

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing January 2016

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#### South Africa Summary 28 January 2016

*The treasury, South African Reserve Bank (SARB), International Monetary Fund (IMF) and a number of private banks predict that growth for 2016 will be lower than 2015. Many predict that growth will fall below 1% for the whole year. The treasury considers tax increases in order to fund government spending in the poor economic climate. Finance minister Pravin Gordhan halts South African Revenue Service (SARS) commissioner Tom Moyane's plans to restructure the organisation. The struggle between the two becomes public after a newspaper publishes leaked SARS documents that criticise Gordhan. The cabinet approves President Jacob Zuma's (2009-present) plan to tender for a \$32 billion nuclear energy programme. This is despite fears that the country is unable to afford it, and mismanagement at the Nuclear Energy Corporation of South Africa (Necsa).*

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#### The economic year ahead – from bad to worse

Finance minister **Pravin Gordhan**, the **South African Reserve Bank (SARB)**, the **International Monetary Fund (IMF)**, and a number of private banks are all predicting that 2016 will be a worse year for the economy than 2015. South Africa's economy has suffered low growth, high unemployment and a depreciating currency since 2009; however, President **Jacob Zuma's** (2009-present) recent decision to fire former finance minister **Nhlanhla Nene** has severely damaged market confidence. Now a range of internal and external observers are predicting that growth may stay below 1% for the year ahead, with a risk of the economy slipping into a recession.

*"We didn't think that the economy could get any worse in 2016 than it had been in 2015...but we were wrong. The market conditions are difficult but South Africa is performing below other emerging markets due to political interference...and I really mean the actions of Jacob Zuma."<sup>1</sup>*

According to the national treasury, growth for 2016 will be below 1.5%, well below the 5% needed to correct the current economic trajectory.<sup>2</sup> The economy grew 0.7% in Q4 2015.<sup>3</sup> The SARB's financial indicator, which it published on 26 January, points towards South Africa heading into a recession in the first or second quarters of 2016.<sup>4</sup> The indicator for 2015 fell to 93.7 points in November, where it remained for the rest of the year, ending a 26-month consecutive fall. The projections from the indicator show that the SARB believes that growth will be considerably less than 1% across the year. Figures within the SARB told the media that the bank was likely to increase interest rates by 50 basis points at its next monetary policy committee (MPC) meeting.<sup>5</sup> According to SARB sources, the reason for the increase is the depreciation of the rand, which has fallen 8% against the dollar from R15.10 to R16.40 since 1 January, reaching a record low of R17.10/\$ on 10 January.<sup>6</sup>

The IMF published a 2016 growth forecast for South Africa of less than 1% on 20 January.<sup>7</sup> The IMF reduced its growth outlook to 0.7%, down from 1.3% it predicted in October. It has reduced its

<sup>1</sup> Source, newspaper editor, Johannesburg

<sup>2</sup> Business Day, 4 Jan 2016.

<sup>3</sup> Business Day, 4 Jan 2016.

<sup>4</sup> Business Day, 26 Nov 2015.

<sup>5</sup> Business Day, 4 Jan 2016.

<sup>6</sup> XE.com.

<sup>7</sup> Business Day, 20 Jan 2016.

predictions for 2017 to 1.8% down from 2.1%.<sup>8</sup> The IMF's predictions carry significant weight with the financial markets and institutional investors alike, but multiple international observers have also predicted less than 1% growth in 2016. **Barclays Africa Group** recently revised its 2016 growth forecast down to 0.9% and **Bank of America Merrill Lynch** slashed its prediction to 0.4%.<sup>9</sup> According to the IMF the global context of uneven recovery in developing economies will continue due to the continuing slowdown in **China**, lower commodity prices, and ongoing strain in some of larger market economies.<sup>10</sup> The **National Development Plan (NDP)** targets growth of 5.4% per annum.<sup>11</sup> The economy is also at high risk of a downgrade to 'junk' grade from ratings agencies **Moody's**, **Standard & Poor's**, and **Fitch**.<sup>12</sup> This will place further pressure on the rand.<sup>13</sup>

The poor economic predictions have startled the ruling **African National Congress (ANC)**. Secretary general **Gwede Mantashe** told journalists after a three-day meeting of the **National Executive Committee (NEC)** that the government must do *"everything it can to avoid a recession at all costs"*.<sup>14</sup> Mantashe promised that the ANC would work with the government to avoid this, including making sure that the government worked to increase international confidence in the economy.<sup>15</sup> Gordhan will give his 2016 budget speech in February, in which he will outline his plan for rescuing the economy. According to figures within the tax administration this could include a number of tax hikes, including the reintroduction of a 43-45% tax bracket for the *"super rich"*.<sup>16</sup> The treasury may also increase the threshold for capital gains tax, which is currently 33.3% for individuals.<sup>17</sup> It may also consider a one-off levy on corporates of between 5-7%. **Nazrien Kader**, the head of taxation services at the treasury said:

*"I think multi-national companies should perhaps brace themselves."*<sup>18</sup>

### **Gordhan fights to bring SARS back in line**

Finance minister Pravin Gordhan and **Tom Moyane**, the commissioner of the **South African Revenue Service (SARS)**, are clashing over SARS' future. On 8 January Gordhan ordered Moyane to suspend the restructuring process at SARS that would have made widespread changes to the organisation.<sup>19</sup> Moyane is a close ally of President Zuma. He has drawn criticism for the reforms, which include stripping SARS of its ability to investigate tax fraud in senior public sector officials and removing the specialist investigations units that Gordhan set up when he was SARS commissioner from 1999 to 2009.<sup>20</sup> Gordhan had reportedly expressed concern over Moyane's proposed reforms.<sup>21</sup> According to sources, the struggle between the two is a major test of Gordhan's authority:

*"Moyane is one of Zuma's men, he won't fight fair and isn't intimidated by Gordhan's position because he has the president behind him...Gordhan needs to be able to bring Moyane into line to show Zuma's other deployed allies that he is not to be messed with."*<sup>22</sup>

Moyane also suspended deputy commissioner **Ivan Pillay** and has not reinstated him despite a court ruling in Pillay's favour against the decision (see *ARC Briefing South Africa April 2015*).<sup>23</sup> SARS falls

<sup>8</sup> Business Day, 20 Jan 2016.

<sup>9</sup> Daily Maverick, 20 Jan 2016.

<sup>10</sup> Business Day, 20 Jan 2016.

<sup>11</sup> Business Day, 20 Jan 2016.

<sup>12</sup> Business Day, 4 Jan 2016.

<sup>13</sup> Business Day, 4 Jan 2016.

<sup>14</sup> Business Day, 28 Jan 2016.

<sup>15</sup> Business Day, 28 Jan 2016.

<sup>16</sup> Moneyweb, 28 Jan 2016.

<sup>17</sup> Moneyweb, 28 Jan 2016.

<sup>18</sup> Moneyweb, 28 Jan 2016.

<sup>19</sup> Business Day, 8 Jan 2016.

<sup>20</sup> Business Day, 8 Jan 2016.

<sup>21</sup> Source, senior newspaper editor, Johannesburg

<sup>22</sup> Source, senior newspaper editor, Johannesburg

under the purview of the national treasury. Gordhan is reportedly undertaking a thorough review of the reform programme in order to ensure that it is delivering best value for money.<sup>24</sup> According to political commentators:

*“This is just the beginning of a long running tussle between Gordhan and Moyane... Gordhan sees Moyane trying to undo everything he built and is going to push hard not to let that happen, but Moyane has the backing of the president.”<sup>25</sup>*

The planned reforms involved introducing a new operating model for SARS. Moyane planned to commission **United States (US)**-based consulting firms **Gartner** and **Bain and Company** and internationally listed **KPMG** to carry out a review of SARS. The terms of reference of the proposed reforms had included ensuring that SARS performed in line with its strategic priorities, clarifying its decision making process and streamlining its governance structures.<sup>26</sup> Former finance minister Nhlanhla Nene established a special advisory committee to SARS in February 2015, which retired judge **Frank Kroon** chairs. Kroon’s advisory committee found that SARS had no legal basis to set up covert investigation units, that they were a waste of money and that the matter should be handed over to the **South African Police Service (SAPS)** for further investigation.<sup>27</sup> However, Nene had in his October mini-budget already questioned the ongoing cost of hiring the consultants to restructure SARS at a time when the state’s finances are stretched.<sup>28</sup> Political analysts point to political motives behind the decision:

*“SARS is one of the most effective revenue services in the world...when so many departments are full of waste and corruption, going after SARS makes no sense. It is keeping the government afloat.”<sup>29</sup>*

The struggle came into public view again on 20 January when the **Sunday Times** newspaper published leaked SARS documents.<sup>30</sup> Internal SARS documents ended up in the hands of journalists.<sup>31</sup> These documents included a draft report that KPMG wrote into the so-called “*rogue spy units*”<sup>32</sup> and a legal opinion from firm **Mashiane Moodley and Monama** regarding Moyane’s power vis-à-vis Gordhan’s. The legal opinion Moyane obtained states that he does not need ministerial approval to carry on with his restructuring programme as long as it does not impact SARS’ operations and is within the law.<sup>33</sup> However, this may clash with the mandate of the Kroon committee. When Nene set up the committee, he specified that the SARS Act defines the organisation as “*subject to any directives and guidelines on policy matters issued by the minister*”.<sup>34</sup>

The KPMG report says that Gordhan did not have knowledge of the spy units when he was SARS commissioner, but reprimands him for not knowing about them, claiming that he should have done so.<sup>35</sup> Gordhan told a press conference on 25 January that he expected the leaking of documents from SARS to stop, and was reportedly angry at KPMG’s accusation that he turned a blind eye to illegal operations within SARS.<sup>36</sup> He told the media that:

<sup>23</sup> Business Day, 8 Jan 2016.

<sup>24</sup> Business Day, 8 Jan 2016.

<sup>25</sup> Source, political journalist, Johannesburg.

<sup>26</sup> Business Day, 8 Jan 2016.

<sup>27</sup> Business Day, 29 Apr 2015

<sup>28</sup> Daily Maverick, 17 Dec 2015.

<sup>29</sup> Source, political journalist, Johannesburg.

<sup>30</sup> Sunday Times, 20 Jan 2016.

<sup>31</sup> Mail and Guardian, 22 Jan 2016.

<sup>32</sup> Daily Maverick, 25 Jan 2016.

<sup>33</sup> Daily Maverick, 25 Jan 2016.

<sup>34</sup> Business Day, 25 Jan 2016.

<sup>35</sup> Business Day, 25 Jan 2016.

<sup>36</sup> Business Day, 25 Jan 2016.

*"One of the things South Africans should be worried about is when a crucial institution like a tax administration is going to be damaged reputationally or institutionally. Don't play with state institutions because at the end of the day it is not only the current generation that suffers but generations to come. Be very careful about spreading unsubstantiated rumours."<sup>37</sup>*

### Energy ministry to launch tenders for nuclear energy

The energy ministry confirmed on 27 December that the cabinet had officially approved President Zuma's plans for a nuclear energy programme.<sup>38</sup> The programme is ostensibly to help South Africa increase its electricity generation capacity. However, the large cost of the programme and the amount of time it will take to develop make it a less effective solution to the power crisis than many others. Zuma's critics believe that the president will use it as cover to enrich himself at the expense of the state:

*"If the nuclear deal goes ahead, you can be sure that it is going to pay for the pensions of the president and everyone around him."<sup>39</sup>*

There is contradictory information on whether the country can afford the programme, which aims to generate 9,600 megawatts (MW) of energy from nuclear fission plants.<sup>40</sup> A disagreement over the deal reportedly led to Zuma firing former finance minister Nhlanhla Nene on 9 December.<sup>41</sup> Nene had publically stated that the country could not afford the \$32 billion scheme.<sup>42</sup> Current finance minister Pravin Gordhan told the media on 17 December that the treasury would sanction a formal tender process only if the country could afford it.<sup>43</sup> The cabinet published a government gazette on 21 December formally announcing that it had decided to go ahead with the tender. Department of energy director-general **Thabane Zulu** told the media on 27 December that his department would go ahead and launch the tender process.<sup>44</sup> This shows Zuma's continuing political influence, and confirms fears that Gordhan will not stand in his way:

*"Gordhan may protest in private, he will try and keep costs down, but he will not stand up to Zuma and stop the government wasting billions of dollars on this nuclear plan."<sup>45</sup>*

South Africa needs to increase its power generation capacity, and an extra 9,600MW of power would allow the country to overcome its generation deficit.<sup>46</sup> This has led to regular power-cuts or "load shedding" since late 2013.<sup>47</sup> However, the nuclear programme has no specific timeframe and experts believe that it will be at least 15 years until any nuclear plant will come on-line.<sup>48</sup>

South Africa currently has one nuclear power plant, the **Koeberg Power Station** at **Melkbosstrand**, 30 km northwest of **Cape Town** in **Western Cape** province.<sup>49</sup> The **Nuclear Energy Corporation of SA (Necsa)**, the state-owned enterprise (SOE) that runs it, is currently arguing with the auditor-general over how it disposes of nuclear waste.<sup>50</sup> Necsa argues that it cannot take on the cost of decommissioning and waste disposal alone. The auditor general first sanctioned Necsa in 2013 after it filed incomplete and inaccurate papers on its waste disposal plan.<sup>51</sup> Necsa has two court cases

<sup>37</sup> Gordhan in Business Day, 25 Jan 2016.

<sup>38</sup> Business Day, 27 Dec 2015.

<sup>39</sup> Source, former cabinet minister, South Africa

<sup>40</sup> Mail and Guardian, 24 Dec 2015.

<sup>41</sup> Business Day, 27 Dec 2015.

<sup>42</sup> Mail and Guardian, 24 Dec 2015.

<sup>43</sup> Business Day, 27 Dec 2015.

<sup>44</sup> Business Day, 27 Dec 2015.

<sup>45</sup> Source, senior journalist, Johannesburg

<sup>46</sup> Moneyweb, 27 Dec 2015.

<sup>47</sup> Moneyweb, 27 Dec 2015.

<sup>48</sup> Moneyweb, 27 Dec 2015.

<sup>49</sup> Moneyweb, 27 Dec 2015.

<sup>50</sup> Business Day, 28 Jan 2016.

<sup>51</sup> Business Day, 28 Jan 2016.

currently running against senior executives. Former director **Medi Mokuena** has filed claims to sanction chief executive **Phumzile Tshelane** and to declare him and two other directors delinquent.<sup>52</sup> Observers point to the pattern of mismanagement at SOEs and question whether Necsa has the capacity to handle further power plant developments:

*“It scares me that we trust **South African Airways (SAA)** to fly planes, but do we really want the kind of mismanagement we see there running a series of highly volatile nuclear reactors? If this [the nuclear deal] goes ahead then we need to make sure Zuma’s appointees are nowhere near it.”<sup>53</sup>*

## Implications

At the beginning of 2015 internal and external observers predicted that growth would be low, below 2%, but the situation would get better from 2016. The situation could not be more different. South Africa now is looking at another year of negligible growth, a deeply sceptical international market situation and the same deep-rooted internal issues that kept growth low through 2015. Key events to watch for are labour negotiations, due to resume in the mining sector later this quarter, further trouble at SOEs – particularly SAA which is rapidly running out of money – and the return of load shedding which has put a semi-permanent downwards pressure on growth. Politically, however, the dire economic situation is placing a range of allies against President Zuma. Gordhan is more combative than in his previous tenure as finance minister. Mantashe is now publically criticising the management of SOEs, where Zuma has appointed most of the executives and directors. The country could be moving onto a corrective course where a reinvigorated ANC restores good governance. The concern is that the economic hole is too deep for the ANC to dig the country out of in the medium term. Tax increases have the potential to put further pressure on consumers and scare investors away. Gordhan will have to come up with a radical, yet achievable, plan next month to get the country back on track.

The actions of Moyane at SARS show the level of political interference in the organs of the state. It also shows the power that Zuma’s allies wield when the commissioner of the taxation authority can publicly defy the finance minister. Gordhan may eventually have his way but Moyane appears to be making it clear that it will come at significant reputational cost. There is a danger Gordhan will back down as he has larger problems to fix, in which case Moyane will be able to complete the implementation of his restructuring plans.

The nuclear deal is an unaffordable, ineffective way of addressing the power crisis. There is significant risk that the president and his allies will gain, directly or indirectly, from the large scale tendering process. Sources close to the ANC believe that Zuma may now focus on strengthening his personal position. However, while his allies fight to keep their positions, the president is looking increasingly isolated. He lost his bid to recapture the finance ministry. This has enabled a range of enemies to take very public positions against him and increases the centre-right ‘moderates’ power within the ANC. A likely upshot of this is that **Cyril Ramaphosa** now stands a greater chance of succeeding him at the *legkotla* in 2017.

<sup>52</sup> Business Day, 28 Jan 2016.

<sup>53</sup> Source, former minister, Johannesburg

### About Africa Risk Consulting:

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