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# Why IMF assistance to South Africa is not a realistic expectation in the near term

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There is no debating that South Africa's government finances are in a dire state. The justifiable expansion in government spending that immediately followed the 2007/08 global financial crisis has been supplanted by a decade of loose fiscal policy and sub-par macroeconomic growth. Before accounting for the inevitable realisation of Eskom's contingent liabilities to the fiscus, South Africa's "lost decade" has resulted in the doubling of government debt – from 26% in the 2008/09 fiscal year to 57% (and counting) at present.

Against a backdrop of weak government finances, sickly economic growth and seemingly absent political will to effect growth-enhancing policy reform – there's growing disquiet about the prospect of South Africa approaching the International Monetary Fund (IMF) for bailout financing.

Two key questions need to be answered to determine whether these fears are well founded:

1) Does South Africa fail a debt sustainability assessment?
2) Is South Africa's capital market access at imminent risk?

Firstly, central to determining South Africa's debt sustainability over the medium term is an examination of the country's debt profile and debt burden indicators. To avoid a debt trap, what we ultimately need to form is a credible view that the primary budget surplus required to stabilise the country's debt burden is attainable in the medium term. In this economic environment, a primary budget surplus in the medium term (forthcoming five years in IMF lexicon) will only realistically be achieved through average economic growth in excess of **2.6%** over the next five years, assuming all else is equal, or cumulative expenditure containment of **R150bn** over this same period.

However, the domestic economy is simply inadequately geared to sustainably grow in excess of 2.6**%** in the medium term, so we can largely discount this as a credible solution to achieving debt sustainability. Mercifully, in preparation for the 2020/21 national budget, National Treasury has issued a compulsory budget baseline reduction of 5% in 2020/21 fiscal year, 6% in 2021/22 and 7% in 2022/23, which, if adhered to by national departments and public institutions, can be read as an important first step away from the fiscal cliff.

Related to the assessment of the sovereign's debt burden is its debt profile. Despite South Africa's burgeoning funding requirement in the past decade, the financing thereof has been astute. The deficit has been predominantly financed through the issuance of long-dated nominal bonds. National Treasury has shied clear of its 20-25% prudential limit to inflation-linked bond issuance and, most importantly, the so-called "original sin" of foreign currency debt issuance has been well avoided, with a modest 5.5% of outstanding gross government debt denominated in foreign currency. This is a crucial differentiator between South Africa and the basket of sovereign nations that have fallen off the fiscal cliff in the post crisis era (see Figure 1). Further to this, countries requiring an IMF bailout often do so because they have a pending debt payment that they are unable to roll-over. South Africa's gradual foreign currency debt maturity profile suggests that foreign currency funding pressures remain benign, implying minimal redemption or roll-over risk (see Figure 2).

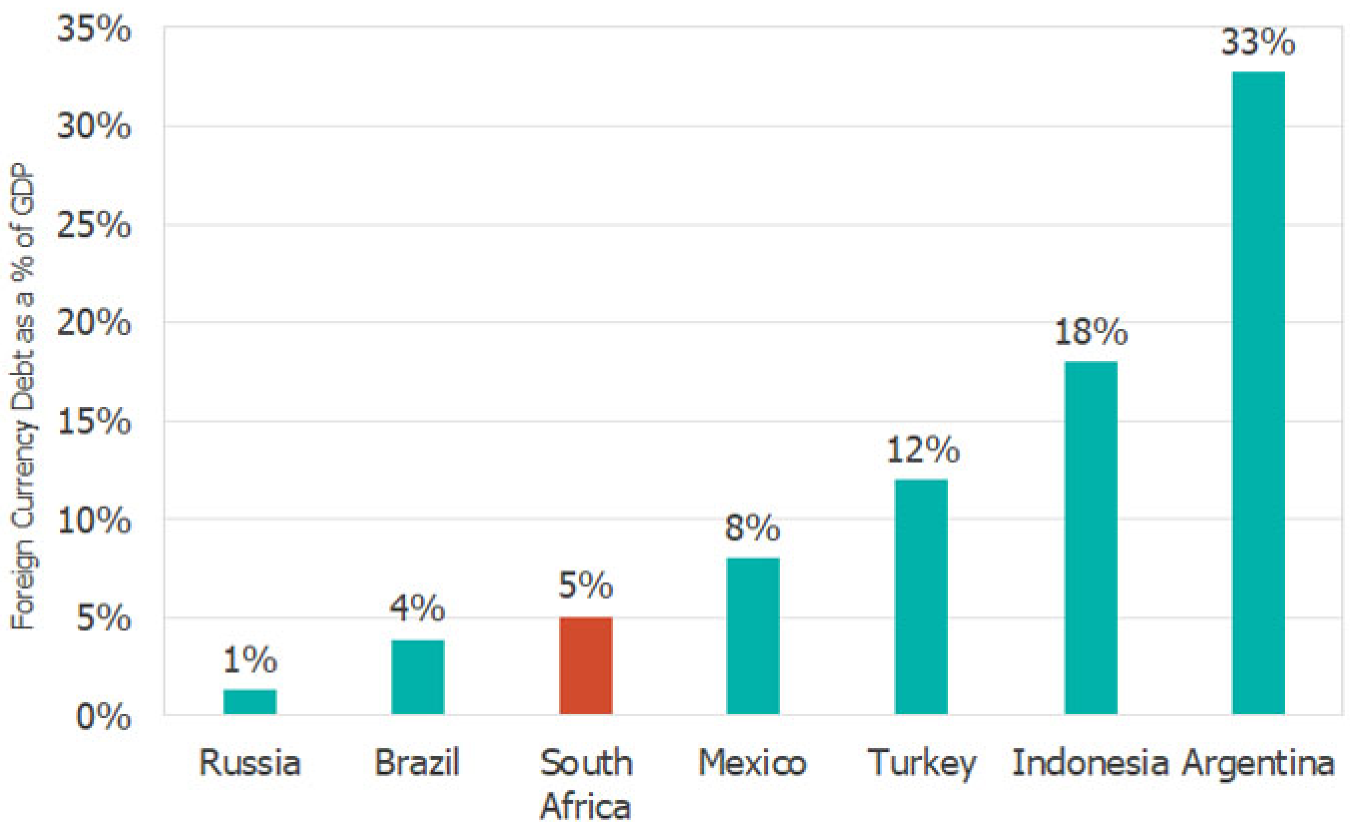
The importance of low foreign currency debt issuance coupled with a free-floating exchange rate regime, which by design acts as an economic "shock absorber" – adjusting as and when appropriate to facilitate a Balance of Payments equilibrium – cannot be overstated for the effective management of Balance of Payments risk. South Africa's balance of payment's risk is further buttressed by $41bn in foreign currency reserves held by the South African Reserve Bank – equivalent to 5.8 months import

coverage. These assets, which include high quality foreign denominated bonds and foreign currency, can be used by the central bank to both effect monetary policy objectives as well as to ensure payment of imports in the event of balance of payments distress.

To the second aforementioned question, the currency's high beta nature relative to emerging market peers is symbolic of the relative depth and ease of access of South Africa's financial markets. Foreign investors' access to South Africa's financial markets is further illustrated by non-resident holdings of South African issued government debt, which is currently at 37% of outstanding issuance. These foreign ownership statistics measure fairly relative to emerging market peers with comparatively deep, liquid financial markets (see Figure 3).

Consequently, while South Africa's economic outlook hasn't looked gloomier in the post-democratic era, it is still too early for the ignominious calls for external debt relief from the IMF. Significant time has been wasted, trust eroded and economic damage caused in the past decade, but there remains a brief window of opportunity for policy makers to swallow the bitter pill that is fiscal probity and resolutely enact growth-enhancing structural reform – South Africa's sovereignty depends on it.

**Figure 1: South Africa's foreign currency denominated debt issuance compares favourably relative to countries that have previously received an IMF bailout**




Source: Futuregrowth

**Figure 2: South Africa's gradual foreign currency denominated debt maturity profile is indicative low redemption risk**

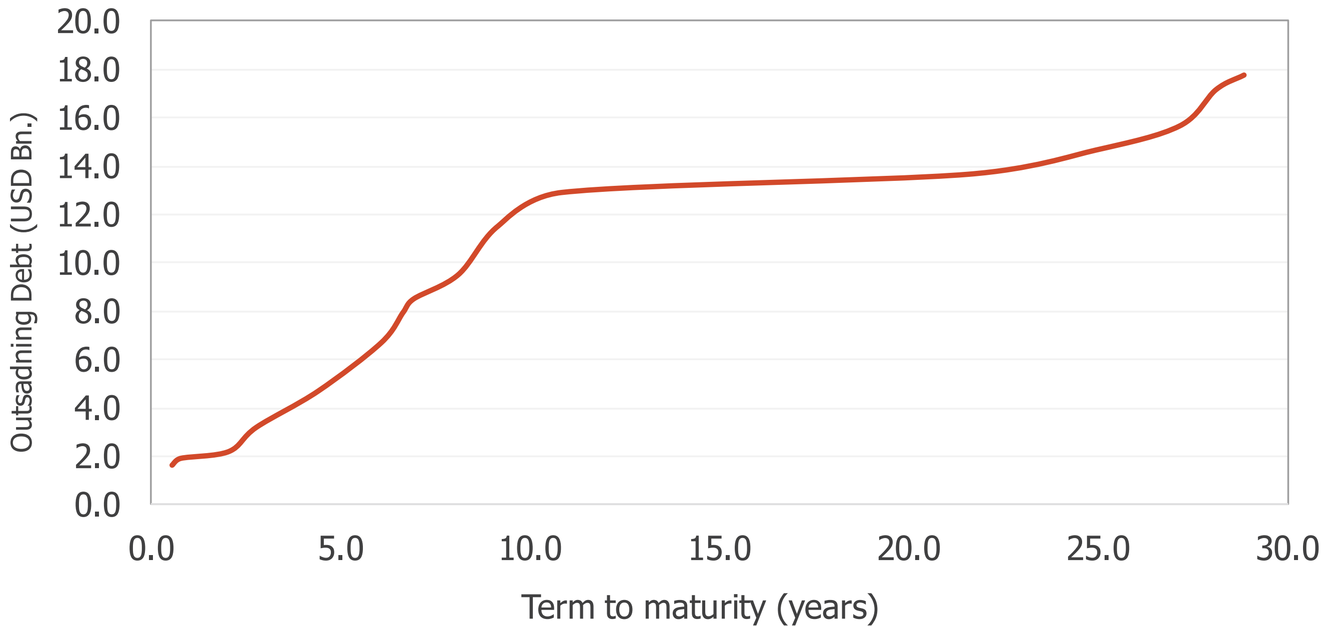
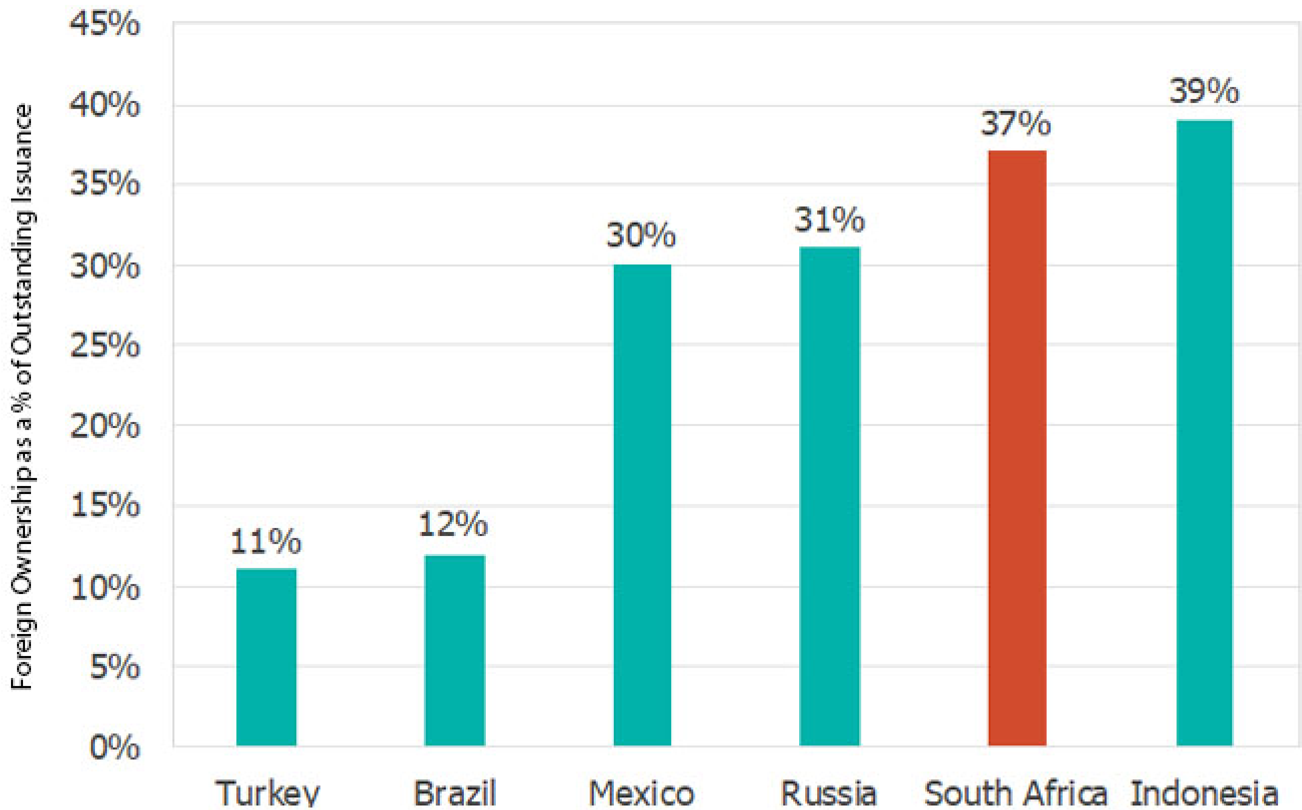



**Figure 3: Non-resident holdings of South Africa's debt comparative to Emerging Market peers**




Source: Futuregrowth

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