

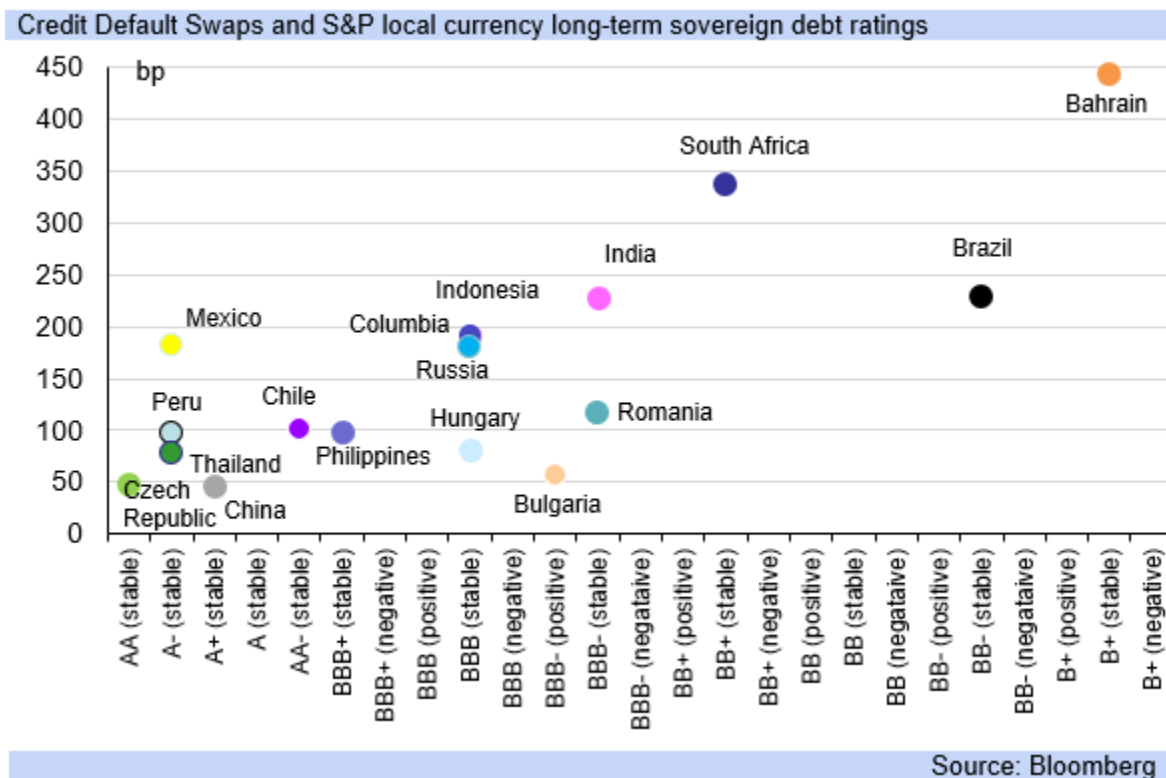
Credit Rating Note

Saturday 28 March 2020

Moody's finally downgrades South Africa amid Covid-19 crisis, risks are skewed to the downside not just for SA

- After a long process, with multiple warnings, Moody's has finally dropped SA to sub-investment grade at Ba1, and has also put a negative outlook on the rating – which is now equivalent to the BB+ negative of Fitch. S&P already has SA on BB, and both Fitch and Moody's are signalling that is the next step for South Africa.
- Global economic shutdowns in the face of Covid-19 has caused turmoil, both already in financial markets ahead of the measures and on institution in economies as many large and small corporates face severe weakening of balance sheets, with the economic effect likely already in the region of the recession of the global financial crisis just over a decade ago.
- While there are widespread expectations of such a global recession, the uncertainty is also high as it remains unknown how long it will take to contain the virus, and so how long the global economy will be negatively affected.
- Policy support measures announced are very substantial globally, but the shock could prove worse than currently anticipated, superseding the great recession of 2008-2009 stemming from the global financial crisis, with risk currently tilted to the downside, depending on the degree and extent of disruption to global economic activity.
- Consensus expectations are currently for the global economy to recover in 2021, and indeed for this to begin in the second half of 2020. Our expectation is similar for South Africa, with a contraction in GDP growth of -2.7% y/y in 2020, with a particularly sharp contraction in the second quarter of this year.
- The additional expenditure measures government seeks to institute in South Africa to provide some support in the face of Covid-19 will worsen government finances, as will the contraction in GDP and the negative impact to corporate and household incomes on the shutdown. However, breaking the spread of Covid-19 is paramount, and the costs will be even more substantial if it is not.

- Moody's most recent report on South Africa detailed "(d)ownside risks to growth are both immediate and longer term, relating to heightened uncertainty about the economic impact of the coronavirus pandemic and persisting domestic impediments to growth."
- The agency added that "(t)he negative outlook (it has instituted on SA's new Ba1 rating) reflects downside risks to economic growth and fiscal metrics, that could lead to an even more rapid and sizeable increase in the debt burden, further lowering debt affordability and potentially weakening South Africa's access to funding."
- "South Africa risks another credit rating downgrade, potentially before the end of this year. Moody's in particular warns that an increased likelihood of "the debt burden ... ris(ing) to even higher levels than currently projected, with even greater uncertainty regarding its eventual stabilisation, would exert downward pressure on the rating, as would any indications that the government's access to funding at manageable costs has structurally deteriorated."
- Further credit rating downgrades to SA's sovereign debt would weaken (and add to the volatility of) financial market indicators, negatively impacting the growth and socio-economic outlook. The financial markets have already viewed SA worse than BB+, at closer to B+.



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