We expect South Africa’s sovereign rating outlook to be upgraded to “Stable” from “Negative” and its “Ba2” rating level to be affirmed

- **South Africa’s current Negative outlook has been in place for 14 months, and we think Moody’s needs to change it without further delay.**
- **Such a rating action by Moody’s would follow that taken by Fitch Ratings at the end of CY21.**
- **While global geopolitical uncertainties cloud the horizon and stagflation risks are building, South Africa is a relatively benign spot now, and we think Moody’s (as a base case) may look further out to 2H23 for any slippage in the country’s fiscal trajectory, growth dynamics or external vulnerability.**
- **Political uncertainty risks may come to the fore in 2H22 as the governing party holds its policy and elective conferences, but we do not yet see these events shifting its fundamental credit views in the near term; instead, we concentrate on how any political outcomes may translate into growth or fiscal performances.**
- **Consequently, we believe South Africa’s ratings will be firmly anchored in the “Ba” rating band for some time to come, until the latter half of this decade at least, all things being equal.**

Current rating levels and outlook

Long-term issuer rating (foreign): Ba2

Long-term issuer rating (domestic): Ba2

Last rating action: Downgrade from “Ba1/Neg.” to “Ba2/Neg.” on 20 November 2020

- Moody’s is scheduled to release its review of South Africa’s credit standing after markets close on 1 April 2022. However, it is not mandatory for Moody’s to review the rating.
- Moody’s conducted a periodic review of its Middle East and Africa (MEA) portfolio of sovereigns (including South Africa) on 22 March 2022; this was a substantive-enough review of relative credit metrics in accordance with its own Release Standards and EU CRA regulations. This means it could skip the scheduled review in lieu of this periodic review already conducted, although this is not our expectation.
- We expect a revision of South Africa’s outlook, premised on the understanding of Moody’s outlook definition, which asserts that an outlook indicates a likelihood of a rating change in a particular direction, and that this is time-bound. In general, about one-third of Moody’s positive/negative outlooks are followed by an upgrade/downgrade (respectively) within an 18-month horizon, and about 90% of “Stable” outlooks experience no rating change a year later[1].
- In this context, then, South Africa’s “Negative” outlook has been in place for 14 months, and the next scheduled review is only in November 2022 (24 months after the current outlook was assigned). This is why we think Moody’s will be prompted not to skip this review and needs to change this outlook – we think to “Stable” from “Negative”.

ANALYST DETAILS

Jones Gondo

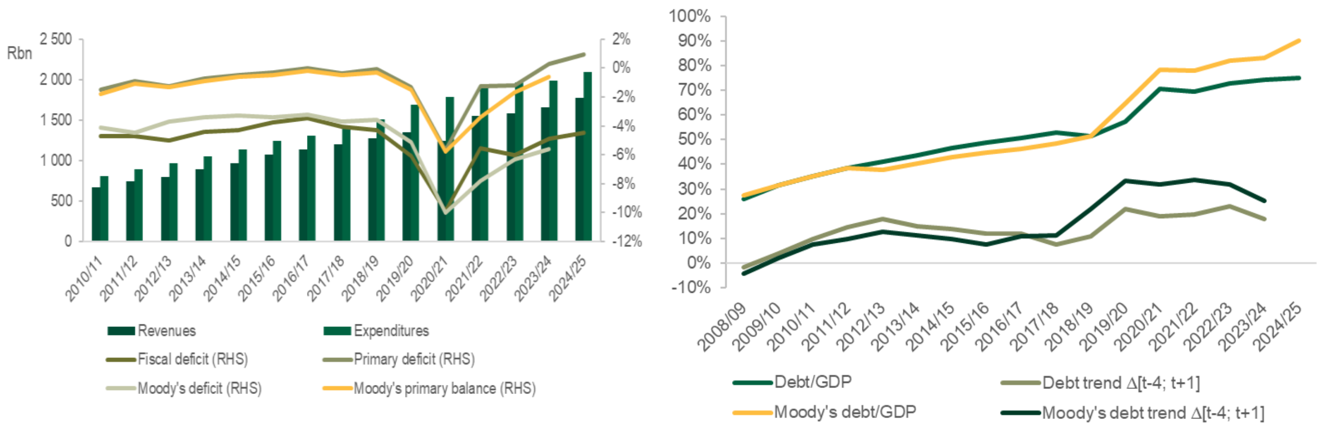
JonesG@Nedbank.co.za

+27115354050

[1] Moody’s Rating Symbols and Definitions, 22 March 2022

- The rating transition statement in its credit opinions highlights the following:
    - **Upside scenario (revising the outlook to Stable from Negative):** *"We would likely change the rating outlook to stable if the government's efforts to consolidate its fiscal position were contributing to slow and eventually arrest the increase in the debt burden, as well as to reduce the cost of debt. A slow, but durable pick-up in growth, at least partly as a result of meaningful and effective labour market or power sector reforms, and a steadily narrowing fiscal deficit could contribute to such an outcome. On the fiscal side, the government's pursuit of the moderation in its wage bill would be an important indicator."*
    - **Downside scenario (downgrade to Ba3 or lower):** *"We would likely downgrade further South Africa's ratings if we concluded that its debt burden and related pressures on debt affordability were likely to continue rising inexorably and materially faster and for longer than we currently expect. This could reflect difficulties in implementing growth-enhancing reforms, ongoing shocks to primary expenditure or revenues, or sustained rises in the level or volatility of interest rates. Any indication of diminished access to funding at interest rates that would further endanger government debt sustainability would put significant downward pressure on the rating."*
- Both the MTBPS and the Budget Review have demonstrated South Africa's tilt towards the upside scenario, with the budget deficit narrowing more quickly than initially expected (and the primary balance maintaining a marginal surplus compared to Moody's marginal deficit forecast). The court decision on the public-sector wage bill in the National Treasury's favour has eased expenditure pressures substantially, and revenue has benefited from one-off windfalls as a result of commodity price rallies upping the tax take. This has meant that the pace of debt accumulation (debt trend) will begin to ease from a historical-period difference in debt to GDP (2023 vs 2018) from 34% currently to 20% (on the National Treasury's projections), which could improve the debt trend sub-factor by a notch within the fiscal rating scorecard, but it will not be sufficient to reverse the downgrades these adjustments induced in 2019 and 2020. The result is that South Africa's debt to GDP is seen to stabilise at a much lower level compared to Moody's peak estimate in 2024 of around 90%.

Exhibit 1: National Treasury's vs Moody's fiscal deficit and debt trends



Source: Moody's, National Treasury, Nedbank CIB Markets Research

- Overall, we think the South African government's fiscal authorities have done enough to halt the credit deterioration and anchor South Africa's ratings firmly within the "Ba" rating bands.
- If the Moody's rating committee is dovish, we could see a technical adjustment of the rating band from "Ba2-B1" currently to "Ba1-Ba3". This could happen if they removed the discretionary two-notch negative adjustment to their final fiscal score which they had applied to reflect that "backward-looking scorecard metrics understate the deterioration in fiscal dynamics". This would indicate the anchoring of South Africa's "Ba2" rating within the "Ba" band rather than being rated at the top of a lower transition band that crosses into the "B" category.
- We expect the tone of any commentaries to still be cautious of event risks given the uncertain global macroeconomic and geopolitical backdrop, but believe its base case is that risks have settled in South Africa over the next 12-18 months.

Exhibit 2: Moody's sovereign rating scorecard at 24 Nov 2021: South Africa

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial	Final	Weights	NCIB Comments
Factor 1: Economic strength				**ba1**	**baa3**	**50%**	Unchanged
Growth dynamics	Average real GDP growth (%)	2016-2025F	0.7	caa1		25%	
	Volatility in real GDP growth (%)	2011-2020	2.7	ba2		10%	
Scale of the economy	Nominal GDP ($ billion)	2020	335.4	a1		30%	
National income	GDP per capita (PPP, Intl$)	2020	13289	ba1		35%	
Adjustment to factor 1	# notches				1	max ±9	
Factor 2: Institutions and governance strength							
Quality of institutions	Quality of legislative and executive institutions			baa		20%	
	Strength of civil society and the judiciary			baa		20%	
Policy effectiveness	Fiscal policy effectiveness			ba		30%	
	Monetary and macroeconomic policy effectiveness			baa		30%	
Specified adjustment	Government default history and track record of arrears				0	max -3	
Other adjustment to factor 2	# notches				0	max ±3	
F1 x F2: Economic resiliency				**baa3**	**baa3**		
Factor 3: Fiscal strength				**b3**	**caa2 → b2 (bullish scenario, base case is caa1)**		We could see a revised initial score to "b2" from "B3" upon revision of the debt trend below. If the committee were to reverse the discretionary "-2 notches" below for "Other adjustment to factor 3", then the final fiscal strength score could be revised to "b2" which would be sufficient to adjust the Government Financial Strength score back into investment grade "baa3"
Debt burden	General government debt/GDP (%)	2020	78.4 → 69.5	ba3 → ba2		25%	
	General government debt/revenue (%)	2020	308.3 → 280.5	ba3 (unchanged)		25%	
Debt affordability	General government interest payments/revenue (%)	2020	16.4 → 17.3	b1 (unchanged)		25%	
	General government interest payments/GDP (%)	2020	4.2 → 4.3	b1 (unchanged)		25%	
Specified adjustments	Total of specified adjustment (# notches)			-3	-3 → -2	max ±6	Revised to -2 on debt trend between 20%-30% from >30%
	Debt trend	2016-2021F	31.7 →19.9	-3	-3 → -2		
	Foreign currency debt/general government debt	2020	18.3	0	0		
	Other non-financial public sector debt/GDP	2020	12.1	0	0		
	Public sector assets/general government debt	2020	0	0	0		
Other adjustment to factor 3	# notches				-2 → 0 (bullish scenario, base case unchanged)	max ±3	If the committee is bullish, we could see this removed.

Exhibit 2: Moody's sovereign rating scorecard at 24 Nov 2021: South Africa

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial	Final	Weights	NCIB Comments
F1 x F2 x F3: Government financial strength				**ba1**	**ba1 → baa3 (bullish scenario, base case unchanged)**		
Factor 4: Susceptibility to event risk							
Political risk				baa			
	Domestic political risk and geopolitical risk			baa			
Government liquidity risk				a	a		
	Ease of access to funding			a			
Specified adjustment	High refinancing risk				0	max -2	
Banking sector risk				baa	baa		
	Risk of banking sector credit event (BSCE)	Latest available	ba2	ba1-ba2			
	Total domestic bank assets/GDP	2020	105.7	80-180			
Adjustment to F4 BSR	# notches				0	max ±2	
External vulnerability risk				a	a		
	External vulnerability risk			a			
Adjustment to F4 EVR	# notches				0	max ±2	
Overall adjustment to F4	# notches				0	max -2	
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**Ba2 – B1**	**Ba2 – Ba1 → Ba1-Ba3 (bullish scenario, base case unchanged)**		**In bullish scenario, we could see this band upgraded to Ba1 – Ba3 (only if government financial strength improves to baa3 by removing discretionary negative adjustments to the fiscal strength score**

Moody's, Nedbank CIB Markets Research