Republic of South Africa
Rating Report

BB+ NEGATIVE OUTLOOK

Credit strengths	Credit challenges
• A large and well-diversified economy • Favourable public-debt profile • Credible monetary-policy framework • Robust financial sector • Access to multilateral support	• Rising government-debt ratio and growing interest burden • Moderate economic growth potential • Governance challenges • Socio-economic vulnerabilities

Rating rationale:

Large and well-diversified economy: South Africa has one of the largest economies (nominal GDP of around USD 399bn in 2023) of the African continent with furthermore comparatively elevated GDP per capita (USD 6,485) as compared with averages of sub-Saharan Africa.

Favourable public debt profile: Public debt mostly denominated in domestic currency, on fixed-rate basis and with long average maturities, mitigating interest-rate, forex and debt roll-over risks.

Credible monetary policy framework: Strong independence and governance support South African Reserve Bank (SARB)'s efficacy in the management of inflation and preserving financial stability.

Strong financial industry: A large and well-regulated financial industry supports economic development and resilience to external shocks, and mitigates government funding dependencies upon fickle international markets. However, an emerging sovereign-bank nexus is a concern.

Ratings challenges include: i) a rising debt burden in view of elevated primary expenditure, growing interest costs and contingent liabilities; ii) modest economic growth potential, enervated by unsatisfactory energy infrastructure and elevated unemployment; iii) governance challenges; and iv) socio-economic risks hindering structural reform.

South Africa's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	bb-	ZAR [+0]	0	BB+
Public Finance Risk		20%	b+		-1/3	
External Economic Risk		10%	bbb		+1/3	
Financial Stability Risk		10%	aaa		+1	
ESG Risk	Environmental Factors	5%	cc		0	
	Social Factors	7.5%	a-		-1/3	
	Governance Factors	12.5%	ccc		0	
Indicative outcome		**bb**			**+1**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Negative Outlook reflects our view that risks to the ratings are skewed to the downside over the next 12-18 months.

Positive rating-change drivers	Negative rating-change drivers
• Stabilisation of public-debt trajectory • Reforms raise economic growth potential • External-sector risk profile improves	• Public-debt burden deteriorates further • Growth outlook stays impaired • External-sector risks rise • Governance challenges escalate

Ratings and Outlook

Foreign currency

Long-term issuer rating	BB+/Negative
Senior unsecured debt	BB+/Negative
Short-term issuer rating	S-3/Stable

Local currency

Long-term issuer rating	BB+/Negative
Senior unsecured debt	BB+/Negative
Short-term issuer rating	S-3/Stable

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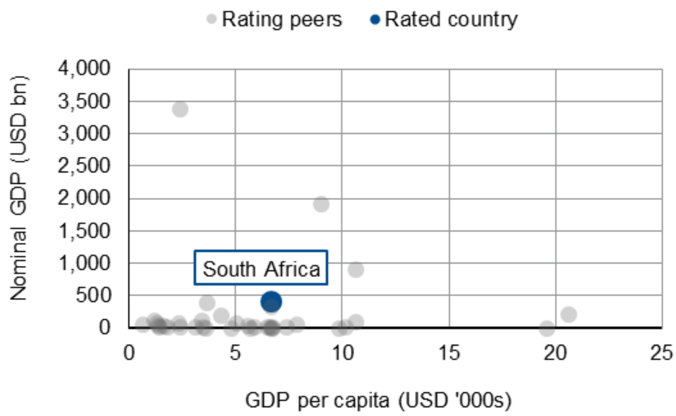
Domestic Economic Risks

- **Growth outlook:** Following a post-Covid rebound (4.9% growth in 2021), GDP growth eased to 2% in 2022 with slowdown across economic sectors, especially in mining and manufacturing. This reflected rising input costs, lower export demand alongside supply-chain disruptions. The government's capacity to materially support the economy and anchor recovery from the Covid-19 crisis is constrained by narrow fiscal space. We foresee output growth of 0.8% this year, before a rebound to 1.8% next year, as volatility in international economic conditions adds to persistent domestic vulnerabilities to electricity-production disruptions and transport network difficulties. Long-run growth potential is estimated at 1.5% a year despite annual working-age population changes of 1.5% a year estimated by the OECD over 2023-28. However, South Africa's economy is large and well diversified – with significant tertiary (67% of value added) and manufacturing (16%) sectors. The economic reform agenda begun in October 2020 (Operation Vulindlela) is the most ambitious and integrated programme to date and should help address economic challenges. As of Q3 2022, almost 50% of reform milestones are either completed or on track to be completed.
- **Inflation and monetary policy:** Inflation picked up modestly to 7.1% in March 2023. There has been a decrease in fuel prices, although food prices remain high. As importantly, core inflation edged up to 5.2% YoY in March – the highest level since February 2017. We expect headline inflation to average 6.1% in 2023 after 7% last year, before declining to 5% in 2024. The policy rate has been raised nine times since November 2021, most recently by 50bps to 7.75% last month. We expect the central bank to further hike rates to 8.25% during 2023 before cutting rates to 7.25% by the end of 2024.
- **Labour market:** The unemployment rate is structurally elevated at 32.7% in Q4 2022, and youth unemployment is 61%. We project national unemployment to average 33% over 2023 and 2024, as the economic slowdown weighs on employment prospects. We see the jobs crisis persisting medium run given population growth near output growth and outstanding labour-market skills shortages. Labour-market inflexibility, reflecting heavy unionisation across public and private sectors, constitutes a significant challenge for productivity and investment growth.

Overview of Scope's qualitative assessments for South Africa's *Domestic Economic Risks*

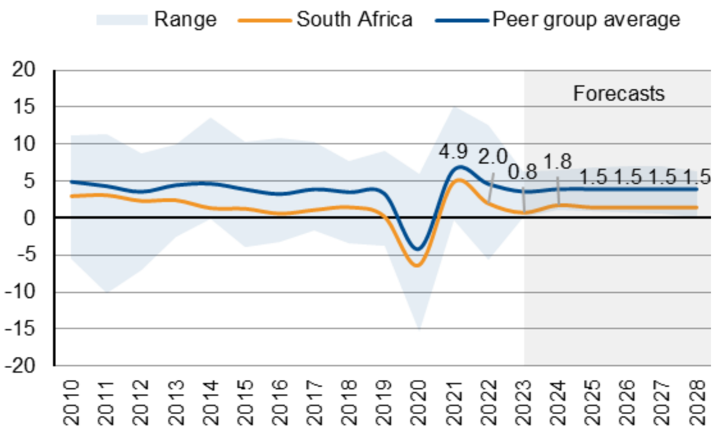
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Growth potential of the economy	Weak	-1/3	Energy and infrastructure bottlenecks and rigid labour markets dampen productivity, investment and long-run economic growth
	Monetary policy framework	Strong	+1/3	Effective management of inflation supported by strong, independent central bank and robust monetary policy framework
	Macro-economic stability and sustainability	Neutral	0	Large and highly-diversified economy anchors resilience to economic shocks, but inflexible labour market and chronic electricity shortages

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

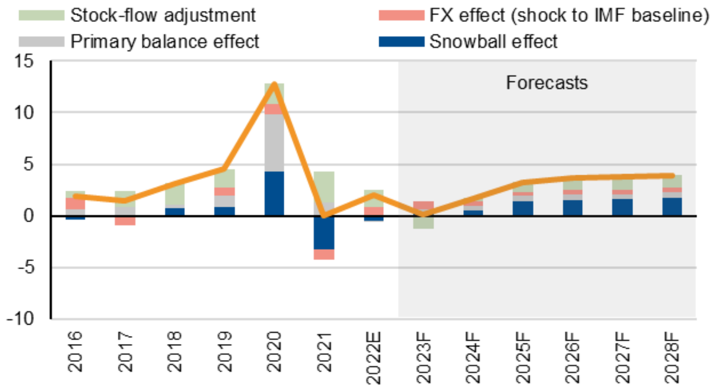
Public Finance Risks

- **Fiscal outlook:** We foresee a general government fiscal deficit of 5.5% of GDP in FY2023/24, after said deficit declined to 4.5% in FY2023/24, with the primary account assumed to be slightly in deficit at -0.5% of GDP from FY2023/24 to the end of our forecast period (FY2028/29). This comes after higher-than-anticipated revenue collections in FY2021/22, which lowered the deficit to 6% of GDP, from 10% of GDP in FY20/21. The 2023 Budget delivers a ZAR 254bn debt relief for Eskom, the largest national energy utility, over the next three years, to ease pressures on the company's balance sheet and support broader industry restructuring. However, this will adversely affect efforts to stabilise the public-debt ratio. Spending rises – mostly related to debt service, social programmes and support for state-owned companies – and non-observation of nominal expenditure ceilings since FY2018/19 represent a core credit weakness – calling into question the reliability of the fiscal framework. Inflation-linked domestic debt (26% of domestic bonds), high demand for transfers and subsidies, and long-standing demands for public investment weigh on medium-run fiscal sustainability. However, the reorganisation of the South African Revenue Service could hike national government revenues (from 28% of GDP). South Africa's fiscal framework, such as spending ceilings and strong transparency support debt sustainability.
- **Debt trajectory:** We expect the general government debt ratio to rise to 76.1% of GDP by 2025, before reaching 87.5% by 2028. Hence, a government expectation for public debt to peak at 73.6% by FY2025/26 – although postponed and revised up already compared with a 71.1% peak the National Treasury had earlier projected by FY2022/23 – continues to appear optimistic. General government debt to GDP was only 24% as of 2008. Net interest payments amount to around 18% of general government revenue in 2023 but could reach 28% by 2028, compared with lows of 8% as of 2008.
- **Market access and debt structure:** Public debt is mostly fixed-rate (73% of the domestic debt securities), denominated predominantly in rand (around 87%) and with a long average maturity (of 12 years). This sound public-debt structure curtails interest-rate, forex and debt roll-over risks amid global monetary tightening and current rand volatility. However, long-term sovereign yields have risen by well over 100bps since April of last year. South Africa remains vulnerable to global policy tightening and shifts in market sentiment as non-resident investors continue to hold around 25% of domestic bonds as of March 2023 – despite recent significant exits of such international investors.

Overview of Scope's qualitative assessments for South Africa's *Public Finance Risks*

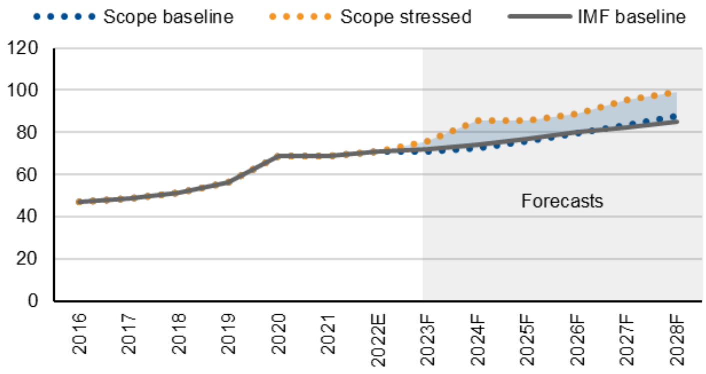
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Fiscal policy framework	Weak	-1/3	The national fiscal framework has been undermined during recent years due to overspending and has failed to curtail rising debt
	Debt sustainability	Weak	-1/3	Steady rise of the public-debt burden, which is elevated by emerging-market standards
	Debt profile and market access	Strong	+1/3	Mostly local-currency denominated debt with long average maturities but high borrowing rates; deep domestic capital markets

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

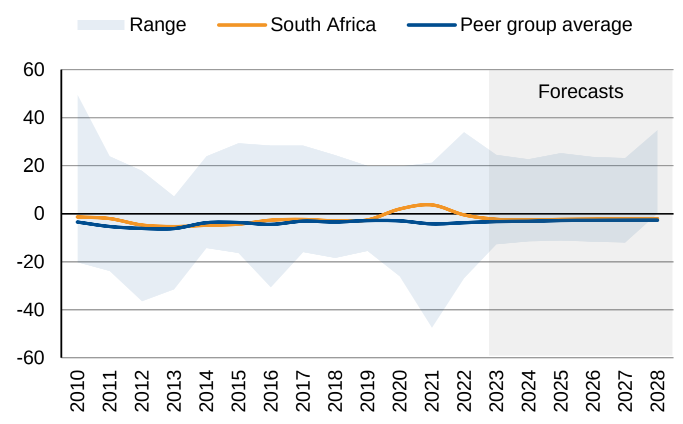
External Economic Risks

- **Current account:** After two consecutive years of surpluses, the current-account balance returned to a deficit of 0.5% of GDP in 2022. This was due to lowered export volumes and prices, while the value of imports continued to rise as import prices rose. We expect a correction in export commodity prices and higher imports to persist in 2023. The trade balance has been exposed to operational disruptions at local petroleum refineries from delays in oil supplies, as well as the transport company Transnet's strikes hampering rail freight and port operations. Pre-pandemic annual current-account deficits were predominantly funded via substantive portfolio equity and debt investment. The external sector of South Africa has been strengthened recently; however, it remains vulnerable during phases of global crises and emerging-market capital outflows.
- **External position:** South Africa's net international investment position represents a core differentiating factor in South Africa's favour when compared against emerging-market ratings peers. It amounted to 17% of GDP as of Q4 2022, an increase from lows of 4.2% of GDP at the beginning of last year, given a smaller decrease in foreign assets than in foreign liabilities. External debt has been held to only 39% of GDP as of Q4 2022 with only half of this debt in foreign currency. Nearly 80% of external debt is long-term.
- **Resilience to short-term external shocks:** South Africa's floating exchange rate enables rand depreciation to act as a shock absorber during crises and limit the drawdown of official reserves. Foreign-exchange reserves (of USD 47bn as of February 2023) cover 87% of short-term foreign debt, stronger than an average coverage of 56% in 2022, but still weaker than the above 100% as of the early 2010s. Constructively, the central bank has a long-running policy of restraint from interventions in foreign-exchange markets. The nominal effective exchange rate of rand has depreciated 8% since the start of this year. The impact of the severe electricity load-shedding on growth and investor sentiment was furthermore reflected in the rand's value. Rand is the most actively traded of the African continent and, according to the 2022 Bank for International Settlements triennial survey, contributed at least 1% of global foreign-exchange market turnover.

Overview of Scope's qualitative assessments for South Africa's *External Economic Risks*

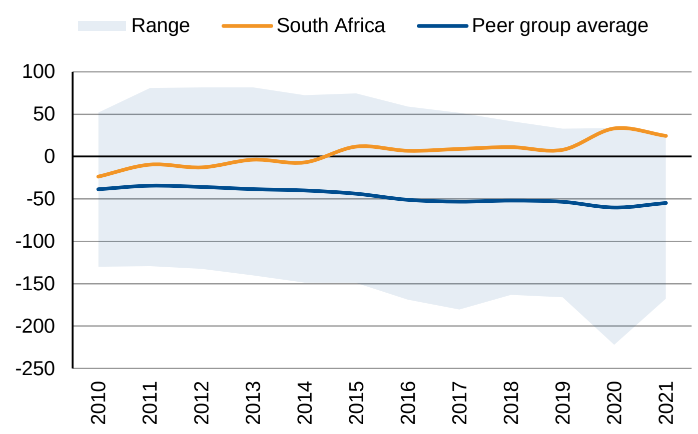
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Current account resilience	Neutral	0	Current-account surpluses after the Covid-19 crisis have re-reverted to a deficit. Vulnerability to global crises and capital outflows.
	External debt structure	Strong	+1/3	Manageable levels of external debt with a strong external debt structure
	Resilience to short-term external shocks	Neutral	0	Moderate levels of foreign-currency reserves, but strengthened coverage of short-term external debt. Vulnerability to large and sustained capital outflows, but floating exchange-rate regime is a shock absorber. Access to multilateral liquidity channels.

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

Financial Stability Risks

- **Banking sector:** The banking sector, with total assets amounting to 109% of GDP as of 2022, is strong but concentrated, with the top-five banks holding about 90% of system-wide assets. Banking-system fundamentals are sound as reflected in a strong tier-1 ratio (15% of risk-weighted assets as of February 2023). Sound bank fundamentals aid resilience against some deterioration in asset quality amid rising rates. Non-performing loans (NPLs) rose to a still moderate 4.8% of gross loans in February. The sound financial system is supported by the regulatory oversight of SARB with a domestic financial framework in line with Basel-III requirements. Nevertheless, the economy faces regulatory weaknesses in its money laundering oversight.

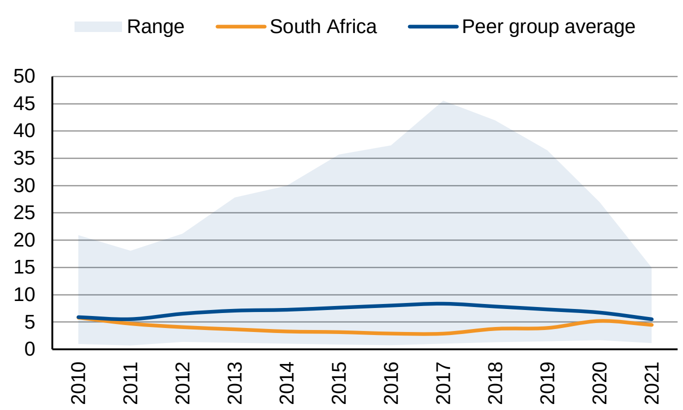
- **Private debt:** Indebted households (household debt amounted to 47% of net disposable income as of December 2022) are vulnerable to shocks to their incomes during present economic slowdown and a rising cost of living, as well as to higher interest rates. However, corporate debt (31% of GDP as of February 2023) is low by comparison with that in ratings peers' economies.

- **Financial imbalances:** Domestic banks' exposures to South African government bonds have risen (from holding 14% of domestic government bonds as of March 2018 to 20% by March 2023) while holdings of "other" South African financial institutions rose even more substantially (to holding 23% of South African domestic bonds in March 2023, from 9% as of June 2017). This is as non-resident investors exited (from 43% as of March 2018, reaching 25% by March 2023), aggravated recently by global rates tightening. Deep domestic financial markets make available to domestic banks access to significant liquidity – and reduce their dependency on foreign-currency financing – curtailing exposures to large-scale refinancing risks or sudden reversals in international investor sentiment. However, an increasing sovereign-bank nexus represents an emerging concern.

Overview of Scope's qualitative assessments for South Africa's *Financial Stability Risks*

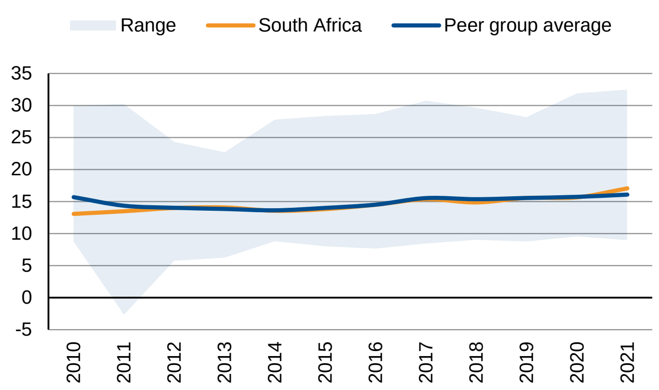
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Strong	+1/3	Robust funding structure with well-developed and deep domestic capital markets
	Banking sector oversight	Strong	+1/3	Well-regulated and resilient banking sector with strong oversight from South African Reserve Bank in line with Basel-III requirements
	Financial imbalances	Strong	+1/3	Moderately indebted households, but corporate debt levels are low; rising sovereign-bank nexus; curtailed dependency of the banks on financing from international investors

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

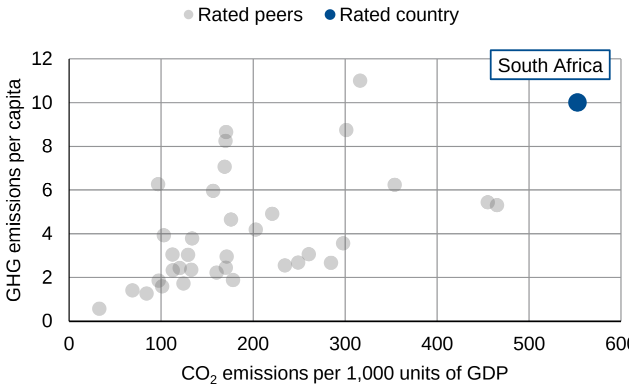
ESG Risks

- **Environment:** Challenges in the transition to a decarbonised energy architecture given consequences of said transition for the core mining and manufacturing sectors. Reducing heavy reliance on coal (which accounts for 70% of energy and 80% of electricity), diversifying the energy mix, and investing in renewables are priorities. International donors will mobilise USD 8.5bn to initiate the first part of the Just Transition Energy Investment Plan presented during COP27 for coal phase-out and de-carbonisation. However, the complete funding – estimated at USD 98bn – still needs to be finalised. Rehabilitation of domestic electricity production capacity, such as extension of the life of the Koeberg nuclear power station, coupled with raising supply via renewable energies, through the Independent Power Producer Programme, will require multi-billion-rand investment.
- **Social:** Structural socio-economic vulnerabilities are reflected in high income inequalities and elevated poverty (40% of the population) and unemployment. Absent reforms of the labour market and professional training system, we expect tensions around elevated youth unemployment to persist given poor employment opportunities. South Africa benefits from a benign old-age dependency ratio, due nevertheless to rise from 9.6% as of 2020 to 17.4% by 2050 under the UN's medium-fertility scenario. Demand for social spending ought to stay elevated as illustrated during debate recently around making permanent the Covid-era Social Relief of Distress grant introduced May 2020 and recently extended to March 2024.
- **Governance:** The ruling African National Congress (ANC) is at risk of missing out on an absolute majority in 2024 general elections, as its polling continues to weaken over a perceived failure to deliver quality and inclusive services and create jobs. A fragmented opposition, however, is likely to lead to ANC retaining power. Reports of state capture were reemphasised in the decision of the Financial Action Task Force to list South Africa as a "jurisdiction under increased monitoring". National Treasury's decision earlier this month to lift some disclosure requirements and move the disclosure of irregular, fruitless and wasteful expenditure instead to Eskom's annual report for three years – before promptly withdrawing this exemption upon critique – underscores underlying governance risks. Acceleration of the Zondo Commission's core structural-reform recommendations might enhance perceptions around the control of corruption and bolster the investment climate.

Overview of Scope's qualitative assessments for South Africa's *ESG Risks*

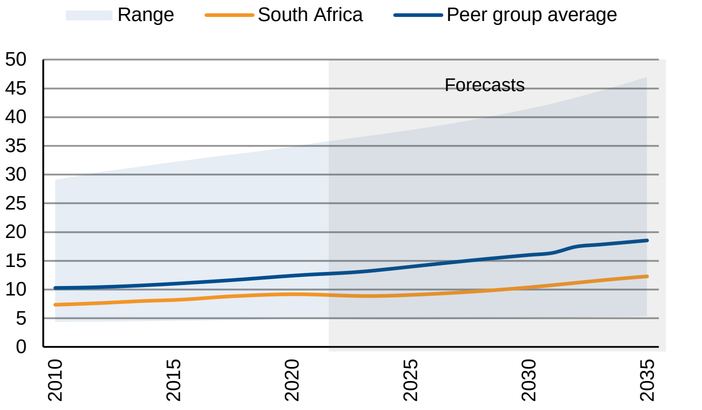
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b-	Environmental factors	Neutral	0	Significant greenhouse gas emissions and transition costs as compared with economies of sovereign ratings peers
	Social factors	Weak	-1/3	Acute socio-economic risks amid elevated poverty and unemployment; below-average education and health outcomes
	Governance factors	Neutral	0	Comparative political stability; governance challenges remain – illustrated in the brief lifting of some of Eskom's disclosure requirements

CO_2 emissions per GDP and per capita, $mtCO_2e$



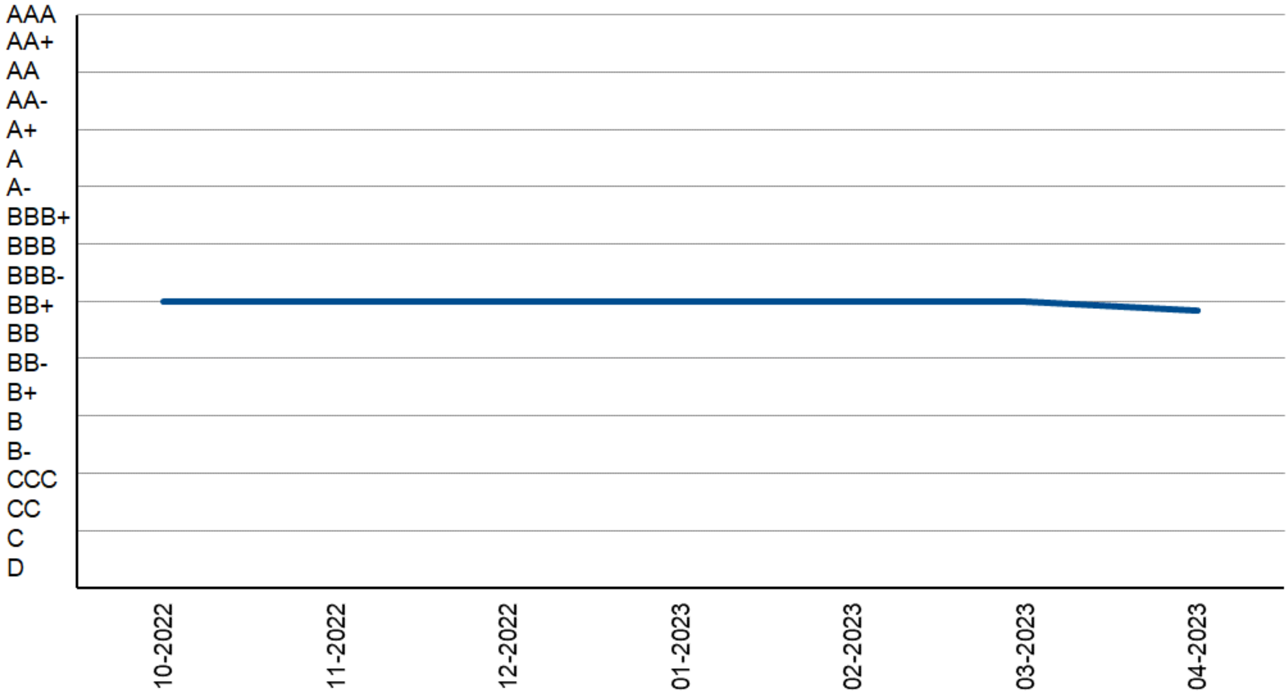
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Georgia
Greece
Turkey

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected indicators

This table presents a selection of the macro indicators considered during Scope's ratings process, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other select international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022	2023
Domestic Economic	**GDP per capita, USD '000s**	IMF	7.0	6.6	5.7	7.0	6.7	6.5
	Nominal GDP, USD bn	IMF	404.0	388.4	337.5	418.9	405.7	399.0
	Real growth, %	IMF	1.5	0.3	-6.3	4.9	2.0	0.1
	CPI inflation, %	IMF	4.6	4.1	3.3	4.6	6.9	5.8
	Unemployment rate, %	WB	24.2	25.5	24.3	28.8	-	-
Public Finance	**Public debt, % of GDP**	IMF	51.7	56.2	69.0	69.0	71.0	72.3
	Interest payment, % of revenue	IMF	12.8	13.4	16.3	15.6	16.4	18.5
	Primary balance, % of GDP	IMF	-0.4	-1.1	-5.5	-1.3	0.1	-0.8
External Economic	**Current account balance, % of GDP**	IMF	-2.9	-2.6	2.0	3.7	-0.5	-2.3
	Total reserves, months of imports	IMF	4.8	5.4	7.1	5.6	-	-
	NIIP, % of GDP	IMF	11.2	8.0	33.3	24.4	15.6	-
Financial Stability	**NPL ratio, % of total loans**	IMF	3.7	3.9	5.2	4.5	-	-
	Tier 1 ratio, % of risk-weighted assets	IMF	14.9	15.2	15.0	15.9	16.8	-
	Credit to private sector, % of GDP	WB	118.7	117.9	111.2	-	-	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	582.6	586.1	569.5	552.6	-	-
	Income share of bottom 50%, %	WID	5.8	5.8	5.3	5.3	-	-
	Labour-force participation rate, %	WB	60.0	60.1	-	-	-	-
	Old-age dependency ratio, %	UN	8.9	9.1	9.2	9.1	9.0	8.9
	Composite governance indicators*	WB	0.0	0.1	0.1	0.0	-	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging Market and Developing Economies
5y USD CDS spread (bps) as of 20 April 2023	291.5

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