

SOVEREIGN RISK MONITORING AND MANAGEMENT

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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Background

- **Why are we rated?**
 - Independent assessment of the country's credit worthiness.
 - Influence investor sentiment.
 - Benchmark SA against peers.
- **Importance of having a good rating**
 - Lower cost of borrowing.
 - Ease of access to foreign markets.
- **The aim of internal methodology**
 - pro-actively monitor, identify and measure the risk factors which constrain the sovereign rating.
 - use the findings of the methodology to decide on the mitigation strategies.
 - use the findings of the methodology to formulate the strategy to be communicated to the rating agencies during the rating reviews in order to secure best possible outcomes.

Current ratings assigned to SA by major credit rating agencies

		Moody's	S&P	Fitch	R&I
Low Risk	Investment Grade	Aaa	AAA	AAA	AAA
		Aa1	AA+	AA+	AA+
		Aa2	AA	AA	AA
		Aa3	AA-	AA-	AA-
		A1	A+	A+	A+
		A2	A	A	A
		A3	A-	A-	A-
		Baa1(-ve outlook)	BBB+	BBB+	A- (stable outlook)
		Baa2	BBB (-ve outlook)	BBB (Stable outlook)	BBB
		Baa3	BBB-	BBB-	BBB-
High Risk	Speculative \ Non-Investment Grade	Ba1	BB+	BB+	BB+
		Ba2	BB	BB	BB
		Ba3	BB-	BB-	BB-
		B1	B+	B+	B+
		B2	B	B	B
		B3	B-	B-	B-
		Caa1	CCC+	CCC+	CCC+
		Caa2	CCC	CCC	CCC
		Caa3	CCC-	CCC-	CCC-
		Ca	CC	CC	CC
		C	C	C	C
		D	D	D	D

Current rating
 Rating prior to downgrade
 First rating in 1994

Source: National Treasury

Internal sovereign risk monitoring and measurement tools

- Semi-annual sovereign risk analysis and rating methodology;
- Monthly sovereign risk highlights reports; and
- Monthly credit evaluation and probability of default reports.

Key rating indicators

Economic structure and performance component	Government finance	External payment and debt	External vulnerability	Socio-economic environment
<ul style="list-style-type: none"> ▪ Real Gross Domestic Product (GDP), ▪ Inflation rate ▪ Gross investment (% of GDP) ▪ Gross domestic savings (% of GDP) ▪ Gross Domestic Product per Capita 	<ul style="list-style-type: none"> ▪ Ratio of government revenue to GDP ▪ Ratio of government expenditure to GDP ▪ Ratio of government debt to GDP 	<ul style="list-style-type: none"> ▪ Current account deficit (CAD) ▪ Ratio of external debt to GDP ▪ Level of official foreign reserves 	<ul style="list-style-type: none"> ▪ External vulnerability indicator (EVI) 	<ul style="list-style-type: none"> ▪ Human Development Indicator (HDI) ▪ Unemployment ▪ Income inequality (Gini coefficient) ▪ Access to electricity, water, and sanitation ▪ HIV/Aids ▪ Political developments

Source: National Treasury

Empirical example - internal risk rating methodology (risk scoring)

Rating Components	Weights	2010				Priority Methodology		
		Median	South Africa	Risk rating	weighted risk rating	Strategic importance	Risk priority	Ease of measure
Economic structure and performance								
Gross Domestic Saving/GDP	125	24.00	22.00	6.00	0.34	5	5	5
Gross Investment/GDP	125	23.00	23.00	6.00	0.34	5	5	5
Inflation (%cpi) - headline	100	3.00	3.50	7.00	0.32	5	4	5
GDP growth (% change)	125	4.00	2.60	5.00	0.28	5	5	5
GDP per Capita	125	11.60	7.70	4.00	0.23	5	5	5
Government Finances								
Government revenue/GDP	125	34.00	34.00	7.00	0.39	5	5	5
Government expenditure/GDP	125	37.00	33.00	7.00	0.39	5	5	5
Government debt/GDP	125	46.00	33.00	8.00	0.45	5	5	5
External Payments and Debt								
Current account balance/GDP	125	-3.20	-3.30	4.00	0.23	5	5	5
External debt/GDP	125	32.00	22.00	8.00	0.45	5	5	5
Official Foreign reserves	125	82.00	43.80	5.00	0.28	5	5	5
Monetary, external vulnerability and liquidity								
External vulnerability indicator	125	75.00	63.00	8.00	0.45	5	5	5
Socio-economic environment								
Human Development Index (HDI)	125			4.00	0.23			
Unemployment	125		24.00	5.00	0.28	5	5	5
HIV/AIDS	80			6.00	0.22	5	4	4
Income inequality (Gini coeff)	100		0.69	3.00	0.14	5	5	4
Skill development (Education Budget as % of GDP)	30		7.00	7.00	0.09	5	3	2
Political environment								
Free elections	125			8.00	0.45	5	5	5
Institutional independence	30			7.00	0.09	5	3	2
Leadership succession	100			7.00	0.32	5	5	4
Risk of war	30			7.00	0.09	5	3	2
Total	2220				6.05			

Empirical example - monthly credit evaluation and probability of default report

SUMMARY TABLE

(Hover cursor over headings for instructions)

COUNTRY	Date	PD %	5 YR CDS spread (bp)	CDS PD Implied Rating	S&P	Moody's	Fitch	R&I	
South Africa	6/4/2013	11.88	187.36	BBB/Baa2	BBB	Baa1	BBB	A-	Button 6
Brazil	6/4/2013	9.49	148.34	BBB+/Baa1	BBB	Baa2	BBB	BBB	Button 7
Bulgaria	6/4/2013	7.17	110.41	A/A2	BBB	Baa2	BBB-	#N/A N/A	Button 9
Colombia	6/4/2013	7.00	107.51	A/A2	BBB	Baa3	BBB-	BBB-	Button
Croatia	6/4/2013	18.74	309.67	BB/Ba2	BB+	Ba1	BBB-	BBB	Button
Czech Republic	6/4/2013	3.62	54.84	AA-/Aa3	AA-	A1	A+	A	Button
Estonia	6/4/2013	4.94	60.68	A+/A1	AA-	WR	A+	#N/A N/A	Button
Hungary	6/4/2013	17.25	284.34	BB+/Ba1	BB	Ba1	BB+	BBB-	Button
Kazakhstan	6/4/2013	10.90	169.64	BBB+/Baa1	BBB+	WR	BBB+	#N/A N/A	Button
Latvia	6/4/2013	7.55	115.87	A/A2	BBB	Baa2	BBB	BBB	Button
Lithuania	6/4/2013	7.46	114.62	A/A2	BBB	Baa1	BBB+	#N/A N/A	Button
Mexico	6/4/2013	6.71	103.00	A/A2	BBB	Baa1	BBB+	BBB	Button
Panama	6/4/2013	6.83	104.70	A/A2	BBB	Baa2	BBB	#N/A N/A	Button

Areas of improvement and vulnerability identified by the methodology (recent analysis)

Areas of improvement

Government Expenditure

Spending which reprioritise capital investment over recurrent spending

Political Environment:

Transparent and smooth political leadership succession

Policy Certainty, Predictability & Transparency

From RDP, GEAR, ASGISA to NGP and NDP

Socio-Economic Environment:

Increased roll-out of the HIV/AIDS programmes reflected in the declining rate of infection

Areas of vulnerability

Economic Structure and Performance

Low growth

External Vulnerability

Current account deficit

Government Finances

Budget deficit

Socio-Economic Environment:

Income inequality exacerbated by high levels of poverty and unemployment and low skill base

Level of risk exposure from the areas of vulnerability identified by the methodology



Special Attention:
Moderate to high risk



Marginal:
Moderate risk



Acceptable:
Moderate risk

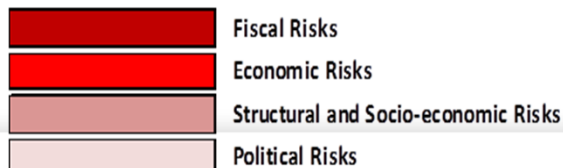
Rating Components	Level
Socio-economic Environment	
Economic Structure and Performance	
External Vulnerability	
Government Finances	
Political Environment	

Source: National Treasury

The evolving risk landscape, 2007 - 2014

(Top 4 domestic risks in terms of impact)

	2007	2008	2009	2010	2011	2012	2013	2014
1st	Infrastructure bottlenecks - Eskom's power supply shortages	Infrastructure bottlenecks - Eskom's power supply shortages	Growth	Growth	Debt sustainability and Budget deficit	labour unrest in the mining sector. Political and policy uncertainty (Mangaung)	Growth	Growth
2nd	Inflation	Growth	Financing of the current account deficit	Financing of the current account deficit	Growth	Slowing growth. Risk to the fiscal consolidation strategy	labour unrest in the mining sector	Fiscal consolidation leading up to national elections
3rd	Policy and political uncertainty - ANC elective conference - Polokwane	Inflation	Triple challenges of unemployment, poverty and inequality	Triple challenges of unemployment, poverty and inequality	Slow implementation of infrastructure	Slow implementation of infrastructure	Inconsistent policy messages from the political leadership. Lack of concrete policy interventions in the mining sector	Implementation of NDP
4th	Triple challenges of unemployment, poverty and inequality	Financing of the current account deficit	Debt sustainability and Budget deficit	Debt sustainability and Budget deficit	Inconsistent policy messages from the political leadership	Financing of the current account deficit	Triple challenges of unemployment, poverty and inequality	Ratings downgrade resulting in higher debt servicing costs



Conclusion

- **Rating constraints**

- Steep socio-economic challenges.
- Fiscal sustainability and growth.



- Poverty.
- High unemployment.
- Wide income disparities.
- Poor general education attainment.

- **Strategic areas to enhance rating**

- Execution of growth policies.
- effective implementation of the National Development Plan (NDP).
- Shifting resources from consumption to infrastructural investment.
- Quality programmes for job creation and implementation.

- **Strategic actions to enhance the sovereign rating**

- Continuous engagements with the CRAs.
- Collaboration inside and outside government .
- Coherence in communicating government's position on policy matters.

THANK YOU