The last of the big 3 credit rating agencies junks South Africa – now what?

The core function of a credit rating is to indicate the degree of credit-worthiness of an issuer of debt instruments, be it a country, city or company. It is an analytical assessment of the ability of the entity to honour its debt obligations.

However, credit ratings have become a proxy of economic success, or even national worth. They are baked into so many criteria, including in mandates for investors who seek to invest in assets other than debt instruments (such as a filter for countries whose equity markets to invest in).

It doesn't have to be this way. In the aftermath of the global financial crisis, competition authorities and global bodies such as the IMF and EU encouraged the investment community not to 'hardwire' credit ratings in their buy and sell mandates, but to consider these as just one input into decision-making.

Nonetheless, an investment grade rating is not only a useful decision metric, but it is seen as a badge of honour.

South Africa, by 2005, held an investment grade rating at all three majors (S&P, Fitch and Moody's).

And yet, if we take such a rating in its expanded meaning, as an indicator of success, do we belong in this club?

In 2016, writing in the Business Day, I argued that:

The trouble is that macroeconomic stability is only part of the puzzle when it comes to economic success. The countries that top the charts…have done far more than draft good budgets or raise interest rates timeously to earn their renown. Countries such as Norway, Germany and South Korea are also known for their high levels of productivity, their innovation as well as their competitiveness.

Here, I'd like to view this issue through the lens of human development. One internationally comparable measure is the Human Development Index. The HDI is an index that measures three dimensions of human development:

- a long and healthy life – measured by life expectancy,
- access to education – measured by expected years of schooling of children at school-entry age and mean years of schooling of the adult population,
- a decent standard of living – measured by Gross National Income per capita adjusted for the price level of the country

Here's how South Africa ranks compared to all 189 countries assessed by the UN. Each line represents a country.

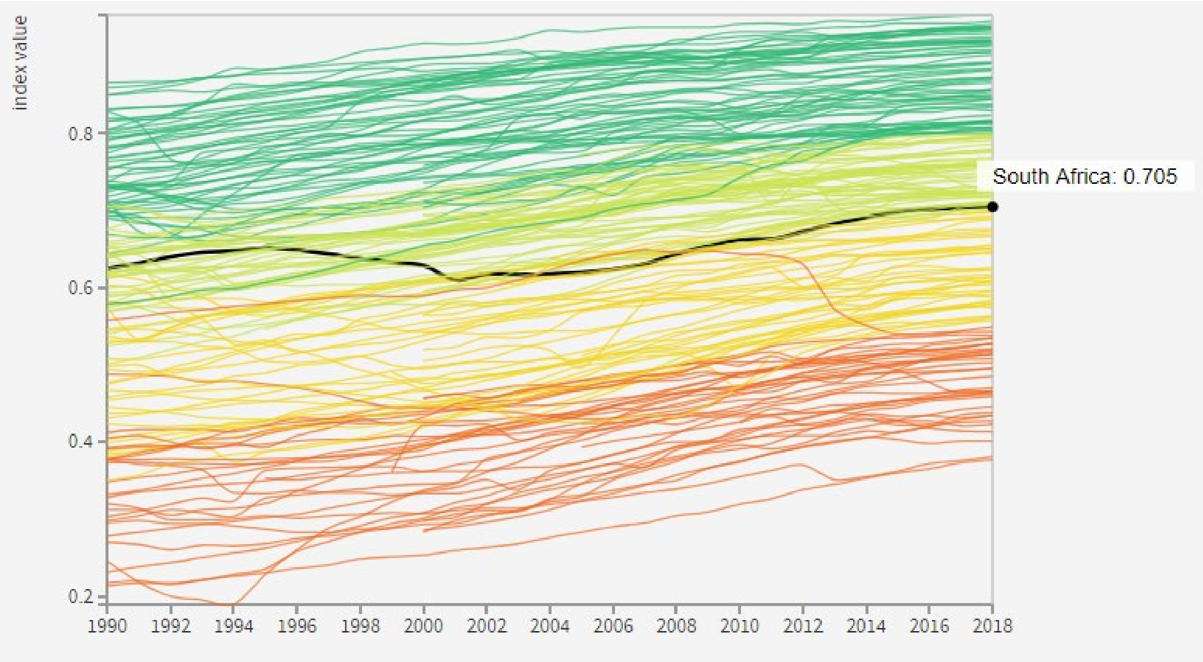

Figure 1: Human development index – all countries ranked by the UN

(When this score is adjusted for inequality, South Africa ranks much lower.)

Let's take the same index, but for countries that are ranked investment grade by at least 2/3 of S&P, Moody's and Fitch.

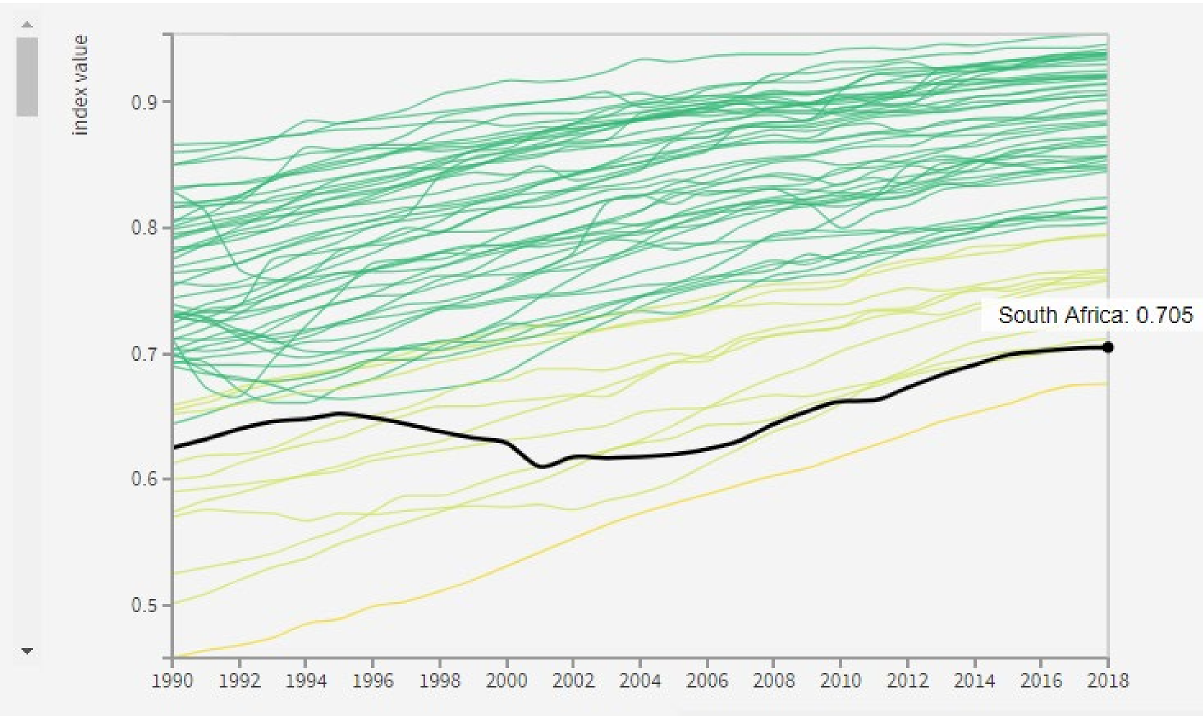

Figure 2: Human development index - investment grade countries

Of all countries ranked investment grade, South Africa has a higher HDI index than only 2 countries – Morocco and India, and is close to Indonesia (Figure 2, 3).

The countries with scores below or close to South Africa have also had such steep improvements in their score over the past 3 decades, beginning far lower than us. This suggests real dynamism in those countries, whereas South Africa has been, in relative terms, stagnant.

HDI rank	Country	HDI rank	Country
1	Norway	31	Cyprus
2	Switzerland	32	Poland
3	Ireland	34	Lithuania
4	Germany	35	United Arab Emirates
4	Hong Kong, China (SAR)	36	Andorra
6	Australia	36	Saudi Arabia
6	Iceland	36	Slovakia
8	Sweden	39	Latvia
9	Singapore	40	Portugal
10	Netherlands	41	Qatar
11	Denmark	42	Chile
12	Finland	43	Hungary
13	Canada	46	Croatia
14	New Zealand	50	Kazakhstan
15	United Kingdom	52	Bulgaria
15	United States	52	Romania
17	Belgium	57	Kuwait
18	Liechtenstein	57	Uruguay
19	Japan	61	Malaysia
20	Austria	67	Panama
21	Luxembourg	76	Mexico
22	Israel	77	Thailand
22	Korea (Republic of)	79	Colombia
24	Slovenia	82	Peru
25	Spain	85	China
26	Czechia	94	Botswana
26	France	111	Indonesia
28	Malta	113	South Africa
29	Italy	121	Morocco
30	Estonia	129	India

Figure 3: Human development ranking - investment grade countries

Make no mistake. Sovereign ratings matter. But was ours a case of ‘fake it till you make it’? It will be an arduous road to belong to this club again. But this time, it’s important to take care of the fundamentals and to pay attention to human development.

There’s no modern investment case without a human capability underpinning.

Though these are not metrics that credit rating agencies consider, at least not directly, they underpin sustainable and resilient growth. Indeed, this is not to say that South Africa can’t regain its investment grade status whilst remaining a development outlier like India or Morocco. The point is that a particular notch on the credit rating scale is not, in of itself, the ultimate goal.

We should always have the stars in our sights, but for the most part, we’re still *trying to get to Mamelodi*, as the song by Lady Zamar and Junior Taurus goes.

How do we overcome this difficult moment, not just the expected blow by a rating agency, but against the context of a global pandemic? In the short term, energy will be focused on the fall-out from covid-19. We are still in the first phase of our economic response. A thoroughgoing response, which draws on more measures to support a wider set of households, including the most vulnerable or precarious, will test our fiscal metrics severely.

We also need to think deeply about driving structural change that delivers inclusive growth.

Have the credit rating agencies not made this point many times themselves?

Had they not warned us that prevailing socio-economic conditions, and the resultant political economy dynamics, will pose a threat to economic sustainability?

If I were to summarise the current administration's policy stance, I would say that it is animated by the following economic growth themes:

1. Performance-based industrial policy: much work has been underway to implementing sectoral 'Masterplans' in collaboration with the private sector, to support value-added activities in identified sectors. There's also an established programme to lower the cost of doing business that would benefit all sectors of the economy.
2. Promoting labour-intensive sectors: deepening economic activity in sectors with the prospect to create jobs on a significant scale that talk to the country's skills profile, particularly in tourism and agro-processing.
3. Targeted investment mobilisation: to stimulate and drive investment with a focus on fixed investment and infrastructure development; by functioning and rehabilitated SOEs, the domestic private sector and foreign direct investment.
4. African integration and economic development: an investment-led trade strategy, which is based on deepening trade whilst supporting industrialisation and infrastructure development on our continent. Key opportunities include deepening trade within SADC, but also with West and North Africa by growing exports in key value added manufacturing and service sectors.
5. Progressively greening the economy: through a pragmatic process of developing new value chains such as adding value to materials of the future required for cleaner tech (platinum, rhodium, vanadium, manganese, green jet fuel); developing the waste economy; tapping into climate finance sources and adopting circular economy principles. This involves developing new industries but also embedding a less emission-intensive way of doing business across the economy. This a growth opportunity but also comes with a great deal of risk of transitioning from one set of certain activities to uncharted waters.
6. Harnessing the digital economy: this also involves supporting new industries but also enhancing efficiency and productivity by rethinking existing activities (smarter and safer mining, digital medicine, connected classrooms etc.). This also presents an opportunity to use connectivity to overcome the spatial divide and reduce transaction costs in the economy.

These growth themes have to backed by practical actions informed by policy, be it releasing spectrum or reforming the electricity supply industry that powers the rest of the economy.

Across various sectors, economic actors can point to key decisions that need to be taken, or operationalised, to kick-start investment and production.

It's no secret that this is not an insignificant backlog.

Before long, some creative 'fastrack' measures will need to be considered to tackle this policy overhang. If one were to find a silver lining in recent weeks, it is the agile and unconventional ways of working that government has adopted, in service of a common goal.

It goes without saying that these growth themes have to be adapted to a dramatically different local and global context. Labour intensity and trade integration are under threat in the short to medium term. On the other hand, the digital economy is under the spotlight as we try to sustain economic activity under conditions of restricted movement and new business models are widely adopted. But, taken together, with the necessary shifts in emphasis, these themes represent a shift from a resource-driven, emissions intensive economy with low levels of human capital development.

The twin shocks of covid-19 and the loss of the last golden star take us to unfamiliar waters when it comes to macroeconomic policy. The playbook to impress pre-covid-19 global economic orthodoxy – belt-tightening, a pruned state, financialisation – is invalidated by the demands and realities of crisis management and post-pandemic reconstruction.

Monetary policy is becoming activist as the situation demands. Fiscal policy will have to contend with social variables in a sharper way.

Even at this early stage, covid-19 has revealed what the HDI tries to quantify. The material conditions facing the majority of South African households – how they live, get to work, experience shocks – are not sustainable.

This is not to moralise misfortune like a medieval philosopher, but there are some important reflections that should arise from this global pandemic. With the economic fallout likely to be compounded by the decision by Moody's, this moment demands a structural break with the past.

And what do the people say in Mamelodi?

Author: Trudi Makhaya

References:

http://hdr.undp.org/en/data

National Treasury response to Moody's decision: https://bit.ly/33SWs9g