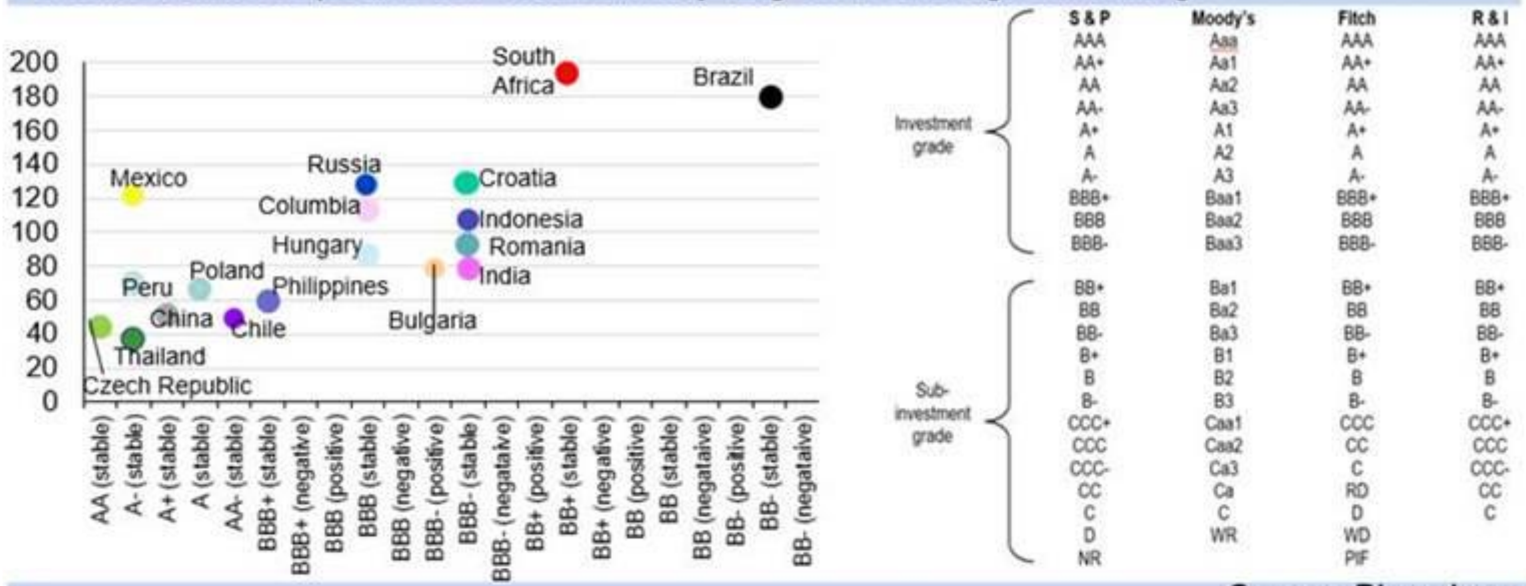
Investec

SA Economics

Credit Ratings Note

27th May 2019

Standard & Poor's maintains a stable outlook on its BB+ local currency rating of SA long-term sovereign debt, but warns of a downgrade on any further fiscal deterioration, weaker growth or erosion of rule of law



	S & P	Moody's	Fitch	R & I
Investment grade	AAA	Aaa	AAA	AAA
	AA+	Aa1	AA+	AA+
	AA	Aa2	AA	AA
	AA-	Aa3	AA-	AA-
	A+	A1	A+	A+
	A	A2	A	A
	A-	A3	A-	A-
	BBB+	Baa1	BBB+	BBB+
	BBB	Baa2	BBB	BBB
	BBB-	Baa3	BBB-	BBB-
Sub-investment grade	BB+	Ba1	BB+	BB+
	BB	Ba2	BB	BB
	BB-	Ba3	BB-	BB-
	B+	B1	B+	B+
	B	B2	B	B
	B-	B3	B-	B-
	CCC+	Caa1	CCC	CCC+
	CCC	Caa2	CC	CCC
	CCC-	Ca3	C	CCC-
	CC	Ca	RD	CC
	C	C	D	C
	D	WR	WD	
	NR		PIF	

- With Standard & Poor's already rating South Africa's long-term sovereign debt sub-investment grade on both the local and foreign currency front, Friday's S&P review did not cause much market reaction, with the agency leaving SA's rating and outlook unchanged as expected.

- S&P said SA's ratings "are constrained by the weak pace of economic growth, particularly on a per capita basis, as well as its large and rising fiscal debt burden, and sizable contingent liabilities." It "could raise the ratings if economic growth and fiscal outcomes strengthen in a significant and sustained manner beyond … (its) current projections".

- The rand has largely ignored the S&P outcome, instead seeing some mild stabilisation over the weekend, after last week's further escalations in US protectionism and consequent retaliation caused some risk-off in global financial markets, with the rand weakening.

- Indeed, the rand depreciated to R14.54/USD, R16.22/EUR and R18.43/GBP last week on the rise in risk aversion, from its post-election strong points of R14.13/USD, R15.83/EUR and R18.09/GBP where markets favoured the election outcome.

- US-Chinese trade tensions have ratcheted up another level (the US threatens 25% tariffs on US$300bn of additional imports from China), with concerns growing that China will halt trade talks with the US, while the risk that the trade tensions will turn into a full blown trade war has increased significantly.

- The rand today is at R14.42/USD, R16.14/EUR and R18.33/GBP, but will likely remain volatile this week, influenced by risk appetite levels in global financial markets which particularly influences SA's portfolio flows (the purchases and sales of SA's bonds and equities).

- S&P highlights that the financing of SA's current account "remains vulnerable to changes in investor sentiment because it is predominantly funded through volatile portfolio and other investment inflows. Such inflows can be susceptible to changes in foreign investor sentiment and emerging market appetite."

- "(G)ross external financing needs are large, at 109% of current account receipts plus usable reserves in 2019, and we expect it to remain high through 2022." "Nevertheless, we consider the depth of local capital markets and the flexible exchange rate regime to be key rating strengths that should help cushion against any large-scale withdrawal of external funds."

- "South Africa's external debt, net of liquid assets--including both foreign currency debt and rand debt held by foreign investors--is still not very high, at below 40% of current account receipts. However, it has been rising, primarily driven by net inflows of nonresidents' purchases of government local currency debt securities."

- The bulk of government debt in South Africa is rand debt, with a low percentage, only around 10%, issued in foreign currency. S&P recognises "(t)his shields the government debt from exchange-rate shocks. However, nonresidents hold 39% of the government's rand-denominated debt as of April 2019, down from 43% a year ago."

- Consequently "(w)hile the large presence of international investors in South Africa's debt markets helps improve liquidity and can lower the government's cost of funding, it also means the economy is vulnerable to global emerging market sentiment and global interest rate movements."

Local Currency Long Term

South Africa - S&P Ratings	
11/20/1995	BBB+
02/25/2000	Upgraded to A-
05/07/2003	Upgraded to A
08/01/2005	Upgraded to A+
01/25/2011	Downgraded to A
10/12/2012	Downgraded to A-
06/13/2014	Downgraded to BBB+
12/02/2016	Downgraded to BBB
04/03/2017	Downgraded to BBB-
11/24/2017	Downgraded to BB+

South Africa - Fitch Ratings	
06/05/1996	BBB
05/19/2000	Upgraded to BBB+
05/02/2003	Upgraded to A-
08/25/2005	Upgraded to A
01/10/2013	Downgraded to BBB+
12/04/2015	Downgraded to BBB
07/22/2016	Downgraded to BBB-
04/07/2017	Downgraded to BB+

South Africa - Moodys	
11/20/1995	Baa1
11/29/2001	Upgraded to A2
07/16/2009	Downgraded to A3
09/27/2012	Downgraded to Baa1
11/06/2014	Downgraded to Baa2
06/09/2017	Downgraded to Baa3

Source: Bloomberg's

- The most recent commentary from S&P focussed on a number of weaknesses, including "South Africa's fiscal position remains weak, with sizable fiscal deficits, a large debt burden, and sizable contingent liabilities, with the latter largely tied to the energy utility Eskom."

- "The effect on tax collection of subdued economic growth, as well as higher-than-expected VAT refunds, led to shortfalls in government revenues in 2018/2019 (April 2018-March 2019), while increases in public-sector wages put pressure on expenditures."

- "From 2019/2020 onward, continued slow revenue growth tied to low GDP growth, significant spending on wages , and financial support for Eskom and other state-owned-enterprises will remain the main constraints to fiscal consolidation." "South Africa's economic growth continues to remain well below most emerging market peers on a per capita basis."

- "Eskom's financial issues and mismanagement have long weighed on the government and escalated further this year
with extended power cuts and the need for further liquidity support." "While the government breached its self-imposed expenditure ceiling in 2019/2020, we expect it will keep trying to limit slippage."

- S&P has revised down its "general government deficit projection to 4.5% of GDP for fiscal 2019/2020 ending March 2020, and 4.2% on average for 2019-2022. We estimate that the annual change in net general government debt (which reflects the government's net funding requirements), will average 4.7% of GDP per year over 2019-2022."

- It "now expect(s) debt stabilization to be more gradual than we had previously forecast. We project that government debt (net of liquid assets) will increase to around 56% of GDP in the fiscal year ending March 2023 and that debt-servicing costs, measured by the ratio of interest to revenues, will increase to just above 13% of revenues."

- With Standard & Poor's already rating SA's long-term sovereign debt sub-investment grade, its slightly poorer assessment on some of the government finance metrics has not led it to change its rating or even outlook, although it does warn that further marked fiscal deterioration could cause it to lower its ratings of SA's long-term sovereign debt.

- It specifically warns it "could lower the ratings if we were to observe continued fiscal deterioration, for example due to higher expenditure pressures, the crystallization of contingent liabilities, if economic performance structurally weakened, or if external financing pressures mounted."

- However, S&P expects "with the elections now over, the South African government will pursue some reforms and attempt to improve economic growth and try and contain fiscal deficits. We

project economic growth will pick up modestly from 2020, helping to contain the rise in government debt."

- Specifically, "(e)fforts will focus primarily on cutting costs, slimming ministerial head-counts, improving state-owned enterprises, and tackling graft. However, the government will likely continue to shy away from difficult and contentious issues such as widespread staff retrenchments in state-owned enterprises, and tackling the labour unions. Overall reform efforts are likely to be lacklustre and unlikely to be significant enough to drive strong GDP growth."

- S&P's calmer approach to its rating on SA is in contrast to Moody's (see "Credit Ratings Note: Post-election Moody's warns of a credit rating downgrade if SA's structural weaknesses are not resolved, particularly rising debt, high expenditure in relation to weakening tax revenues and low economic growth, 16th May 2019, website address below).

- Earlier this month Moody's issued a stark warning that SA is at risk of losing its investment grade if policies did not sufficiently address rising sovereign debt, fiscal overspending in relation to revenue and economic growth. However, with SA already at sub-investment grade from S&P, S&P clearly feels SA is aligned with its sub-investment grade peers.

Local Currency Credit Ratings – Long Term Sovereign Debt

	S&P	Moody's	Fitch
Czech Republic	AA	A1	AA-
Chile	AA-	A1	A+
China	A+	A1	A+
Poland	A	A2	A-
Mexico	A-	A3	BBB+
Peru	A-	A3	A-
Thailand	A-	Baa1	BBB+
Botswana	A-	A2	NR
Russia	BBB	Baa3	BBB-
Colombia	BBB	Baa2	BBB
Hungary	BBB	Baa3	BBB
India	BBB-	Baa2	BBB-
Philippines	BBB-	Baa2	BBB
Croatia	BBB-	Ba2	BB+
Bulgaria	BBB-	Baa2	BBB
Indonesia	BBB-	Baa2	BBB
Romania	BBB-	Baa3	BBB-
South Africa	**BB+**	**Baa3**	**BB+**
Brazil	BB-	Ba2	BB-
Turkey	BB-	Ba3	BB+
Kenya	B+	B2	B+
Nigeria	B	B2	B+
Ghana	B	B3	B
Ethiopia	B	B1	B
Rwanda	B	B2	B+
Uganda	B	B2	B+
Mozambique	B-	Caa3	CC
Zambia	B-	Caa2	B-
Angola	B-	B3	B
Dem. Rep of Congo	CCC+	B3	NR
Namibia	NR	Ba1	BB+

Source: Rating Agencies