NEWS RELEASE

May 31, 2021

R&I Downgrades to BB+/BBB-, Stable, Affirms a-3: Republic of South Africa

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Republic of South Africa**

Foreign Currency Issuer Rating: BB+, Previously BBB-
Rating Outlook: Stable

Domestic Currency Issuer Rating: BBB-, Previously BBB
Rating Outlook: Stable

Foreign Currency Short-term Debts: a-3, Affirmed

RATIONALE:

The COVID-19 outbreak has put a strain on South Africa's economy, which was already in a downturn prior to the pandemic. In 2021, the economy is expected to rebound from negative growth, but its growth potential will unlikely be bolstered sufficiently in the medium term given the structural problems left unsolved, such as persistently high unemployment rates and power supply restrictions. Despite ongoing all-out efforts for fiscal adjustment, the prospect of deficit reduction remains highly uncertain and outstanding debt will most likely keep rising for some more years. In light of these circumstances, R&I has downgraded both the Foreign and Domestic Currency Issuer Ratings by one notch. The stability of the country's external position and financial system has been maintained. Because R&I finds no major problem with the domestic funding environment, the Rating Outlook is Stable.

The economy contracted by 7% in 2020 due to strict lockdown measures from late March of the year. Both the government and the central bank project high growth for 2021, partly in a rebound from the previous year. Even so, high unemployment rates, power supply restrictions and the market's concern about a possible deterioration in the fiscal outlook may constrain economic activity and push up capital costs, which will highly likely impede a medium-term recovery in growth rates. While R&I favorably views the fact that a return to a trend growth rate is conservatively assumed for fiscal management in the near term, it is not considered easy to achieve growth that enables steady fiscal consolidation.

Outstanding central government debt exceeded 80% of gross domestic product (GDP). The government estimates the fiscal deficit for FY2020 (April 2020-March 2021), a year hard hit by the pandemic, at 14% of GDP and intends to reduce it to 6.3% of GDP over the three-year period from FY2021, meaning that fiscal deficits will remain wider than the FY2019 level for the foreseeable future. Although the government expects the outstanding debt ratio to peak out at 88.9% in FY2025, projections of the ratio have been revised upward several times. While it is good news that actual tax revenue is trending higher than the government's conservative estimate, whether public sector wages can be curtailed warrants attention as the key to fiscal consolidation. With financial assistance anticipated to continue for state-owned enterprises that are slow to improve their financial conditions, there is still a high downside risk to the fiscal outlook, in R&I's view. The government needs to cement this outlook while maintaining the stability of funding.

According to the central bank, the inflation rate for 2020 hit a record low. The central bank is providing indirect support for economic activity through aggressive rate cuts and liquidity supply, and will likely enter a phase of finding the right timing for normalization. Although there are risk factors such as exchange rate fluctuations and electricity prices, R&I expects inflation to hold steady, broadly within the central bank's target range.

On the back of a rapid slowdown in imports and price hikes in platinum and other main exports, the current account balance moved into surplus, leaving more room for domestic funding. While outstanding external debt keeps rising, direct investment claims held by the corporate sector are large, thus leading to

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a positive net international investment position, with foreign assets slightly exceeding foreign liabilities. The fact that the country maintains a stable financial system continues to underpin the sovereign creditworthiness.

On the political front, the power structure centered on the governing party African National Congress (ANC) is unchanged, though a gradual shift is observed from the ANC's monopoly to major parties struggling for seats in the parliament. President Cyril Ramaphosa will likely retain a political base within the ANC that is necessary to press ahead with reforms. The strong organizational capacities of the finance ministry and the central bank, among others, are not enough by themselves to overcome economic and social hardships. It is essential for a wide range of political entities to share a sense of crisis and make concerted efforts to implement initiatives including rationalization of state-owned enterprises.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
https://www.r-i.co.jp/en/rating/about/rating_method.html

R&I RATINGS:	**As of May 31, 2021**
ISSUER:	**Republic of South Africa**
	Foreign Currency Issuer Rating
RATING:	**BB+, Previously BBB-**
RATING OUTLOOK:	**Stable**
	Domestic Currency Issuer Rating
RATING:	**BBB-, Previously BBB**
RATING OUTLOOK:	**Stable**
	Foreign Currency Short-term Debts
RATING:	**a-3, Affirmed**

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