NATIONAL ASSEMBLY

QUESTION FOR WRITTEN REPLY
QUESTION NUMBER: 1691 [NW1897E]
DATE OF PUBLICATION: 9 JUNE 2017

1691. Ms Z Jongbloed (DA) to ask the Minister of Finance:

(1) Whether the downgrading of the South African economy to junk status (a) has had or (b) will have any effect on the Government Employee Pension Fund; if not, what is the position in this regard; if so, what are the relevant details;

(2) whether any (a) plans and/or (b) strategies have been put in place to safeguard the pensions of civil servants against possible negative effects; if not, why not; if so, what are the relevant details? NW1897E

REPLY:

<u>Impact of Downgrades on the GEPF's Investments Thus Far.</u>

The GEPF has allocated approximately 95% of its assets to listed assets, as per the investment policy statement. Due to the nature of the GEPF's size, its performance is directly linked to the performance of listed markets. The downgrade has had a minimal impact on GEPF's performance thus far based on the performance of the following asset classes which form approximately 90% of the GEPF's domestic listed assets:

- **Listed equities:** according to the PIC, the performance of the All Share Weighted Index's total return was flat from the first downgrade in April 2017 to 30 June 2017.
- **Fixed income:** the PIC stated that the performance of domestic bonds was not negatively affected. Foreign investors continue to buy domestic bonds over domestic

equities. The ratings downgrade has affected only bonds issued by the SA government in foreign markets.

The PIC has indicated that it is important to note that at the moment, only Fitch has downgraded SA's long term local currency rating to sub-investment grade. S&P and Moody's have it at one notch above junk. This partially explains why SA has not yet experienced a mass selloff in domestic bonds by foreigners.

Hypothetical Impact of Further Downgrades Based on Current Portfolio Positioning.

The PIC has stated that SA runs the risk of being excluded from the World Government Bond Index should all the credit rating agencies downgrade the domestic credit rating to below investment grade.

The PIC expects that in the event of further downgrades resulting in index exclusion. Bond yields will spike to around 125bps in the short term and normalise at around 65 – 85 bps higher than prior the downgrade event. Similarly, the PIC expects a high degree of volatility in the Rand based on the higher beta of forex relative to bonds as well as estimates on current positioning in forex markets relative to a fair value estimate incorporating risk premia.

Current Portfolio Positioning to Mitigate the Negative Effects of Further Downgrades.

Market Positioning

The PIC have provided their outlook on the following asset classes, should markets underperform due to further credit downgrades:

- **Listed equity:** the listed equity index is diversified across sectors and has exposure to rand hedge shares, which may cushion some losses if the Rand weakens due to further downgrades.
- **Listed fixed income:** the Fund is positioned in line with the specified benchmark as per the mandate. Further downgrades would have a negative impact on the performance of listed fixed income. The impact of further downgrades would not only be on the Fund but on the benchmark as well.

Strategic Asset Allocation.

The GEPF has a long-term strategic asset allocation along with optimal ranges in which the Fund is willing to take risk with respect to investment views in order to avoid underperformance and mitigate the negative effects of a further credit downgrade. The GEPF has not changed its asset allocation and/or ranges to safeguard against the negative effects of further credit downgrades. The GEPF is a long term investor and a defined benefit pension fund whose investment strategy has been designed, taking long-term objectives into account, using a liability driven approach after an extensive asset liability modelling exercise.

Conclusion

The PIC have stated that the probability for further downgrades remains high in the context of sluggish growth and a confidence deficit, hurting investment and consumer spending.