NATIONAL ASSEMBLY

QUESTION FOR ORAL REPLY

QUESTION NUMBER: 345 [NO3657E]

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★345. Mr T D Harris (DA) to ask the Minister of Finance:

Whether, with regard to the recent downgrades in South Africa's sovereign credit ratings by (a) Moody's and (b) Standard and Poor's ratings services, he has calculated the (i) direct cost to the fiscus in terms of increased borrowing costs related to the downgrades and (ii) indirect cost to the economy; if not, why not; if so, what are the estimated costs?

NO3657E

REPLY:

i) Ratings downgrades impact the fiscus and the economy by raising investors' perceptions of risk and reducing the number of investors willing to invest in South Africa. This results in a higher cost of borrowing, not only for the fiscus, but also for private sector and state-owned corporates who face a higher cost of debt or equity issuance as a result of heightened perceptions of country risk.

Ratings downgrades may also result in a weaker exchange rate, which can raise the cost of key imports such as petrol and raise the overall inflation rate. Secondary effects on the economy may include lower confidence levels that result in slowing domestic activity.

ii) The National Treasury has been carefully monitoring the impact of the downgrades, but the precise impact is difficult to determine given the interplay of a number of factors. High levels of global liquidity, low returns in developed countries, and rising allocations to South Africa by portfolio managers due to our inclusion in the World Global Bond Index (WGBI) have had an important dampening effect on the potential risk aversion associated with the ratings downgrades.

At the same time, a number of domestic constraints to investment, including wild cat strikes and electricity constraints, may have affected the performance of financial market indicators such as the rand and equity markets. The depreciation of the exchange rate has gathered momentum since the downgrades, with the rand one of the weakest emerging market or commodity currencies since September. Indicators of domestic confidence and activity have been subdued for much of 2012 as a result of global economic uncertainties, and have been exacerbated by recent domestic strike activity.

To date, there has been only a slight increase in the cost of borrowing for longer dated government bonds, with a maturity of seven years or longer. There has been no discernible change in the cost of borrowing for shorter-term government debt. While the pace of foreign sales of equities has picked up pace since the ratings downgrades, foreign investor appetite for South African government bonds remains strong. There has been an increase in the cost of borrowing for Eskom since the downgrade announcement, although yields remain below levels observed during the first half of 2012. Current yields on Eskom bonds remain reasonably low by historic comparison.

iii) In a world of volatile global capital flows, however, we cannot take this relatively sanguine outcome for granted. The “negative” outlook attached to the ratings poses a risk of further downgrades, which may occur at a time when global market conditions are not so favourable.

iv) Government policy response to the downgrades

The downgrades highlighted downside risks to growth and investment, social tensions and pressure on the fiscus. These factors are not new to us. Government remains committed to taking the necessary measures to lift the growth potential and competitiveness of the South African economy. This is reflected in the plans of the 2012 Budget, including continued investment in infrastructure with the view of enhancing the productive capacity of our economy and the competitiveness of our industries, improving competitiveness through regulatory reforms and a competitiveness support package and continued investment in skills development and education. Continued spending on the social wage to reduce poverty and improvements to the efficiency of government spending are critical to manage social tensions.

These priorities have been outlined in the Medium Term Budget Policy Statement, and will be executed in a manner consistent with the three principles of the fiscal framework: counter cyclicality, debt sustainability, and intergenerational equity.