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Q&A: SOUTH AFRICA'S DOWNGRADE TO JUNK STATUS AND GOVERNMENT BONDS - APRIL 2017

1. Is a downgrade to junk status a buying opportunity for government bonds?

The event of the downgrade by itself does not create the opportunity. It is only when markets over-react negatively to this. So far the market's reaction has been muted if measured by the bond market's reaction. RECM does not see current levels as a buying opportunity yet.

2. As an investment strategy, what factors come into play when buying government bonds, is it the inflation path or does junk status weigh more?

The downgrade in the government's debt rating is a point-in-time judgement about the government's willingness and ability to pay interest and repay principal debt – this is a view on the creditworthiness of the government. If you are buying the ZAR-denominated bonds, then the credit is not an issue – the government can print all the money they need to repay the bonds. You have to take into account inflation, which is more important. So keep an eye on inflation.

3. R20 billion of bonds have been bought since President Zuma asked Gordhan to cut short his overseas international trip in late March. Is this a normal investment reaction to junk status or is there manipulation going on?

The SA government bond market is massive, so these numbers do not look out of the ordinary.

4. Can we expect more South African bonds to be bought in the future with junk status hanging over us?

There are sufficient investors that would buy these bonds. The constituents of the group of buyers might change though. At the moment the market 'clears' at rates of about 9%. The bigger concern for the country is whether Treasury will be able to issue new debt at reasonable interest rates, and so far it looks like it is the case.

5. Anything you want to add?

A credit rating is not a beauty contest, and does not reflect the extent to which investors 'like' South Africa as a country. There are fairly straight forward calculations one can do to calculate whether a country will be more likely or less likely in future to service their debt and repay the principal when it falls due. One can only but look at the fact that the total amount of debt relative to the size of the economy (Debt/GDP) has doubled from 25% to 50% in the last 8 years to see where it is going. That is a combination of the government increasing spending while the economy is not growing, and them having to borrow more as a result. And as our debt burden increases, our ability to keep servicing it reduces. Simple as that.

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