

AFRICA RISK CONSULTING

Country briefing - South Africa

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Summary

South Africa's economy is in a slump: growth is down and inflation is rising. Monetary policy measures have little effect. Labour disputes continue. Metalworkers down tools for four weeks as mineworkers end a five-month platinum strike. The strike prompts Anglo American Platinum to sell its domestic mines. New public enterprises minister Lynne Brown criticises state sector companies' poor performance. Ratings agency Standard & Poor's places electricity utility Eskom on credit watch. Finally, good news for investors as mineral resources minister Ngoako Ramathlodi announces he is urging the president not to sign the controversial amendments to the mineral resources bill into law.

1.1 Budget report card – low growth, rising inflation and depreciating rand

The economic outlook is gloomy. Finance minister **Nhlanhla Nene's** budget speech on 21 July warned of difficult times ahead because of declining growth, the depreciating rand increasing the cost of servicing government debt, a hostile global climate of rising interest rates and declining commodity prices.¹ In July the **South African Reserve Bank (SARB)** revised its growth forecasts for the economy down from 2.8% in January to 1.7% and may revise them further as bank governor **Gill Marcus** said that the 1.7% assumed a speedy resolution to the metalworker strikes (see below).² The rand has fallen 2.6% against the dollar since March and was 10.57 to the dollar on 22 July, down from 10.75 on 18 July, a fall of 1.6% in a week. Inflation has risen from 6.1% in April to 6.6% in May and the reserve bank has revised its projections for year-on-year rates for 2014 up to 6.3%.³

"The treasury and the SARB are caught between a rock and a hard place; there is little that can be done in terms of monetary policy to change the factors that are hurting the economy – strikes, poor exports, inefficiency and high unemployment – but they have to act to prevent inflation and currency depreciation adding to the existing problems." ⁴

¹ Business Day, 22 Jul 2014

² Business Day, 18 Jul 2014

³ FT, 17 Jul 2014

⁴ Source, financial analyst, Johannesburg

In order to combat these issues the reserve bank's **Monetary Policy Committee (MPC)** raised the repurchase rate up 25 basis points to 5.75%. The repurchase rate (or repo rate) is the rate at which the SARB will buy back debt from banks in the event of a fiscal shortfall. Analysts are divided over whether the incremental 25 point increase will have the desired effect.

*"With a raise that marginal there is a real chance that the MPC will have to raise the repo rate again next month, but they don't want to spook the markets with a raise."*⁵

The deficit reduction plans are still in place including caps on public spending (see *ARC South Africa March 2014 Briefing*), and the treasury forecasts that the budget deficit will decrease from 4% of GDP in 2014 to 2.8% by the end of 2016. However, Nene admits that if the current poor economic climate continues, it will be a stretch to reach this target. The rising stock of public debt makes this more difficult. From a current level of R1.59 trillion (\$141 billion), it is set to reach R2 trillion (\$190 billion) by 2017.⁶

1.2 Numsa strike begins as Amcu strike ends; ongoing labour disputes show effects

Labour woes continue. Neither business nor government nor the official mediation body is able to curb union power. The **Association of Metalworkers and Construction Union (Amcu)** strike that brought the platinum industry to a halt for five months came to an end on 25 June. Unions delayed the agreement a week longer by making last minute demands for immunity from prosecution for illegally striking workers. The next day (26 June) the **National Union of Metalworkers of South Africa (NUMSA)** announced that its 200,000 members in the metalworking and engineering industries would strike for a 12% pay increase from 1 July. The **National Union of Mineworkers (NUM)** and **Solidarity** joined the strike. Unions rejected a "quick fix" wage increase offer from employer groups, the **Steel and Engineering Industries Federation of Southern Africa (Seifsa)** and the **National Employment Association of SA (Neasa)** on 16 July.⁷ The dispute went before the **Council for Conciliation, Mediation and Arbitration (CCMA)**, which tabled a new proposal of increases ranging from 8% to 10%. The unions accepted a deal of a 10% increase for their lowest paid workers on 28 July.⁸ Seifsa and Neasa have both criticised the deal for not taking into account the long term costs on the industry.⁹ Reserve bank governor Gill Marcus criticised ever-increasing wage

⁵ Source, financial journalist, Johannesburg

⁶ Business Day, 22 Jul 2014

⁷ Mail and Guardian, 16 Jul 2014

⁸ FT, 28 Jul 2014

⁹ Mail and Guardian, 21 Jul 2014

demands and said that unless productivity increased, the settlements could fuel a wage-price spiral that would negatively affect employment trends.¹⁰

*"When the governor of the central bank publicly criticises labour settlements you know you're in trouble; the unions have to recognise that wage inflation can't rise at an exponential rate."*¹¹

High profile strike action leads to inter-union competition. Following the deal with **Anglo American Platinum (Amplats)**, **Lonmin Platinum** and **Impala Platinum** in late June, Amcu called a wildcat strike at Impala's **Marula mine (Limpopo Province)** on 3 July.¹² The strike only lasted a week but highlighted a struggle between Amcu and NUM for control of platinum workers in the eastern platinum belt. NUM shop stewards report that Amcu workers threaten them when they try to address strikers.¹³

*"These guys [Amcu and NUM] having been waging a war for control of the platinum shafts since 2012...having a single union as a majority partner across the mines, especially if that union is Amcu, means more strikes with higher demands are likely."*¹⁴

The strikes are having a negative effect on the economy. Ratings agency **Standard & Poor's (S&P)** gave labour disputes as a reason for its June downgrade (see *ARC South Africa June 2014 Briefing*).¹⁵ The five-month Amcu strike cost the industry \$2.6 billion in earnings and the 70,000 striking workers \$1 billion in wages. Amplats on 21 July announced the sale of its platinum mining operations after an 88% decrease in profits.¹⁶ Assets for sale include **Rustenburg, Union, Pandora** and **Bokoni** mines.¹⁷ The move may force a change of ownership from international miners to South African companies with **Sibanye Gold** declaring an interest in acquiring the assets.

The ongoing Numsa strike and potential NUM strikes could hurt the development of state power company **Eskom's Medupi** power plant, already five years behind schedule, which is vital to addressing the country's power shortfall – another factor destabilising the economy. The power utility has gone to the CCMA to negotiate a deal to keep the project on track, but unions mistrust the mediation body as it has ruled in Eskom's favour in the past.¹⁸ The metalworking and engineering strike has also affected South Africa's

¹⁰ FT, 17 Jul 2014

¹¹ Source, financial analyst, Johannesburg

¹² Mail and Guardian, 20 Jul 2014

¹³ Mail and Guardian, 20 Jul 2014

¹⁴ Source, journalist, Johannesburg

¹⁵ FT 13 Jun 2014

¹⁶ Reuters, 21 Jun 2014

¹⁷ Independent Online, 22 Jul 2014

¹⁸ Business Day, 17 Jul 2014

automotive industry. The strike forced **General Motors** to suspend all output from 3 July.¹⁹ Other major manufacturers including **Ford**, **Nissan**, **BMW**, and **Toyota** followed suit soon after.²⁰ Labour disputes in South Africa have already hurt the automotive industry with a strike in October 2013 leading to BMW cancelling plans to manufacture its new generation of cars in the country.²¹

Telkom, the state-owned and semi-privatised telecoms operator, has backed down from a restructuring deal pending "*consultation with stakeholders*" after the **South African Telecoms Union (SATU)** threatened strike and court action over job losses in its 19,000 strong workforce.²² SATU claimed that Telkom wanted to cut 9,500 jobs, the company denied this and said instead that they planned to cut 1,000 managerial positions.²³ However, Telkom halted proceedings after talks on 17 July with unions.

*"Corporations seem worried; they think they could be the next industry in line for a strike lasting weeks but many have to cut costs in the current economic climate."*²⁴

Previously the government has been able to retain influence with striking unions through the **Congress of South African Trade Unions (Cosatu)** which is part of the governing tripartite alliance. However, Cosatu is increasingly irrelevant to maverick unions such as Numsa and Amcu and it will be up to the government to act directly. Deputy president **Cyril Ramaphosa** has made the first move by suggesting on 24 July that strikes require a ballot to go ahead. Currently union leaders can call a strike without consulting members first with only 48 hours' notice.²⁵ Ramaphosa is a former unionist and **African National Congress (ANC)** activist turned businessman. He is unpopular with the unions who consider him to be an ally of business rather than theirs.²⁶ Ramaphosa called for any changes to the labour code to be sensitively handled but given the unpopularity of any moves against the unions, there may not be other government figures willing to openly support him.²⁷

1.3 Eskom on credit watch as public enterprises minister calls for better service

Eskom's myriad problems continue. It has a R225 billion (\$21 billion) shortfall through cutting costs after the **National Energy Regulator of South Africa (NERSA)** denied it a 16% tariff increase in March 2013,

¹⁹ Business Day, 3 Jul 2014

²⁰ Business Day, 28 Jul 2014

²¹ BBC, 2 Oct 2013

²² Mail and Guardian, 18 Jul 2014

²³ Mail and Guardian, 8 Jul 2014

²⁴ Source, journalist, Johannesburg

²⁵ FT, 24 Jul 2014

²⁶ Source, journalist, Johannesburg

²⁷ Reuters, 24 Jul 2014

capping it at 8%.²⁸ Eskom has been unable to plug this shortfall and exists on government loans. It is the largest corporate borrower in the country and has R245.8 billion (\$23.6 billion) in unpaid debt securities and borrowing.²⁹ Eskom also requires a further R300m (\$28.51m) to fund its expansion programme which includes the highly delayed Medupi power plant that Eskom now claims will definitely be producing by the end of 2014.³⁰ To make matters worse, ratings agency S&P placed Eskom on emergency credit watch on 3 June. The company has 90 days to improve its situation or it will be listed as sub-investment grade. Eskom's finance director **Tsholofelo Molefe** has said that if that were to happen, it would increase the cost of funding the company by 30%-40%.³¹

The group has also struggled to provide regular service with power provision problems from March through to May. New public enterprises minister **Lynne Brown** has questioned Eskom's declining performance despite government support. She called on Eskom to "*do something amazing*" soon, stating that the delays to the Medupi plant had negatively affected the economy. Brown announced that she planned to appoint a new CEO to replace acting chief executive **Collin Matjila** by the end of August.

There is some good news for Eskom as **Exxaro Resources** approved the \$347m **Belfast** coal mine on 26 June that will produce an estimated 2.2m tonnes of coal a year, 500,000 of which will supply Eskom's coal power plants.³²

1.4 Mineral resources bill amendments to be reviewed

Mineral resources minister **Ngoako Ramathodi** announced on 18 June that he had urged President **Jacob Zuma** (2009 - present) not to sign the controversial amendments to the mineral resources act into law but to send it back to parliament to reconsider the "hostile clauses". Parliament approved the amendments in March 2014, which give the government an automatic 20% stake in all projects and the option to purchase the other 80%.³³

Mining and oil companies have warned that these amendments threaten investment. If Zuma does send the amendments back to the assembly then it could ease some of their operational pressure:

²⁸ Mail and Guardian, 1 Mar 2013

²⁹ Bloomberg, 11 Jul 2014

³⁰ Bloomberg, 11 Jul 2014

³¹ Business Day, 14 Jul 2014

³² Miningmx 26 Jun 2014

³³ FT, 18 Jun 2014

*"What the IOCs [international oil companies] want is regulatory consistency. Without it, financing operations is complicated as there are no guarantees that the government won't force a sale of the asset."*³⁴

Zuma is keen to market South Africa's mineral resources internationally and is seeking investors to extract its shale gas reserves, estimated to be the world's fifth largest at 483 trillion cubic ft.³⁵ International oil companies have renewed their interest in the country in recent years. **United States (US)-based Exxon Mobil, Anglo-Dutch Shell** and **US Andarko** all have exploration operations off the coast. **France's Total** started drilling the first new offshore oil well in a decade in June.³⁶

2 Implications

South Africa seems unable to kick its economic slump which will last at least until the end of the year. Poor growth prospects and rising inflation mean that the economy is unlikely to be able to generate sufficient jobs or exports necessary to get the country back on its feet. The series of strikes is to blame for this. The true extent of the negative effect of Amcu's platinum strike on the economy and jobs is yet to be understood. The platinum industry is reeling and is unlikely to start producing until the end of the year. Amplats' decision to disinvest is likely to mean future job losses, which in turn will increase pressure on the ANC government. The Numsa strike hot on the heels of the Amcu strike hits another crucial sector – manufacturing – threatening jobs and growth further. The dissatisfaction of the sector bodies at the 10% deal struck shows the power of the unions to hold business to ransom. The battle for union membership has increased competition for settlements that in turn fuel wage inflation – with little focus on wider issues of economic decline.

Macro-economic steadiness from the reserve bank and the finance ministry is insufficient to restore the country's prospects. Unless the government takes urgent steps to intervene to restore balance in the relationship between business and labour, disinvestment in mining and manufacturing will continue. Unless government acts, the medium term outlook will see a significant loss of jobs as mining and manufacturing companies restructure to cover the cost of strikes and as they invest in increased mechanisation to protect themselves against future strikes. This will have a knock on effect on the political environment.

³⁴ Source, oil trader, Johannesburg

³⁵ Mail and Guardian, 19 Jun 2014

³⁶ FT, 18 Jun 2014

The voices of reason, Nene and Marcus, recognise this but neither is in a position to implement quick-fix changes. For all his talk on 21 July of increasing productivity and efficiency, Nene knows that many of South Africa's economic problems are endemic and require tackling corruption, labour laws and infrastructure deficiencies. To reverse these will require action on labour regulations. Ramaphosa's comments on this may be a sign that the government is finally prepared to tackle illegal strikes and potentially amend the labour code. However this move will be highly unpopular with the ANC and there will be few willing to stand with Ramaphosa on this issue.

Corruption continues to be a major problem, especially in state-owned enterprises. The appointment of competent boards and management could turn this around and Lynne Brown's new Eskom chairperson could signal the way forward on this front. Eskom's mounting debt and decreasing efficiency shows the negative effects of corrupt management on infrastructure deficiencies that make the country a less attractive place to invest.

Until such time as the above are addressed, the economy is likely to remain deflated. The removal of deterring regulation such as the mineral resources act amendments is a good start but will not lead to increased investment overnight. The oil and gas industries and the prospect of new offshore oil discoveries could reverse negative growth trends. Zuma described shale gas as a "*game changer*" last month in his state of the nation address and an extraction industry could be very lucrative. But as extraction is highly technical it would offer few jobs for South Africa's low-skilled unemployed workers.

In the meantime, the trend where South Africa has become the stepping-stone for FDI flowing into the rest of the continent with little of it stopping in South Africa will also continue. South Africa will continue to lose out to the region, to countries with higher growth rates, lower labour costs, lighter regulatory regimes and more competitive taxation.