

AFRICA RISK CONSULTING**South Africa Monthly Briefing September 2016**

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President Jacob Zuma (2009-present) reappoints Dudu Myeni as chair of failing state-owned enterprise (SOE) South African Airways (SAA). The appointment increases private sector concerns over SOEs as Futuregrowth Asset Management withdraws \$128m investment from the sector. Deputy president Cyril Ramaphosa sells his stake in fast food company McDonald's SA prompting speculation he is about to launch his long awaited campaign to succeed president Jacob Zuma. However, he fails to win a public endorsement from the Congress of South African Trade Unions (Cosatu). Ratings' agency Moody's announces that it will only downgrade South Africa's sovereign debt rating to junk status if growth drops below 0.2%. Statistics South Africa shows year on year growth is at 0.6% and projects 0.3% average across 2016.

Zuma reappoints Myeni as SAA chair

President **Jacob Zuma** (2009-present) reappointed his alleged mistress, **Dudu Myeni**, as chair of failing state-owned enterprise (SOE) **South African Airways (SAA)** on 13 September.¹ The reappointment demonstrates the president's ability to make patronage-based appointments despite opposition from within and outside the ruling **African National Congress (ANC)**. It also decreases the likelihood of any private sector involvement in South Africa's numerous SOEs in financial trouble. Former employees, the media and industry analysts blame Myeni for poor governance and extremely poor financial management at SAA for the past seven years.² Myeni's reappointment is also Zuma moving against finance minister **Pravin Gordhan** who has repeatedly called for Myeni's resignation since his reappointment as finance minister in December 2015.³

Under Myeni, SAA has had seven chief executive officers (CEOs) in the past five years, a repeated turnover of board members, and a \$240m bailout from the finance ministry.⁴ The pilots and ground staff of SAA publicly declared on 8 April they have no confidence in Myeni to lead the SOE.⁵ However, Zuma answered a parliamentary question from opposition **Democratic Alliance (DA)** leader **Mmusi Maimane** saying that he had complete confidence in Myeni's skills and suitability to turn the company around.⁶ The president's direct intervention to reappoint Myeni also shows a shift in power over SOEs from the treasury and public enterprises ministry to the presidency.⁷ This coincides with the introduction of the **Presidential State-Owned Companies Co-ordinating Council** in late August (see *ARC Briefing South Africa August 2016*).⁸ Other opposition parties also criticised the president in parliament on 13 September, referring to Myeni as "*Dudu Myeni-Zuma*".⁹

¹ Business Day, 13 Sept 2016.

² Business Day, 13 Sept 2016.

³ Business Day, 13 Sept 2016.

⁴ Business Day, 13 Sept 2016.

⁵ Eyewitness News, 14 Sept 2016.

⁶ Eyewitness News, 14 Sept 2016.

⁷ Business Day, 13 Sept 2016.

⁸ Business Day, 13 Sept 2016.

⁹ Business Day, 13 Sept 2016.

“Every time Zuma reappoints Myeni we have yet more proof that nobody in the ANC can bring him to order...he flaunts his ability to act against the interests of the country.”¹⁰

The reappointment increases the risk that the poor governance at SOEs will continue. This has already caused the private sector to move away from financing them. Domestic fixed income money manager **Futuregrowth Asset Management** on 31 August suspended lending to six SOEs.¹¹ Futuregrowth suspended lending to the state-owned power utility **Eskom**, rail and ports operator **Transnet**, **South African National Roads Agency**, **Land Bank of South Africa**, **Industrial Development Corporation**, and **Development Bank of Southern Africa**.¹² It had planned to imminently lend R1.8 billion (\$128.3m) to three of the above.¹³ Chief investment officer **Andrew Cantor** said Futuregrowth will only resume lending and rolling over existing debt once their corporate governance and oversight over borrowing and lending have improved.¹⁴ The announcement had an immediate impact on the markets and yields on Eskom and Transnet’s dollar bonds increased following Futuregrowth’s announcement.¹⁵

Will Cyril make his move? Ramaphosa finalises McDonald’s sale

Deputy president **Cyril Ramaphosa** sold his stake in fast food company **McDonald’s SA** to **United Arab Emirates (UAE)**-based **MSA Holdings** on 21 September.¹⁶ The sale of McDonald’s may be a precursor to his launching his long awaited campaign to succeed Zuma as ANC president in 2017. MSA Holdings is a subsidiary of **United States (US)**-based group parent company **McDonalds Inc** that operates its stores in the **Middle East**.¹⁷ The **Competition Commission** cleared the sale on 16 September.¹⁸ This is the final sale of Ramaphosa’s assets owned through former broad-based black economic empowerment (BBBEE) vehicle **Shanduka Holdings**.¹⁹ In 2014 he offloaded the majority of his assets into **Pembani Group**, which telecoms company executive director **Phuthuma Nhleko** owns and operates. The new Pembani Group is now the largest BBBEE group in South Africa, with Ramaphosa’s interests held in a blind trust. McDonalds was sold separately as Ramaphosa holds the licence to operate McDonald’s in South Africa personally and not through a corporate entity.²⁰ McDonald’s SA is currently searching for a suitable replacement for Ramaphosa as the preferential licence holder.²¹

Some analysts believe that, with the final offloading of corporate assets, Ramaphosa will feel secure enough to take on Zuma. Ramaphosa broke his long silence over in-fighting in the ANC at the funeral of former minister **Makhenkesi Stofile** on 25 August saying that the government “*was at war with itself*”.²² He repeated the sentiment at the **National Economic Development and Labour Council (NEDLAC)** summit on 9 September and added that government leaders should “*act with decorum*” to make sure economic stability is maintained.²³ The comments clearly made an impact on Zuma. When DA leader Maimane asked him to justify on 15 September whether there was infighting in the government, the president told him to “*ask Ramaphosa*”.²⁴ However, apart from these two statements,

¹⁰ Source, opposition politician, Cape Town

¹¹ Bloomberg, 31 Aug 2016.

¹² Bloomberg, 31 Aug 2016.

¹³ Bloomberg, 31 Aug 2016.

¹⁴ Bloomberg, 31 Aug 2016.

¹⁵ Bloomberg, 31 Aug 2016.

¹⁶ Mail and Guardian, 21 Sept 2016.

¹⁷ Mail and Guardian, 21 Sept 2016.

¹⁸ Mail and Guardian, 21 Sept 2016.

¹⁹ Mail and Guardian, 21 Sept 2016.

²⁰ Mail and Guardian, 21 Sept 2016.

²¹ Mail and Guardian, 21 Sept 2016.

²² Daily Maverick, 21 Sep 2016.

²³ Daily Maverick, 21 Sep 2016.

²⁴ Daily Maverick, 21 Sep 2016.

Ramaphosa has kept quiet as Zuma has increased his influence over SOEs, reappointed Dudu Myeni (see above), and pushed out finance minister Gordhan (see *ARC Briefing South Africa August 2016*).

*“The question on everyone’s lips is “where on earth is Cyril?” – we expected him to back Gordhan and [ANC chair] **Gwede Mantashe** against Zuma but instead he was quiet for months.”²⁵*

According to ANC sources, one of the problems that Ramaphosa faces is that he has no clear support base within the party.

*“Everybody knows that the **ANC Youth League**, the Premier League [premiers of **Mpumalanga, Free State and North West Provinces**], and the **ANC Women’s League** back Zuma....but Ramaphosa has no clear support base.”²⁶*

Ramaphosa reportedly hoped to get an endorsement from tripartite alliance partner the **Congress of South African Trade Unions (Cosatu)**. His allies within the congress – **South African Democratic Teachers Union (Sattu)**, **National Education Health and Allied Workers Union (Nehawu)**, and **National Union of Mineworkers (NUM)** – have pushed the executive committee to endorse him.²⁷ Media outlets reported that a special central executive committee meeting on 19 September would result in an endorsement for the tradition of the deputy president succeeding the president, effectively endorsing Ramaphosa.²⁸ However, Cosatu president and Zuma ally **Sidumo Dlamini** told the media that more consultation was needed and it would make the announcement at the appropriate time.²⁹

“Cyril has left it too late and the energy that was behind him has moved on, the gathering of centrists and business leaders that rallied against Zuma in December last year has dissipated...to get back a strong position now is going to be difficult.”³⁰

Moody’s gives 30% chance of downgrade as economy hold steady

Ratings’ agency **Moody’s** led a delegation to South Africa from 16 to 20 September and announced that it would only downgrade the sovereign debt rating to junk status if growth dropped below 0.2% in 2016.³¹ This reduces the chance of a downgrade significantly; Moody’s quantified this probability at roughly 30%, and its announcement will increase domestic and international confidence in the economy. Speculation over whether or not ratings agencies – and Moody’s in particular – would downgrade the debt rating is a matter of widespread public speculation from commentators, politicians and business leaders.³² Moody’s is due to formally rate the economy in a written statement on 25 November.³³ The new target gives the finance ministry an achievable benchmark to avoid the downgrade – which could drastically increase the cost of public and private borrowing with potentially disastrous economic effects. Moody’s projects that growth will sit at 0.4% in 2016, increasing to 1.1% in 2017 and to 2% by 2019.³⁴ It will keep its outlook as negative as the delegation found little evidence that the economy showed significant signs of rapidly improving.³⁵

“This statement is both a vote of confidence in the ability of the finance ministry to keep South Africa from sinking and a painful reminder of quite how poor the medium term prospects are.”³⁶

²⁵ Source, opposition politician, Cape Town

²⁶ Source, ANC insider, Johannesburg

²⁷ Daily Maverick, 21 Sept 2016

²⁸ Daily Maverick, 21 Sept 2016.

²⁹ Business Day, 19 Sep 2016.

³⁰ Source, ANC insider, Johannesburg

³¹ Business Day, 20 Sept 2016.

³² Business Day, 20 Sept 2016.

³³ Business Day, 20 Sept 2016.

³⁴ Business Day, 20 Sept 2016.

³⁵ Business Day, 20 Sept 2016.

³⁶ Source, fund manager, Cape Town

Moody's lead analyst for South Africa, **Zuzana Brixiova**, outlined that the major risk to the credit rating was political divisions.³⁷ Brixiova clarified that it was not the divisions themselves that posed the risk, but their impact on effective policy making and implementation.³⁸

"The noise by itself is not an issue, but the question is whether the noise creates division which impedes structural reforms and could undermine the rating."³⁹

The assessment concurs with statistics that government agencies released across September showing that while the economy is deflated, it is not in danger of a recession as some analysts predicted.

- **Statistics South Africa (SSA)** on 6 September published second quarter data showing that the economy grew 0.6% year on year.⁴⁰ Quarterly growth was higher at 3.3% in Q2, driven by increased exports in the mining and metals sectors. It was the largest quarterly growth since the fourth quarter 2014.⁴¹ The level of growth beat market consensus with economists forecasting 2.3% to 2.6% growth.⁴² SSA, however, warned of the importance of viewing the quarterly data in the context of the sharp contraction in the first quarter.⁴³ SSA said a more accurate measure is first half growth of 0.3%.⁴⁴
- The **National Ports Authority** released figures on 12 September showing that South Africa's bulk exports fell 4.9% year-on-year in August.⁴⁵ The reduced figures are partly due to the closure of a coal railway line between mines in Mpumalanga Province and the coast.⁴⁶
- SSA announced on 14 September that the retail sector grew just 0.8% in July, well below the 2% growth that economists and sector experts expected.⁴⁷ Higher interest rates and reduced lending are placing increased pressure on consumers.
- The **South African Reserve Bank's (SARB)** quarterly bulletin showed the current account deficit has reduced from 5.3% of gross domestic product (GDP) in Q2 to 3.1% in Q3 – performing better than the finance ministry had projected.⁴⁸

Implications

Zuma acts consistently – if the opposition, media, markets and members of his own party align against him on an issue, he will dig in his heels and not back down. Dudu Myeni is disastrous for SAA and has overseen a period of rapid financial and organisational deterioration within the SOE. It is possible that if this had not come to light, Zuma would have quietly moved her on as was the case with Eskom chief **Collin Matjila**. However, as with the **Nkandla** spending scandal, as soon as the president feels the world is arrayed against him, he refuses to budge. He cannot abide being seen as weak and losing political ground to his enemies. It will take a top-level court ruling to remove Myeni. Her reappointment further damages the reputation of SOEs, and it is likely that other backers, like Futuregrowth, will withdraw finance in the short and medium term. This in turn will add to the government's spending and borrowing burdens, slowing down the economic recovery further.

Ramaphosa is slowly emerging from Zuma's shadow, however he may have left it too late. The *legkotla*, where the ANC elects its new president, is just over a year away and he has little time to build a support base. Zuma and his allies will be actively working to prevent this, hence Cosatu backing down from endorsing Ramaphosa. It is understandable that Ramaphosa would wait to make

³⁷ Daily Maverick, 19 Sept 2016.

³⁸ Daily Maverick, 19 Sept 2016.

³⁹ Brixiova in Daily Maverick, 19 Sept 2016.

⁴⁰ The Cable, 6 Sept 2016.

⁴¹ Multiple sources: Reuters, 6 Sept 2016; Bloomberg, 6 Sept 2016.

⁴² www.afkinsider.com

⁴³ www.afkinsider.com

⁴⁴ www.afkinsider.com

⁴⁵ Mail and Guardian, 12 Sept 2016.

⁴⁶ Mail and Guardian, 12 Sept 2016.

⁴⁷ Statistics SA bulletin, 14 Sept 2016.

⁴⁸ Business Day, 13 Sept 2016.

his move until he was entirely free of corporate ties. However, it has cost him his support within the ANC and the patience of those outside it who once viewed him as their hope for a more stable South Africa.

Moody's statement on South Africa was nuanced enough so that all sides of the economic debate can take something from it. For the members of the ANC who believe the agency is playing politics by threatening to downgrade, it gave an achievable growth target. This also helps businesses trying to bring finance into the country, who are consistently undermined by the lack of economic stability. For the opposition, and some members of the ANC, who want external confirmation of how bad the economy is under Zuma, it gave a damning indictment of the impact of political interference on economic stability. This arms the finance minister with yet more ammunition to attempt to refocus political will onto fixing the economy. The economic statistics on Q2 show that it is possible to build an economic recovery from the current position. However, if Zuma and his allies derail that process growth could just as easily slip worryingly close to Moody's 0.2% cut off point.

About Africa Risk Consulting:

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