MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

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THIRD COMMONWEALTH STAKEHOLDERS' CONFERENCE ON PUBLIC DEBT MANAGEMENT AND USER GROUP MEETING

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Secretary-General

Honoured Guests

Ladies and Gentlemen

I'm honoured to have been invited to address you this morning on your first day of the 3rd Commonwealth Secretariat Stakeholders' Conference on Public Debt Management.

I am told that there are about 70 delegates representing 35 countries in this conference, so let me take this opportunity to welcome you to South Africa, and hope that you will have fruitful discussions over the next few years.

The theme of this conference: "*Public Debt Management in an Uncertain Era*" is quite apt considering that we are grappling with the challenges that the post-crisis world has presented us with.

About seven years ago, the world experienced a global financial and economic crisis that is comparable only to the Great Depression of the 1920s in its scale and destruction. As a result of the crisis, many countries were plunged into recession, many experienced massive job losses and revenue shortfalls. The global economy is yet to recover fully from the impact of the crisis.

The crisis exposed structural imbalances in many economies and highlighted the need for reforms that will transform economies into those that are much more resilient. As we speak, the global economic environment remains uncertain and the rate of growth in some emerging markets is expected to be lower than previously anticipated, a few years ago.

In South Africa, we experienced a recession in 2009 that led to a tax revenue shortfall of R60 billion. This recession came at a time when we had just posted two years of a budget surplus. As a result, we had fiscal room to respond and take an expansionary stance to counter its effects. Government has expanded its debt in response to difficult economic circumstances. As a percentage of GDP, net debt has grown from 21.8 per cent at the start of the financial crisis in 2008/09 to 40.8 per cent in 2014/15. Revenue collection has underperformed due to weak economic growth, leading to increased debt accumulation to support the fiscal stance.

On the other hand, advanced economies took extraordinary measures to ease monetary policy to counter the effects of the crisis, taking their interest rates to near zero. The impact of this on emerging economies was an unprecedented rise in inflows that led to an appreciation in local currencies.

The 2015 global economic growth picture is a mixed one. The International Monetary Fund (IMF) projects global GDP growth to increase only slightly to 3.5 per cent in 2015, rising to 3.7 per cent in 2016 from 3.4 per cent in 2014. The United States remains on track to lead global growth, while in the EU and Japan, growth is expected to recover only gradually. Emerging market growth is expected to remain low in 2015 and pick up modestly in 2016 as commodity prices are under pressure.

With that improvement in the outlook, the United States has signalled that it will be raising interest rates to unwind the quantitative easing of the past few years. The Quantitative Easing program of the US Federal Reserve Bank was officially wound down in October 2014 after US$4.5 trillion was accumulated since November 2008.

CHANGING GLOBAL MACROECONOMICS ENVIRONMENT AND SPILLOVER INTO PUBLIC DEBT MANAGEMENT

Where does that uneven global growth picture leave emerging markets such as ours?

Firstly, our economic recovery from the crisis has been much slower than we had anticipated. We have projected growth of 2.0 per cent in 2015. While this is an achievable and realistic target, 2per cent is not nearly enough to deliver the kind of tax revenue that we need to address our challenges.

With the normalisation of monetary policy in advanced economies, the "easy money" is slowly drying up and this has risks for countries.

To continue to attract capital flows, emerging market economies will have to demonstrate strong growth prospects and good governance. Fiscal frameworks need to be able to withstand higher interest rate costs whilst at the same time delivering higher growth.

This is going to force countries to carefully consider the trade-offs between short term and long term growth. This is reflected in decisions about the balance between taxation and debt issuance on the one hand and the balance between investment spending and spending on current expenditure on the other.

Getting this balance right is made even more challenging by the fact that we live in uncertain times. There are questions as to whether the current low growth environment reflects a period of adjustment or a prolonged lower growth scenario.

Countries urgently require structural reforms to raise growth levels and address the lingering impact of the crisis on unemployment, including 50 per cent youth unemployment in some countries, and debt overhangs.

Furthermore, countries that are dependent on international capital flows will need to have stable macroeconomic frameworks in place so they can withstand negative shocks that come from the global economy. Stable, predictable and transparent fiscal and monetary policies are critical in raising confidence and attracting investment.

For South Africa, we have acknowledged that while the global economy has been a drag, the main constraints to growth are domestic in nature. Recent data shows that the domestic economic landscape remains a challenging one.

GDP growth in the first quarter of 2015 was at 1.3 per cent quarter-on-quarter on a seasonally adjusted and annualised basis, highlighting the negative impact of the energy challenges that the country is facing.

We have taken several steps to address the energy challenge and expect that economic growth will reach 3 per cent by 2017, as more electricity comes onto the grid and as consumer spending improves and trade with the rest of Africa rises.

South Africa has committed to promoting structural reforms that are needed to lift growth over the long term. Government's Medium-Term Strategic Framework sets out how we will achieve the goals of faster growth, higher employment and lower inequality in the National Development Plan (NDP).

We are making good progress in areas such as ports reform, the introduction of a single transport regulator, broadband rollout and the reform of key state owned enterprises such as South African Airways (SAA) and Eskom. We have also had success in putting in place policies that target job creation such as the Jobs Fund, Expanded Public Works Program (EPWP) and the Employment Tax Incentive (ETI) .

IMPACT ON THE FISCUS

As I said before, an expansionary fiscal stance supported the economy since the financial crisis in 2008 but this countercyclical approach has reached its limits. Our fiscal stance is underpinned by three principles of counter cyclicality, intergenerational equity and long-term debt sustainability.

In line with this, government has committed itself to narrowing the budget deficit and stabilising debt by introducing and sticking to expenditure ceilings and taking measures to raise revenue.

The 2015 Budget emphasizes the need for government to strengthen budget preparation and expenditure controls to improve efficiency of resource allocation and the composition of spending. Capital remains the fastest-growing item of non-interest expenditure over the medium term, while progress is being made to limit the rate of spending growth for current expenditure. We have done this while protecting spending in key areas such as education and health.

Over the medium term however, lower-than expected global and domestic growth remains one of the main fiscal risks, which would reduce revenue collections, widen the primary balance and increase debt-service costs.

NAVIGATING PUBLIC DEBT MANAGEMENT IN THE NEW NORMAL

Given this challenge, how then do we remain true to the principles that underpin our fiscal policy, particularly the one of long term debt sustainability?

I am sure this is a question for many policymakers around the world and one you will be discussing at length over the next two days.

For many countries, government borrowing has risen in the post-crisis years. However, there appears to be limits to the ability to stabilise the economy, when government debt is too high. This means fiscal policy becomes weaker at higher debt levels. It is therefore critical that governments maintain prudent debt levels and rebuild fiscal space.

At the dawn of democracy, South Africa was at risk of being caught in a debt trap. The new government opted to first get its fiscal house in order. Sound macroeconomic policies, such as monetary and fiscal policies, enabled government to implement its infrastructure programme at much lower costs. This foundation laid the basis for macroeconomic stability and an improvement in the country's credit ratings. By the early 2000s, government had reduced its debt from 38 per cent of GDP to 22 per cent of GDP. So, by the time the crisis hit in 2008, the government had built enough fiscal space to be able to respond to the crisis in a countercyclical manner.

There are several lessons we have learned over the years but I would like to leave you with these few thoughts. In as far as sound debt management is concerned, we have learned that there are a few non-negotiables and those include:

- Prudent macroeconomic policies;
- Fiscal and monetary discipline:

- Building a strong and liquid local currency bond markets
- Promoting policies that make a country an investment-friendly destination

I have made the case for prudent macroeconomic policy and fiscal discipline so let me conclude with a few remarks about building strong and liquid local currency bond markets.

Well-functioning bond markets are important drivers of economic development as they promote the efficient mobilisation of domestic savings, financial stability and market-based monetary policies. A balanced government bond market (covering issuances across the yield curve), together with proper market infrastructure, would also facilitate the development of the broader capital market such as infrastructure bonds and corporate bonds. The development of the local bond market and the transparency thereof has seen increased activity from international bond investors. In 2009 foreign investors held about 10 per cent of South African local currency bonds. Fast forward to 2014, the holding by non-residents is sitting at about 35 per cent.

The development of the local currency bond market should therefore, be a key policy priority. But for that to succeed, countries should support the accumulation of domestic savings and investable funds so the development of pension funds and insurance products is important. Domestic financial intermediaries have a better appreciation of local risks and circumstances and play a central role in mobilising domestic resources to support local bond markets.

I will stop here and hope that this gathering will, over the next two days, deliberate and come to a better understanding of how we need to approach debt management in this era of uncertainty.

I thank you