



A WORD FROM OUR CIO



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What does a ratings downgrade mean for the South African economy?

On 3 April, S&P Global Ratings (S&P) announced that it had moved South Africa's long-term foreign currency sovereign credit rating to below investment grade ('junk status'). The move comes in response to the cabinet reshuffle announced late on 31 March. S&P's decision stems from concerns that the changes indicated that 'policy continuity' has been put at risk and that South Africa's economic outlook could come under pressure. Ratings agency Moody's has also put South Africa on downgrade watch.

What does junk status mean?

Junk status is a reflection on the creditworthiness of a country. It means that the perceived probability of defaulting on the capital loan repayment for South African sovereign bonds is considered higher than that of investment grade bonds issued by other countries. In return for taking additional risk, investors will demand greater compensation in the form of higher yields. This cost will be directly borne by government and corporates, but ultimately passed on to consumers and shareholders.

What is the likely impact on the local economy?

From an economic perspective, the South African government may struggle to raise funding for projects. Yields on bonds will have to move higher to compensate investors for the additional sovereign risks, which increases the governments' cost of capital. This will place additional pressure on the national budget, and ultimately, taxes. In addition, corporate financing cost will increase which places pressure on earnings and growth. The rand has already responded to the news of a ratings downgrade by weakening sharply, and further rand volatility is likely to continue.

Will junk status rating affect the average South African?

As the cost of borrowing moves higher as described above, economic conditions for local businesses become more difficult. Further currency volatility is likely to impact on import costs, deficits and inflation. This means it becomes more difficult for the economy to grow at its full potential, while pressures on tax revenues rise. All of this means the economic environment becomes more challenging for both businesses and consumers.

What should investors do?

Investors should maintain a balanced investment outlook and ensure any changes to their portfolios are in line with their needs and not in response to short-term market noise. Diversification is key as a strategy to dealing with market uncertainty.

Can junk status be reversed?

Junk status is not irreversible, but it will take a concerted effort and proof of sound economic and fiscal governance. Our two main concerns are the current account and the fiscal budget. South Africa will need to improve on our relative attractiveness in order to attract investment. We need to increase our export to import ratio, and get a firmer grip on our fiscal spending. Economic growth will go a long way towards increasing spending power, but ultimately we will simultaneously have to cut spending and increase revenue in order to make swift work of recovering our investment grade status.