national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

1. Background

1.1. The Minister of Finance, Mr Nhlanhla Nene, was removed from his post on the evening of 9 December 2015 and replaced by Mr Des van Rooyen, an event now referred to as Nenegate.

1.2. This act resulted in an increase in bond yields and a depreciation of the currency when markets opened the next morning, as investors re-priced the risks associated with investing in South Africa. The change in Ministers increased perceptions of the risk that the South African government's commitment to fiscal sustainability was weakening.

1.3. National Treasury was requested by the Zondo Commission to estimate the long term impact of Nenegate on national government debt. This is a response to that request.

2. Quantifying the impact of Nenegate

2.1. **There is always an element of uncertainty in estimating the impact of an event such as Nenegate.**

i. ***To have an impact on the fiscus, the moves in asset prices need to be sustained. However, financial markets are moved by a range of factors every day***. Financial market prices are influenced by domestic as well as international movements and it is not always possible to disentangle these effects (see annexure, table 1).

ii. ***It was not only Nenegate which changed risk perceptions in relation to South Africa – other political choices after this event reinforced these risk perceptions*** (see annexure, figure 4). Comparison of the varying impact of these different events is itself a difficult task. Redl (2018) in a recent article in the South African Journal of Economics developed an index for domestic and global political uncertainty, which shows a spike in uncertainty around Nenegate that is large, but not as high as other events (e.g. the release of the 2017 MTBPS).

2.2. **The estimates provided should be read within this context.** Point estimates should not give a false sense of certainty in relation to the costs of specific events. We calculate two scenarios:

i. we assume there was a sustained increase in the risk perceptions of investors, resulting in bond yields being ***0.5 percentage points higher*** and the rand 10 per cent weaker against the US dollar

ii. we assume there was a sustained increase in the risk perceptions of investors, resulting in bond yields being ***1 percentage point higher*** and the rand 10 per cent weaker against the US dollar

2.3. **Under scenario i)**:

i. ***The stock of debt for 2016/17 would have risen by R26 billion*** compared to the projections in the 2015 MTBPS

ii. ***Debt-service costs for 2016/17 would have been R3 billion higher***.

2.4. **Under scenario ii)**:

i. ***The stock of debt for 2016/17 would have risen by R33 billion*** compared to the projections in the 2015 MTBPS

ii. ***Debt-service costs for 2016/17 would have been R5 billion higher***.

2.5. **In both scenarios**, the higher debt would have increased outstanding stock of debt, and thereby increased interest payments over time. The debt stock (and associated higher interest costs) would only fall when government is able to run sufficient primary budget surplus to repay this debt. Since no primary surplus has been generated, applying these shocks to subsequent financial years generates similar results.

2.6. **This R26bn to R33bn shock had to be absorbed by the fiscal framework.** This was done with a combination of higher-than-planned taxes, borrowing or lower-than-planned expenditures.

2.7. **The actual outcomes in 2016 Budget and in subsequent years were a combination of decisions** to balance the Government's policy mandate and manage higher political risk premia, in light of forecast trends in macroeconomic variables and the fiscal framework. At the time of the 2015 MTBPS, national government debt and debt-service costs for 2016/17 were estimated to be R2 156 billion and R143 billion respectively. During the 2016 Budget these estimates were revised to R2 234 billion for national government debt and R148 billion for debt-service costs.

2.8. In addition, **it should be noted that the impact of political uncertainty can stretch well beyond the direct impact on the fiscus**. This analysis does not take these broader effects into account.

i. Mavee et al (2016) show that domestic political uncertainty accounts for increases in exchange rate volatility beyond that generated by international volatility shocks.

ii. Redl (2018) finds that uncertainty can reduce growth and raise inflation.

iii. Hlatshwayo and Saxegaard (2016) find that increased uncertainty reduces the responsiveness of exports to exchange rate movements.

3. Conclusions

3.1. Political uncertainty has real costs, although it is difficult to isolate the exact costs of a specific individual event over a period.

3.2. The ultimate incidence of those costs will depend on the spending and taxation choices the Government makes. However, ultimately South African citizens, and taxpayers, are worse off.

3.3. Econometric evidence suggests that the cumulative impact of many events that raise political and economic uncertainty increase the costs of borrowing and reduce investment and growth. Together, these factors hamper our efforts to raise employment and fight inequality.

ANNEXURE: Supporting Information

A.1. **The cost of servicing national government debt is influenced by the volume of debt, new borrowing and macroeconomic variables such as interest, inflation and exchange rates**.

i. Higher bond yields increase the cost of issuing new bonds, which in turn affects the total debt stock, although that is determined primarily by past borrowing. In turn, increased debt servicing costs puts pressure on total spending.

ii. A weaker currency immediately increases the size, in rand terms, of foreign currency debt as a proportion of GDP. It also increases the costs of servicing that debt in rand terms.

A.2. The table below compares average yields or prices before and after Nenegate over a range of different time periods.

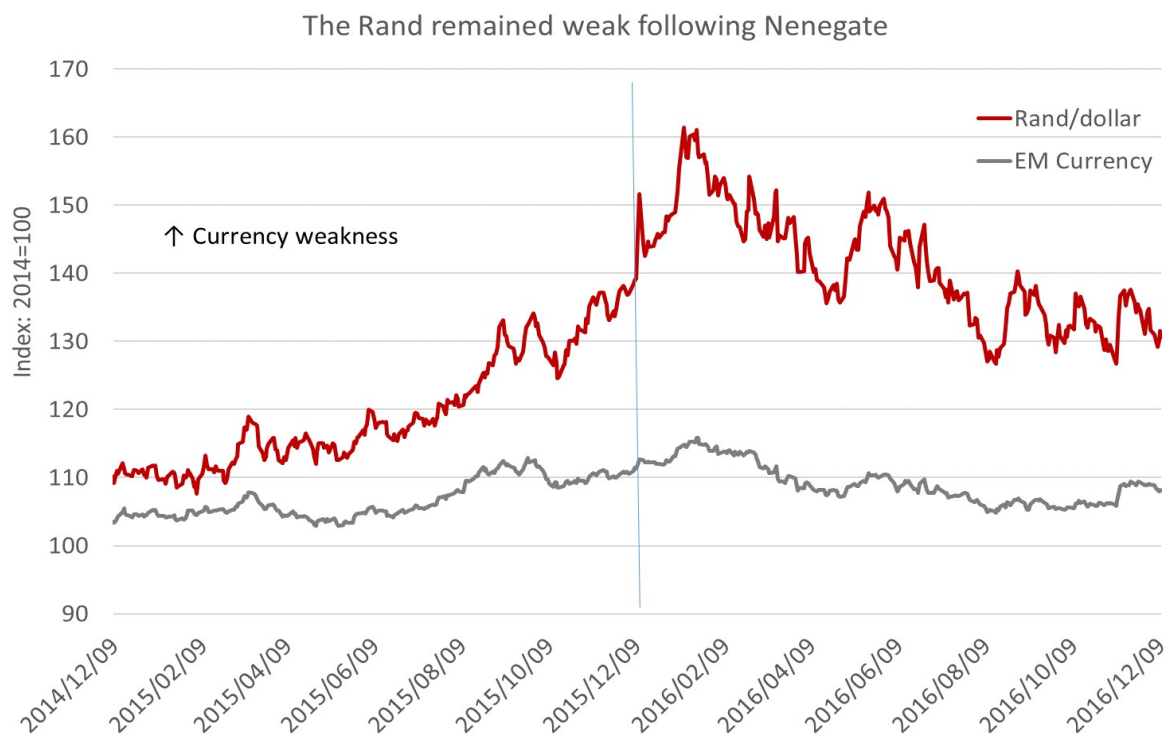
Table 1: movement in key financial market prices

The change since Nenegate	SA 2 year Bond Yield	SA 10 year Bond Yield	JP Morgan EMBIG SA Sovereign Spread	JP Morgan EMBIG Emerging Market Spread	R186 Bond Yield	Rand / dollar
Avg 1 month before Nenegate vs avg 1 month after Nenegate	1.03	1.03	0.80	0.32	1.05	-7.6%
Avg 2 months before Nenegate vs avg 2 months after Nenegate	1.19	1.10	1.10	0.55	1.10	-12.3%
Avg 6 months before Nenegate vs avg 6 months after Nenegate	1.10	0.98	1.01	0.47	0.97	-14.1%
Avg 1 year before Nenegate vs avg 1 year after Nenegate	1.11	1.02	0.71	0.23	0.97	-15.1%

Note that bond yield changes are absolute changes in percentage points.
Exchange rate changes are in percent.
A bond yield represents the interest rate at which investors are willing to lend to the government. The higher the interest rate, the riskier they perceive lending to the government to be.
The spreads relate to the difference in the average bond yields of lending to South Africa (or EM countries) compared to the US. The larger the spread, the riskier investors perceive lending to SA or emerging markets more broadly. We look at changes in emerging market spreads because South Africa is affected by both local and global factors.
The R186 is a bond issued by government maturing in 2026. It is a highly liquid bond that is traded intensively by both locals and foreigners. The more often a bond is traded, the more accurate its prices are likely to reflect investor perceptions.
Source: Bloomberg, BESA, NT calculations

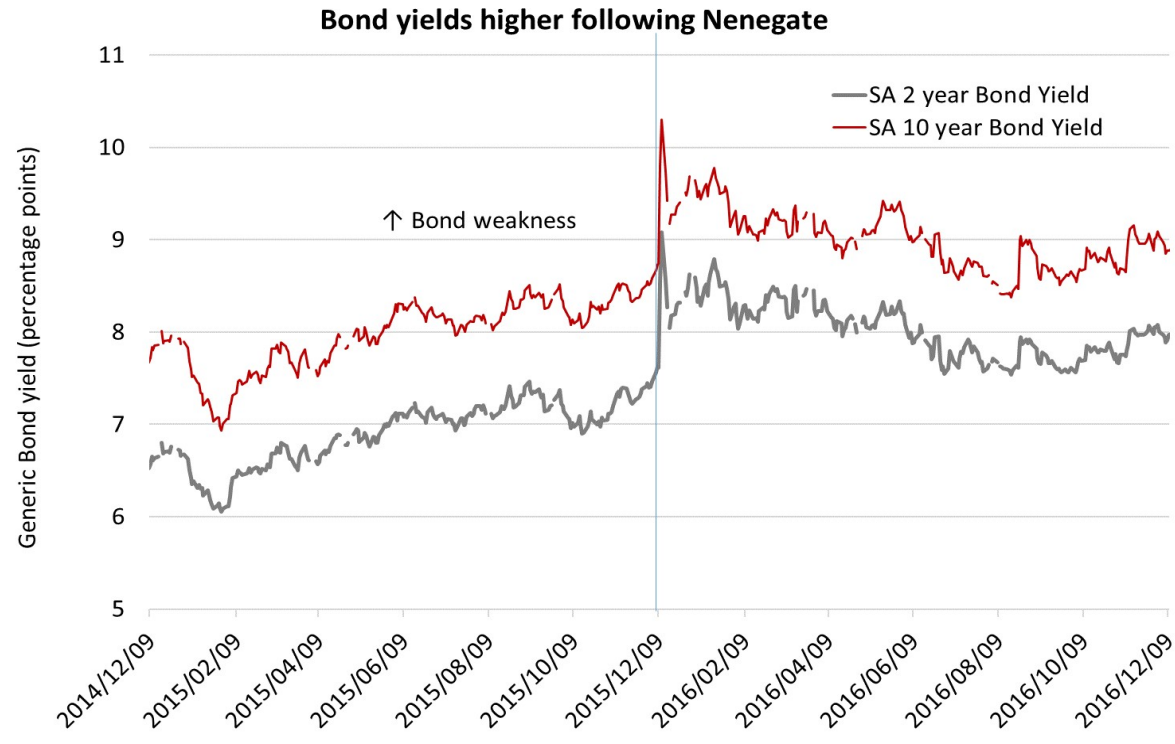
A.3. The charts below give some indication of the movement of key financial market prices.

Figure 1: Currency movements



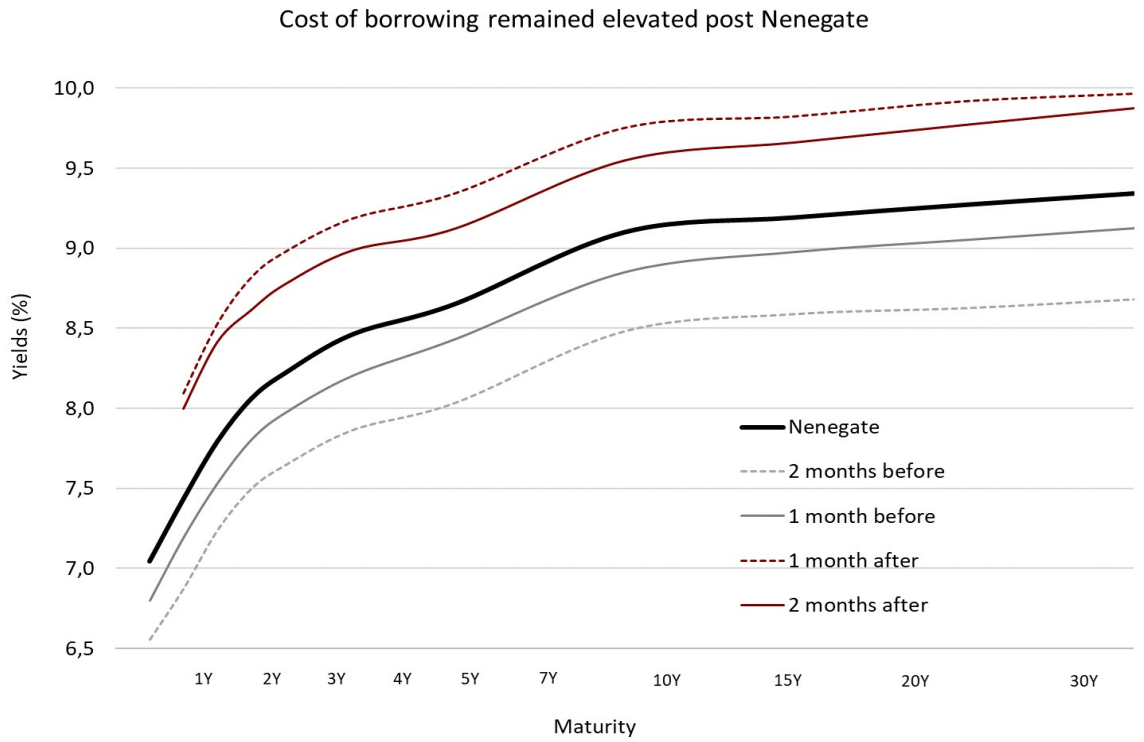
Source: Bloomberg, National Treasury

Figure 2: Two, ten year bond yield movements



Source: Bloomberg, National Treasury

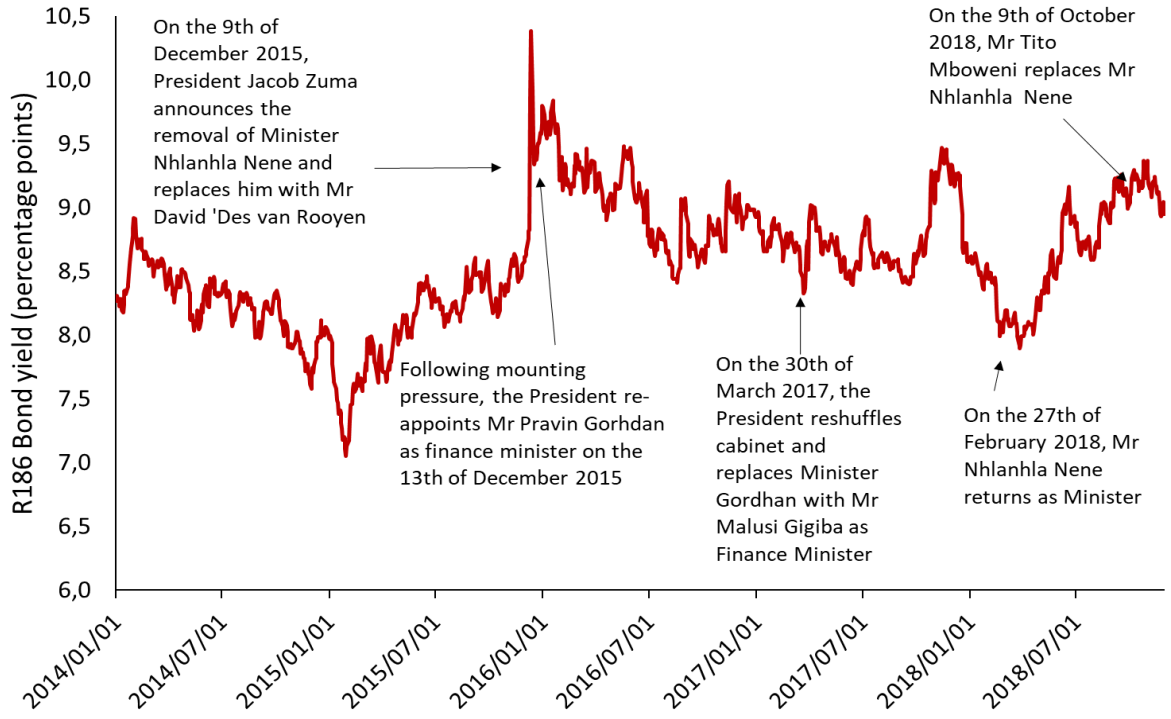
Figure 3: Bond yield curve at select dates



Source: Bloomberg, National Treasury

Note: A yield curve shows the rate at which investors are willing to lend to government over different time horizons. Usually, the longer the loan, the higher the interest rate (yield), since there is more uncertainty about the future.

Figure 4: Political events affected bond yields



Source: Bloomberg, National Treasury

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