Moody's blues could hit SA

Moody's Investor Service is the the only credit rating agency yet to downgrade the country to junk status. But whether this will happen today is anyone's guess. Even economists are divided as to whether junk is on the cards or not. Having adopted a cautiously optimistic "wait and see approach" since 2017, a less than enthusiastic response to National Treasury's 2019 budget may finally dampened that optimism.

Following Finance Minister Tito Mboweni's budget speech in February, Moody's said that the 2019 Budget highlighted the government's limited fiscal flexibility amid a challenging economic environment, with further erosion in fiscal strength after the October 2018 medium-term budget policy statement had already pointed to wider deficits over a longer period. The agency has forecast real GDP growth at 1.3% in 2019 and 1.5% in 2020, lower than Treasury's estimates of 1.5% and 1.7%.

Moody's has retained South African debt ratings at investment grade since 2017, with this on review for downgrade. "At the time, the agency said the review period would allow it to assess the South African authorities' willingness and ability to respond to the rising pressures through growth-supportive fiscal adjustments that raise revenues and contain expenditures; structural economic reforms that ease domestic bottlenecks to growth; and improvements to SOE governance that contain contingent liabilities.

"Following President Cyril Ramaphosa's first State of the Nation Address last year, Moody's upgraded the credit outlook from negative to stable and this action seemed to indicate hopes of economic growth and fiscal prudence. However, Budget 2019 has not been able to demonstrate any meaningful remediation," says Ian Matthews, head of business development at Bravura.

Junk status

Currently South Africa is rated by Moody's at Baa3, which is one notch above sub-investment grade. Ba1, -2 and -3 are below investment grade and deemed junk status. The country has been rated below investment grade since 2017 by ratings agencies Standard & Poor and Fitch.

“When Standard & Poor downgraded its credit rating for South Africa in November 2017 to BB (below investment grade) the decision led to South Africa being excluded from the Barclays Global Aggregate index, whose inclusion criteria require investment grade rating on its local currency debt from any two ratings agencies. Fitch had already downgraded South Africa’s credit rating to BB+ in April 2017, which meant that South Africa was excluded from the Barclays index as well as the JPMorgan Emerging Market Bond Index Global," he says.

Should Moody’s also downgrade South Africa to junk status, the country would no longer be eligible for inclusion in debt gauges such as Citigroup Inc.’s World Government Bond Index (WGBI). “Having satisfied the three criteria of size, credit quality and lack of barriers to entry in 2012, the inclusion of the South African Government Bond Index marked the first African government bond market to be included in the WGBI,” says Matthews. “A downgrade by Moody’s would render South Africa unable to meet the required credit quality and could potentially see forced outflows of capital amounting to as much as $10bn.”

Government review

Moody’s has just completed a periodic review of the government of South Africa. “This does not announce or pre-empt a rating action and does not involve a rating committee. The review records that the credit profile of South Africa (issuer rating Baa3) reflects the country's moderate (+) economic strength, balancing the economy's relatively large size and diversification against persistently slow growth due to weak business confidence and structural impediments. South Africa also has moderate (+) institutional strength, moderate (+) fiscal strength reflecting rising government debt and low (+) susceptibility to event risk driven by domestic political risk," he says.

Eskom, the biggest threat to South Africa’s economy, and the most compelling reason to downgrade may conversely keep the country out of junk. Matthews says, “Moody’s might not flip the switch on Friday, opting to wait out government’s proposed plans for turning the utility around. This would potentially give South Africa another few months or years in which to implement remedial strategies. If this is to be the case, make no mistake that it would be our final warning.”