

# APRM CREDIT RATING TECHNICAL SUPPORT MISSION

## CREDIT RATING MANAGEMENT PROCESSES IN SOUTH AFRICA

Presented by Jim Matsemela  
Head, Sustainable Public  
Debt Management (CABRI)

November 2023 | JHB, SOUTH AFRICA

# CREDIT RATING AGENCY APPOINTMENT PROCESS

## Background and Objective:

- Since 1994/95 South Africa issued bonds in the International debt capital markets for purposes of meeting government's foreign currency commitments, set benchmarks for State-Owned Companies (SOCs) as well as to diversify funding sources

## Action:

- Appointment of Credit Rating Agencies as a requirement

## Challenge:

- Unlike Cash Management, Debt Management and the Management of Govt Guarantees stated in the Public Finance Management (PFM) Act (1999) or National Treasury (combining both former Department of Finance and Department of State Expenditure) established in terms of section 216 of the RSA Constitution (1996) – there is no detailed chapter in the Constitution or Public Finance Management Act making provision for the appointment of Credit Rating Agencies
- The procurement legislation was not enacted yet, but there was a PROCESS in place

## Question:

- Does the process followed in appointing CRAs matter for transparency and accountability of public debt management as a specialist branch of modern public financial management?

## CREDIT RATING AGENCY APPOINTMENT PROCESS (Con't)

### OLD PROCESS

- National Treasury (NT) through the Asset & Liability Management(ALM) Division (DMO) solicit ratings by sending an application to a specific rating agency, requesting the rating services
- NT through Strategy & Risk Management (SRM) Chief Directorate (CD) submits a contract/agreement and fee structure received from CRA to NT Legal Services Unit – to review the agreement and advice
- Once the NT-LSU reviewed and commented on the agreement and fee structure – submission is prepared for Head of ALM (DDG) to sign and approve on behalf of NT
- Signed copy send to CRAs becomes contractual agreement
- Signed fee structure implies NT is obliged to pay annual and/or quarterly fees for subsequent 3 years (initially yearly contracts)

### NEW PROCESS

- 6 months before expiry of the 3-year contracts – Supply Chain Management (SCM) Unit within Office of Chief Financial Officer sends letters of reminders to the ALM Division
- SCM Unit requests NT Legal Services Unit to draft contracts or review drafts prepared by Business Unit/ Service Provider for new contracts
- SCM Unit facilitate contract signing process
- SCM and Contract Manager commence contract activities
- Contract Manager conducts quarterly contract assessments
- Contract Manager ensures payments are made as per contract schedule
- Contract Manager prepares a close-out report at the end of every 3 years

# WHO RATES THE REPUBLIC OF SOUTH AFRICA

South Africa has solicited credit ratings from the following major credit rating agencies:

• **Moody's Investors Service (Moody's)**

• **S&P Global Ratings (S&P)**

• **Fitch Ratings (Fitch)**

**Ratings and Investment Information, Inc. (R&I) - unsolicited since 2020**

# BACKGROUND AND STRATEGIC FOCUS

## STRATEGIC FOCUS

### Why are we rated?

- Independent assessment of the country's credit worthiness;
- Influence investor sentiment; and
- Benchmark sovereign against peers.

### The importance of having a good rating

- Lower cost of borrowing.
- Ease of access to foreign markets

### STRATEGIC FOCUS:

- Coordinate and manage sovereign credit rating review missions of solicited credit rating agencies (CRAs): Moody's, S&P, and Fitch
- Formulate sovereign credit rating enhancement strategies, for engaging with CRAs, which should translate to favourable credit rating outcomes
- Convey accurate and updated data and information to CRAs timeously
- Monitor and report on the following risks that constrain the rating: Economic, Fiscal, Socioeconomic and Political risks

# MANAGEMENT OF SOVEREIGN RATING REVIEW PROCESS

THE OBJECTIVE OF NT STRATEGY IS TO ENSURE THAT GOVT SPEAKS WITH ONE VOICE WHEN COMMUNICATING WITH CRAs

**STEP 1: ORGANISE SOVEREIGN CREDIT RATING REVIEW MISSIONS (MOODY'S, S&P, FITCH)**

- Beginning of the calendar year, engage all CRAs on the dates about sovereign rating review visits
- Engage NT in order of sequence (Head DMO/DDG, DG/Permanent Secretary and Minister of Finance on dates proposed by CRAs
- Confirm the dates approved by the Minister's office with CRAs

**STEP 2: PREPARE NATIONAL TREASURY STRATEGY FOR ENGAGING WITH CRAs**

- Engage CRAs on the main themes of the rating review visits
- Agree on discussion topics and on industry experts that the CRAs want to interview during the visits
- Write a notification memo to Minister informing him/her about the upcoming CRA visits and key themes of the discussion topics
- In collaboration with SARB develop strategy for communicating with CRAs to ensure favourable outcomes from rating review process

**STEP 3: COMPILE FEEDBACK REPORT AFTER SOVEREIGN CREDIT RATING REVIEW MISSIONS**

- Accompany CRAs on their government and private sector meetings
- Draft feedback report and process closure for the Minister of Finance
- Through internal engagements deliberate on risk exposures that were highlighted by CRAs, and
- Advice on possible mitigation strategies

**STEP 4: PROVIDE COMMENTARIES TO THE DRAFT RATING ACTION REPORTS/GOVT RESPONSE**

- Review draft credit action reports from CRAs for factual correctness
- Circulate the draft reports to NT and SARB Principals or Executives for further inputs
- After publication of the credit rating action by CRAs, in collaboration with NT Communications Unit release the internal press statement

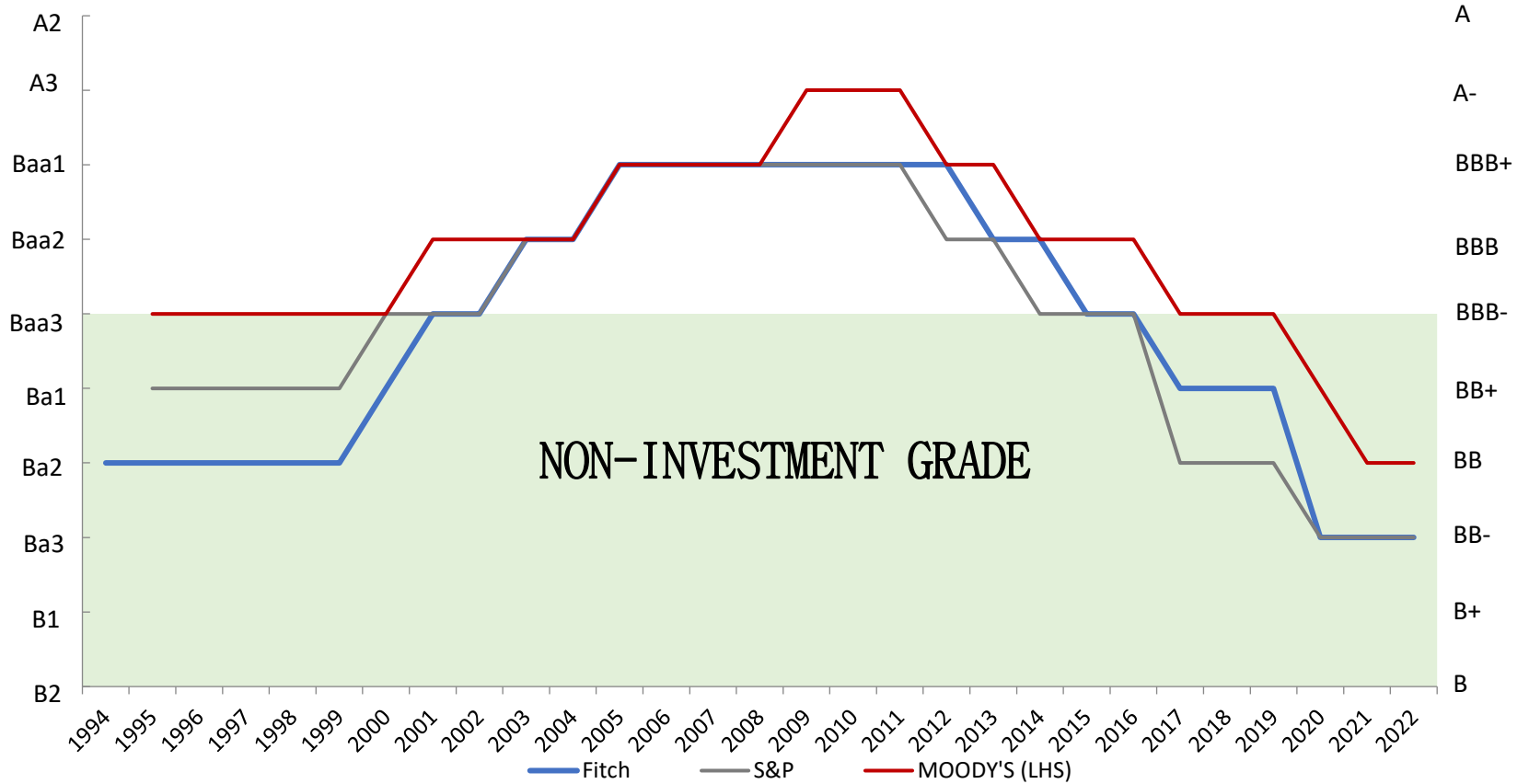
## STEP 5: ONGOING MONITORING OF SOVEREIGN RISK EXPOSURES

- Compile weekly and monthly sovereign rating development reports
- Compile quarterly and bi-annual forward-looking sovereign risk analysis reports

# KEY RATING INDICATORS ALIGNED TO CRA RATING METHODOLOGIES

Economic structure and Performance	Government Finances	External Payments and Debt	Susceptibility to Event Risk
<ul style="list-style-type: none"> <li>▪ Gross Domestic Saving/GDP</li> <li>▪ Gross Investment/GDP</li> <li>▪ Inflation (% CPI) - Headline</li> <li>▪ GDP Growth (% Change)</li> <li>▪ GDP Per Capita</li> </ul>	<ul style="list-style-type: none"> <li>▪ Government Revenue/GDP</li> <li>▪ Government Expenditure/GDP</li> <li>▪ Government Debt/GDP</li> <li>▪ Government Debt Interest Payments/Revenue</li> <li>▪ General Government Balance/GDP</li> </ul>	<ul style="list-style-type: none"> <li>▪ Current Account Balance/GDP</li> <li>▪ External Debt/GDP</li> <li>▪ Official Foreign Reserves</li> </ul>	<ul style="list-style-type: none"> <li>▪ Political Risk</li> <li>▪ External Vulnerability</li> <li>▪ Socio-Economic Risk</li> <li>▪ Institutional Independence</li> </ul>

# SOUTH AFRICA'S CREDIT RATING EVOLUTION





# SUMMARY OF RECENT CREDIT RATING UPDATES

- On **1 April 2022**, **Moody's** affirmed South Africa's long term foreign and local currency debt ratings at 'Ba2' and revised the outlook to stable from negative.
- On **8 March 2023**, **S&P** affirmed South Africa's long term foreign and local currency debt ratings at 'BB-' & 'BB' and revised the outlook to stable from positive.
- On **17 July 2023**, **Fitch** affirmed South Africa's long term foreign and local currency debt ratings at 'BB-' and maintained a stable outlook.

Rating Agency	S&P		Fitch		Moody's	
Date of Review	08-Mar-23		17-Jul-23		01-Apr-22	
	Current rating	Previous rating	Current rating	Previous rating	Current rating	Previous rating
Foreign currency credit rating	BB-	BB-	BB-	BB-	Ba2	Ba2
Domestic currency credit rating	BB	BB	BB-	BB-	Ba2	Ba2
Outlook	Stable	Positive	Stable	Stable	Stable	Negative
	Foreign currency credit rating is three notches below investment grade while domestic currency credit rating is two notches below investment grade		Both foreign and domestic currency credit ratings are three notches below investment grade		Both foreign and domestic currency credit ratings are two notches below investment grade	

# TARGETED KEY POLICY EVENTS THAT INFORM ENGAGEMENTS WITH CRAs

## *Policy events:*

- January – State of the Nation Address & January 8th Statement;
- February – Tabling of the main Budget
- April – National Elections (occurs after every five years);
- June – Policy conference of the ruling party (occurs after every five years);
- Medium Term Strategic Framework (MTSF) - (tabled after every five years);
- August - Local Government Elections (occurs after every five years);
- October – Medium Term Budget Policy Statement (MTBPS); and
- December – Leadership elective conference of the ruling party (occurs after every five years).

## *Annual and semi-annual sovereign rating missions:*

- March & October – Moody's Investors Service (Moody's); and
- April/May & November – S&P Global Ratings (S&P) and Fitch Ratings (Fitch).

# STRATEGIC AREAS TO ENHANCE CREDIT RATINGS

- **Rating risk exposures**

- Low growth;
- Electricity supply constraints;
- Fiscal sustainability (rising debt);
- Policy uncertainty; and
- Steep socio-economic challenges.



•Poverty  
•High unemployment  
•Wide income disparities  
•Poor general education attainment

- **Strategic areas to enhance rating**

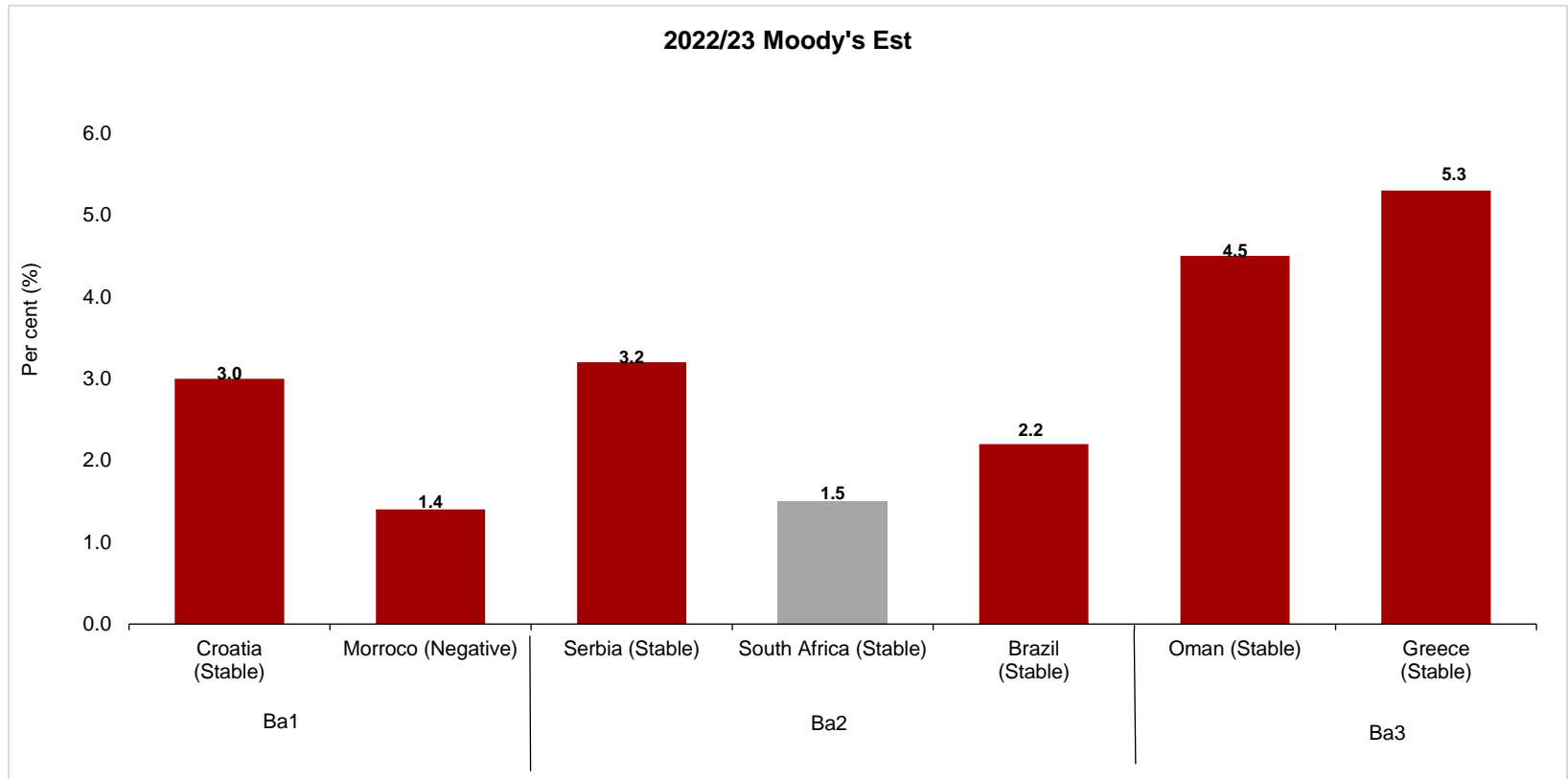
- Implement economic reforms to unlock the country's economic growth potential;
- Promote green energy and encourage PPPs and IPPs to reduce the energy capacity constraint on Eskom;
- Fast-track the implementation of the SOC's reforms to improve governance standards and financial viability;
- Maintain fiscal discipline;
- Diversify funding sources;
- Shifting resources from consumption expenditure to infrastructural investment; and
- Develop quality programmes for job creation and implementation.

- **Strategic actions required to enhance rating**

- Continuous engagements with the CRAs;
- Coordinating policy efforts inside and outside government; and
- Coherence in communicating government's position on policy matters.

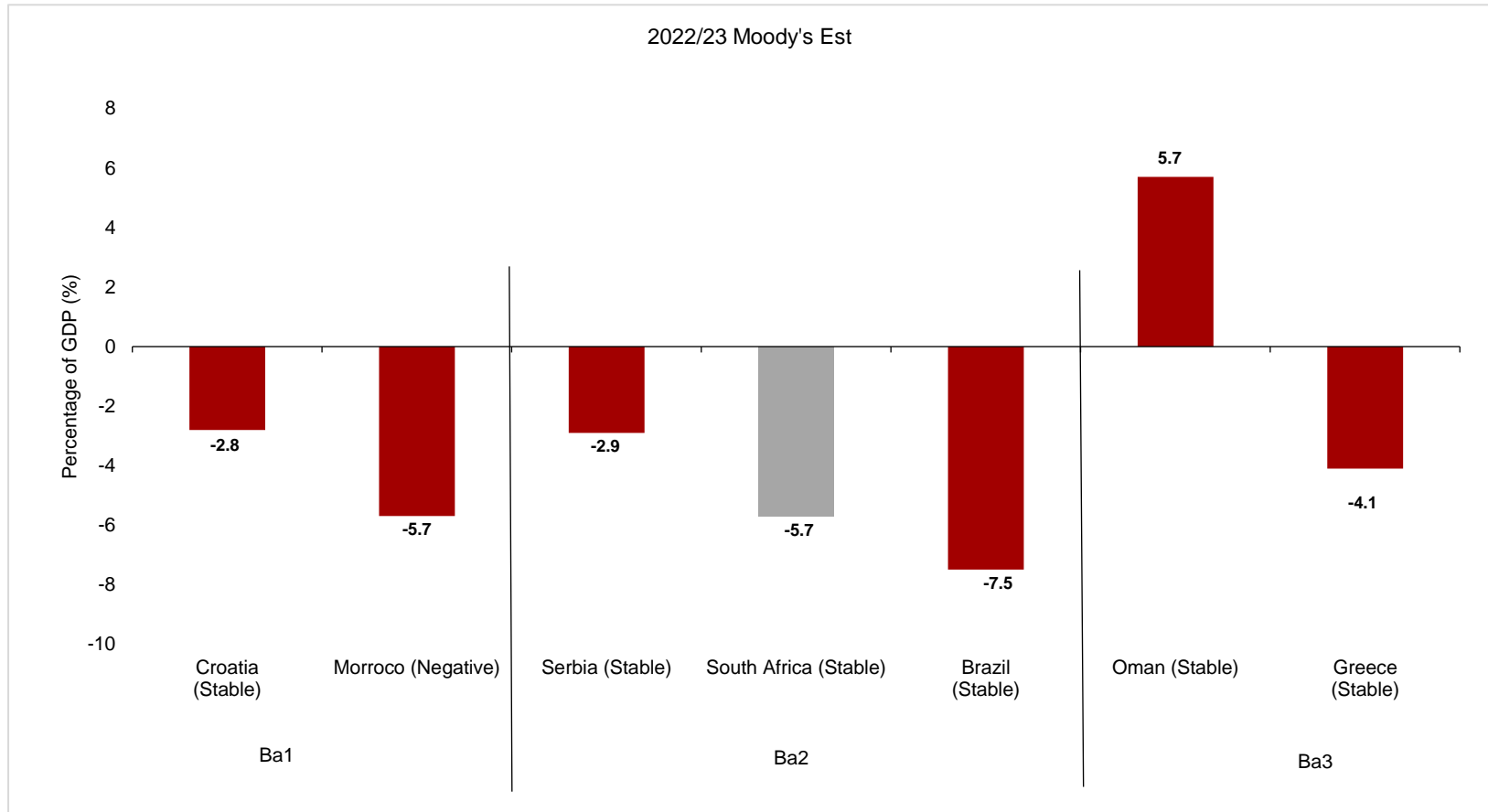
# ADDITIONAL - PEER ANALYSIS

## Real GDP



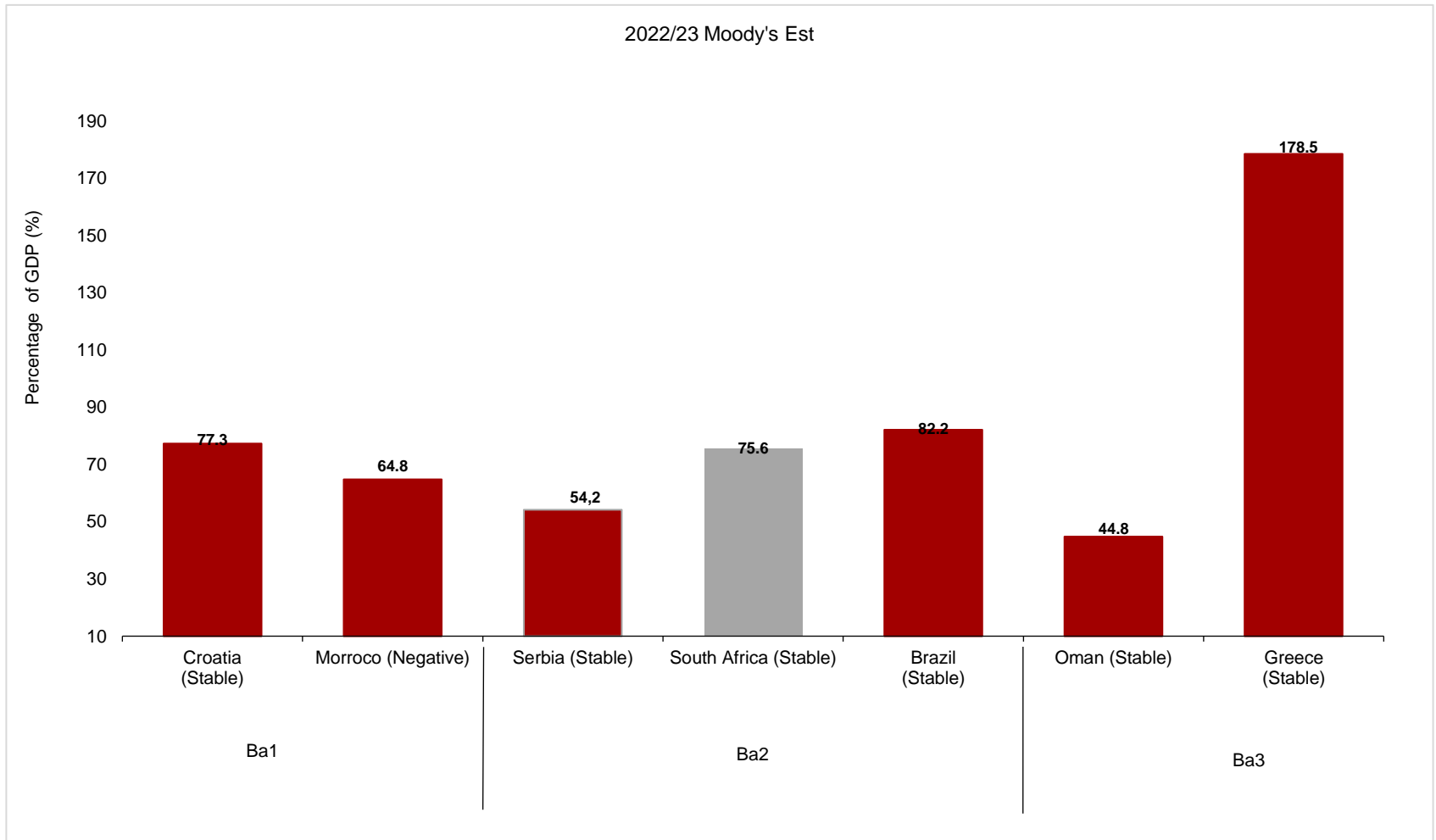
# ADDITIONAL - PEER ANALYSIS

## Budget Balance



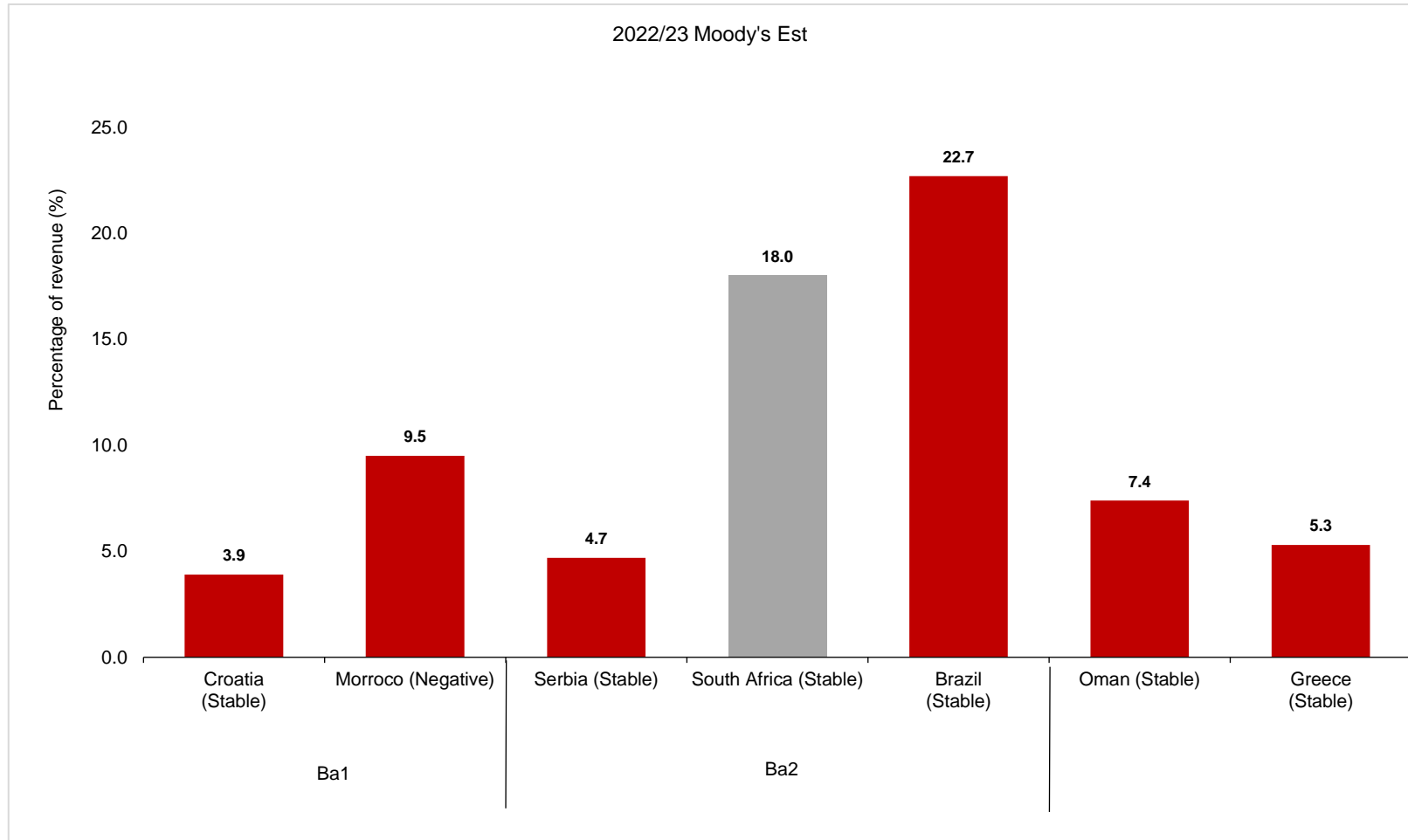
# ADDITIONAL - PEER ANALYSIS

## Debt-to-GDP



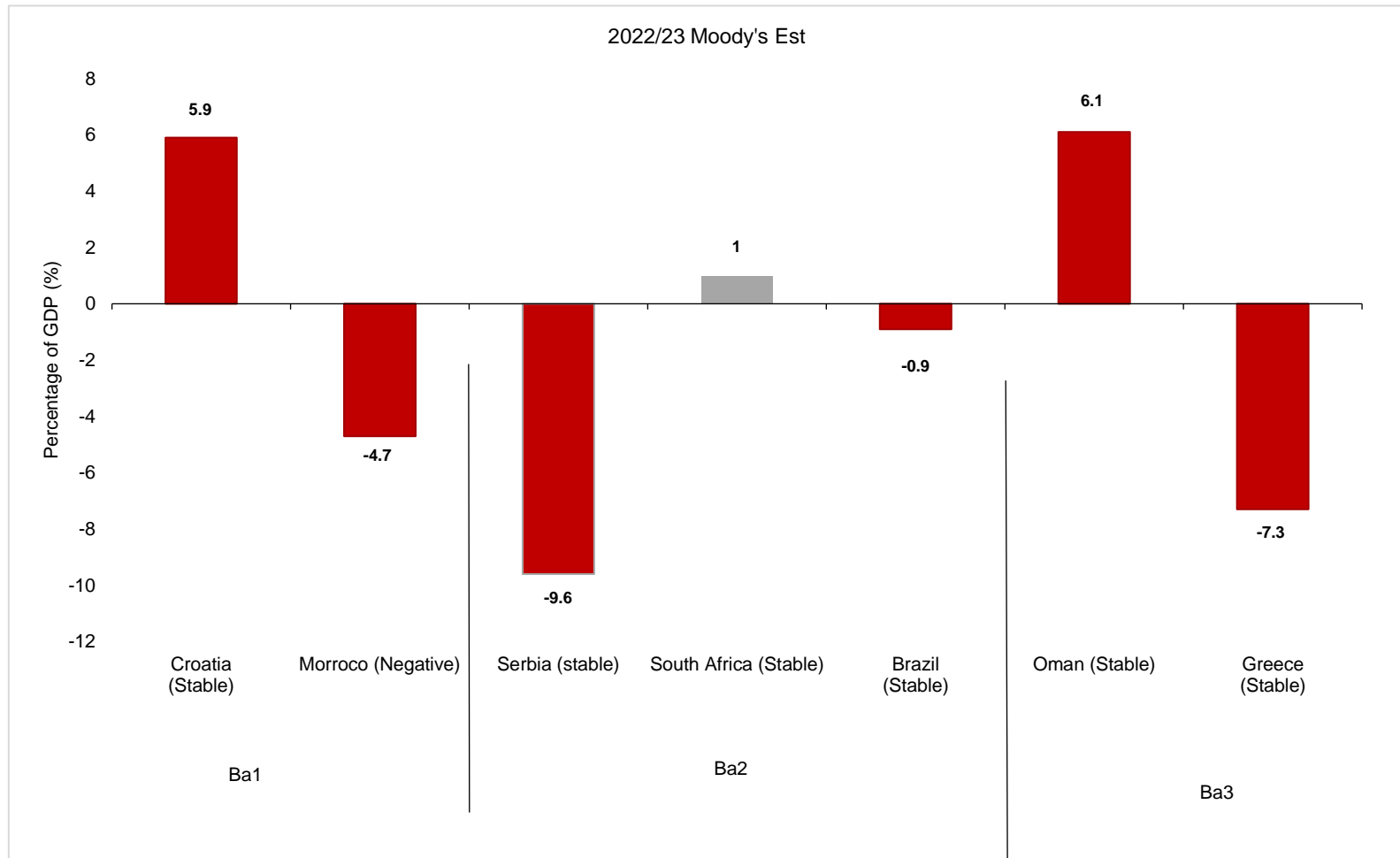
# ADDITIONAL - PEER ANALYSIS

## Interest Payment-to-Revenue



# ADDITIONAL - PEER ANALYSIS

## Current Account Balance





# SA SOVEREIGN RATINGS UNDER DIFFERENT MACRO-FISCAL POLICY INITIATIVES

## RECONSTRUCTION AND DEVELOPMENT

### 1993/94

- Budget Review 1994 announces that formal long-term credit ratings will be sort
- Consolidation of Public Finances
- Debt as % of GDP was 48.7%
- Govt included R15 bn of debt of TBVC states and self-governing in the public debt register, Debt as % of GDP increased to 52.5%
- Dept of Finance & State Exp under one Ministry
- Fitch assigned (BB) in Sep 1994, Moody's (Baa3) and S&P (BB) in Oct 1994

## GROWTH, EMPLOYMENT & REDISTRIBUTION

### 1998/99

- Duff and Phelps, Moody's, S&P reconfirmed their 1997 ratings of government debt as follows:
- LT Foreign Currency Debt:
  - Moody's (Baa3)
  - S&P (BB+)
  - Duff & Phelps (BBB)
- LT Local Currency Debt:
  - Moody's (Baa1)
  - S&P (BBB+)
  - Duff & Phelps (A)
- Since 1994/95 primary balance was positive but debt ratio peaked in 1996 at 56.1% of GDP and was projected to decrease to 55.6% of GDP in 1999 and then further down to 53% of GDP 3 years later
- This is the period in which South Africa implemented debt management reforms such as introduction of primary dealership system (Apr 1998)
- PFM Bill replaced Exchequer Act and gave effect to Section 216 of the Constitution (establishment of NT, greater transparency and expenditure control)

### 2003/04

- Net loan debt declined to 36.8% of GDP, while interest on public debt declined as well from its peak of 6.4% of GDP in 1998 to 4.7% of GDP in 2003
- Restructuring of SOEs contributed R24.8 billion to the fiscus
- S&P (BBB) and Fitch (BBB), which initially assigned SA sub-investment grade in 1994 upgraded SA 3 times
- Moody's and R&I, which initially assigned investment grades to SA back in 1994, upgraded SA once to Baa2 and BBB+, respectively
- Moody's placed SA on positive review in 2003
- Debt management strategy of reducing debt service costs subject to acceptable levels of risk saw further diversification of funding instruments

## ASGISA

## NGP

### 2008/09

- Onset of global financial crisis from 2008 threatened the achievement of ASGISA rolled out a year earlier in 2006
- However, Govt had created sufficient fiscal space over the past decade
- To ensure that SOEs contribute to SA development mandate during the downturn, govt planned to recapitalize SOEs and provide guarantees
- Q4 2008, Fitch, S&P and R&I revised outlook of SA ratings from stable to negative, while later in July 2009 Moody's upgraded SA to A3 with stable outlook

## NATIONAL DEVELOPMENT PLAN – 2030

### 2013/14

- NDP together with New Growth Path and Industrial Policy Action Plan lay the basis for social and economic transformation
- Budget framework anchored by the non-interest expenditure ceiling (2012) and guided by principles of countercyclicality, debt sustainability and intergenerational equity
- Major CRAs affirmed SA investment-grade status.
- Sound and predictable macroeconomic policies, independent constitutional institutions, deep local capital markets, strong banking sector, manageable public debt, low foreign currency exposure and flexible exchange rate - supported the ratings

### 2018/19

- Government spending has exceeded revenue since 2008
- Gross loan debt as % of GDP increased by 47.2 percentage points between 2008/09 and 2022/23
- Debt service cost – fastest rising item with cost of funding rising across all maturities
- In March 2023, S&P revised SA credit rating outlook to stable from negative and affirmed LT foreign and local currency ratings at BB- and BB, respectively
- In July 2023, Fitch affirmed SA LT foreign and local currency debt ratings at BB- and maintained stable outlook

### 2023/24



**THANK YOU**

**CONTACT: [JIM.MATSEMELA@CABRI-SBO.ORG](mailto:JIM.MATSEMELA@CABRI-SBO.ORG)**