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COMMENTARY

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IMF OR SARB FUNDING?

South Africa is facing an external induced crisis. The crisis can also be regarded as an external shock to the economy. In most cases, external shocks such as the COVID19 crisis, the 2008/09 global financial crisis create macroeconomic instability in the domestic country. Whilst, the 2008 financial crisis affected SA through the external sector, that is, a shock in the capital markets, that in turn affected our ability to attract investors and borrow in international markets, the COVID19 crisis resulted in a near shut down of the economy as most sectors are currently closed. Some of our macroeconomic indicators such as the exchange rate have gone northward. This has had socio-economic strain to both industries and consumers.

When there is a crisis such as this, Government has a role to play. What are the instruments at the disposal of Government? Two instruments are available, that is Fiscal and Monetary Policies. The fiscal policy is the measure that government puts in place in revenue collection through taxes and including how the tax revenue is spent. Government's fiscal arm is already over stretched with a budget deficit of 7% as announced in the Budget statement.

SA has accumulated debts to fund some capital programmes in ESKOM, Gautrain and other entities. This debt is estimated to be around 62% of GDP. However, SA's debt is still sustainable in comparative terms. SA's fiscal position is already constrained and the COVID19 shock came at a time when the economy was already distressed and the fiscus underperforming. The President noted that through reprioritising the current budget, about R130 billion would be raised. This is how far the fiscus can go based on the current budget, with the deficit of 7% included.

How can SA finance the R500 billion announced by the President?

External Funding- such as IMF, World Bank, BRICS bank or IDB. This option has its own implications. What we are simply doing is to spend more than we can produce, in other words spending against future production. SA is already burdened by debt service costs which amount to billions of Rands per annum.

However, like I indicated above, SA's debt situation at 62% is still sustainable compared to other countries. The level of debt sustainability for a country has been a subject of research by economists around the world. Obviously not comparing SA and the US which has a debt ratio of more than 150% of GDP, Portugal 123%, Greece 181%, Japan 253%, Egypt 101%, etc. Within BRICS, SA has the highest Debt to GDP ratio, with countries such as India 18%, Russia 40%, China 18% and Brazil 18%.

There is also an option for borrowing from the domestic market. This option will also reduce the amount of liquidity in the market as the government sells Bonds or Treasury Bills. SA's treasury Bills are not lucrative to investors as all credit rating agencies have ranked the country in the junk status. Besides, this will not be the best approach as the current policy is to ensure increased liquidity in the market. Secondly, government has Monetary instruments that it can use to stabilise the economy and to fund a budget deficit. SARB has already responded to the crisis through reducing the repo rate as a measure to increase liquidity in the market.

The central bank can also reduce the reserve ratio of commercial banks. The reserve ratio is the amount of reserves commercial banks must hold on to. These reserves are not available to the market as loans or as investments. The reserves are meant to ensure that Commercial Banks are always liquid. I doubt if SARB would want to use this policy instrument given that through its position on commercial Bank Capital adequacy, SA's financial market is one of the most stable in world.

The last instrument at the disposal is the central bank is increasing money supply in the economy through the Printing Press. Remember, the central bank does not create money like what commercial banks do through deposit taking. The central bank is responsible for monetary policy, that is controlling interest rates, money supply and exchange rate. Increasing money supply means printing more money such as running the printing machine nonstop to generate the R500 billion required to fund COVID19 economic shock.

What is the consequence of this? The money printing is not backed by real production in the economy. This money has not been created as a result of normal exchange of goods and money in the economy. The result is more money in the economy chasing few goods. This situation is generally inflationary. The country then must choose between borrowing and running the printing press nonstop, which is likely to destabilise macroeconomic indicators even further. The argument that some economists use to justify printing of more money is that SA's inflation is quite low and that SARB can still allow inflation to somewhat gallop beyond the 3-6% target band.

History sometimes tells us that once inflation starts galloping, it might be difficult to contain it. The world is replete with such examples. However, I can also say for both of these options as long as the printed money or borrowed money is used for production and infrastructure development, the downside risks will be minimal because SA will be able to generate more revenue through taxes in future as the economy grow. The main challenge is when money is used for current consumption like payment of social grants and the wage bill. These are consumptive in nature. There might also be leakages in the system through underground transactions and corrupt activities which is a cause for concern.