R202 (3.45%; 2033)	1 385	2.57	13 004
R210 (2.6%; 2028)	605	2.40	4 091
Retail	52	3.00	65
Total	**30 421**		

R1.4 billion worth of retail bonds purchased since this product was launched

Domestic long-term bond issuance is expected to average R70 billion a year over the next three years (see Table 5.3). In 2009/10 issuance will be in existing bonds. Sales of 2-, 3- and 5- year fixed-income and 3-, 5- and 10- year inflation-linked retail bonds will continue. Since the launch of government's retail bond in 2004, To date, a total of R1.4 billion worth of these bonds have been purchased.

To facilitate settlements in the capital market, government provides the primary dealers in benchmark government bonds with an overnight repurchase facility at a zero per cent return. As of 31 January 2009, repurchase transactions of R11.3 billion were entered into, mainly in the R153 and R157 bonds.

In February 2009, Statistics South Africa (Stats SA) is publishing a rebased and reweighted consumer price index (CPI) that better represents average household consumption spending. The National Treasury will adjust inflation-linked bonds in accordance with the new CPI.

Funding the public sector borrowing requirement

In funding the increase in the public sector borrowing requirement from R90.5 billion in 2008/09 to R185.7 billion in 2009/10, government takes into account the present level of volatility and higher borrowing costs in global markets. The financing strategy also recognises the need to ease funding pressures in the domestic market.

Owing to the strength of South Africa's capital market, most of the borrowing requirement can be financed domestically, using a combination of money market instruments, promissory notes, syndicated loans and bond issuances. Government's average weekly bond issuance will increase to R1.4 billion in 2009/10, marginally higher than the R1.3 billion weekly average in January 2009.

To reduce pressure on the domestic market and ensure an appropriately balanced portfolio, the public sector will also borrow on international capital markets during 2009/10. In addition, indications are that loans of up to US$6.5 billion are available from the World Bank and the African Development Bank.

Government has already started to improve the coordination and sequencing of the public sector's domestic and international issuance programmes, contributing to stability and certainty. Government guarantees will increase the market appetite for the debt of state-owned entities.

Foreign loans

Government intends to borrow about US$1 billion a year in global capital markets

Government intends to borrow about US$1 billion a year in global capital markets to refinance part of foreign maturing loans and interest payments. Government has also entered into a new €1 billion export credit agency financing structure for the purchase of eight Airbus A400M aircraft for the Department of Defence.

In 2008/09, export credit agency drawdowns on arms procurement loan agreements will reach R29.5 billion, or 91 per cent of the total. Drawdowns over the next three years total R2.9 billion, with the final instalment scheduled for 2011/12. In 2008/09 government drew R2 million on a World Bank loan to provide financial and technical support to municipalities.

Cash balances

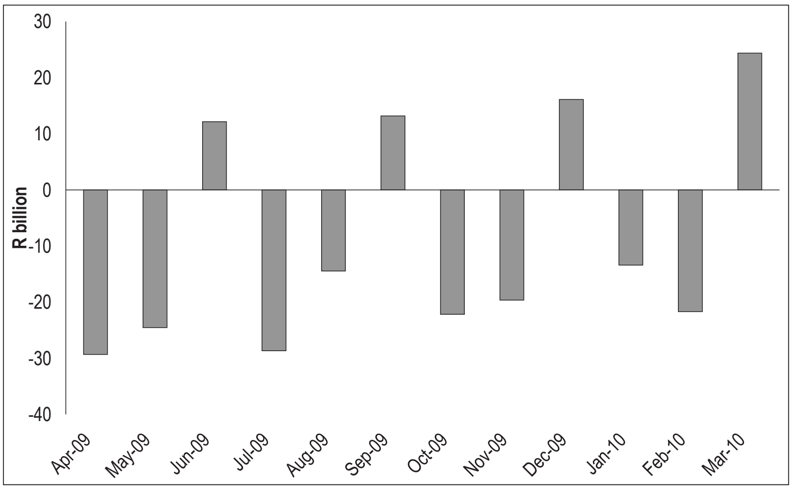
The National Treasury is responsible for maintaining adequate liquidity in the National Revenue Fund and investing surplus cash. Expected monthly cash flow requirements for 2009/10 are shown in Figure 5.5. Cash requirements are higher during the first half of the year.

Sterilisation deposits increase to R66.4 billion in 2008/09

Government's total cash includes deposits held by the Reserve Bank and commercial banks. The Reserve Bank uses the deposits that it holds to "sterilise" the excess cash created in the money market when purchasing foreign exchange reserves. Capitalised interest will increase sterilisation deposits with the Reserve Bank from R63.1 billion in 2007/08 to R66.4 billion in 2008/09.

Operational cash available to finance the borrowing requirement is invested mainly with commercial banks. A year-end operational cash balance of R41.6 billion is expected for 2008/09. In 2009/10 operational year-end cash balances will decrease to R33 billion, a level to be maintained over the two subsequent years in line with government's expected cash requirements.

Figure 5.5 Projected monthly gross surplus/deficit before borrowing, 2009/10[1]



1. *Excludes monthly opening cash balances*

The losses and profits on the foreign exchange activities of the Reserve Bank are accounted for on the GFECRA. The balance on this account is split into transactions with a cash-flow and a non-cash flow impact. Valuation gains increased to a net R97 billion as of 31 December 2008, R72 billion higher than a year earlier.

Valuation gains increased to a net R97 billion at the end of 2008

Government's debt portfolio

Total debt

Net loan debt consists of total domestic and foreign debt less the cash balances of the National Revenue Fund. Debt is affected by the net borrowing requirement, currency fluctuations and changes in cash balances. Total government debt is shown in Table 5.7.

Table 5.7 Total government debt, 2005/06 – 2011/12

End of period	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt	461.5	471.1	480.8	533.5	629.3	722.4	798.5
Foreign debt[1]	66.8	82.6	96.2	95.2	107.3	111.3	120.0
Gross loan debt	**528.3**	**553.7**	**577.0**	**628.7**	**736.6**	**833.7**	**918.5**
Less: National Revenue Fund bank balances	-58.2	-75.3	-93.8	-108.0	-102.0	-105.6	-108.2
Net loan debt[2]	**470.1**	**478.4**	**483.2**	**520.7**	**634.6**	**728.1**	**810.3**
As percentage of GDP :							
Net loan debt	*29.6*	*26.4*	*23.4*	*22.6*	*25.6*	*27.1*	*27.4*
Foreign debt	*4.2*	*4.6*	*4.7*	*4.1*	*4.3*	*4.1*	*4.1*
As percentage of gross loan debt:							
Foreign debt	*12.6*	*14.9*	*16.7*	*15.1*	*14.6*	*13.4*	*13.1*

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

The value of South Africa's inflation-linked bonds is being adjusted to take account of changes in CPI. Up until now, the adjusted capital value has not been included in total debt. Historic numbers were adjusted in Table 8 of Annexure B since the first issuance in 1999/00. By 2011/12 revaluation of inflation-linked bonds will add R55.7 billion to the outstanding debt.

Foreign debt as a percentage of GDP falls to 4 per cent in 2011/12

In 2008/09, net loan debt is expected to increase by R37.5 billion to R520.7 billion or 22.6 per cent of GDP, reaching a projected R810.3 billion or 27.4 per cent of GDP in 2011/12. Government's foreign debt as a percentage of GDP is estimated to decline to about 4 per cent of GDP over the same period. Foreign debt as a percentage of gross loan debt will average 13.7 per cent over the medium term.

Maturity and composition of government debt

Average maturity of domestic bonds has increased to 11.2 years

Table 5.8 sets out the average maturity and duration of domestic marketable bonds. The average maturity increased from 8.6 years in 2007/08 to 11.2 years in 2008/09. The weighted average term (duration) of interest and redemption cash flows increased from 5.5 years in 2007/08 to 7.4 years for 2008/09. This can be ascribed to switches from short- to longer-dated bonds, higher issuance of longer-dated bonds and lower interest rates.

Table 5.8 Maturity distribution of domestic marketable bonds, 2006/07 – 2008/09

Years to maturity	2006/07	2007/08	2008/09	
			Estimates	
Percentage of total	Portfolio[1]		Funding[2]	Portfolio[1]
0 – 3	21.7	21.4	–	2.1
3 – 7	24.7	32.6	22.7	29.5
7 – 10	23.6	14.8	23.5	16.2
10 – 19	20.8	22.5	29.8	44.8
Longer than 19	9.2	8.7	24.0	7.4
Years				
Average duration[3]	5.4	5.5	8.3	7.4
Average maturity	8.4	8.6	12.9	11.2

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

Table 5.9 shows the composition of domestic debt by various funding instruments, which are broadly categorised as bonds and Treasury bills. The foreign debt portfolio is concentrated in Euro- and US dollar-denominated instruments, which account for 84.6 per cent of the total foreign debt.

Table 5.9 Composition of domestic debt by instrument, 2005/06 – 2008/09

End of period	2005/06	2006/07	2007/08	2008/09
R billion		Outcome		Estimate
Bonds	**419.1**	**423.6**	**427.7**	**467.4**
Fixed-income	349.2	351.5	350.8	374.6
Floating rate	11.4	4.8	4.8	7.8
Zero coupon	2.2	2.1	2.2	2.1
Inflation-linked	54.5	63.7	68.6	81.5
Retail	1.8	1.5	1.3	1.4
Treasury bills	**41.9**	**47.1**	**52.9**	**66.0**
Shorter than 91-days[1]	1.4	1.3	1.0	0.7
91-days	28.0	29.7	31.7	37.7
182-days	7.8	9.0	10.4	14.3
273-days	4.7	7.1	9.8	13.3
Other[2]	**0.5**	**0.4**	**0.2**	**0.1**
Total	**461.5**	**471.1**	**480.8**	**533.5**

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

Sovereign credit rating outlook

During the fourth quarter of 2008 the freezing up of international credit markets increased pressure on rating agencies to communicate the impact of the changing environment in a more critical way.

One reflection of these developments has been the decision by three ratings agencies (Fitch Ratings, Rating and Investment Information Inc and Standard & Poor's) to revise the outlook for South Africa from stable to negative. While the outlook has been revised downwards, South Africa has not been downgraded. A fourth major agency, Moody's Investors Service, affirmed the rating outlook as positive. The revisions were attributed to the country's large current account deficit, fears of economic deterioration and political uncertainty ahead of the 2009 elections. However, government's prudent macroeconomic policies are supportive of South Africa's long-term rating outlook.

Provisions and contingent liabilities

Debt, provisions and contingent liabilities are well within the risk management guideline

The National Treasury has redefined its broad risk management guideline – that net loan debt and contingent liabilities should not exceed 50 per cent of GDP – to include provisions. As of 31 March 2008, net loan debt, provisions and contingent liabilities amounted to 34.4 per cent of GDP, which is also well within the Southern African Development Community's macroeconomic convergence target of 60 per cent of GDP.

Provisions and contingent liabilities are summarised in Table 5.10. Provisions are liabilities for which the payment date or amount is uncertain. The provisions for the multilateral institutions are the unpaid portion of government's subscription to these institutions, which are payable on request. Contingent liabilities may or may not be incurred, depending on future events. In 2007/08 provisions increased by R6.2 billion to R50.5 billion, mainly as a result of increased subscription commitments to the International Monetary Fund and the World Bank. Contingent liabilities decreased by R8.4 billion to R177.1 billion, owing largely to improvements to the actuarial position of the Government Employees Pension Fund.

Table 5.10 Composition of provisions and contingent liabilities, 2005/06 – 2007/08

End of period R billion	2005/06	2006/07	2007/08
Provisions	**41.5**	**44.3**	**50.5**
Special Drawing Rights	0.8	0.8	0.8
International Monetary Fund	17.2	16.7	20.1
International Bank for Reconstruction and Development	9.5	11.1	12.4
Multilateral Investment Guarantee Agency	–	0.1	0.1
African Development Bank	6.5	7.7	8.6
Leave credits	7.5	7.9	8.5
Contingent liabilities	**160.0**	**185.5**	**177.1**
Guarantees	67.9	67.8	64.5
Post-retirement medical assistance[1]	37.0	56.0	56.0
Road Accident Fund[1]	21.4	23.9	30.3
Government pension funds[1]	12.8	12.8	–
Claims against government departments	9.1	11.8	10.9
Export Credit Insurance Corporation	7.2	10.9	12.7
Unemployment Insurance Fund[1]	2.3	2.0	2.3
SASRIA reinsurance cover	1.0	–	–
Other[2]	1.3	0.3	0.4
Total	**201.5**	**229.8**	**227.6**

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

Government's guarantee exposure is expected to increase by R27.1 billion in 2008/09, mainly as a result of guarantees for existing Eskom debt of R26 billion. Guarantee fees of R51.2 million were received from state-owned entities. Details of guarantee commitments from 2004/05 to 2007/08 are set out in Table 9 of Annexure B.

State debt cost

The volume of debt, new borrowing requirements, interest rates, inflation rates and the value of the currency influence the total cost of state debt. Table 5.11 summarises trends and projections to 2011/12.

Table 5.11 State debt cost, 2007/08 – 2011/12

	2007/08	2008/09		2009/10	2010/11	2011/12
R million	Outcome	Budget	Revised	Medium-term estimates		
Domestic	48 248	46 637	48 741	49 301	53 968	59 921
Foreign	4 629	4 599	5 540	5 967	6 172	6 905
Total	**52 877**	**51 236**	**54 281**	**55 268**	**60 140**	**66 826**
State debt cost as percentage of :						
GDP	*2.6*	*2.2*	*2.4*	*2.2*	*2.2*	*2.3*
GDP-accrual[1]	*2.7*	*2.4*	*2.6*	*2.4*	*2.4*	*2.4*
Revenue	*9.4*	*8.2*	*8.9*	*8.6*	*8.5*	*8.6*

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

In 2008/09, state debt cost is estimated to be R3 billion higher than the budgeted amount due to higher borrowing requirements, a weaker-than-expected currency and higher interest rates. State debt costs are projected to increase to R66.8 billion by 2011/12. However, state debt cost as a percentage of GDP is projected to decline from 2.6 per cent in 2007/08 to 2.4 per cent in 2008/09, averaging 2.2 per cent over the medium term. Measured as a percentage of revenue and expenditure, debt service costs will continue to decline.

Asset management

Capital structure and dividend policies of state-owned entities to be reviewed in 2009/10

Over the past several years the National Treasury has reviewed the business model of state-owned entities. These reviews, along with capital structure and dividend policies approved by Cabinet in 2005, will inform the financing programmes of the entities in the period ahead. The National Treasury will, in consultation with the relevant executive authorities, review the individual capital structure and dividend policies of state-owned entities from 2009/10.

Policy stance on guarantees for state-owned entities

Under normal circumstances state-owned entities should operate on the strength of their own balance sheets. Exposure to the financial discipline of debt to achieve operational efficiency has reduced the amount drawn on government guarantees from R84.7 billion in 2001/02 to R64.5 billion in 2007/08.

If, however, a clear need for shareholder support is identified, a guarantee to provide security for borrowing can be considered, provided that a sound business plan is in place to ensure long-term financial sustainability. In the present economic environment government intends to sustain its capital investment programme financed mainly on the balance sheets of the state-owned entities. In addition, it is important that these investments take place at as low a cost as possible.

Requests for guarantees from various state-owned entities are under consideration. In extending guarantees, government remains mindful of its guideline for total debt, provisions and contingent liabilities.

Over the next five years, major state-owned entities plan to spend R669.4 billion on infrastructure. Of this amount, Eskom projects total about R356 billion, and Transnet projects total R81 billion. Government will continue to support the broader public sector to sustain investment in infrastructure projects.

Assistance to Eskom

Government is providing Eskom with a deeply subordinated loan on flexible terms

During 2008, government finalised the key features of its R60 billion support package for Eskom. Funding is to be provided in the form of a 30-year, deeply subordinated loan. Eskom will ultimately be required to repay the principal loan with interest. However, the interest payments are structured flexibly based on the yield of the R209 (6.25%; 2036) bond, plus a margin. Eskom will only be required to service interest on the loan if its credit profile supports an investment grade rating. Financial modelling shows that Eskom will become cash positive after 10 years, and to entice refinancing of the loan the interest rate is stepped up by 25 basis points after year 10.

Additional funding for Eskom from World Bank is being considered

The funding will be provided to Eskom in the following manner: R10 billion in 2008/09, R30 billion in 2009/10 and R20 billion in 2010/11. The Eskom Subordinated Loan Special Appropriation Act provides for this multi-year appropriation and the first tranche of R5 billion was transferred to Eskom on 31 December 2008. Government will also underwrite Eskom debt of R176 billion, which consists of R26 billion of existing debt and R150 billion in new debt over the next five years. The National Treasury and Eskom are engaged in discussions with multilateral agencies, including the World Bank, to obtain additional funding for the power utility's infrastructure programme.

Assistance to SAA

South African Airways (SAA) initiated a turnaround strategy in 2007/08 to improve profit margins by March 2009. SAA posted a net loss of R1.1 billion for the 2008 financial year largely due to restructuring costs of R1.3 billion and fuel price volatility. Government has allocated R1.6 billion to SAA during 2009/10 to meet restructuring costs and ensure financial sustainability.

Development finance institutions

Review recommends restructuring some DFIs to improve their efficiency and contribution to development

Government completed its review of the development finance institutions (DFIs) in 2008. The review recommends restructuring some DFIs to improve their effectiveness, as well as enhanced government coordination of their mandates and deliverables. Access to loan finance from DFIs, particularly for industrial, bulk infrastructure, housing and agriculture investments, can facilitate the funding of development projects within current market constraints.

The Industrial Development Corporation (IDC) has a strong balance sheet that can be leveraged to fund potential investments of R60 billion over the next five years. As of 31 March 2008, the IDC had share capital of R1.4 billion and reserves of R74.4 billion.

The DBSA can contribute to municipal infrastructure and support smaller state-owned entities

The current balance sheet of the Development Bank of Southern Africa (DBSA) suggests that the bank can provide up to R38 billion in loans to meet infrastructure funding needs. Options to boost this capacity through a range of measures, including increasing the DBSA's callable capital, are being investigated. The DBSA plays a crucial role in providing loan finance for municipal infrastructure.

The Land Bank requires additional support to become sustainable

The new management of the Land Bank has submitted a turnaround strategy to the National Treasury. Progress to date includes the recovery of R474 million of non-performing loans, improved liquidity and the implementation of control systems. Programmes that support emerging farmers and land reform initiatives need to be reinforced by appropriate access to loan finance. To meet these objectives it may be necessary for government to inject additional capital into the Land Bank to ensure that it operates on a financially sustainable basis.

Conclusion

For the medium-term period ahead, South Africa will be a net issuer of debt. The resilience and depth of South Africa's bond markets enable government to fund the bulk of the borrowing requirement domestically. In addition to providing a loan to Eskom, government will consider other support for state-owned-entities and DFIs to provide liquidity and to ensure successful implementation of capital investment programmes.