5

Asset and liability management

In brief

- Government's debt management policy has proven resilient in a highly volatile global environment. Prudent policy, and deep and liquid domestic capital markets, will continue to ensure that government is able to finance its borrowing requirement.
- Net debt stock as a share of GDP is expected to be 39.7 per cent in 2013/14, peaking at 44.3 per cent by 2016/17 in line with countercyclical fiscal policy.
- Debt-service costs will remain manageable, stabilising at 3.1 per cent of GDP in 2015/16.
- Government's debt position is sustainable, with a long-dated maturity structure and a low level of foreign currency liabilities.
- In 2013, all major rating agencies affirmed South Africa's investment-grade sovereign credit rating.
- To ensure that the finances of state-owned companies are healthy and well managed, oversight will be strengthened through amendments to Treasury Regulations.

Overview

Flexible debt management strategy minimises interest and repayment risk

Since the start of the global financial and economic crisis in 2008, government's countercyclical fiscal policy and the fiscal space created in previous years have allowed for a widening budget deficit and higher levels of debt to increase infrastructure investment, continue funding social priorities and support the economy.

Government's flexible debt management strategy ensures that additional borrowing minimises interest and repayment risks. These considerations are necessary to maintain a stable debt portfolio and avoid burdening the country with repayment obligations for many years to come, undermining the principle of intergenerational equity.

Borrowing strategy is sufficiently responsive to withstand long-term adjustments

South Africa's borrowing strategy is sufficiently responsive to withstand long-term adjustments in global and domestic capital allocations and short-term market shocks. This strategy was tested over the past year as the US Federal Reserve announced a slowdown in its large-scale bond-buying programme, triggering a global sell-off in emerging-market assets. In

January 2014, non-resident investors were net sellers of R22.4 billion of South African government bonds. However, the financing programme has continued without interruption, with domestic investors taking the global sell-off as an opportunity to increase investments in South African government paper, highlighting the depth of the local bond market.

Government's borrowing requirement decreases to R151 billion in 2016/17

In 2013/14, government's borrowing requirement will be R162.9 billion, R5.6 billion lower than projected in the October 2013 *Medium Term Budget Policy Statement*. It is projected to decrease to R151 billion in 2016/17. Although South Africa's exposure to foreign currency denominated debt remains low, government will raise about US$1.5 billion a year over the medium term in global financial markets.

Diverse debt portfolio, coupled with low coupon rates and declining issuance, helps contain debt-service costs

Financing the borrowing requirement, in combination with inflation and currency devaluation, will increase government's net loan debt from R1.4 trillion in 2013/14 (39.7 per cent of GDP) to R2 trillion by 2016/17 (44.3 per cent of GDP). The cost of servicing debt over the same period will increase from R101.3 billion (2.9 per cent of GDP) to R139.2 billion (3.1 per cent of GDP). While debt-service costs have risen as the volume of debt has increased, the effective interest rate paid on debt has fallen from 9.9 per cent in 2006/07 to 6.4 per cent in 2013/14. The diversity of the debt portfolio, coupled with low coupon rates and declining issuance over the medium term, will help keep debt-service costs at sustainable levels.

Amendments to Treasury Regulations will strengthen oversight of state-owned companies

State-owned companies play a central role in government's infrastructure plans, with investments financed on the strength of their own balance sheets. The finances of these companies need to be healthy and well managed. Forthcoming amendments to Treasury Regulations will strengthen the oversight of state-owned companies. Accounting authorities will be required to submit quarterly capital spending reports to the National Treasury. To minimise risk exposure, state-owned companies that have been authorised to borrow, issue guarantees or enter into any transaction that may bind them to future financial commitments will be required to conclude a shareholder compact with their executive authority in consultation with the National Treasury.

This chapter reviews developments in South Africa's debt markets, the 2014/15 funding strategy, the composition of government's debt portfolio, and the finances of state-owned companies and development finance institutions.

Managing government debt in democratic South Africa

During 20 years of democracy, the management of government's financial assets and liabilities has been transformed. Before 1994, there was no dedicated unit responsible for debt management, nor was there clear coordination between monetary and fiscal policy.

Government's financing requirements were mainly covered by Treasury bills and fixed-rate bonds in the domestic market, with no access to borrowing in global markets. Government cash was not efficiently managed, which took a toll on the Reserve Bank's monetary policy operations. Funding instruments were illiquid and markets underdeveloped, making it difficult and costly to raise financing. Government's operations were characterised by a lack of transparency. Rising debt and debt-service costs constrained resources.

In 1994, the new government began developing a debt management strategy that would enable it to borrow sustainably at reasonable cost to support its development objectives. Government has worked to deepen the domestic debt markets, broaden its investor base, diversify its financing instruments, integrate cash and debt management, and coordinate monetary and fiscal policy.

Over time, South Africa has established itself as a credible global borrower, securing financing at competitive rates and establishing benchmarks for local firms to borrow abroad. Risk is prudently managed using benchmarks for domestic and foreign debt, and fixed and non-fixed rate debt. The maturity profile is smoothed through switch and buy-back programmes.

Debt management has contributed to broader policy objectives, including reversing the country's foreign exchange reserves from a negative net position to current levels of about US$50 billion.

To enhance its creditworthiness, government has gradually increased oversight of borrowing by state-owned companies. Steps in this area include monitoring borrowing plans and debt-maturity profiles; compiling a treasury best-practice manual; approving borrowing limits; managing contingent liability exposure; and meeting regularly with the treasuries of these companies.

Over time, government's approach resulted in improved global credit ratings. While sovereign ratings have been under pressure in recent years, South Africa's ratings remain at investment grade.

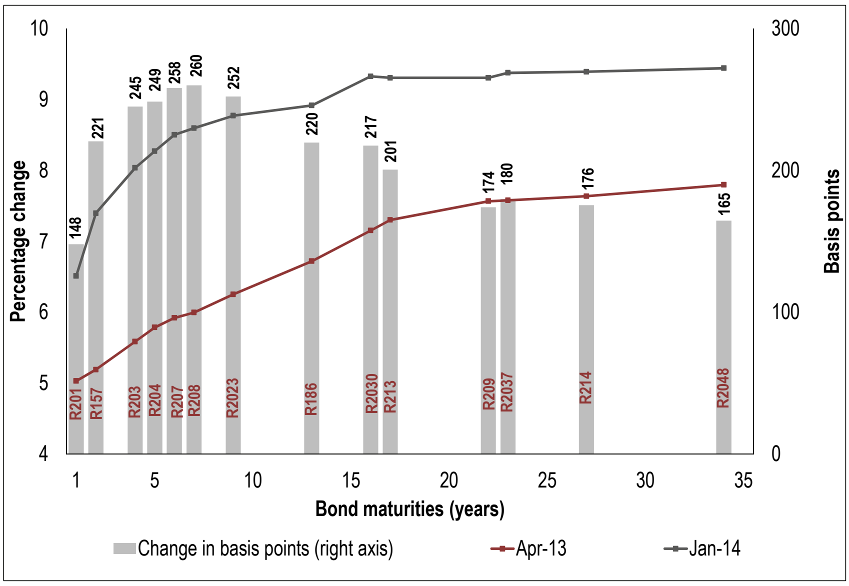
South African debt markets

Domestic bond market

Short-term interest rates remained relatively stable in 2013, anchored by the Reserve Bank's repurchase (repo) rate – the rate at which private banks borrow from the central bank.

Short-term interest rates remained relatively stable in 2013, anchored by the repo rate

Figure 5.1 Fixed-rate bond yield curve movement



Source: Bloomberg

The repo rate stood at 5 per cent between July 2012 and January 2014. At the end of January 2014, the Reserve Bank increased the repo rate by 50 basis points to 5.5 per cent.

Bond yields rose by more than 200 basis points since April 2013

Over and above the monetary policy adjustment, government bond yields have risen in line with international trends, in response to the US Federal Reserve's intention to slow down its bond-buying programme. Since April 2013, South African government bond yields have increased by an average of more than 200 basis points, which has eroded the value of existing investments in bonds, and presented a buying opportunity for investors.

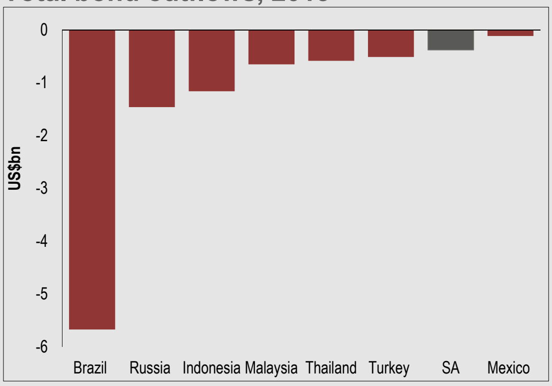
Pullback from emerging market bonds

According to Emerging Portfolio Fund Research (EPFR), South Africa recorded US$382 million in capital outflows from bonds in 2013, down from US$3.8 billion in inflows recorded in 2012. This reflects the allocation decisions of the large US mutual and pension funds.

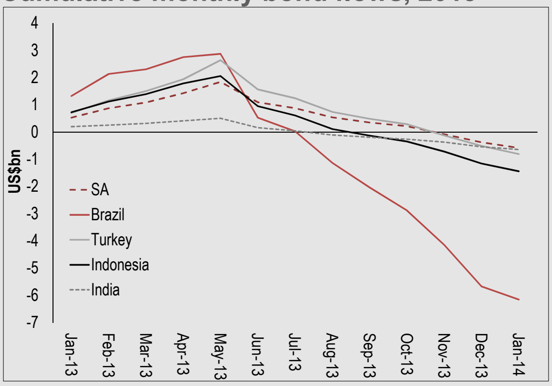
During the first quarter of 2013, emerging markets continued to receive strong capital inflows. The turning point came in May, when the US Federal Reserve announced its intention to reduce its monetary stimulus.

On balance, US investors opted to retain their investments in South African bonds through 2013. Data from the beginning of 2014 shows a pattern of capital disinvestment affecting most emerging markets, due to concerns about continued tightening of US monetary policy, slower growth and rising external vulnerabilities in developing countries. According to preliminary EPFR estimates, South Africa experienced outflows of US$710 million in January 2014, accounting for 4.2 per cent of total emerging market outflows in that month.

Total bond outflows, 2013



Cumulative monthly bond flows, 2013



Source: Emerging Portfolio Fund Research

International bond market

Emerging markets raised US$474 billion in global markets despite volatility

Short-term concerns about emerging market bonds grew during the second half of 2013. The announcement of a shift in US monetary policy saw the JP Morgan EMBI+ sovereign spread index, which measures the total return on dollar-denominated sovereign Eurobonds, widen from 265 basis points on 22 May 2013 to 389 basis points on 24 June 2013. Despite volatile market conditions, emerging-market debt issuers raised US$474 billion in 2013, up about 1 per cent from 2012.

South Africa's investment-grade sovereign credit rating affirmed in 2013

During 2013, major rating agencies affirmed South Africa's investment-grade credit ratings. The country's sound and predictable macroeconomic policies, independent constitutional institutions, deep local capital markets, strong banking sector, manageable public debt, low foreign currency exposure and flexible exchange rate continue to support investment-grade credit ratings.

However, South Africa's credit ratings continue to be constrained by a weak growth performance, high unemployment and wide income disparities, as well as low national savings and infrastructure bottlenecks that limit growth potential.

National government debt

When spending exceeds income, government incurs a budget deficit. The deficit is financed through borrowing in the domestic and international markets. These loans add to government's overall debt, on which it pays interest. Government also takes into account its contingent financial obligations, such as commitments with uncertain payment dates or amounts, and guarantees, which result in expenditure when a specific event occurs.

Financing the borrowing requirement

National government's borrowing requirement is the main budget balance, discussed in detail in Chapter 3. As Table 5.1 shows, the borrowing requirement is expected to amount to R162.9 billion in 2013/14, increasing to R179.8 billion in 2014/15 before declining to R151 billion in 2016/17. In addition, government will borrow R154.9 billion over the medium term to finance debt due (loan redemptions). The borrowing requirement is financed through loans made in the domestic and global markets and by using surplus cash.

Main budget borrowing requirement of R179.8 billion in 2014/15

Table 5.1 Financing of national government borrowing requirement,[1] 2012/13 – 2016/17

R million	2012/13 Outcome	2013/14 Budget	2013/14 Revised	2014/15	2015/16	2016/17
				Medium-term estimates		
Main budget balance[2]	**-165 734**	**-178 047**	**-162 942**	**-179 781**	**-174 473**	**-151 026**
Financing						
Domestic short-term loans (net)	**22 555**	**23 000**	**23 000**	**23 000**	**24 000**	**26 000**
Treasury bills	16 826	24 103	23 159	23 000	24 000	26 000
Corporation for Public Deposits	5 729	-1 103	-159	–	–	–
Domestic long-term loans (net)	**125 768**	**143 610**	**148 993**	**132 098**	**135 356**	**121 009**
Market loans (gross)	161 554	165 648	170 648	167 103	165 075	180 637
Loans issued for switches[3]	-3 848	-1 310	-1 135	–	–	–
Redemptions	-31 938	-20 728	-20 520	-35 005	-29 719	-59 628
Foreign loans (net)	**-11 622**	**-4 335**	**380**	**1 288**	**12 205**	**3 006**
Market loans (gross)	–	12 390	19 619	16 290	15 780	14 955
Arms procurement loan agreements (gross)	61	–	–	–	–	–
Redemptions (including revaluation of loans)	-11 683	-16 725	-19 239	-15 002	-3 575	-11 949
Change in cash and other balances[4]	**29 033**	**15 772**	**-9 431**	**23 395**	**2 912**	**1 011**
Cash balances	27 224	11 272	-18 809	18 895	-1 588	-3 489
Other balances[5]	1 809	4 500	9 378	4 500	4 500	4 500
Total	**165 734**	**178 047**	**162 942**	**179 781**	**174 473**	**151 026**

1. A longer time series is presented in Table 1 of Annexure B
2. A negative number reflects a deficit
3. Net of loans issued and redeemed in switch transactions
4. A negative change indicates an increase in cash balances
5. Net movement in national departments' bank balances due to differences between funds requested and actual cash flows

New classification of extraordinary transactions

The new consolidated fiscal framework was presented in the 2013 *Medium Term Budget Policy Statement*. Items previously classified as extraordinary receipts and payments are now brought into the budget framework as National Revenue Fund receipts and payments. The most significant elements of these transactions are valuation profits on foreign exchange transactions and premiums on loan transactions. These classifications are found in Tables 3 and 4 of Annexure B.

Domestic short-term borrowing

Treasury bill issuance to be concentrated in long-term maturities

Short-term borrowing consists of Treasury bill issuance and borrowing from the public sector through the Corporation for Public Deposits, into which provinces and some state-owned companies are required to invest their surplus cash. Over the medium term, net Treasury bill issuance is expected to average R24 billion per year. To reduce supply pressures in 91-day Treasury bills, issuance will be concentrated in longer-dated maturities.

Table 5.2 Domestic short-term borrowing, 2013/14 – 2014/15

	2013/14			2014/15		2013/14	2014/15
R million	Opening balance	Net change	Closing balance	Net change	Closing balance	Weekly auction estimates	
Corporation for public deposits	**18 985**	**-159**	**18 826**	**–**	**18 826**	**–**	**–**
Treasury bills	**171 985**	**23 159**	**195 144**	**23 000**	**218 144**	**7 770**	**8 215**
91-day	45 349	460	45 809	2 096	47 905	3 685	3 685
182-day	38 244	4 114	42 358	3 922	46 280	1 665	1 780
273-day	43 860	5 393	49 253	7 297	56 550	1 300	1 450
364-day	44 532	13 192	57 724	9 685	67 409	1 120	1 300
Total	**190 970**	**23 000**	**213 970**	**23 000**	**236 970**		

Domestic long-term borrowing

Domestic long-term loan issuance R5 billion higher in 2013/14

Domestic long-term loans consist of fixed-rate bonds, inflation-linked bonds and retail bonds. In 2013/14, budgeted domestic long-term loan issuance increased by R5 billion to R170.6 billion. This increase was financed by higher-than-anticipated take-up of non-competitive fixed-rate bond auctions.

Financing instruments

The main domestic instruments that government uses to raise financing are:

- Fixed-rate bonds, which offer a fixed rate of interest, known as the “coupon”, paid periodically during the life of the bond – usually twice a year.
- Inflation-linked bonds, which provide investors with cover against inflation, adjust the principal according to changes in the inflation rate, and pay a fixed rate of interest on the adjusted principal.
- Treasury bills, with maturities of less than a year, are issued at a discount, which represents the interest.
- Cash, which can be drawn down, and borrowings from the Corporation for Public Deposits.

Non-competitive government bond auctions

Domestic bonds are sold in weekly auctions. Both fixed-rate and inflation-linked bond auctions start with competitive bidding, where bidders propose a buying yield or rate. The highest bid offered is accepted for all successful bidders. In the case of fixed-rate bonds, competitive bidding is followed by a non-competitive bid auction, which gives successful bidders a 48-hour option to take up an additional 50 per cent of their competitive bid auction allocations at the yield at which the auction settled.

Fixed-rate bond issuance in 2013/14 was concentrated in longer maturities. The new fixed-rate bonds, R2030 (8 per cent; 2030) and R2037 (8.5 per cent; 2037) and inflation-linked bond I2046 (2.5 per cent; 2046) were well received.

Funding programme continues to minimise refinancing risk

In 2014/15, domestic long-term loan issuance will be R167.1 billion. The current weekly auction levels in domestic bonds are expected to be broadly maintained. The new fixed-rate bonds maturing in 2032 and 2044, announced in the 2013 Budget, will be introduced in 2014/15. The funding programme will continue to focus on minimising short-term refinancing risk, in line with the economic outlook over the short to medium term.

Table 5.3 Domestic long-term loan issuance, 2013/14

As of 31 January 2014 R million	Cash value	Average yield %	Outstanding value
Fixed-rate[1]	**110 131**	**8.4**	
R2023 (7.75%; 2023)	25 061	7.5	46 973
R186 (10.5%; 2025/26/27)	6 953	7.9	138 420
R2030 (8%; 2030)	6 338	8.9	6 876
R213 (7%; 2031)	20 233	8.4	75 827
R209 (6.25%; 2036)	6 134	8.1	75 867
R2037 (8.5%; 2037)	14 298	9.1	15 152
R214 (6.5%; 2041)	12 447	8.9	67 553
R2048 (8.75%; 2047/48/49)	16 196	9.0	40 374
Retail	2 472	6.9	9 498
Inflation-linked[2]	**34 026**	**2.1**	
I2025 (2.0%; 2025)	8 198	1.6	15 174
R210 (2.6%; 2028)	4 947	2.2	43 954
I2038 (2.25%; 2038)	8 289	2.1	17 837
I2046 (2.5%; 2046)	6 889	2.4	6 972
I2050 (2.5%; 2049/50/51)	5 652	2.2	16 569
Retail	51	1.5	194
Total	**144 157**		

1. Includes non-competitive auction allocations of R20.1 billion
2. Outstanding value is revalued using the relevant reference consumer price index

Domestic long-term loan issuance to reach R180.6 billion in 2016/17

Issuance of domestic long-term loans will decrease to R165.1 billion in 2015/16 before increasing to R180.6 billion in 2016/17 due to higher bond redemptions.

The bond-switch programme mitigates refinancing risk – the risk that government will not be able to raise money to repay debt at any scheduled point, or will have to do so at a high cost. The programme eases pressures on targeted areas of the redemption profile by exchanging short-term for long-term debt. Switch auctions in 2013/14 reduced 2014/15 loan redemptions by R10.6 billion, to R35 billion.

Refinancing risk beyond the medium term managed through switch programme and accumulation of cash

In 2016/17, and especially in the four years beyond the medium term, loan redemptions will increase sharply. To manage this refinancing risk, government will continue to exchange shorter-dated debt for longer-term debt as market conditions permit. Future switch auctions will be scheduled on an ad hoc basis, rather than being set out in a formal calendar, and there will no longer be pre-set targets. This will limit price manipulation and resulting market volatility. Government will also continue to draw from the strength of its cash balances to reduce dependence on switch programmes.

Since they were launched in 2004, government's retail bonds have helped to promote household savings and finance the borrowing requirement. During 2013/14, investments in retail bonds amounted to R3 billion, of which R1.8 billion were reinvestments of maturing bonds and capitalised interest. A total of R9.7 billion is currently invested in these bonds.

New retail bond to be made accessible to community savings groups

A new top-up retail bond product that allows regular deposits into existing investments will be introduced in 2014. The top-up retail bond will also be accessible to community savings groups, such as stokvels. Government, learning from experiences in the wholesale market, will also explore introducing a sukuk (Islamic) retail bond. The interest rates on retail bonds are shown in Table 5.4.

Table 5.4 Interest rates on retail bonds, February 2014

Percentage	Bond maturity		
Fixed-rate	**2-year**	**3-year**	**5-year**
	7.00	7.50	8.00
Inflation-linked	**3-year**	**5-year**	**10-year**
	1.00	1.25	2.25

Foreign borrowing

In September 2013, government raised R19.6 billion in global markets through the issuance of a 12-year, US$2 billion bond with a coupon rate of 5.875 per cent. The bond issue was nearly four times oversubscribed, reflecting South Africa's credibility with international investors.

Borrowing of US$1.5 billion a year in global markets

Government minimises foreign currency debt to manage external vulnerabilities. Over the medium term, government intends to borrow about US$1.5 billion a year in global markets to maintain benchmarks in major currencies and to meet part of its foreign currency commitments. The balance of these commitments will be met from foreign currency purchases in the domestic market. To diversify funding, government will enter the sukuk market in 2014. Borrowing from export credit agencies will be considered to finance projects with large foreign exchange commitments.

Cash balances

In 2014/15, cash balances will fall by R18.9 billion to finance part of borrowing requirement

Government's total cash, which consists of deposits in rands and US dollars held with commercial banks and the Reserve Bank, will total R186.4 billion by the end of 2013/14, decreasing to R167.5 billion in 2014/15 as cash is used to finance part of the borrowing requirement. Of government's total cash balances in 2013/14, R125.6 billion are deposits made with the Reserve Bank to increase the level of official foreign exchange reserves and are not available to finance government expenditure.

The losses and profits on the foreign exchange activities of the Reserve Bank are accounted for on the Gold and Foreign Exchange Contingency Reserve Account. The balance on this government account is split into transactions with a cash flow and non-cash flow valuation impact. Due to the depreciation of the rand, valuation gains increased to R172 billion as of 31 December 2013, R69 billion higher than a year earlier, with R27 million in realised cash-flow losses to be settled by government. A longer time series is presented in Table 10 of Annexure B.

Table 5.5 Change in cash balances, 2012/13 – 2016/17

R million	2012/13 Outcome	2013/14 Budget	2013/14 Revised	2014/15	2015/16	2016/17
				Medium-term estimates		
Rand currency						
Opening balance	**130 450**	**100 041**	**103 774**	**123 157**	**107 157**	**107 157**
Domestic funding	-6 946	2 616	25 546	-10 718	748	10 046
Foreign exchange purchases[1]	-19 730	–	-6 163	-5 282	-748	-10 046
Closing balance	**103 774**	**102 657**	**123 157**	**107 157**	**107 157**	**107 157**
of which:						
Tax and loan accounts	*36 617*	*35 500*	*56 000*	*40 000*	*40 000*	*40 000*
Sterilisation deposits[2]	*67 157*	*67 157*	*67 157*	*67 157*	*67 157*	*67 157*
Change in rand cash balance[3] (opening less closing balance)	**26 676**	**-2 616**	**-19 383**	**16 000**	**–**	**–**
Foreign currency[4]						
Opening balance	**64 376**	**68 057**	**63 828**	**63 254**	**60 359**	**61 947**
Foreign exchange purchases[1]	19 730	–	6 163	5 282	748	10 046
Interest on foreign exchange balances	856	1 000	393	438	433	428
International borrowing	–	12 390	19 619	16 290	15 780	14 955
Foreign funding	-21 134	-27 278	-26 749	-24 905	-15 373	-21 940
Closing balance	**63 828**	**54 169**	**63 254**	**60 359**	**61 947**	**65 436**
US$ equivalent	*8 724*	*7 524*	*8 013*	*7 522*	*7 522*	*7 527*
Change in foreign currency cash balance[3] (opening less closing balance)	**548**	**13 888**	**574**	**2 895**	**-1 588**	**-3 489**
Total change in cash balances[3]	**27 224**	**11 272**	**-18 809**	**18 895**	**-1 588**	**-3 489**
Total closing cash balance	**167 602**	**156 826**	**186 411**	**167 516**	**169 104**	**172 593**

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

Other elements of the debt portfolio

Government incurs debt to finance its borrowing requirement. Inflation and currency movements also affect the level of inflation-linked and foreign debt.

Table 5.6 Total national government debt,[1] 2010/11 – 2016/17

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
		Outcome		Estimate		Medium-term estimates	
Total gross loan debt[2]	**990.6**	**1 187.8**	**1 365.7**	**1 586.4**	**1 777.9**	**1 990.9**	**2 201.1**
Total net loan debt[3]	**820.4**	**989.7**	**1 181.6**	**1 375.5**	**1 589.1**	**1 804.6**	**2 019.0**
As percentage of GDP:							
Total gross loan debt	*36.0*	*39.8*	*42.7*	*45.8*	*46.9*	*48.0*	*48.3*
Total net loan debt	*29.8*	*33.2*	*36.9*	*39.7*	*41.9*	*43.5*	*44.3*
Foreign debt as percentage of:							
Gross loan debt	*9.9*	*9.8*	*9.1*	*9.3*	*8.3*	*7.8*	*6.8*
Net loan debt	*4.8*	*5.0*	*3.7*	*4.4*	*4.1*	*4.2*	*3.7*

1. A longer time series is presented in Table 10 of Annexure B
2. Forward estimates are based on projections of exchange and inflation rates
3. Net loan debt is calculated with due account of the cash balances of the National Revenue Fund (cash balances of government's accounts with the Reserve Bank and commercial banks)

Total loan debt

Net loan debt, which consists of total domestic and foreign debt, less cash balances, is expected to be R1.4 trillion by the end of 2013/14. By 2016/17, loan debt is expected to increase to R2 trillion or 44.3 per cent of GDP.

Net loan debt increasing to R2 trillion, 44.3 per cent of GDP in 2016/17

Debt-service costs

Debt-service costs to stabilise at 3.1 per cent of GDP in 2015/16

The costs of servicing government debt are influenced by the volume of debt, new borrowing and market variables such as interest, inflation and exchange rates. In 2013/14, debt-service costs are expected to be R1.5 billion higher than the budget estimate, mainly due to the weakening of the rand and higher interest rates on short-term loans. Table 5.7 summarises trends and projections to 2016/17. Debt-service costs as a percentage of GDP are expected to stabilise at 3.1 per cent in 2015/16.

Table 5.7 National government debt-service costs, 2012/13 – 2016/17

	2012/13	2013/14		2014/15	2015/16	2016/17
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic loans	81 358	92 596	93 230	106 212	117 873	130 154
Short-term	9 704	10 971	11 694	14 818	18 616	20 788
Long-term	71 654	81 625	81 536	91 394	99 257	109 366
Foreign loans	6 763	7 145	8 026	8 689	8 774	9 047
Total	**88 121**	**99 741**	**101 256**	**114 901**	**126 647**	**139 201**
As percentage of:						
GDP	*2.8*	*2.8*	*2.9*	*3.0*	*3.1*	*3.1*
Expenditure	*9.1*	*9.4*	*9.7*	*10.1*	*10.3*	*10.5*
Revenue	*11.0*	*11.4*	*11.4*	*11.9*	*12.0*	*11.9*

The effective interest rate of South Africa's debt, measured by debt-service costs divided by the volume of debt, decreased from 9.9 per cent in 2006/07 to 6.4 per cent in 2013/14, and is expected to remain broadly at this level over the medium term.

Composition of loan debt

The average term-to-maturity of government bonds – the time remaining until a bond is repaid – is expected to increase from 12.6 years in 2012/13 to 13.2 years in 2013/14. The longer the average term-to-maturity, the more time government has to repay its debt obligations. The non-fixed rate debt component of the domestic debt portfolio stabilised at 35 per cent in 2013/14.

Foreign debt exposure remains low at 9.3 per cent in 2013/14

Government's gross exposure to loans raised in the international market will be 9.3 per cent of total debt in 2013/14, or 4.4 per cent in net terms after taking into account foreign exchange deposits of US$8 billion. Of total foreign loans, 79 per cent is denominated in US dollars, 11 per cent in euros and 4 per cent in yen.

Government maintains debt portfolio benchmarks to minimise and manage risk. Since the current benchmarks were established in 2000, the relative importance of risk factors has changed in line with macroeconomic, fiscal and financial market variables. Funding instruments have also become more diverse since 2000.

Adjusting risk benchmarks in government's debt portfolio

Following a review, the National Treasury proposes to modify its basket of strategic risk benchmarks. These changes will improve the management of refinancing, inflation and currency risk, as shown in the table below. The proposed benchmarks – some of which are new or have been updated – will be assessed and reported annually.

New risk benchmarks

Description	Range or limit
Share of debt maturing within a year (including Treasury bills)	Limit to 15% of total domestic debt *Previous: inflation-linked bonds and Treasury bills not exceeding 30% of domestic debt*
Share of debt maturing in 5 years (fixed-rate and inflation-linked bonds)	Limit to 25% of total domestic debt
Average term-to-maturity of fixed-rate bonds and Treasury bills	Range of 10-14 years
Average term-to-maturity of inflation-linked bonds	Range of 14-17 years
Share of inflation-linked bonds as % of domestic debt	Range of 20-25% *Previous: inflation-linked bonds and Treasury bills not exceeding 30% of domestic debt*
Share of foreign currency debt as % of total debt	Limit of 15% *Previous: range of 20-25%*

Debt ownership

The ownership of government's domestic bonds is shown in Table 5.8.

Table 5.8 Ownership of domestic government bonds, 2009 – 2013

Percentage of total	2009	2010	2011	2012	2013
Non-residents	13.8	21.8	29.1	35.9	36.4
Residents					
Pension funds	39.9	36.5	33.0	29.8	29.1
Monetary institutions	18.3	17.7	16.3	17.0	14.6
Insurers	12.4	14.1	11.6	9.4	8.6
Other financial institutions	13.2	8.1	8.0	5.8	8.2
Other	2.4	1.8	2.0	2.1	3.1

Source: Share Transactions Totally Electronic Ltd

Non-resident investors hold 35.7 per cent of domestic bonds

Despite negative sentiment towards emerging markets in 2013, non-resident investors maintained their level of holdings in government bonds. As Table 5.8 shows, non-resident investors held 36.4 per cent of these bonds during 2013, compared with 29.1 per cent held by local pension funds. In January 2014, non-resident investors were net sellers of R22.4 billion in government bonds, and their overall holding dipped to 35.7 per cent of these bonds. Of inflation-linked bonds, local pension funds hold 63 per cent, while monetary institutions hold 17 per cent and non-resident investors 3 per cent. The maturity of fixed-rate bonds held by non-resident investors is spread across the yield curve.

Of the total amount of Treasury bills issued, 70 per cent is held by South Africa's commercial banks, partly to meet their prescribed liquid asset requirements, and 3 per cent is held by non-resident investors.

Provisions and contingent liabilities

Net loan debt, provisions and contingent liabilities to amount to 54.8 per cent of GDP this year

Provisions and contingent liability projections are shown in Table 5.9. 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 are obligations, such as government guarantees, that only result in expenditure when a specific event occurs. The National Treasury publishes detailed information on provisions and contingent liabilities in the *Annual Consolidated Financial Statements* of national departments.

As at 31 March 2014, net loan debt, provisions and contingent liabilities are expected to amount to 54.8 per cent of GDP, and are projected to reach 57.1 per cent of GDP by 31 March 2016, before falling to 56.7 per cent in 2016/17. This remains below the Southern African Development Community's macroeconomic convergence target of 60 per cent of GDP, and compares favourably with many developed countries.

The National Treasury carefully monitors contingent liabilities and their potential impact on the fiscus.

Table 5.9 Composition of provisions and contingent liabilities,[1] 2012/13 – 2016/17

End of period	2012/13	2013/14	2014/15	2015/16	2016/17
R billion	Outcome	Estimate	Medium-term estimates		
Net loan debt	**1 181.6**	**1 375.5**	**1 589.1**	**1 804.6**	**2 019.0**
Provisions	**116.2**	**124.0**	**146.4**	**143.1**	**137.4**
International Monetary Fund[2]	50.3	52.4	70.5	68.3	64.7
International Bank for Reconstruction and Development[2]	15.9	17.6	18.8	18.2	17.3
Multilateral Investment Guarantee Agency[2]	0.1	0.1	0.1	0.1	0.1
African Development Bank[2]	32.7	36.1	38.6	37.4	35.5
Development Bank of Southern Africa Limited[3]	4.8	4.8	4.8	4.8	4.8
Government employee leave credits	12.4	13.0	13.6	14.3	15.0
Contingent liabilities	**369.8**	**400.6**	**420.8**	**422.2**	**424.1**
Guarantees	180.2	209.2	229.2	234.8	241.5
Post-retirement medical assistance	65.3	65.3	65.3	65.3	65.3
Road Accident Fund	60.3	55.9	57.2	56.6	56.3
Claims against government departments	43.7	43.7	43.7	43.7	43.7
Export Credit Insurance Corporation of SA Limited	12.5	18.3	16.8	12.9	8.1
Unemployment Insurance Fund	3.2	3.6	4.0	4.3	4.6
Other[4]	4.6	4.6	4.6	4.6	4.6
Total	**1 667.6**	**1 900.1**	**2 156.3**	**2 369.9**	**2 580.5**
Percentage of GDP	*52.1*	*54.8*	*56.9*	*57.1*	*56.7*

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

The major state-owned companies that hold guarantees are shown in Table 5.10. Details of guarantee commitments are set out in Table 11 of Annexure B. Fees of R152 million were received in 2013/14 on these guarantees. During 2013/14, no new guarantees were issued. Other developments include the following:

- The R5 billion guarantee previously provided to South African Airways (SAA) for two years was converted into a perpetual guarantee to enable the airline to remain a going concern. During the year, SAA raised R3.2 billion of funding against the guarantee.
- In 2012/13, South African Express (SAX) was granted a R539 million two-year guarantee. SAX secured a R300 million revolving loan

facility for working capital under this guarantee, and is at an advanced stage of raising additional financing of R239 million.

- The South African Broadcasting Corporation repaid the outstanding balance on the R1 billion guarantee loan raised in 2009/10 ahead of schedule and the guarantee was cancelled.
- After Denel's three separate guarantees were consolidated into a R1.85 billion, five-year guarantee in 2012/13, Denel was able to raise debt through bonds and commercial paper. As a result, its long-term rating was upgraded to AAA.

Table 5.10 Guarantee exposure to major state-owned companies and development finance institutions,[1] 2012/13 – 2013/14

Institution	2012/13		2013/14	
R billion	Guarantee	Exposure[2]	Guarantee	Exposure[2]
Total	**467.5**	**180.2**	**466.2**	**209.2**
of which:				
Eskom	*350.0*	*103.5*	*350.0*	*122.3*
SANRAL	*38.7*	*19.5*	*38.7*	*26.4*
Development Bank of Southern Africa	*29.6*	*25.6*	*29.6*	*25.6*
Trans-Caledon Tunnel Authority	*25.5*	*20.5*	*25.5*	*20.5*
South African Airways	*7.9*	*2.2*	*7.9*	*4.9*
Transnet	*3.5*	*3.8*	*3.5*	*3.8*
Denel	*1.9*	*1.9*	*1.9*	*1.9*
Land Bank	*1.9*	*0.9*	*1.6*	*1.1*

1. A longer time series is presented in Table 11 of Annexure B
2. Includes accrued interest

The National Treasury, together with the Department of Public Enterprises, actively monitors the performance of state-owned companies such as Denel, Eskom, SAA and SAX. These companies are required to submit monthly or quarterly reports according to their guarantee conditions.

State-owned companies with government guarantees are required to submit regular reports

State-owned companies

Capital expenditure

Medium-term capital expenditure by major state-owned companies is projected to reach R381.9 billion. Investments by Eskom, Transnet and the South African National Roads Agency Limited (SANRAL) account for 90 per cent of this amount.

Table 5.11 Major state-owned companies'[1] capital expenditure programmes, 2012/13 – 2016/17

	2012/13	2013/14		2014/15	2015/16	2016/17
R billion	Outcome	Budget	Revised	Medium-term estimates		
Capital expenditure	**109.9**	**111.9**	**107.1**	**126.9**	**131.8**	**123.2**
of which:						
Eskom	*60.4*	*61.9*	*56.4*	*59.5*	*52.2*	*40.0*
Transnet	*27.6*	*28.6*	*25.3*	*41.3*	*51.6*	*55.0*
Central Energy Fund	*10.2*	*4.9*	*12.8*	*4.9*	*4.8*	*3.8*
SANRAL(toll and non-toll)	*8.1*	*8.3*	*8.3*	*11.9*	*15.8*	*17.0*
Trans-Caledon Tunnel Authority	*1.4*	*3.6*	*1.7*	*4.8*	*2.9*	*2.7*
Other	*2.2*	*4.6*	*2.6*	*4.5*	*4.5*	*4.7*

1. State-owned companies listed in Schedule 2 of the PFMA (excluding development finance institutions) and including SANRAL

Eskom and Transnet spent a combined R88 billion in 2012/14

In delivering on their infrastructure commitments, state-owned companies have improved their performance, spending R109.9 billion of a budgeted R137.6 billion (79.9 per cent) in 2012/13, compared with R92.7 billion of a budgeted R131.7 billion (70 per cent) in 2011/12. Underspending was mainly the result of contractors not meeting targeted delivery schedules, labour unrest, poor weather, material shortages and engineering delays. Eskom and Transnet spent a combined R88 billion during this period, bringing state-owned companies' total spending over the past three years to R284.3 billion.

Eskom's infrastructure figures have been revised downwards over the medium term due to lower projected revenue.

Asset base of state-owned companies increased to R793.9 billion at end of 2012/13

Infrastructure investments have led to a steady increase in the asset base of state-owned companies, from R450.1 billion in 2008/09 to R793.9 billion at the end of 2012/13. The net asset value of state-owned companies has increased to R252.2 billion in 2012/13, with Eskom and Transnet accounting for 77 per cent. In 2012/13, state-owned companies' average return on equity slowed to 4 per cent, down from 7.6 per cent in the prior year, mainly due to lower earnings and higher operational costs at Eskom.

Table 5.12 Consolidated balance sheets of state-owned companies,[1] 2008/09 – 2012/13

R billion	2008/09	2009/10	2010/11	2011/12	2012/13
Total assets	450.1	517.8	639.4	708.1	793.9
% growth in assets	*17.7*	*15.0*	*23.5*	*10.7*	*12.1*
Total liabilities	290.6	341.6	442.9	470.6	541.7
% growth in liabilities	*26.9*	*17.6*	*23.8*	*11.1*	*15.1*
Net asset value	159.5	176.2	216.5	237.5	252.2
% growth in asset value	*3.9*	*10.5*	*22.9*	*9.7*	*6.2*
% return on equity	-4.0	3.8	6.7	7.6	4.0

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

Funding plans

Over the next three years, 61.6 per cent or R235.3 billion of funding required for infrastructure development by state-owned companies is expected to be raised in debt markets, with the remainder coming from internally generated cash. Eskom and Transnet will account for the bulk of these borrowings.

Table 5.13 Funding sources for state-owned companies, 2012/13 – 2016/17

	2012/13	2013/14		2014/15	2015/16	2016/17
R billion	Outcome	Budget	Revised	Medium-term estimates		
Domestic loans (gross)	**40.5**	**40.5**	**40.3**	**51.6**	**61.9**	**50.3**
Short-term	26.8	18.9	22.4	32.9	37.5	25.1
Long-term	13.7	21.6	17.9	18.7	24.4	25.2
Foreign loans (gross)	**29.4**	**21.0**	**32.7**	**25.1**	**29.5**	**16.9**
Long-term	29.4	21.0	32.7	25.1	29.5	16.9
of which:						
Multilateral institutions	*16.8*	*13.2*	*10.1*	*7.2*	*6.5*	*6.5*
Export credit agency financing	*4.3*	*5.8*	*4.7*	*3.8*	*9.1*	*1.4*
Total	**69.9**	**61.5**	**73.0**	**76.7**	**91.4**	**67.2**
As percentage of total:						
Domestic loans	*57.9*	*65.9*	*55.2*	*67.3*	*67.7*	*74.9*
Foreign loans	*42.1*	*34.1*	*44.8*	*32.7*	*32.3*	*25.1*

Revised borrowings in 2013/14 relate to Eskom's higher borrowing in response to revised revenue estimates.

In 2014/15, an estimated 67.3 per cent of borrowing by state-owned companies will be sourced in the local market. To reduce borrowing costs and ease pressure on the domestic market, state-owned companies are encouraged to pursue funding opportunities with multilateral agencies that offer them favourable funding terms and conditions.

Development finance institutions

National Treasury to review development finance system in 2014/15

In 2014/15, the National Treasury will conduct a comprehensive review of the development finance system, including provincial institutions. The review will strengthen financial management and accountability, helping development finance institutions achieve their mandates more effectively.

Table 5.14 Consolidated balance sheets of development finance institutions, 2012/13 – 2015/16

R billion	2012/13 Outcome	2013/14 Estimate	2014/15 Medium-term estimates	2015/16
Total assets	221.5	223.3	247.3	274.5
Total liabilities	93.5	103.7	119.4	137.3
Development loans	91.8	113.4	132.4	152.5
% growth in development loans	*11.8*	*23.6*	*16.8*	*15.1*

Development finance asset base projected to grow by 24 per cent between 2012/13 and 2015/16

Five agencies – the Development Bank of Southern Africa (DBSA), the Industrial Development Corporation (IDC), the Land Bank, the National Empowerment Fund and the National Housing Finance Corporation – hold 99 per cent of development finance assets. The total asset base of development finance institutions is projected to grow by 24 per cent, from R221.5 billion in 2012/13 to R274.5 billion in 2015/16. The strong asset base supports 66 per cent growth in their combined loan book, from R91.8 billion in 2012/13 to R152.5 billion in 2015/16.

Development Bank of Southern Africa

In 2012/13, the DBSA recorded growth of 3.1 per cent in total assets compared with the previous financial year. Total assets amounted to R53.9 billion, of which development loans made up R42.6 billion (or 79 per cent). These assets, spread across South Africa and other Southern African Development Community countries, are mainly in energy, roads and drainage, water and sanitation, and information and communication technology. In 2012/13, the DBSA achieved a 14 per cent increase in disbursements, amounting to R9.2 billion. However, loan approvals decreased by 26.9 per cent to R18.1 billion in the same period, mainly due to a DBSA restructuring process.

Infrastructure investment: European Union to support project preparation

Under a financing agreement signed by government and the European Union (EU), the EU will make €100 million available to fund infrastructure investments in South Africa over the next three financial years.

The funding is intended to enhance sustainable economic growth and delivery of key services in South Africa and the region. This includes investments in energy, water and the environment, transport (rail, road, air and maritime), information and communication technology, and social infrastructure. The programme will focus on project preparation and building capacity. It will also support long-term loan finance through direct grants, interest rate subsidies or loan guarantees.

The DBSA has been appointed as the fund manager, overseen by an interdepartmental committee.

Land Bank

Disbursements to emerging farmers increased to R247.5 million in 2012/13

The Land Bank's net profit for 2012/13 amounted to R304.6 million, an increase of 89 per cent from the previous year. In 2012/13, the bank's equity strengthened to R6.1 billion, growing by 9 per cent, mainly due to higher earnings. The asset base increased by 21 per cent to R30.8 billion, mainly due to loan book growth of 25 per cent in 2012/13. Disbursements to emerging farmers increased by R145.8 million, from R101.7 million in 2011/12 to R247.5 million in 2012/13.

Industrial Development Corporation

The IDC's net profit in 2012/13 amounted to R1.9 billion, down 40 per cent from 2011/12, as a result of impairment losses on both equity investments (R705 million) and investments in associated companies and joint ventures (R466 million). Loan disbursements for industrial development grew by R16 billion, increasing by 91 per cent from R8.3 billion in 2011/12.

National Empowerment Fund

National Empowerment Fund approved 135 transactions worth R1.3 billion in 2012/13

During 2012/13, the National Empowerment Fund's asset base rose by 2.2 per cent to R5.4 billion. The fund has temporarily suspended new approvals subject to a review of the sustainability of its funding model. Despite funding constraints, the fund approved 135 transactions worth R1.3 billion in 2012/13, of which R946.5 million was disbursed to 87 black economic empowerment businesses. This constitutes the highest level of investment approvals and disbursements since its inception in 2004.

National Housing Finance Corporation

The National Housing Finance Corporation's asset base increased by 5.3 per cent, from R3.4 billion in 2011/12 to R3.6 billion in 2012/13. Over the same period, the corporation's disbursed loans amounting to R480 million, compared to R665 million in 2011/12.

Conclusion

Government's debt management policy has proven resilient in a volatile environment. Prudent policy, in combination with deep and liquid domestic capital markets, will continue to ensure that government can finance its medium-term borrowing requirement. These policies will maintain a stable debt portfolio that will not undermine the principle of intergenerational equity. Strengthened oversight of state-owned companies will ensure that these entities are financially healthy and well managed.