Moody's
INVESTORS SERVICE

Rating Action: Moody's assigns B2 first-time issuer ratings to the Government of Swaziland, with a negative outlook

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London, 27 October 2017 -- Moody's Investors Service ("Moody's") has today assigned first-time issuer ratings of B2 to the Government of Swaziland. The outlook is negative.

The rating assignment is based on the following key drivers:

1. Economic strength assessed at 'Low (+), reflecting the country's relatively small and slow-growing economy, but well integrated and resilient on top of its middle-income status.

2. Institutional strength constrained by governance challenges that have been hampering fiscal policy-making and progress with structural reforms.

3. 'Moderate (+)' fiscal strength that balances low public debt-to-GDP ratio which is below regional and similarly-rated peers, against structural fiscal weaknesses that has caused rapid debt accumulation and increased interest costs in recent years.

4. Moderate (+)' susceptibility to event risk, which reflects ongoing government liquidity challenges.

Concurrent with the first-time rating assignment, Moody's has also assigned a Ba3 ceiling for local currency debt and bank deposits as well as a B1 foreign currency debt ceiling and a B3 foreign currency bank deposit ceiling. The local-currency country ceiling reflects the maximum credit rating achievable in local currency for a debt issuer domiciled in Swaziland (similarly for a bank deposit). The ceilings on foreign-currency bonds and bank deposits capture foreign-currency transfer and convertibility risks.

The negative outlook indicates that the balance of risks to the country's credit profile are tilted to the downside due to the ongoing government liquidity challenges and, absent of significant fiscal measures, the risk that public sector debt increases beyond what is currently incorporated in the B2 rating.

RATINGS RATIONALE

SMALL AND SLOW- GROWING ECONOMY, BUT RELATIVELY WELL INTEGRATED, DIVERSIFIED AND RESILIENT

One key factor underlying the B2 rating is our assessment of economic strength at Low (+), which is constrained by the small size of economy and a growth track record much below its regional peers, averaging less than 3% a year since the early 2000s. On the positive side, wealth levels are materially above that of regional peers, with a GDP per capita in PPP of $9,768 in 2016. Swaziland is also more diversified and resilient to external shocks such as the commodity price shock. Other sources of credit strengths include high adult literacy and a well-developed road infrastructure.

INSTITUTIONAL STRENGTH CONSTRAINED BY GOVERNANCE CHALLENGES THAT HAVE BEEN HAMPERING PROGRESS WITH FISCAL AND STRUCTURAL REFORMS

Swaziland has a dual governance system where modern and traditional systems coexist The modern state comprises democratic parliamentary system, a judiciary and an executive branch. The traditional branch is based on the system of chiefdoms. In Moody's view, interactions between the two systems sometimes slow progress with agreeing on and implementing structural reforms. On a positive side, the CMA arrangement has helped Swaziland achieve price stability and supports regional integration.

Swaziland has mixed score on measures of institutions and governance according to the Worldwide Governance Indicators. It posts a low score on 'Government Effectiveness', but a moderate assessment on 'Rule of Law' and 'Control of Corruption'

MODERATE (+) FISCAL STRENGTH DERIVED FROM STILL RELATIVELY LOW BUT RISING PUBLIC DEBT

The Moderate (+) fiscal strength assessment reflects a still very low public debt, estimated at about 25% of GDP and at 82% of government revenues at the end of 2016. At the same time, large fiscal imbalances are causing public sector debt to accumulate rapidly, which in turn has led to some weakening in debt affordability, which Moody's measures as interest costs over budgetary revenues. Interest to revenues are currently approaching 10%, up from about 6% in 2015/2016 fiscal year.

The budget process and implementation has so far prevented accumulation of excessive debt burden observed in other African countries, but the lack of a medium term consolidation plans puts this achievement at risk. While the government envisages cutting the deficit to 8.3% of GDP in 2017/18, substantial funding needs remain. Medium term consolidation plans have so far not been announced, suggesting that funding issues will continue unless the structural challenges of the budget are addressed. On the expenditure side, the wage bill is still one of the highest in Sub-Saharan Africa and crowds out capital spending.

MODERATE (+) SUSCEPTIBILITY TO EVENT RISK DRIVEN BY GOVERNMENT LIQUIDITY RISKs ARISING FROM THE CHALLENGES OF FUNDING SIZEABLE FISCAL DEFICITS.

Moody's assessed the risk of sudden event as Moderate (+), driven by Government Liquidity Risk, as funding could become a challenge given the heavy reliance on the banking sector for the financing of relatively large fiscal deficits. The Political Risk sub-factor score of Low (+) reflects the stable political track-record exhibited in the Government of Swaziland. The Banking Sector Risk score of Low (-) is based on the relatively small size of the Swazi banking sector, as well as sound levels of capitalization. The External Vulnerability Risk is assessed at Very Low and reflects current accounts that have minimal deficits and forex reserves levels supportive of the long-standing currency peg regime.

RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook reflects the downside risks associated with a continuation or acceleration of government liquidity pressures and, absent of fiscal adjustments, a high likelihood of rapid accumulation of public debt and arrears. The negative outlook is also underpinned by weak growth prospects.

FACTORS THAT COULD LEAD TO AN UPGRADE

Credible fiscal adjustment plan and its implementation that would contain government liquidity pressures, stabilize public debt and resolve expenditure arrears could lead Moody's to stabilize outlook. Diversification of funding sources of the government deficits would also be positive. Any material improvements to institutional strength, especially as related to governance, would also put upward pressure on the credit.

FACTORS THAT COULD LEAD TO A DOWNGRADE

A pronounced deterioration in debt levels or debt affordability could put downward pressure on the credit profile. Relatedly, Moody's could downgrade the sovereign rating if the government liquidity pressures were to increase further. Protracted fall in international reserves below adequate levels that could jeopardize 1-1 peg to the South Africa rand would also put downward pressure on the rating.

GDP per capita (PPP basis, US$): 9,775.8 (2016 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 1.3% (2016 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 7.8% (2016 Actual)

Gen. Gov. Financial Balance/GDP: -12.1% (2016 Estimate) (also known as Fiscal Balance)

Current Account Balance/GDP: -5.3% (2016 Estimate) (also known as External Balance)

External debt/GDP: 48.0% (2016 Estimate)

Level of economic development: Low level of economic resilience

On 24 October 2017, a rating committee was called to discuss the rating of the Government of Swaziland. The main points raised during the discussion were: the issuer's economic fundamentals, including its economic strength, institutional strength/framework; fiscal or financial strength, including its debt profile and susceptibility to event risk. This rating level was also considered relative to its peers.

The principal methodology used in these ratings was Sovereign Bond Ratings published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

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