

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing June 2016

#### South Africa Summary 28 June 2016

*Ratings agencies Standard & Poor's (S&P) and Fitch both retain their previous ratings of South Africa's economy. The announcement contradicts widespread commentator speculation that the country could not avoid a downgrade based on its poor economic performance. The South African Reserve Bank (SARB) reveals that Consumer Price Index (CPI) inflation decreased to 6.1% in May from 6.2% in April. SARB governor Lesetja Kganyago tells the media that the central bank will keep interest rates steady at 7% to keep up pressure on inflation. The appointment by the ruling African National Congress (ANC) of Thoko Didiza as a mayoral candidate triggers widespread unrest across the Tshwane metropolitan area in Gauteng Province. The national ANC decision to appoint Didiza follows violent clashes between supporters of two local candidates.*

#### South Africa retains ratings from S&P and Fitch

Ratings agencies **Standard & Poor's (S&P)** and **Fitch** both retained their previous ratings of **South Africa's** economy on 5 and 8 June respectively.<sup>1</sup> Economic commentators and international observers speculated from the start of 2016 that South Africa was at risk of a downgrade of its sovereign debt ratings, which would have negatively impacted the cost of debt to the government and to consumers.<sup>2</sup> The issue is highly politicised. Commentators view the avoidance of a downgrade as support for finance minister **Pravin Gordhan's** efforts to turn around the economic situation. S&P, which in May 2015 gave South Africa a year to sort out its economy, kept the rating as one level above junk at BBB- with a negative outlook.<sup>3</sup> S&P kept the local currency denominated debt rating at BBB+.<sup>4</sup> The rating gives South Africa a reprieve from 'junk' status, but the ratings agency was critical of the current economic situation:

*"South Africa's weak economic growth, relative to that of peers in similar wealth categories, continues to be hurt by a combination of factors...[the negative outlook signals] that we could lower our ratings on South Africa this year or next if policy measures do not turn the economy around."<sup>5</sup>*

S&P's possible factors include the political situation or any further interference in the operations of the finance ministry.<sup>6</sup> The agency took the view that the efforts of the treasury to turn around the economy were significant enough to maintain the rating at the current level.<sup>7</sup>

Fitch held South Africa's sovereign debt rating at BBB- and kept its rating as stable.<sup>8</sup> The move surprised economists and economic commentators who predicted in the media that the agency was likely to downgrade the rating to negative.<sup>9</sup> Fitch also called on the government to continue an economic reform agenda, and warned that there was a very real possibility of a downgrade if the

<sup>1</sup> Business Day, 8 Jun 2016.

<sup>2</sup> Daily Maverick 6 Jun 2016.

<sup>3</sup> Bloomberg, 6 Jun 2016.

<sup>4</sup> Bloomberg, 6 Jun 2016.

<sup>5</sup> S&P press release, 5 Jun 2016.

<sup>6</sup> S&P press release, 5 Jun 2016.

<sup>7</sup> S&P press release, 5 Jun 2016.

<sup>8</sup> Business Day, 8 Jun 2016.

<sup>9</sup> Business Day, 8 Jun 2016.

performance of the economy did not improve within the year.<sup>10</sup> Fitch called out the issue of political interference in the operation of the finance ministry, including recent rumours that the **National Prosecuting Authority (NPA)** was considering indicting Gordhan for espionage, as a trigger for a downgrade.

*“The dismissal of two finance ministers in a week in December and subsequent tensions between Gordhan and other parts of the government have raised questions about the commitment of the government to sustained fiscal consolidation and prudent governance of state-owned enterprises.”<sup>11</sup>*

According to economic analysts in South Africa, the ratings reflect the good work that Gordhan and the finance ministry put into convincing the agencies that they have a solid economic plan:

*“Gordhan and his team have gone round the houses and made the case that a downgrade would prevent any economic reform plan from functioning....the agencies have given South Africa more time but this is far from a vote of confidence.”<sup>12</sup>*

The economic situation in South Africa remains poor. **Statistics South Africa (SSA)** published data on 8 June showing that the economy contracted 0.2% year-on-year in the first quarter.<sup>13</sup> The contraction was not unexpected due to the drought, the slump in the mining sector, and political uncertainty. It was the first time that SSA released combined production and expenditure data after it assumed responsibility for the latter from the **South African Reserve Bank (SARB)**. SSA shows that first quarter growth contracted 1.2% quarter on quarter.<sup>14</sup> This was largely the result of a worse than expected performance in the mining sector which decreased an annualised 18.1% due to low iron ore and platinum output volumes, and low commodity prices.<sup>15</sup> If the mining sector were excluded, the economy would have increased 0.5%.<sup>16</sup> However, agriculture decreased an annualised 6.5%, and the transport sector 2.7%.<sup>17</sup> With regard to expenditure, household consumption decreased 1.3% due in part to higher interest rates, and fixed capital formation 6% due to low business confidence.<sup>18</sup> Imports and exports both declined 7.1%.<sup>19</sup>

### **SARB pressure works as inflation contracts to 6.1%**

The SARB revealed on 22 June that Consumer Price Index (CPI) inflation decreased to 6.1% in May.<sup>20</sup> The contraction in inflation is welcome news for the economy and for the SARB, which has steadily increased interest rates to keep inflation down. SARB governor **Lesetja Kganyago** told the media on 30 May that the bank would keep interest rates at their current levels to continue exerting downwards pressure on inflation.<sup>21</sup> The SARB’s monetary policy committee (MPC) decided to retain the repo rate (the rate at which it lends to commercial banks) at 7%.<sup>22</sup> This follows SARB policy since 2014 in terms of which it has increased interest rates by a cumulative 200 basis points from 5% to 7%.<sup>23</sup>

<sup>10</sup> Business Day, 8 Jun 2016.

<sup>11</sup> Fitch press release, 8 Jun 2016.

<sup>12</sup> Source, economist, Cape Town

<sup>13</sup> Bloomberg, 9 Jun 2016.

<sup>14</sup> Bloomberg, 9 Jun 2016.

<sup>15</sup> www.miningweekly.com

<sup>16</sup> Bloomberg, 9 Jun 2016.

<sup>17</sup> Bloomberg, 9 Jun 2016.

<sup>18</sup> Bloomberg, 9 Jun 2016.

<sup>19</sup> Bloomberg, 9 Jun 2016.

<sup>20</sup> Business Day, 22 Jun 2016.

<sup>21</sup> Business Day, 31 May 2016.

<sup>22</sup> Business Day, 31 May 2016.

<sup>23</sup> Business Day, 31 May 2016.

The decrease in CPI inflation runs against the SARB's predictions that the cost of living would rise steadily across 2016. Inflation fell from 6.2% in April.<sup>24</sup> The deceleration runs counter to forecasts that had predicted an increase to at least 6.3%, with some commercial banks forecasting an increase to 6.6%.<sup>25</sup> A decrease in the cost of food and the cost of fuel was behind the deceleration.<sup>26</sup> The drop in the rate is likely to prompt the MPC to maintain its benchmark repo rate at 7% at its next meeting on 21 July.<sup>27</sup>

The SARB is trying to avoid a 'stagflation' scenario where low growth and a weak rand drive up inflation. The bank's medium term policy is to continue increasing interest rates to ensure that CPI inflation continues within the 3-6% bracket.<sup>28</sup> According to Kganyago:

*"The South African Reserve Bank is certain that an environment of consistently low and stable inflation is the best contribution it can make to a balanced and sustainable growth (outlook)."*<sup>29</sup>

Kganyago's comments appeased the markets; the rand increased by 0.6% against the dollar across the day's trading to R15.6/\$ at time of writing.<sup>30</sup>

### ANC mayoral candidate sparks riots in Tshwane

The appointment by the ruling **African National Congress (ANC)** of **Thoko Didiza** as a mayoral candidate in August municipal elections has sparked widespread unrest across the **Tshwane** metropolitan area (**Gauteng Province**), which includes South Africa's political capital **Pretoria**.<sup>31</sup> The unrest brings the many underlying tensions and factions within the ANC into the public eye, and has led to increased criticism of the party for an overtly partisan agenda. It also epitomises the volatile political culture that the ANC has engendered under the leadership of President **Jacob Zuma** (2009-present).<sup>32</sup> Violence erupted on 20 June, escalating on 21 June when two people died as a result of the violence.<sup>33</sup> Protestors also set at least 20 busses on fire and have caused an uncalculated amount of damage.<sup>34</sup> The **South African Police Service (SAPS)** had arrested 54 people in connection with the violence at time of writing.<sup>35</sup> According to a source within the ANC,

*"[The district] was the very worst of patronage politics, the municipal committee members handed out jobs, cars, and most of all, places on the ANC [electoral] lists to people who supported their claims to be mayor...people who were paid off are now angry that their patron is not the mayor."*<sup>36</sup>

Local media report that there may be a political element to the violence and that local ANC members planned the protests, rebelling against the central government imposition of Didiza as a candidate.<sup>37</sup> ANC secretary general **Gwede Mantashe** told the media he had received reports of a clandestine meeting of disgruntled party figures on 21 June.<sup>38</sup> The police's specialist investigative team, the **Hawks**, released a statement on 22 June saying that they were investigating senior ANC members in relation to the violence.<sup>39</sup> Numerous media outlets mention regional chairperson **Kgosientso Sputla**

<sup>24</sup> Business Day, 22 Jun 2016.

<sup>25</sup> Business Day, 22 Jun 2016.

<sup>26</sup> Business Day, 22 Jun 2016.

<sup>27</sup> Business Day, 22 Jun 2016.

<sup>28</sup> Business Day, 31 May 2016.

<sup>29</sup> Kganyago in Business Day, 31 May 2016.

<sup>30</sup> [www.xe.com](http://www.xe.com)

<sup>31</sup> Daily Maverick, 22 Jun 2016.

<sup>32</sup> Source, editor of a major newspaper, South Africa

<sup>33</sup> Daily Maverick, 22 Jun 2016.

<sup>34</sup> Daily Maverick, 22 Jun 2016.

<sup>35</sup> Business Day, 22 Jun 2016.

<sup>36</sup> Source, ANC delegate, Johannesburg

<sup>37</sup> Business Day, 22 Jun 2016.

<sup>38</sup> Business Day, 21 Jun 2016.

<sup>39</sup> Business Day, 22 Jun 2016.

and his ongoing struggle for power with regional deputy chair **Mapiti Matsena** as the origin of the unrest.<sup>40</sup> Their disagreement left the Tshwane ANC unable to suggest a candidate to the provincial Gauteng ANC, and resulted in the ANC's higher structures preventing both Sputla and Matsena from running, suggesting Didiza in their place.<sup>41</sup> ANC deputy secretary general **Jessie Duarte** told the media that the party was aware of the disagreements between the two and intended to make sure that Didiza went forward as the candidate in the August municipal elections.<sup>42</sup>

*"The violence in Tshwane is bad, but not as bad as it could have been if Sputla or Matsena won the mayorship....the [national body of the] party stepped in, just too late."*<sup>43</sup>

## Implications

The ratings agencies have listened to Gordhan and South Africa's business leaders and given them more time to sort out the economy. The decision not to downgrade is less a recognition of underlying economic stability, although this is a factor, and more a recognition of the damage a downgrade could do to the economy. Ratings agencies have to balance a role between an observer and an influencer and in this case have decided not to intervene. Politically this will lend support to the Zuma administration as it attempts to deflect criticism over its handling of the economy. Gordhan has managed to keep the economy on track in spite of Zuma and his allies' best attempts to divert it for their own ends. Zuma will benefit, but not as much as South African businesses and consumers who do not have to face the consequences of the government and institutions borrowing money at much higher costs.

The SARB was another factor in the ratings agencies' decision not to downgrade to junk. It has implemented solid monetary policy since the first crash in 2009, keeping up interest rates to keep inflation low. The fall in inflation is due to a change in the weather pattern shifting some of the burden on food imports. The SARB will keep up the pressure and is highly unlikely to reduce its benchmark rate at the next MPC committee. Stagflation is still a danger, especially if other contextual factors, such as a return of power shortages, add to the price of goods and services.

The violence in Tshwane demonstrates patronage issues within local ANC politics. The ANC has the ability to promote any party member as far as the presidency without that person having to win an election so long as he or she makes it onto the right party lists. Getting onto party lists, for positions on local and municipal committees of the party, is the primary mechanism of ANC patronage. In Tshwane, Sputla and Matsena loaded the lists with their supporters in order to secure support for the mayorship. The national ANC intervened to stop further violence when they appointed Didiza. The violence is an outpouring of anger from local residents who see no way to advance in the current economic and political circumstances other than via the ANC's patronage systems. Unless the political system undergoes radical reform, there is a chance that this will happen in other areas.

---

<sup>40</sup> Daily Maverick, 22 Jun 2016.

<sup>41</sup> Daily Maverick, 22 Jun 2016.

<sup>42</sup> Daily Maverick, 22 Jun 2016.

<sup>43</sup> Source, journalist, Johannesburg

### About Africa Risk Consulting:

**Africa Risk Consulting (ARC)** is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

**ARC's** core consulting services include integrity due diligence and corporate investigations, political advisory and country assessments, opportunity monitoring and reputation risk management. Most relevant to private equity firms is ARC's integrity due diligence and corporate investigations capability. Specifically, ARC offers pre-deal integrity checks to highlight red flags before negotiations start; full detailed multi-jurisdictional reputation due diligence; and supplier and senior hire vetting and repeat due diligence for compliance programmes. ARC is unique in that it offers a 10-day delivery for a routine integrity due diligence. ARC also offers a suite of corporate investigations services from immediate investigation, evidence gathering, e-discovery, forensic accounting and whistleblower support on one end to crisis media management and regular monitoring on the other.

[www.africariskconsulting.com](http://www.africariskconsulting.com)

### About ARC Briefing:

**ARC Briefing** is ARC's essential online business information service.

Companies at any stage in their Africa expansion, whether building or communicating an Africa strategy, investing directly, expanding current operations, financing other investors, doing the legal leg-work or researching the Africa growth trend, need ARC Briefing.

**ARC Briefing** is an online information service keeping you:

- Up to date with Country Chronologies of business-critical events
- In the know via Country Briefings on political, economic, business and operating trends. Written in-country, ARC experts analyse and comment
- Ahead with Country Planner which details future elections, budgets, regulatory changes etc.

[www.briefing.africariskconsulting.com](http://www.briefing.africariskconsulting.com)

### Getting in touch

Please contact us by email [info@africariskconsulting.com](mailto:info@africariskconsulting.com) or call + 44 (0) 20 7078 4080

Follow us on Twitter: [@ARCBriefing](https://twitter.com/ARCBriefing)