

IMPACT OF COVID-19 AND SOVEREIGN DOWNGRADE ON SA GOVERNMENT DEBT

CABRI webinar: Managing public debt amidst COVID-19 financing pressures in Africa

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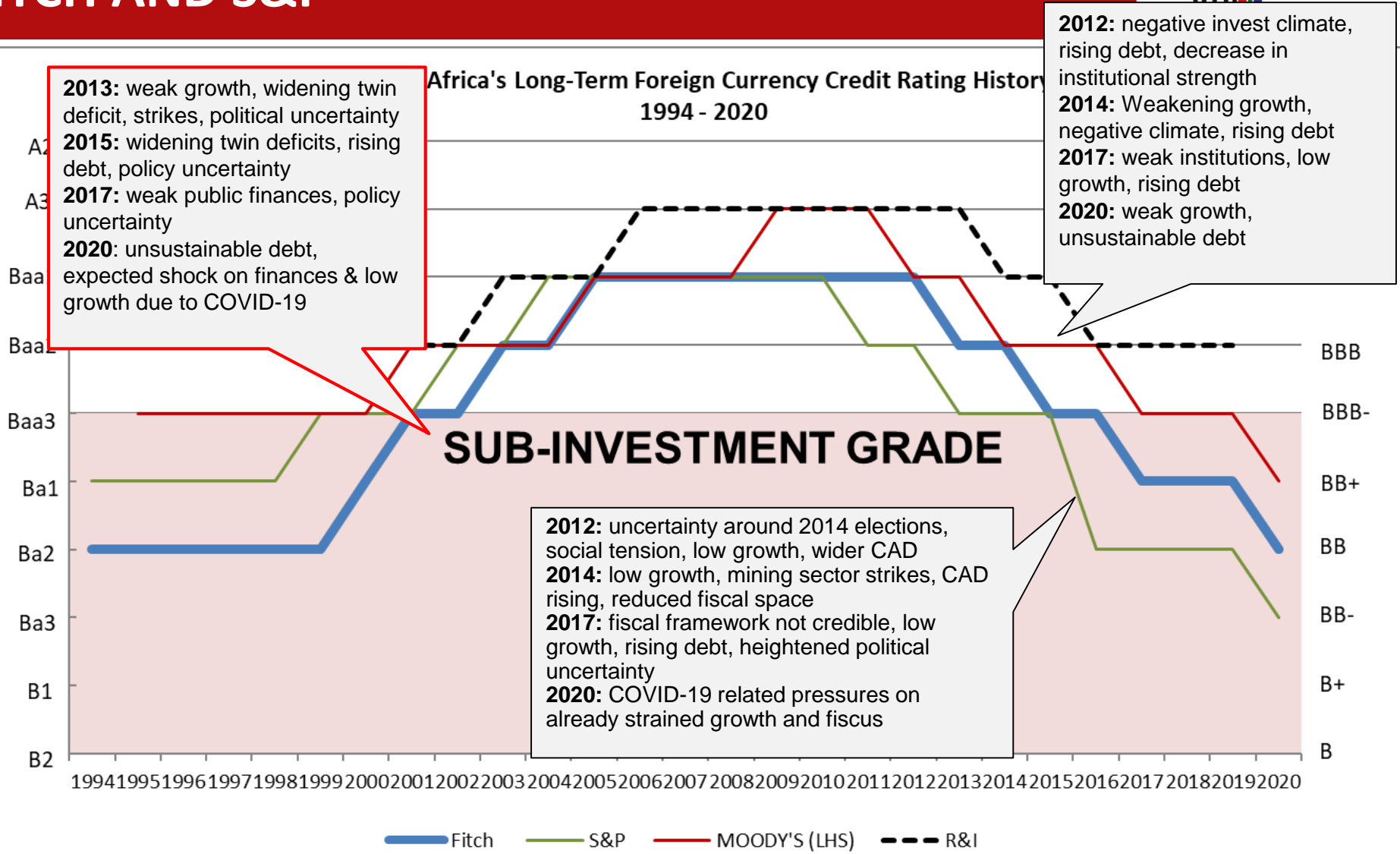
national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



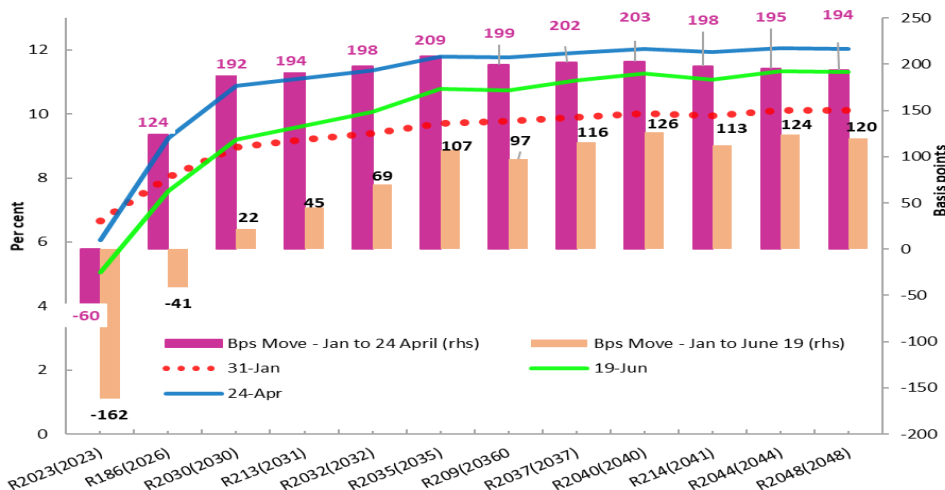
SOUTH AFRICA WAS DOWNGRADED BY MOODY'S, FITCH AND S&P

Africa's Long-Term Foreign Currency Credit Rating History
1994 - 2020



CURVE STEEPENED SIGNIFICANTLY

Fixed rate bond yields – Jan to June 2020



Emerging market asset class impacted negatively during the COVID-19 crisis

Investors showed a risk-off mood.

- SA situation was exacerbated by sovereign ratings actions
- ZAR government bonds making an exit from the WGB index

SAGB's yields weakened significantly

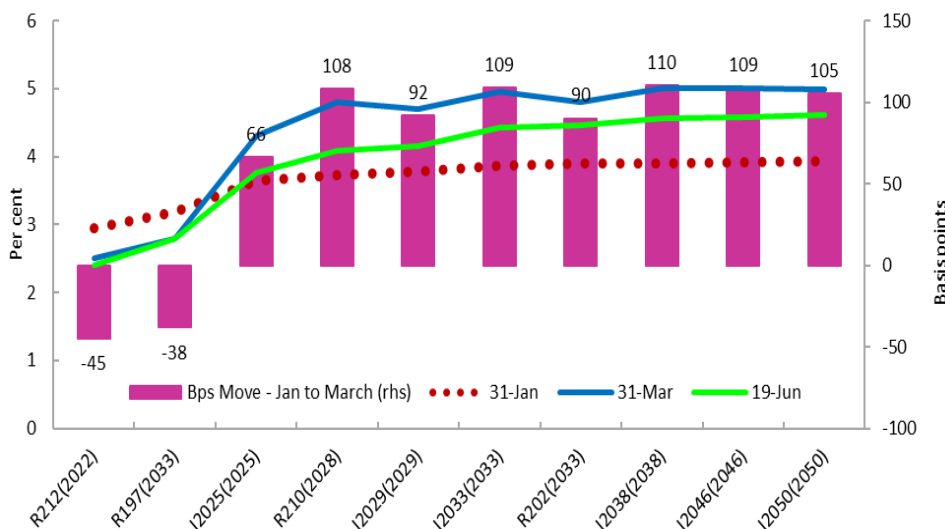
Longer dated fixed rate bond weakened by an average of 192 bps.

- The shorter dated bonds strengthened impacted by the SARB rate cut.
- The R208 bond (maturity Mar 2021) strengthened by about 180 pbs from Jan to March

Long-end inflation-linked bond yields are also weaker since January 2020.

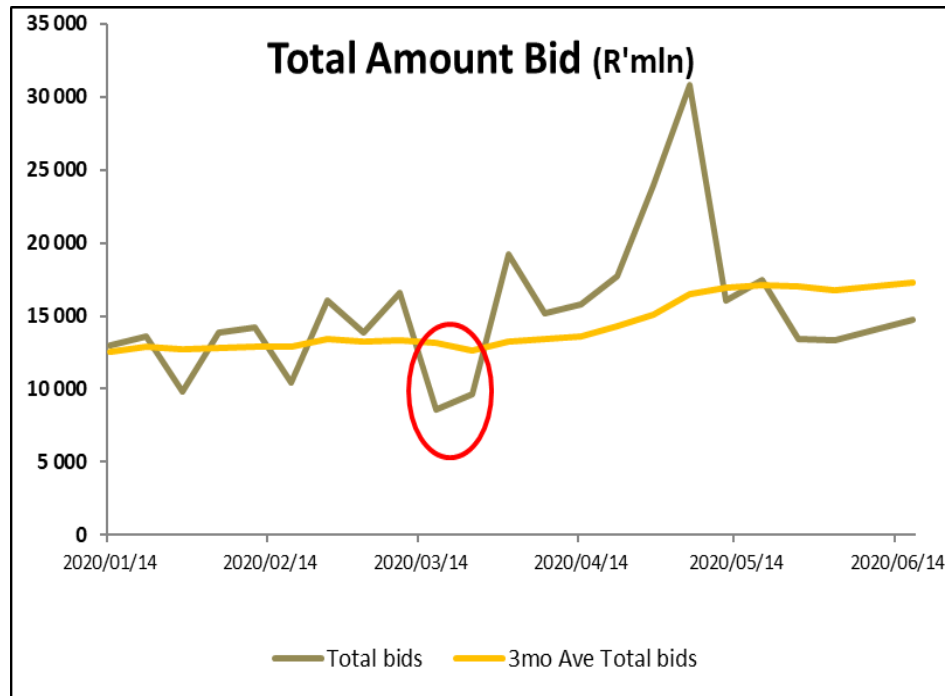
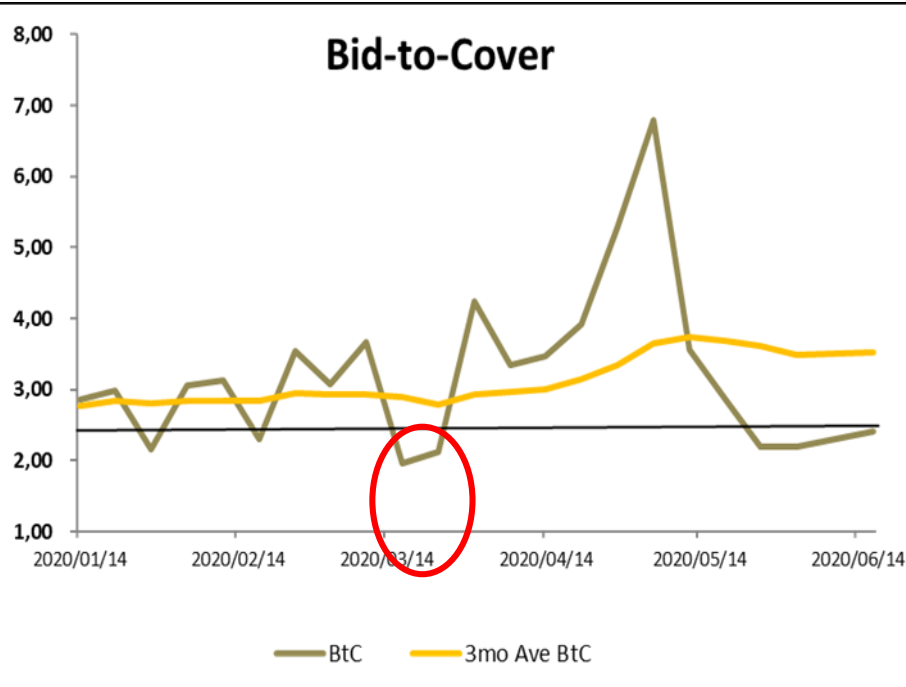
- Short-dated inflation-linked bonds strengthened in line with near term inflation outlook.

Inflation-linked bonds yields – Jan to June 2020

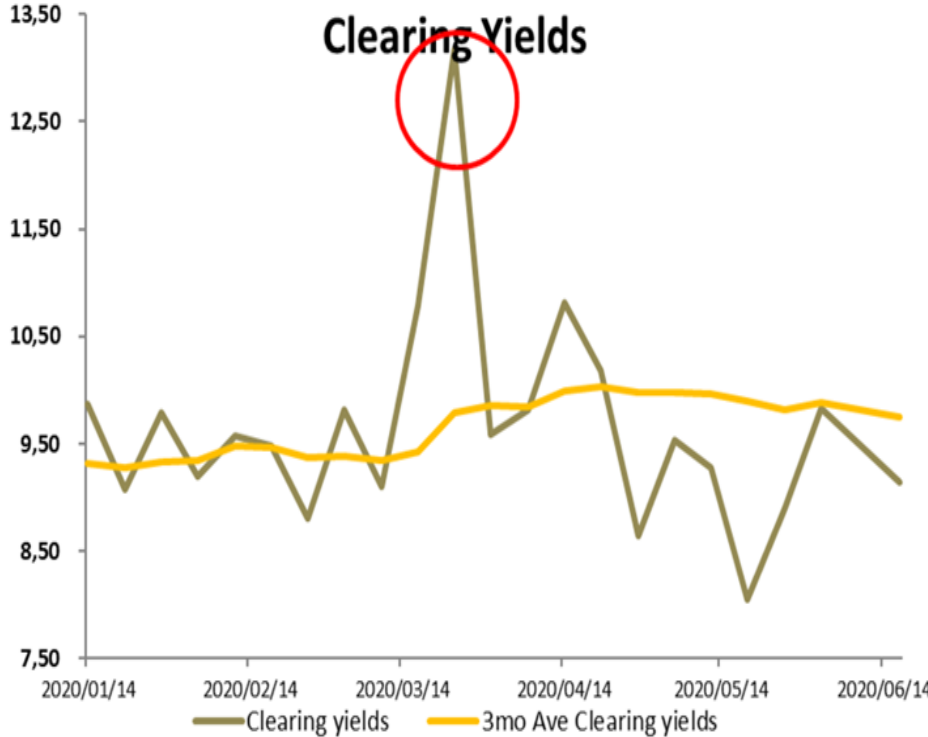


DEMAND FOR PRIMARY AUCTION DECLINED

- Lower than average demand on SAGBs
 - Lower auction bid amounts
 - Lower subscription rates



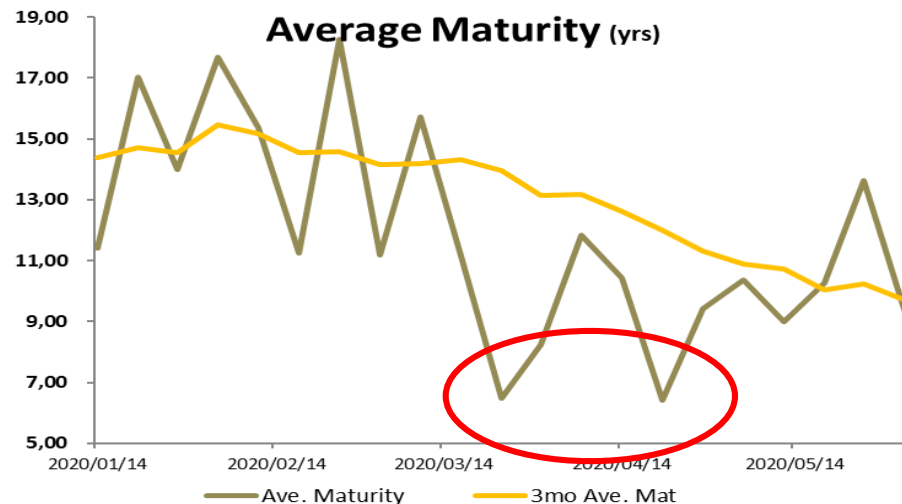
INCREASED GOVERNMENT BORROWING COST



Primary auctions allocated at higher yields

- Fixed-rate bond prices were on average at a 25 per cent discount
- i.e. government gets 75 cents for every R1 debt issued.

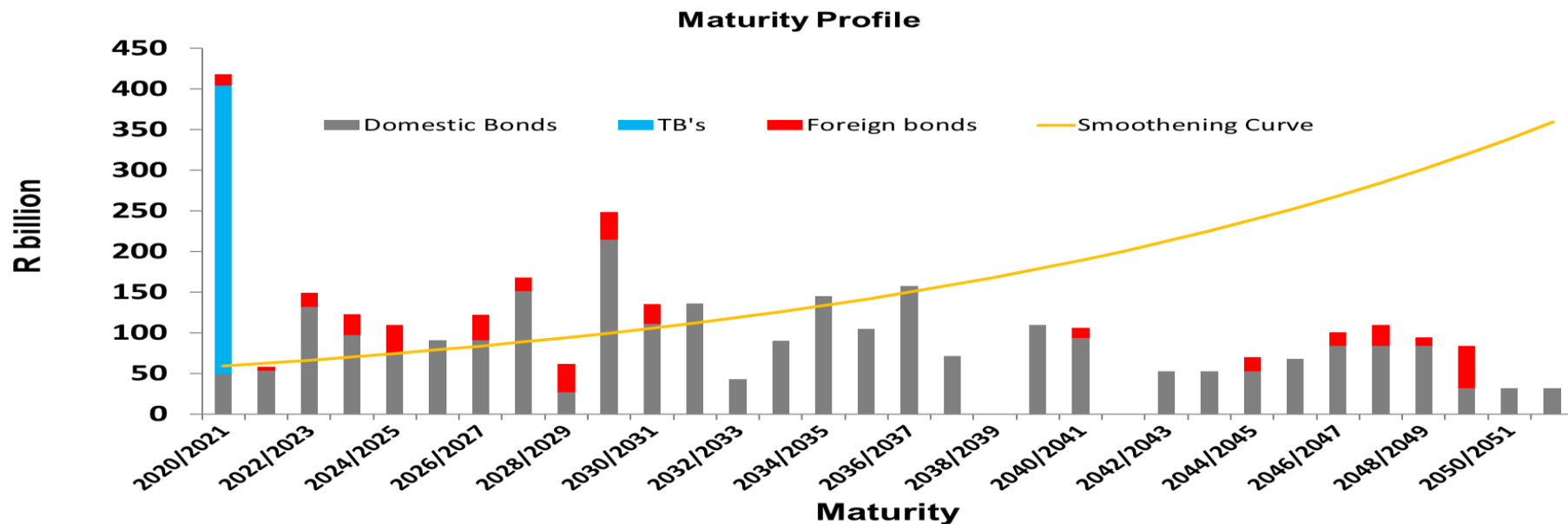
ISSUANCE STRATEGY-SHORTER DURATION



Consideration was to pursue shorter duration

- lower trading levels
- pressure on market players(PDs)

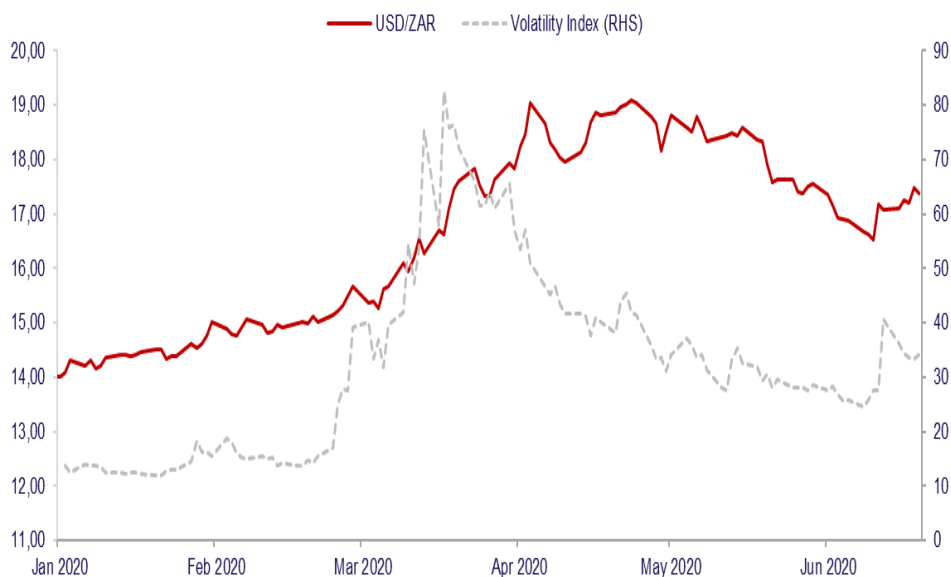
Refinancing risk also a concern



RAND WEAKENING

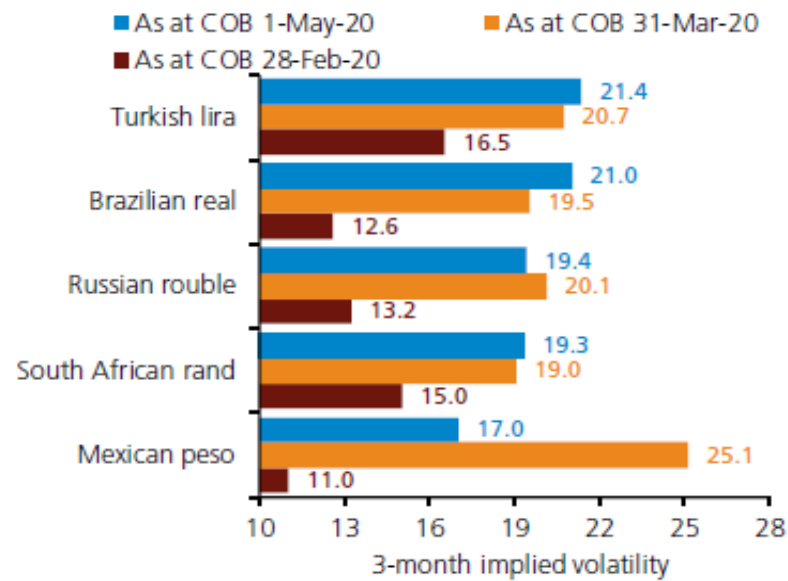
- The Rand has depreciated against the US Dollar since the beginning of the year
 - Weakening from R15.03/US\$ to R19.08/US\$ on 23 April 2020.
- The Rand remains highly volatile against the US\$, but in line with other EM currency volatility

Rand/US Dollar exchange rate – Jan to June



Source: Bloomberg, BondRadar, RMB Investment Banking

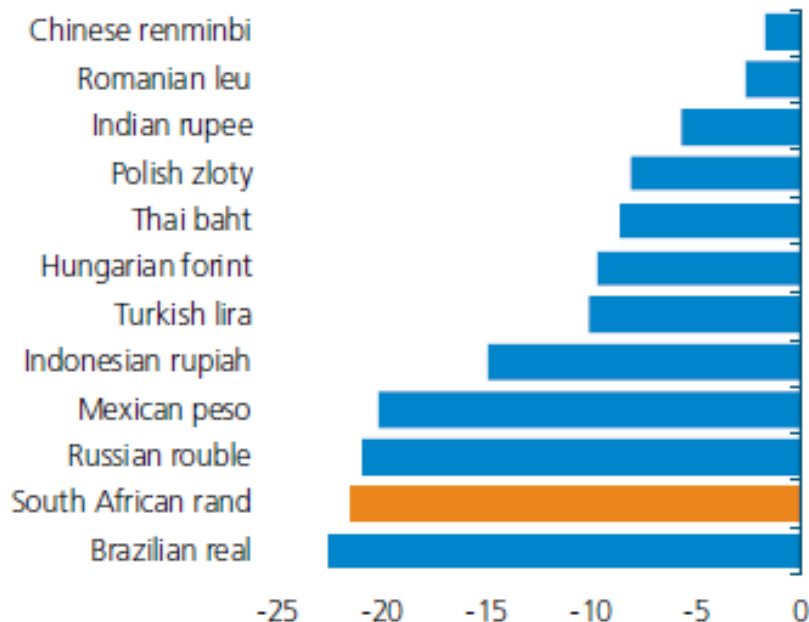
Volatility – selected EM currencies



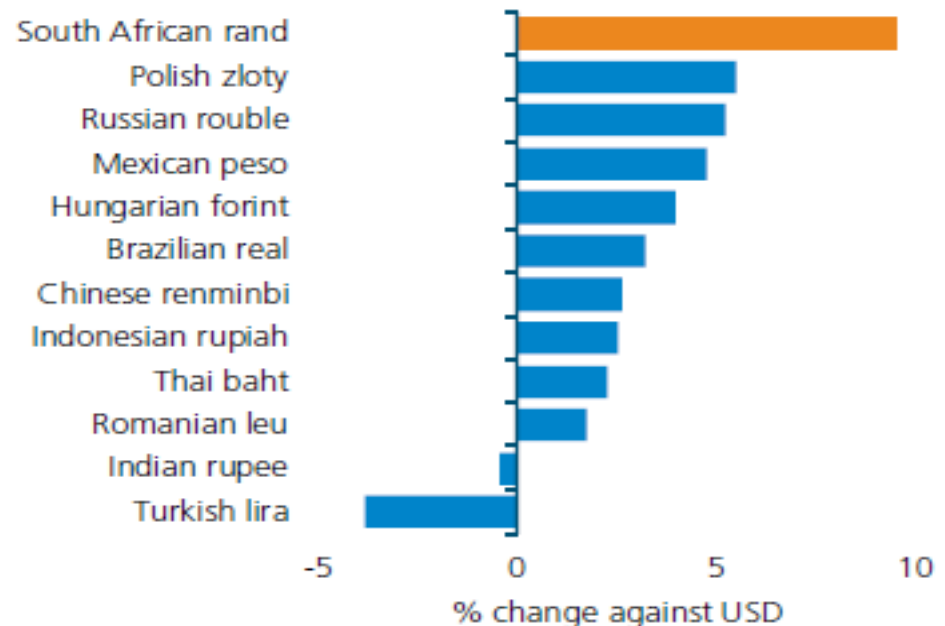
RAND PERFORMANCE COMPARED TO EM PEERS

- The Rand was the second worst performing EM currency in the first quarter of 2020
 - compared to the best performing currency against the US\$ in fourth quarter 2019.

Selected EM Currency performance against the US\$ - first quarter 2020

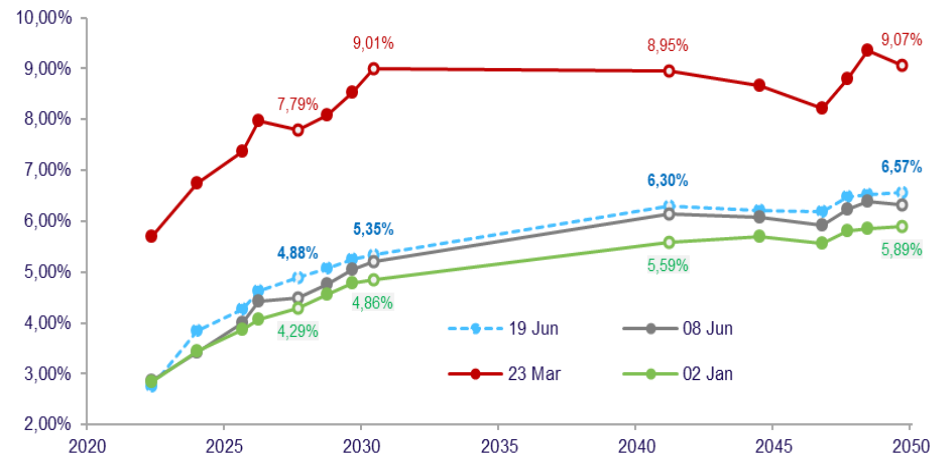


Selected EM Currency performance against the US\$ - fourth quarter 2019



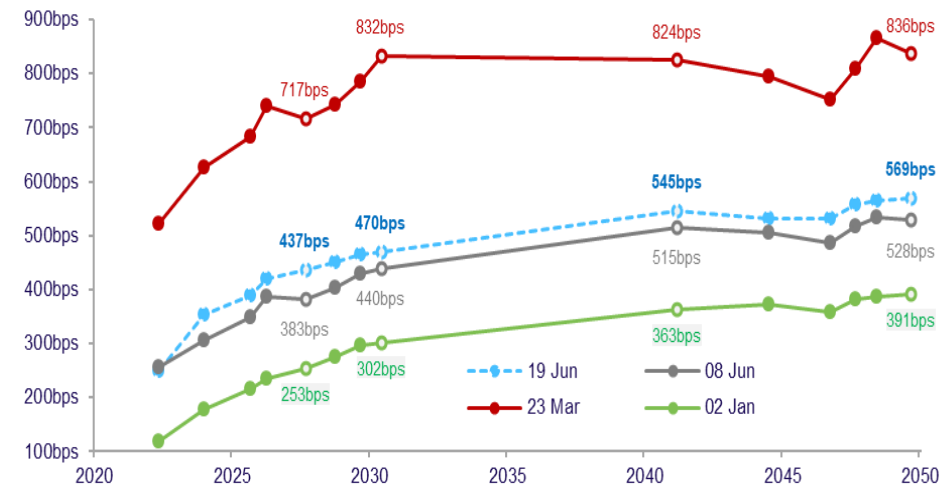
FOREIGN BOND YIELDS

Government US\$ bond yield curve – Jan, Mar and June 2020



- Compared to the weakening of 328 bps on 23 March 2020.
 - significant reduction when compared to the height of the COVID-19 risk in late March
- The SOAF vs US Treasury average spreads have declined from high of 676 bps in March 2020 to the current 559 bps

South African foreign bond – US Treasuries spreads



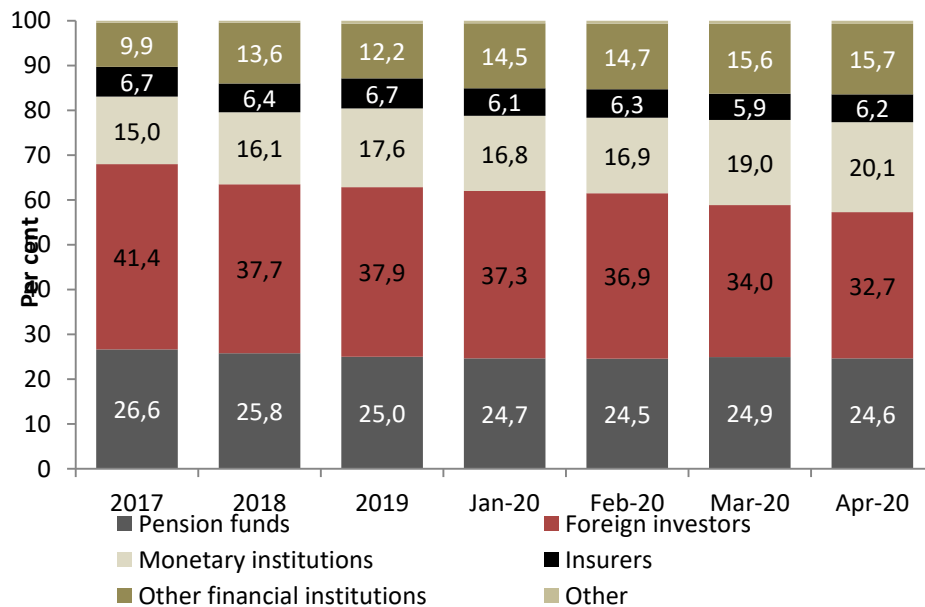
Source: Bloomberg, BondRadar, RMB Investment Banking

- tighter levels since the COVID-19 crises seen early June
- Slightly wider this week after fears of a 2nd COVID-19 wave, and upcoming emergency budget

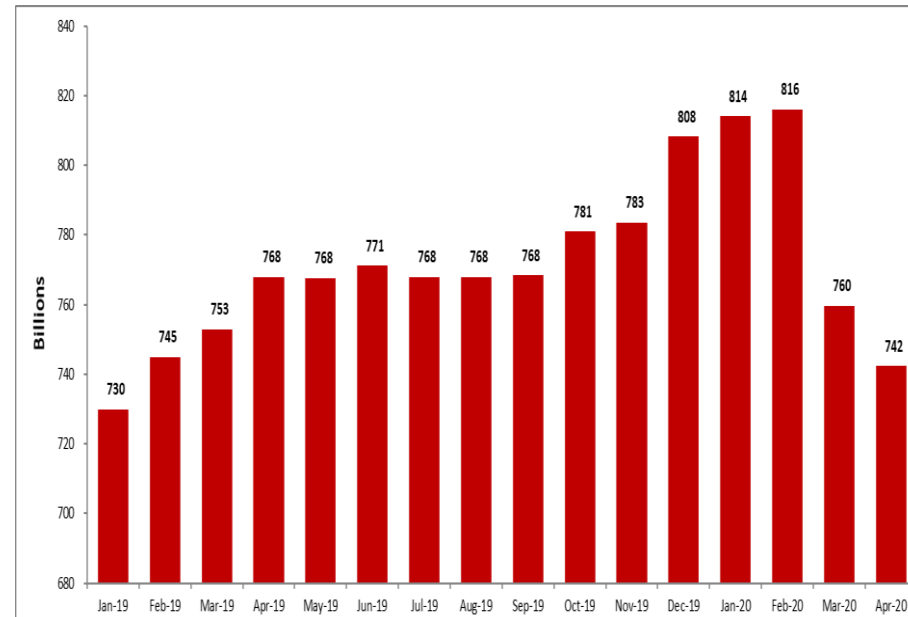
NON-RESIDENCE HOLDINGS OF SOUTH AFRICAN GOVERNMENT BONDS(SAGBS)

- Foreign holdings of domestic government bonds fell to 24.6 per cent in April 2020.
- Nominal holdings decreased by R74 billion to R742 billion by April 2020.
- The uncertainty regarding global economic growth prospects in 2020 sparked capital markets volatility and outflows from emerging markets. SA government bonds yield weakening was exacerbated by credit rating downgrade and the exclusion of SA from the Citi World Government Bond Index (WGBI).
- WGBI estimated AuM US\$796bn;
SAGB weight 0.44%; US\$3.4bn / ZAR 63bn

Holdings of domestic government bonds (%), 2017 – Apr 2020



Non-residents domestic government bond holdings, 2019 -Apr 2020



GOVERNMENT FUNDING OPTIONS

- Weekly Treasury bill issuance increased by R2.5 billion on 27 March 2020 to R10.4 billion and by R1.7 billion on 30 April 2020 to R12.1 billion.
- Delayed weekly government bond auctions due to increase market volatility, constrained liquidity and weaker bond yields.
 - Based on 2020 Budget the weekly fixed-rate bonds and inflation-linked bonds auction amounts increased from R4 530 million to R6 100 million and from R1 040 million to R1 400 million respectively.

Risks to the market funding and borrowing costs

- Further market uncertainty, volatility and lack of trading and funding liquidity
- Increase in issuance will add further pressure to the elevated cost of borrowing
- Further downgrades may also exacerbate the cost of borrowing

GOVERNMENT FUNDING OPTIONS

Non-Market Funding (Multilateral Development Banks-MDBs)

- The following is the summary of the initial responses from MDBs. The tenor is up to 35 years, includes grace periods. No conditionality post disbursements, reports to show how the funds were used.

Institution	Budget support COVID-19	Budget support-Infrastructure Financing
AfDB	To be determined. Still assessing the requests from member countries	To be determined
World Bank	USD 50 million	To be determined
BRICS NDB	USD 1 billion	USD 1 billion
IMF	USD 4.2 billion	N/A
Total	USD 5.07 billion (approx. R95 billion)	

- The funding costs are favourable relative to the market as the pricing is not based on the country risk premium. NT expressed interest subject to successful negotiations and internal approvals.
- Accessing this funding reduces fears of heavy issuance to fund government's activities given massively reduced revenues collection

Risks to the MDBs funding

- South Africa is competing for funding with other countries
- The loan covenants and general conditions of the MDBs needs to be interrogated

CASH MANAGEMENT STRATEGY

- Cash pressures are forecasted for the second quarter and beyond. This could worsen substantially due to :
 - COVID-19 tax relief measures and lower growth substantially resulting in reduction in tax revenues
 - Weekly funding levels not fully realising currently
- Governments cash position over the medium term will need to be monitored closely, together with SARS, Tax Policy and Budget Office
 - Short-term cash pressures to be covered by among others borrowing from the Corporation of Public Deposits(CPD) and use of sterilisation deposits
 - The CPD might be constrained as provinces and SOCs withdraw their savings to address their cash requirements
 - Further increase in Treasury bill issuance will be considered to the extent shortening duration is required
 - Bond auctions to be increased further –associated borrowing cost to be considered

MINISTER OF FINANCE MESSAGE

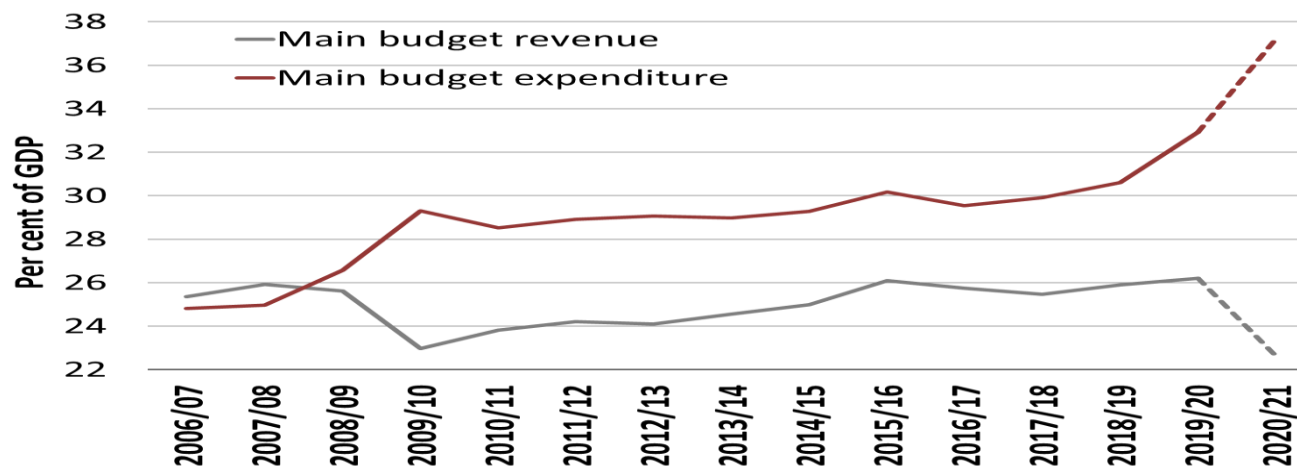
.....“We can no longer spend the way we were spending before. We can no longer do things we had hoped to do before. The situation has radically changed and we need to begin considering the zero-based budget system.

If we do not do this by 2024, our country will be in a situation where the debt to GDP ratio will be higher than the GDP of the country-we will be in a sovereign debt crises”-TT Mboweni(MP)

SUPPLEMENT BUDGET TABLED 24 JUNE

R billion	2019/20 Preliminary	2020/21 Budget	Revised	2021/22 Medium-term estimates	2022/23 Medium-term estimates
Gross borrowing					
Main budget balance	-345,3	-368,0	-709,7	-495,6	-430,5
Redemptions	-70,7	-64,7	-67,2	-64,9	-150,0
Domestic long-term loans	-19,4	-52,5	-52,5	-60,5	-134,2
Foreign loans	-51,2	-12,2	-14,7	-4,4	-15,8
Total	-416,0	-432,7	-776,9	-560,5	-580,5
Financing					
Domestic short-term loans (net)	36,1	48,0	146,0	56,0	64,0
Domestic long-term loans	305,4	337,7	462,5	388,4	451,4
Foreign loans	76,1	29,3	125,2	31,9	63,2
Change in cash and other balances ¹	-1,6	17,7	43,2	84,2	1,9
Total	416,0	432,7	776,9	560,5	580,5

1. A positive value indicates that cash is used to finance part of the borrowing requirement



May GOD Keep Us All Safe...

THANK YOU



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