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The smart money is on junk, say economists

SOUTH Africa's sovereign credit rating will probably be cut to junk status this year, at least by Standard & Poor's, amid concerns the government could fail to reach its budget targets, a poll found yesterday.

All but one of the 16 economists surveyed by Reuters expect SA to lose its investment grade status this year, further hitting markets that have already reacted to expectations of a downgrade.

"A downgrade has been somewhat priced in. Government bond yields are in line with junk status already," said Rajiev Rajkumar, analyst at 4CAST in London.

"Nevertheless, a downgrade would trigger some forced selling by institutional investors as many have a mandate to only hold investment-grade bonds."

Ten economists said a cut to junk, which would put South Africa on a par with peer Brazil, would be negative for markets, and six said it would be very negative.

Economists accurately predicted Brazil's downgrades in two similar Reuters polls last year.

The majority of analysts agreed S&P, which, like fellow agency Fitch Ratings, rates SA just one notch above junk, was most likely to cut. Moody's has it two notches above junk but on review for a downgrade.

Finance Minister Pravin Gordhan has pledged to narrow the budget deficit to 2.4% of gross domestic product by 2018-2019.

Political concerns and policy uncertainty are constraining growth, which is putting budget targets under threat, Rand Merchant Bank economist Carmen Nel said.

South African growth has slowed due to lower prices for its commodity exports and power-generating constraints. The economy is expected to grow 0.7% this year. Economists said a credit rating downgrade would hurt the poor, who depended on social welfare the most, with about a quarter of the labour force out of work.

"A downgrade to junk will increase the country's interest burden on servicing debt, taking money away from where it is needed — the social and welfare dependency scheme," said Colen Garrow, economist at Lefika Securities.

> A credit rating downgrade would hurt the poor

However, emerging market risk sentiment has improved, taking the rand with it.

A Reuters poll of global foreign exchange strategists conducted this month showed that currencies were not likely to sink to new lows, mainly because expectations for US interest rate hikes have been scaled back.

Still, Rand Merchant Bank's Nel said there was likely to be renewed downward pressure on the rand and asset prices leading up to or around the event, particularly given the recent appreciation in asset prices that has partly priced out some of the ratings-related risk.

The rand has recovered from massive selling pressure caused by President Jacob Zuma's decision to sack finance minister Nhlanhla Nene in December, replacing him with little-known Desmond van Rooyen. — *Reuters*