The 9th annual conference of the *Public Sector Economist Forum (PSEF*) in East London (Crawford Beach Lodge in Chintsa), Eastern Cape

(28 November 2017)

Opening Remarks by Jacob Twala - Chairperson of the PSEF

INTRODUCTION AND WELCOME

Programme Director

Representatives from the Eastern Cape Provincial Government

Our panellists: Dr Heinrich Bohlmann (UP), Mr Garry Joseph (CEO, SASDC), and Dr Justine Visagie (HSRC)

Steering Committee Members of the PSEF

Members of the PSEF

Delegates

Ladies and gentlemen

On behalf of the steering committee of the Public Sector Economist Forum and the members thereof, it is my great pleasure to welcome you to the 9th annual conference of the *Forum.* We, the steering committee members of the PSEF feel privileged and honoured to be afforded the opportunity to host this congress in the city of East London.

We are truly humbled by the decision that was taken at the Forum's AGM late last year to bring the 9th congress of the PSEF to the Eastern Cape. It is therefore my greatest pleasure to be here today, particularly as the PSEF marks 9 years since its establishment.

Credit rating

It is, however, with great regret that we start the congress soon after the Standard & Poor Global Ratings has cut South Africa's local currency rating to non-investment grade on Friday last week.

On the other hand, Moody's decided to reprieve the country, with the ratings agency maintaining SA's sovereign rating at one notch above non-investment grade but placing the national rating on review for a downgrade. Similar to S & P, Moody's also cited weaker growth prospects and material budgetary revenue shortfalls as some of its concerns.

Last month the Honourable Finance Minister, Malusi Gigaba delivered his brutally honest maiden Medium Term Budget Policy Statement. It was clear in his candid speech that the country is faced with many challenges, which include a poor performing economy, a growing budget deficit, a projected decline in tax revenue, the threat of further credit rating downgrades and a high unemployment rate.

Ladies and gentlemen as you may be aware, S&P's downgrade on Friday follows repeated warnings by the ratings agency that the government standing R350 billion surety for state-owned power utility Eskom's escalating debt was unsustainable. In its rating action on Friday, S&P again cited concern over the struggling Eskom.

The South African Reserve Bank has recently warned that the government's $125 billion stock of Rand-denominated debt will no longer be eligible for the Citi World Government Bond Index (WGBI).

Subsequently – a large amounts of capital could be flowing out of SA's bond markets as investors move to anticipate the junking of SA's domestic bonds, putting pressure on the Rand exchange rate. Currently, South Africa is the only African government bond market to be incorporated into the index.

Fellow delegates, it is common knowledge that junk status inherently results to weaker currency – which coupled with rising oil prices, is likely to lead to higher inflation and thus prompting the SARB to increase interest rates.

As a result of the downgrade, government will have to pay more in terms of interests to debt. Further to this, there will be a need for funds to finance the much needed projects aimed at intensifying radical economic transformation and spending on other government services. In addition, a downgrade will further make it less likely for the SA Reserve Bank to decrease interest rates in the near future.

In times of difficult circumstances that the country is faced with – there will be no amount of talking without credible rescue plans that will turn the situation around. It will be a long, hard road back to investment grade.

Evidence from other countries

A couple of emerging market economies with similar economic characteristics to SA, which include among others, inflation targeting and floating exchange-rate regimes, reflect that potential outcomes from a downgrade to junk status are severe.

For example, ***Colombia*** fell to junk status in 1999, following a persistently increasing budget deficit which brought the country to its financial knees, thereby necessitating a need for a $2.7 billion International Monetary Fund (IMF) loan. Financial markets operations including equities, bonds and currencies remained depressed for a period of 12 years before the country return from junk to investment grade.

A similar experience of non-investment grade occurred in ***Romania***, which fell into junk status during the 2008 global financial crisis. This was largely driven by a rapidly increasing public sector wage bill and pension benefits. As a result, Romania needed a $16 billion bailout from the IMF and support from other institutions such as the European Union and the World Bank. This left Romania's financial institutions vulnerable, and took six years for the country to return to investment grade.

On the contrary, South Korea – the worst affected country in the 1997 Asian financial crisis – was downgraded four notches to non-investment grade by rating agencies. The country, however, managed to revert to investment grade within a period of 12 months. South

Korea's economy contracted by over 8% in real terms in one year. For its survival, South Korea implemented among other policies, aggressive structural reforms of the financial sector, and speedy intervention in financial markets.

Following on the footsteps of South Korea, the Presidential Fiscal Committee that has been recently established thus needs to work closely with all stakeholders such as business, labour, institutions of higher learning and the civic organisations to restore the business confidence and thus catalysing inclusive growth in the immediate term.

As a country, we thus need to follow from Jackson Brown, Jr, the American author, who once said, I quote, "*The best preparation for tomorrow is doing your best today"*. Hence borrowing from his words South Africa, therefore, need to take decisive *actions* and make *"hard choices"* now to ensure a better tomorrow.

Economic performance

As you may be aware, the economy of the country is expected to grow at 0.7 per cent this year, before accelerating slowly to 1.1 per cent in 2018. The subdued economic performance follows the technical recession from which the economy has since emerged, and the credit rating downgrades earlier in 2017.

Debt

As indicated by the National Minister of Finance, Mr Malusi Gigaba in his maiden speech, while tabling the MTBPS, given the sluggish economic performance in the country, the debt and debt-service costs are projected to rise significantly over the next three to four years. National Treasury forecasts an increase in the debt-to-gross domestic product (GDP) ratio to 60 per cent by the 2020/21 fiscal year. This ratio was 48.3 per cent in 1993/94.

The budget deficit is expected to widen to 4.3 per cent of GDP in the current financial year, far higher than the target of 3.1 per cent projected in February this year.

The debt-service costs will remain the fastest-growing category of public-sector expenditure over the next three years, crowding out the much needed social and economic spending.

The Medium Term Budget Policy Statement shows that the budget expenditure ceiling, as was introduced in the 2014 fiscal year, has been breached by an amount of R3.9 billion for the first time this year.

For the first time, since the 2009 global financial crisis, there is an under-collection of R50.8 billion in tax revenue. With lower economic growth and rising unemployment, which is currently at 27.7 per cent, the outlook remains challenging with regard to tax collections, negatively affecting resources available for government spending.

According to the latest data from Statistics South Africa, the number of unemployed people rose to 6.21 million in the third quarter of this year. The high unemployment rate in the country, especially among the youth, is commonly raised by credit rating agencies as a major setback to South Africa’s economic growth prospects.

As indicated by Wendell Erdman Berry, an American prolific author, I quote, *“We do need a new economy, but one that is founded on prudence and care, on saving and conserving, not on excess and waste."*

Conclusion

Programme director, as I conclude I want to express my sincere gratitude to our three panelists:

- Dr Heinrich Bohlmann (UP)
- Dr Justine Visagie (HSRC) and;
- Mr Garry Joseph (CEO, SASDC)

Who will be sharing their insights on issues related to inclusive growth - radical economic transformation - We are looking forward to your discussion as you unpack the concept of radical economic transformation. We hope that the discussion will touch on questions like, what is economic transformation, why do we need as a country, what is the trend global. We also trust that Mr Joseph will also try to enlighten us as to how radical economic transformation can be implemented by focusing on the supply chain management. Gentlemen, thanks for accepting our invitation.

I must however hasten to mention that we initially invited 5 guest, unfortunately due to other pressing and unavoidable commitments, both Prof Chris Malikane and Mr Lumkile Mondi withdrew at an eleventh hour (both from Wits University).

I finally thank the Programme director for allowing me to speak for more minutes than those allocated to me. I hope I didn’t overstay my welcome.

Ladies and gentlemen, enjoy the conference.