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ISSUER COMMENT
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Contacts

Lucie Villa +33.1.5330.1042
VP-Sr Credit Officer
lucie.villa@moodys.com

Raphaele Auberty +33.1.5330.3414
Associate Analyst
raphaele.auberty@moodys.com

Matt Robinson +44.20.7772.5635
Associate Managing Director
matt.robinson@moodys.com

Marie Diron +44.20.7772.1968
MD-Sovereign/Sub Sovereign
marie.diron@moodys.com

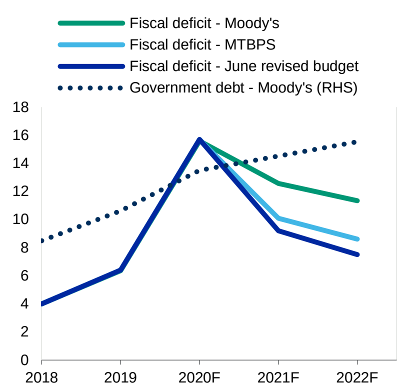
Government of South Africa

Budget maintains reform drive but lacks detail on implementation

On 28 October, the Government of South Africa (Ba1 negative) released its Medium Term Budget Policy Statement (MTBPS) for fiscal year 2020 (ending 31 March 2021), in which it recognised the scale of the country's economic and fiscal difficulties and revised its debt projections upwards. Although the government's focus remains on structural reform and fiscal consolidation, this year's MTBPS, like last year's, does not outline how and when it will implement policies to boost growth and arrest the deterioration in public finances. As a result, we expect the economy will remain subdued and for fiscal consolidation to be slow, sustaining the rise in government debt in the next couple of years.

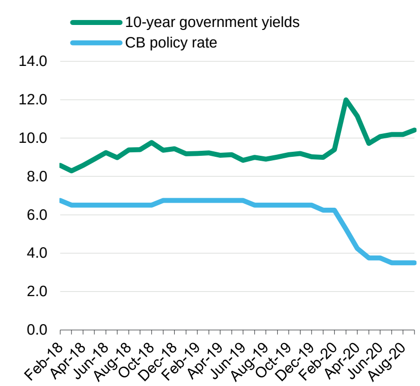
The government now projects a consolidated budget deficit of 15.7% of GDP in fiscal 2020, which is broadly in line with its revised June budget and our own forecasts. However, the authorities have revised their deficit projections for fiscal 2021 and 2022 upwards by approximately 1% of GDP to 10.1% of GDP and 8.6%, respectively because of higher primary spending (see Exhibit 1). As a result, the National Treasury now expects government debt will stabilise at around 95% of GDP by fiscal 2025, a trend somewhere between the “active” and “passive” scenarios presented in its last budget.

Exhibit 1
The government has revised its deficit projections for 2021/22 marginally upwards
% of GDP



Note: Fiscal year ending 31 March; 2019 corresponds to fiscal year 2019/2020. Most SOE guarantees (incl. Eskom and SANRAL) are included from 2019 onwards (principal and interests).
Source: National Treasury, Moody's Investors Service

Exhibit 2
SARB's intervention has not translated into lower yields
%, eop



Source: SARB, Moody's Investors Service

The government's fiscal strategy remains broadly unchanged. The authorities propose to contain spending where possible. In fiscal 2020, it will contain growth in public sector salaries at 1.8%, which is below inflation and the rate set under the three-year agreement on public sector wages running for fiscal years 2018-2020. The government expects further cuts on the wage bill beyond 2020, but negotiations with social partners will be difficult. The MTBPS provides little additional detail on the implementation of structural reforms that would boost economic activity sustainably. The Treasury discarded the option of fiscal stimulus based on low fiscal multiplier estimates.

The South African Reserve Bank's (SARB) accommodative monetary policy provides little support to the government's consolidation efforts. The SARB cut its policy rate by 3.0 percentage points in 2020 to support liquidity, from 6.5% at the end of 2019, and purchased government bonds, but the quantitative intervention has remained small. While the interventions helped temper upward pressure on long-term borrowing costs, yields on 10-year government bonds still increased to 10.4% at the end of September, up from an average of 10.1% in the first nine months of 2020 and 9.1% in 2019 (see Exhibit 2).

Based on higher than projected interest and primary spending, we forecast deficits that are around 2.5% of GDP wider than the MTBPS in each year from 2021 onward. In total, we forecast debt-servicing costs will reach 6.6% of GDP by fiscal 2022, compared to the government's expectations of 5.6%. At that point, the average interest rate on debt would reach 7.8%, exceeding the growth in nominal GDP (5.6%). As a result, South Africa would need a 2.5% primary surplus to stabilise debt-to-GDP, compared to our projection of a 4.7% primary deficit.

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