WORLD BANK WEBINAR

Public Debt Management – the South African Perspective

Presenter: Thembi Mda | Liability Management | 20 November 2014

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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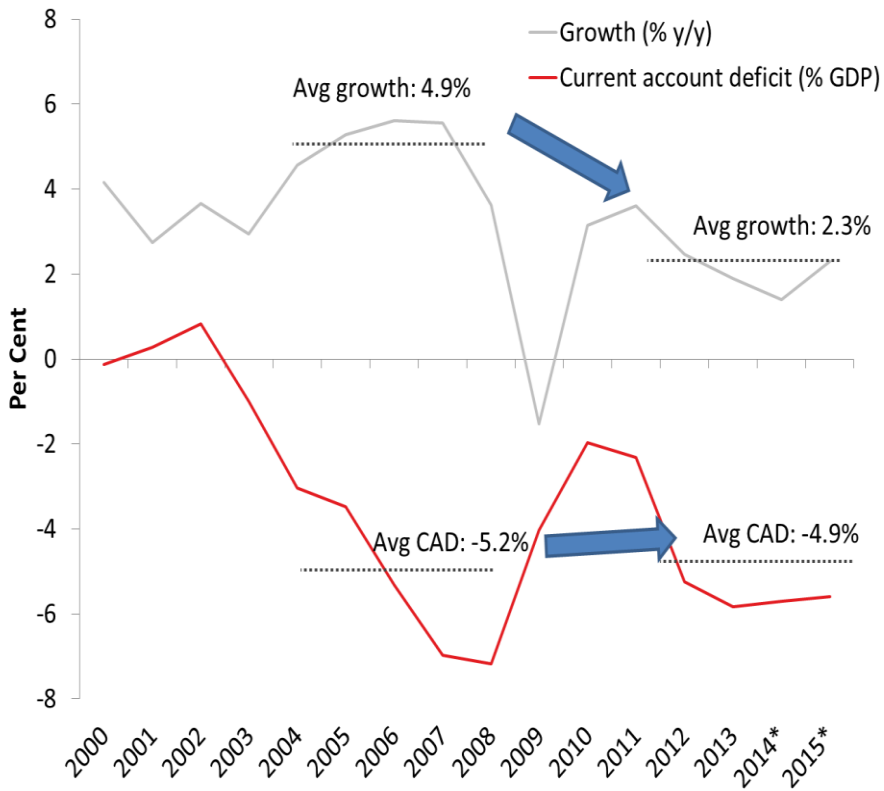
Macroeconomic Developments

GDP Growth and Current Account Deficit



Source: IMF WEO, October 2014, NT calculations
Note 2014, 2015 are forecasts. National Treasury's latest forecasts will be released with Medium Term Budget Policy Statement 22 October 2014
First average represents average growth / CAD from 2004 – 2008.
Second average represents average growth / CAD from 2011 - 2015

- Growth is lower since crisis
  - Weaker consumer (weak employment growth, higher inflation)
  - Private investment subdued (low confidence, electricity constraints)
  - Unemployment 25.5% in Q2 2014
- Current account deficit remains wide despite rand weakness
  - Due to import volumes growing faster than export volumes and unfavorable terms of trade
  - Flexible rand has helped support export competitiveness
  - But electricity constraints limiting the adjustment of the CAD
  - Strike activity worsened export performance further in 2014
- Inflation remains within the target band, but close to upper range
  - Pass through relatively muted
  - Wage increases are major risk

Counter Cyclical Fiscal Policy

- Prudent macroeconomic policies provided SA with space for countercyclical fiscal policy
  - Increase debt issuance post 2008 due to countercyclical policy stance

- **Fiscal Priorities:**
  - Maintaining the expenditure ceiling
  - Reducing the budget deficit
    - As economy begins to grow and expenditure restraint is maintained, the deficit is projected to narrow from 4.1 per cent in the 2014/15 fiscal year to 2.5 per cent of GDP by 2017/18
    - Result is that net debt is projected to stabilise at 45.9 per cent of GDP in 2017/18

- Growth in 2014/15 expected to be 1.4% this year (revised down from 2.9%) due to work stoppages, labor disputes, electricity constraints and other supply side shocks

- It is expected to pick up to 3.0% in 2017 as the global outlook improves, confidence returns to the economy as constraints are relieved

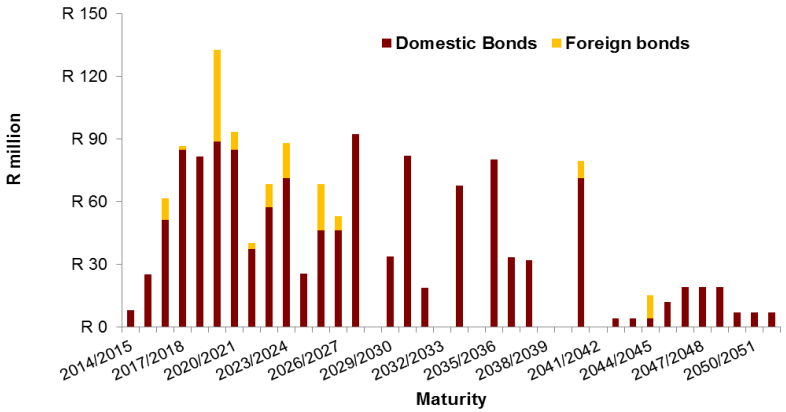
Budget Balance & Debt as a percentage of GDP

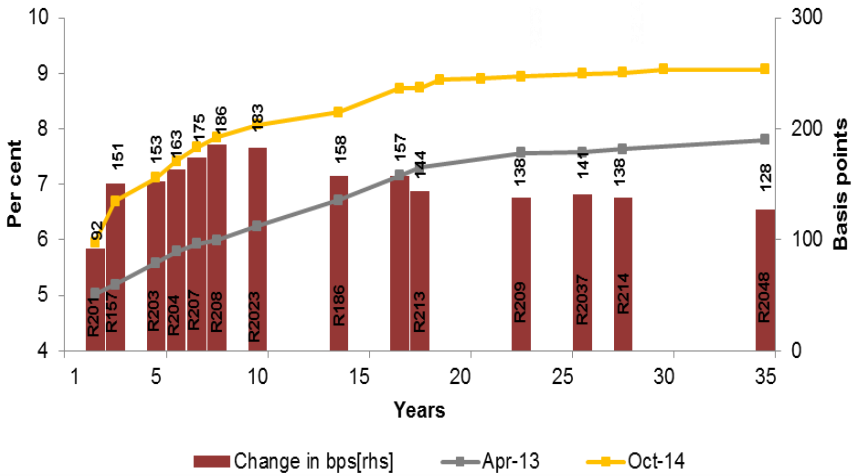
Fiscal Year	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Percentage Change	Actual							Estimates	Medium Term Estimates		
Real GDP Growth	4.6%	2.5%	-0.9%	3.5%	3.3%	2.2%	2.0%	1.4%	2.5%	2.8%	3.0%
Buget Balance % of GDP	1.0%	-1.0%	-6.6%	-4.8%	-3.7%	-4.3%	-3.9%	-4.1%	-3.6%	-2.6%	-2.5%
Debt as % of GDP	23.3%	22.9%	27.4%	29.8%	33.2%	36.9%	39.7%	42.8%	42.8%	45.4%	45.9%

Source: National Treasury

Issuance strategy focused on long-end to reduce refinancing risk

Structure of debt maturity profile and Yield Curve





Domestic Debt

- Issuance concentrated on the long end of curve:
  - Issuance from 2008 to 2011 was concentrated in the short end due to high investor risk aversion
  - Limited supply on short end due to high refinancing risk
  - Recently – increasing domestic and foreign demand for long dated paper

Foreign Debt

- Issue only to finance foreign currency commitments
- Issuance (tenure, yield, timing etc.) dependant on:
  - prevailing market conditions at time of issuance
  - Only two 30 year bonds issued in past three years.
  - Desire to push out maturity where appropriate
- 2014 issuance:
  - dual tranche 12 year, €500 million and 30 year US$1 billion.
  - 5.75 year, US$500 million Islamic bond (Sukuk)

Elevated borrowing costs since April 2013

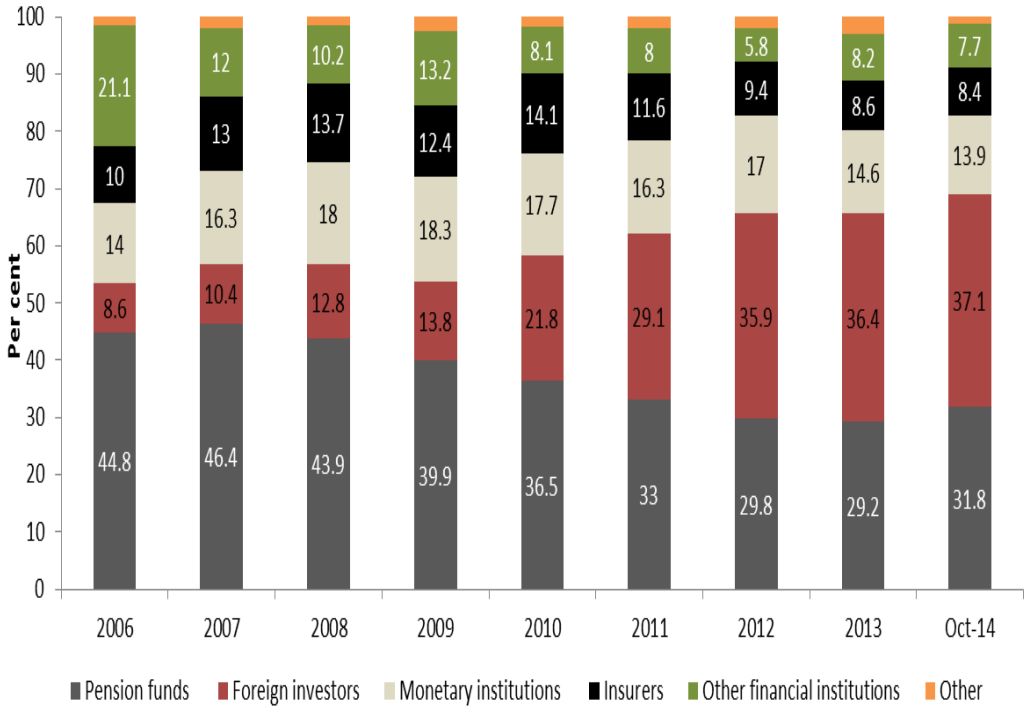
- Yield curve has remained steep since May 2013 due to:
  - Risky emerging market assets sell-off
  - Issuance at the long-end of the curve
  - Monetary policy tightening

- Fixed-rate bonds yield curve has moved by 156 basis points on average since April 2013, Inflation- linked bonds by 58 basis points

Source: National Treasury

Evolution of Investor Base

Holdings of domestic government bonds



Source: Share Transactions Totally Electronic Ltd. ("Strate")

- Non-resident holdings have increased significantly since the 2008 crisis and remain resilient
  - Low interest rates in advanced countries has made emerging market (EM) assets more attractive to foreign flows.
- The 2013 EM capital outflows due to US QE tapering did not have a big impact on SA
  - not much outflows however, there were no new inflows.
- Local pension funds' holdings has declined from 43.9% in 2008 to 31% in 2014
  - Private pension fund holdings have remained constant
  - While government pension fund holdings has decreased (PIC diversified investment strategy into other asset classes)
- EM outflows in January 2014
  - non-resident investors were net sellers of R22.4 billion in government bonds, and their overall holding dipped to 35.7 per cent of these bonds

Reasons for the change in the investor base

Reasons for the Change in Investor Base

Supply Side

- Easy access, deep & liquid financial markets
- Inventors able to sell & buy with ease
- No restriction on foreigners holdings
- No tax on foreigners' holding of bonds
- Primary dealer panel with a wide distribution network (5 international and 4 local banks).
- Government fiscal position
- Transparency and disclosure of government

Demand Side

- Broad base of foreign & domestic investors attracted by diverse range of funding instruments investors
- Easy money policies in advanced countries
- Higher yields in EMDCs

Impact of Change in Investor Base

Advantages:

- Local investors able to absorb sell off by foreigners
- Good auction demand with domestic and local demand
- Diversified funding sources – access new markets
  - Issued in the international Islamic bond market.
  - US$500 million due in June 2020
  - Investor composition – 60% allocated to Middle East and Asia

Disadvantages:

- Relatively high component of Foreign investors leaves SA vulnerable to volatile capital outflows
- Volatile capital flow impact the currency.
- Types of foreign investors in domestic bond market unknown
  - Euroclear non disclosure of holders

Efforts to better understand investor base

- The National Treasury manages an active investor relations (IR) program. The purpose of this is to strengthen relationships with investors and keep up to date with economic, fiscal, funding, political and social developments in South Africa.

- **Road shows:**
  - After the release of the Budget in February and the Medium-Term Budget Policy Statement (MTBPS) in October, the National Treasury visits domestic and international investors to engage them on the contents of the published budget documents and to discuss broader national issues of interest.
  - Since SA credit is so well known, South Africa no longer conducts deal road shows for foreign bond issuances

- **Investor relations website**
  - The IR website (www.investor.treasury.gov.za) was introduced in June 2011 to information readily available to investors.
  - The website exhibits bond auction calendars, policy documents, economic indicators, details of pending events, investor presentations and links to other websites such as those of the SARB and Statistics South Africa (Stats SA).

- **Annual Debt Report**

  National Treasury publishes an annual debt report that give a comprehensive view of the SA's sovereign debt.

- **Group/bilateral meetings with investors**
  - Domestic and international banks organise various investor engagements. Investor meetings include both local and international investors.

Outlook for Coming Years

- Fiscal outlook
  - Expenditure ceiling implemented in 2012 has significantly reduced spending growth. The ceiling will be lowered by R25 billion over the next 2 years.
  - Gross debt to stabilise at 48.4 per cent of GDP in 2016/17, declining to 45.3 per cent by 2020/21
  - From 2015/16, government will be in current surplus, implying that borrowing will finance infrastructure investment rather than consumption spending.
- Expect to see SA still attractive to foreign flows – ease of market access and deep financial markets
- SA vulnerable to downgrades due to labour market instability and low growth.
- Electronic Trading Platform: promote transparency, price discovery in the market to increase local and foreign market participation.
- SA to continue diversification of investor base – development of domestic and international Islamic bond market

Lessons Learned

- Maintain stable and macro, monetary and fiscal policies.
- Control budget expenditure (expenditure ceiling)
- Control over government contingent liabilities
- Diversify funding instruments and investor base
- Primary dealer system has been key to growth of domestic bond market.
- Good communication and regular interaction with local and foreign investors
- Clear political direction
  - Keep politicians informed on appropriate strategies (political buy-in on public debt management and expenditure ceiling).