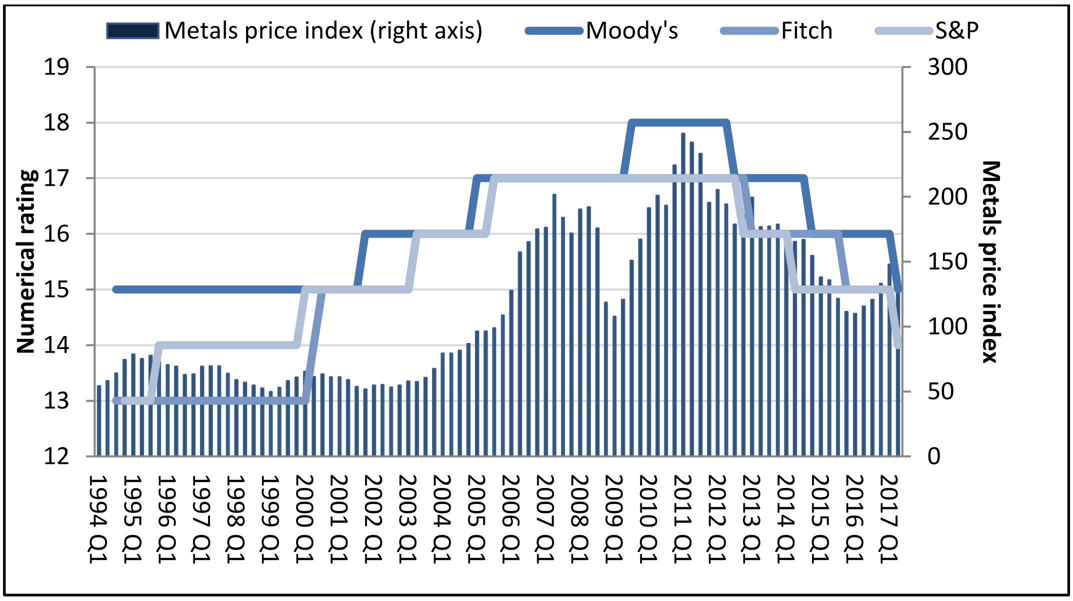
Briefing note: South Africa's credit downgrade – A commodity story

Generating much debate about the state and performance of the South African economy, leading credit ratings agencies recently downgraded South Africa's grade. Fitch and Standard and Poor's downgraded South Africa's long-term sovereign ratings by one notch in April 2017 from BBB- to BB+ while Moody's decreased the country's grade from Baa2 to Baa3 in June 2017. But the downgrades did not affect any of the developments covered in this Real Economy Bulletin, which is based on data up to March 2017.

According to the agencies' statements, the move was primarily driven by the political uncertainty following the Cabinet reshuffle and the perception that the fiscal consolidation stance (notably a rise in contingent liabilities of state-owned enterprises) will, as a result, be undermined by the pursuit of the nuclear power plant programme and efforts to spur radical economic transformation.

While not negating the role of internal political turmoil, South Africa's credit rating history seems, however, to provide other important angles of analysis. The country's credit ratings have been mainly determined by GDP growth, in turn underpinned by global commodity prices. Indeed, considering South Africa's rating in the light of commodity prices, (Graph 1) shows that South Africa's credit rating has been closely linked to international dynamics.

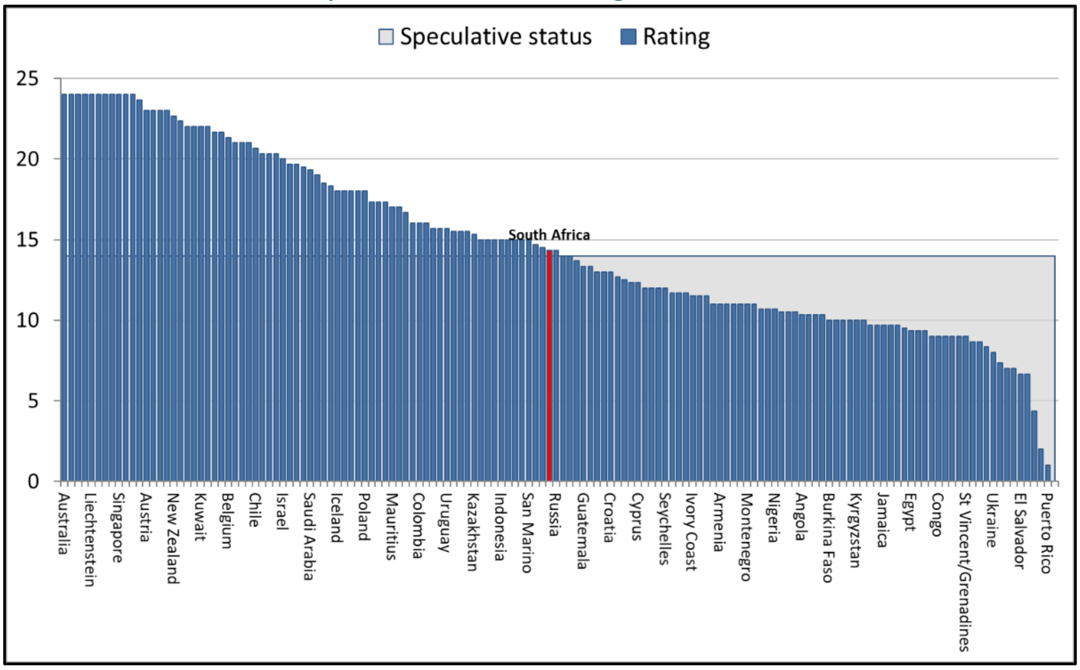
Graph 1. South Africa's credit rating and metal prices, 1994 to 2017



Source: credit ratings converted to numerical scale (0-24). Credit ratings downloaded from Trading Economics. Metals price index: IMF data

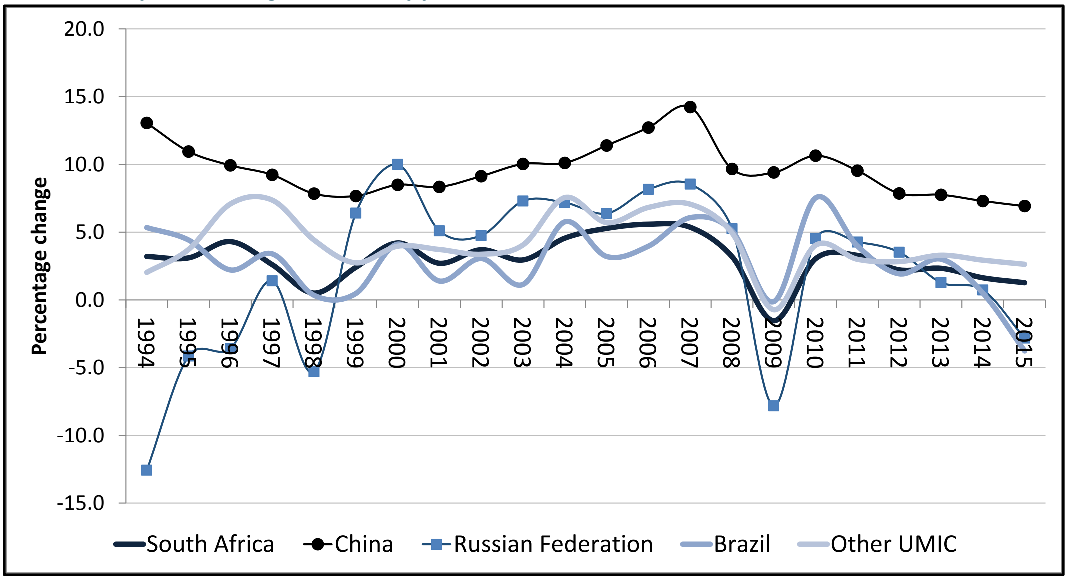
South Africa's ratings should also be put into perspective on a global scale. Based on an average of the three main agencies, South Africa is ranked 72nd out of 146 countries which have a credit rating (Graph 2). South Africa's ratings remain on par with India, Russia, Brazil and even Portugal. The country's weak economic growth performance (the main determinants of credit ratings) moreover appears in line with other upper-middle income economies (with the exception of China), as shown in Graph 3.

Graph 2. World credit ratings, June 2017



Note: The grey area indicates speculative status. Source: *credit ratings converted to numerical scale (0-24). Credit ratings downloaded from Trading Economies*.

Graph 3. GDP growth in upper-middle income economies, 1994 to 2015



Source: World Bank data

While South Africa undoubtedly displays some domestic weaknesses, worsened by the political noise, global dynamics seem to largely explain the downgrade spiral.

Importantly, these trends determined the country's rating, and not the other way around. Indeed, ratings which, as a reminder, are tools to help investors evaluate the risks of a country defaulting on its debts, respond mostly to economic trends.

Undoubtedly, the downgrade will have some noticeable impact on the country, negatively affecting the sentiment on the domestic economy. The acceleration of capital outflows (already triggered by the fall in commodity prices) will ultimately increase the cost of capital, reducing the ability of both the public and private sector to invest. In addition, larger capital outflows are likely to push the value of the rand down, with the known positive effect on exports but negative impact on imports (particularly petroleum). However, in the long run, the impacts on the real economy are expected to be fairly muted and the current credit rating is unlikely to markedly affect South Africa's performance, compared to global demand and commodity prices.