NATIONAL COUNCIL OF PROVINCES

QUESTION FOR ORAL REPLY

QUESTION NUMBER: 59 [CO186E]

★59. Mr W A S Aucamp (Northern Cape: DA) to ask the Minister of Finance:

(1) With reference to the statement he reiterated again this year, that we cannot afford to make any financial mistakes, what will be the effects from any possible further downgrades by rating agencies to the country's economy;

(2) whether any of such possible negative effects have been factored into the drafting of the current Budget; if not, why not; if so, what are the relevant details?

CO186E

REPLY:

(1) Further rating downgrades will cause more investors to withdraw their investment from South Africa and rather invest in the bonds of another country. These outflows are likely to result in a weaker exchange rate, higher borrowing costs for the government, firms and households, and place upward pressure on inflation. Taken together, the downgrade is likely to have a contractionary impact on the economy.

The 2021 Budget set out a plan for returning South Africa to fiscal sustainability. Nevertheless, South African government bonds are currently at sub-investment grade with all three major ratings agencies, and the impact of further downgrades could be severe. In relative terms, South Africa's fiscal position has deteriorated compared to emerging market peers. The ratings agencies have also expressed skepticism at government's ability to implement the proposals outlined in the 2021 Budget.

Quantifying the overall impact of further downgrades is difficult, but several factors point to a system under increasing stress. South Africa's long-term borrowing rates have already moved sharply higher over the past year, reflecting weak domestic growth and large government deficits. At the same time, foreign holdings of government debt have declined sharply, with domestic investors taking up the slack. More recently, inflation expectations in advanced economies (particularly the United States) have begun to rise, resulting in rising yields in those countries. As a result, the benign global environment that has shielded South Africa thus far may be starting to turn.

At the same time, there are also a number of mitigating forces. These include: (i) a floating exchange rate that acts as a shock absorber in times of stress; (ii) a low and stable inflation outlook, managed by an independent central bank, and (iii) deep, liquid and well regulated financial markets. Ultimately, successful implementation of the fiscal strategy outlined in Budget 2021, coupled with growth reforms, is required to maintain or improve our credit rating.

(2) The budget baseline does not include the effects of a ratings downgrade. But the economic forecast already captures the effects of the weak fiscal position. For example, government bond yields remain elevated compared to the pre-COVID-19 period, reflecting a higher risk premium on South African debt. The effects of higher interest rates are captured in the economic forecast and debt-service cost projections.