Ratings agencies not convinced about SA's economic recovery plan - expect further downgrades

The recent credit ratings downgrades by Moody's Investor Services and Fitch Ratings - which gives South Afric its lowest credit rating since 1994 - indicate that ratings agencies are not convinced that government's proposec economic recovery plans have much substance to them.

By Paul Marais 27 Nov 2020

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Rating agencies say government's proposed fiscal consolidation plan is unconvincing and that the plan to freeze public sector wages is unlikely to happen. The latter proposal is already being contested through the judicial system.

The bottom line is that none of the ratings agencies have much hope in an economic recovery in the short term although their expectations of the extent of a contraction in GDP for 2020 have been moderated to be closer to -8% than the anticipated -10%.

Government spending priorities questionable

Despite official spin that the president's annual investment conference last week was a resounding success, the reality is t investors are not lining up to invest in new mega projects. In fact, a number of projects that were included as part of the numbers at last year's conference have subsequently been put on ice. Investment spending has slowed down significantly recent years to the extent that spending in 2019 was at its lowest levels since 2012.

To attract investment South Africa urgently needs to implement economic reforms including putting business-friendly legislation at a more rapid place. This needs to include policy and legal certainty around issues such as expropriation with compensation.

What is becoming increasingly clear is that government's spending priorities are questionable at best. This is exacerbated the failure of just about every state owned enterprise which results in the need for ongoing bailouts. While government has no choice but to bail out strategically important entities like Eskom, it's determination to bail out a less strategically importa organisation like South African Airways is not as easy to understand. At the same time it begs the question of the extent o other wasteful expenses in government departments.

Poor implementation record

South Africa's track record as far as implementation is concerned is poor. Fitch has said that even if the president's Economic Reconstruction and Recovery plan is implemented, 'the effect on reforms would be limited and take time to accumulate'. In a similar vein Moody's maintains that changes are unlikely to occur due to economic and social constraint

The absence of significant new greenfield investment projects should act as a warning system. Until government starts to address crippling government debt, solve the risk of load shedding and address Eskom's burgeoning debt issue, loosen empowerment rules and create a more investor and business friendly environment, there is little incentive for foreign investors to consider SA.

The fact that both Moody's and Fitch have pushed South Africa's credit rating further into junk with a negative outlook poir to the very real threat of further downgrades. Expect further announcements regarding this issue in February next year around the time of the finance minister's budget speech.

Fortunately for South Africa the reaction from the market to the current set of downgrades has been muted. Bullish emerg market sentiment and a smoother US presidential transition appears to be a more significant set of forces than any South Africa-specific malaise.

Vicious cycle

The downgrades, however, have an implication for the country resulting in a higher cost of borrowing for the state. At this stage South Africa can ill-afford a higher cost of borrowing, particularly given rising levels of debt to GDP and lower tax revenue collection as a result of the lockdown. The problem with borrowing to service debt is that no injection is being mac into economic growth generators. At the current rate of decline South Africa will soon not be able to borrow sufficient amounts to service debt. We are rapidly getting into a vicious cycle where more and more of government's revenue will be spent on servicing debt, at the expense of maintaining social expenditure.

The current situation cannot solely be blamed on Covid given that South Africa's structural problems were in existence lon before the pandemic. What 2020 has done, however, is fast track the country's seemingly inevitable race to the fiscal cliff

February's budget announcement will be significant. Expect higher taxes given that cutting back on social grants would provide government with very poor optics in the current environment.

Although tough choices and hard decisions need to be made if South Africa is to achieve any significant degree of economic recovery, recent history indicates that the ruling party has little appetite for these.

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