

AFRICA RISK CONSULTING

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South Africa Summary 28 January 2020

South Africa is facing its most serious political economic and social crisis since the early 1990s as it enters 2020. Political and business confidence has registered historic lows, as the ruling African National Congress (ANC) government appears inert in the face of the looming crisis. Lack of movement in President Cyril Ramaphosa's (2018-present) management of the state-owned enterprises (SOEs) is where his leadership is facing the most criticism from within the party and business. Slowness to act on corrupt ANC leaders for their wrongdoing under Jacob Zuma's (2009-2018) administration has raised the question of whether some are actually 'untouchable'. Nevertheless, considerable progress has been made in restoring the rule of law with a series of arrests anticipated in the first quarter of 2020. The economy is facing a severe downturn as markets factor in a Moody's downgrade. Should it occur, it will close South Africa to institutional investors. Nowhere else is confidence in the ANC lower than in its inability to manage the state power utility, Eskom, which for business has come to symbolise everything that is wrong with South Africa under ANC rule today. Although Eskom is under a new CEO, there has been little movement to address the negative impact that it is having and will have for the next two to three years on the economy.

Political and business confidence hits low point ...

South Africa is facing its most serious political economic and social crisis as it enters 2020. The ruling **African National Congress (ANC)** is riven with division as President **Cyril Ramaphosa** (2018-present) seeks to stem the economic consequences of a decade of grand scale corruption under his predecessor, **Jacob Zuma** (2009-2018). Political and business confidence has registered historic lows as the ANC government appears inert in the face of the looming crisis. At the heart of this apparent inertia is the deep division in the ruling party between those mired in the scandal of grand corruption and those – led by Ramaphosa – seeking to root it out. A series of unscheduled rolling power cuts between 9 December and 13 January¹ gave ammunition to the 'captured' – as the corrupt faction is known – to launch a fresh attack on Ramaphosa through criticism of one of his key allies, public enterprises minister **Pravin Gordhan**.

The criticism served to identify those among the 'captured' wing who hope to stave off criminal investigations into their actions under Jacob Zuma by ousting Ramaphosa. The 'captured' wing of the ANC is reportedly plotting to use the same tactics against Ramaphosa that Zuma used to oust former president **Thabo Mbeki** (1999-2008) at the party's General Council of 2005.² This time, deputy president **David Mabuza** led the charge and criticised Gordhan for "misleading the president" about the power cuts.³ Soon afterwards there were calls from unidentified members of the 'captured' wing for the power utility to be put under the responsibility of energy minister **Gwede Mantashe**, whom sources allege is 'captured' and compromised by his personal private interests.

*"There are signs that Gwede Mantashe is captured. He is thought to have interests in coal and in nuclear. Yet he sits on two of the most important ministries in a rentier fashion."*⁴

¹ Financial Times, 19 Jan 2020

² Africa Confidential, 15 Jan 2020

³ News24, 9 Jan 2020.

⁴ ARC source with close links to ANC leadership, 28 Jan 2020

Soon afterwards, one of the ANC's allegedly most captured, ANC secretary-general **Ace Magashule**, upbraided another favourite target, finance minister **Tito Mboweni**, for saying on social media platform **Twitter** that the ANC's adoption of a resolution to nationalise the **South African Reserve Bank** (central bank) was a mistake. For some, this is the only way that the 'captured' will avoid facing arrest for corruption. This year's ANC General Council is likely to take place between July and September.

However, local sources dismiss this as journalists' "*silly season chatter*" and noted that by the time the ANC's January **National Executive Committee (NEC)** meeting took place, the attack on Gordhan had largely evaporated.

*"I spoke to members of the top six this week and the fight back faction has failed to gain ground. Cyril is still in control. That said, he is held back by his own style. He operates by building big tent consensus which means he ends up falling back on the worst instincts of the ANC."*⁵

Economic commentators agree:

*"We will need to see government take some tough decisions. The [Radical Economic Transformation] RET crowd of Ace, [cooperative governance and traditional affairs minister Nkosazana] Dlamini-Zuma and a few other Zuma loyalists are getting more desperate but I think the media makes them out to be stronger than they are..."*⁶

Others agree that the lack of movement in Ramaphosa's management of the state-owned enterprises (SOEs) is where his leadership is facing the most criticism both from within the party and from business. Ramaphosa's apparent inability to resolve the crisis at state-owned power utility **Eskom** has been particularly damaging. Although some say that this is because of the restraints imposed on him by the so-called "*revolutionary alliance*" between the ANC, the **Congress of South African Trade Unions (Cosatu)** and the **South African Communist Party (SACP)**, it has as much to do with Ramaphosa himself. He, along with the core members of the ANC, is a long-standing socialist and firm believer in the ANC's policy of a "*development state*" and that the government should have a prominent role in the economy.

*"But the ideology of many in the ANC cannot accept that the private sector should and can do better at providing certain services. Be it [public broadcaster South African Broadcasting Corporation] SABC, [state-owned airline South African Airways] SAA, [state-owned aerospace and military technology conglomerate] Denel, [national postal service South African] Post Office ... They all run at huge losses. So we have private sector willing and able to generate clean energy but ANC government still think ideally the state should do all of this. And they have proven they cannot."*⁷

A prominent journalist and commentator notes:

*"The situation is very grim. Ramaphosa cannot consolidate his leadership within, the economy is going in the wrong direction and he can't seem to change the economic direction. He is not a guillotine man: he is process driven, he builds consensus and then waits for things to unfold."*⁸

His views are echoed by a South African fund manager:

*"Most South Africans think Cyril is a good guy. Far better than JZ (Jacob Zuma). But frustration is growing at his seeming lack of decisiveness to force changes through."*⁹

⁵ ARC source with close links to ANC leadership

⁶ ARC source, Johannesburg

⁷ ARC source, fund manager South Africa

⁸ ARC Source, newspaper editor, political commentator, 28 Jan 2020

⁹ ARC Source, SA fund manager

Corruption battle is painstaking and slow

Ramaphosa has come under market, business and public criticism for failing to arrest and charge corrupt ANC leaders for their wrongdoing under Jacob Zuma's administration. It has raised the question of whether the likes of ANC secretary-general Ace Magashule are in fact 'untouchable'.

"[The] Zondo Commission¹⁰ has uncovered lots and there is understandably huge frustration from the public that nothing has been done to these crooks yet. Most people now expect nothing to happen and that crime pays. And unless you stop that perception the corruption will not go away. A few, I think, credible observers argue that CR [Ramaphosa] is letting the courts and [National Prosecuting Authority] NPA do his bidding. He is not going to be seen to interfere. He does not want to be the trigger-puller directly, but has put people in place who will do it according to the book..."¹¹

Arrests and prosecutions would boost confidence:

"Good news surprises are possible and [could] come in the form of charges laid against some high profile politicians and others by the NPA."¹²

The NPA, under its new head, **Shamila Batohi**, is making progress (see *ARC Briefing December 2019*). To re-cap:

- In December, Batohi travelled to the **United Arab Emirates** to negotiate the extradition of key Zuma allies, the **Gupta** brothers, who were at the heart of the "state capture".
- In December, the NPA arrested former security minister and key Zuma and Magashule ally **Bongani Bongo** and a cabinet minister under Zuma.
- Respected newsletter **Africa Confidential** reports that the NPA has completed its investigation into the **Free State Province Vrede Dairy Project** and the matter will be brought to court early in 2020. The Vrede Dairy Project – which notably links the Gupta family and the then Free State Premier Magashule – was an audacious theft of some R220m (\$17m) of public money meant for poor black farmers.¹³

The wheels of justice are making progress in other areas:

- In November, the **Pietermaritzburg High Court** dismissed Jacob Zuma's application to have long-standing corruption charges in relation to South Africa's arms procurement transactions of the late 1990s set aside.
- In December, at the request of South Africa's justice ministry, the **United States (US) Treasury Office of Foreign Assets Control (OFAC)**, placed sanctions on the Gupta brothers and their business partner **Salim Essa**, forbidding them to do business in the US and with US businesses. This reportedly sent the captured wing of Zuma allies scurrying to lawyers to see how it might impact them.
- The NPA arrested on charges of fraud, corruption and other offences two former senior Eskom officials, **Abram Masango** and **France Hlakudi**, for receiving bribes of R30m (\$2.11m) as part of a R1.2-billion (\$84.3m) contract for work on Eskom's **Kusile** power station project. Hlakudi was Eskom's contracts manager for Kusile while Masango was group executive for capital projects and oversaw key contractual processes at troubled power stations Kusile and **Medupi**.
- The **South African Revenue Service (SARS)** has launched an investigation into the income tax affairs of public protector **Busisiwe Mkhwebane**, dating back to 2011. SARS has ordered

¹⁰ The Judicial Commission of Inquiry into Allegations of State Capture

¹¹ Newspaper editor, political commentator, 28 Jan 2020

¹² ARC source, fund manager South Africa

¹³ Africa Confidential

her to hand over copies of all relevant material including financial information, employment income, foreign income, business income, expenses and deductions, and other income.

- The courts ordered populist opposition **Economic Freedom Fighters** and its spokesman **Mbuyiseni Ndlozi** to apologise to and pay journalists **Thandeka Gqubule-Mbeki** and **Anton Harber** R40,000 (\$2,740) each in damages for falsely claiming that these journalists worked for the apartheid government.¹⁴
- The state-owned rail services company **Passenger Rail Agency of South Africa (PRASA)** is going to court to have set aside questionable contracts worth almost R6 billion (\$411m) linked to Zuma benefactor **Roy Moodley** and former Prasa CEO **Lucky Montana**.

Eskom crisis neuters South Africa's growth for 2020 ...

Nowhere else is confidence in the ANC lower than in its management of state-power utility Eskom, which for business leaders has come to symbolise everything that is wrong with South Africa under ANC rule today. Despite management changes, it remains riddled with corruption, has soaked up over R500 billion (\$34.3 billion) of taxpayers' money and given the unscheduled "load shedding" during the holiday season – to apparently little effect. It was not Pravin Gordhan who fell on his sword however, but power utility Eskom chairman **Jabu Mabuza** who took responsibility for December's power cuts and resigned.

*"Eskom is the biggest problem. Without stable supply of electricity the economy will not grow. Problems are vast and corruption is deep. The two new plants Medupi and Kusile are way over budget and time and are now not producing to specifications. To fund these monster plants Eskom incurred massive debt, which at R450 billion (\$30.8 billion) is too much. Eskom cannot service the debt out of running income any more. The debt will have to be restructured in some way."*¹⁵

Responsibility for the turnaround now falls to the new CEO, **Andre de Ruyter**. The government's main proposed reform is to split Eskom into three separate entities, covering generation, transmission and distribution. Finalising and implementing a restructuring plan, which could take two to three years, offers hope of medium-term stabilisation but will do little to alleviate power constraints in the interim period.¹⁶ Initial views are not that favourable and the three-way reform programme is being questioned.

*"Ruyter is Tito [Mboweni]'s man. The best man for the job was [former **LNG Canada CEO**] **Andy Calitz** who knows Eskom inside and out. Ruyter is a political appointment. He was appointed because he will tow the party line. He is a good PR man but he is already toning down some of things he had earlier said he would do. Even Tito cannot stray too far from the party line."*¹⁷

The power crisis is not only having a negative impact on business sentiment but has also had a tangible effect on the economy. The treasury acknowledged in its 2019 medium-term budget statement that SA is experiencing its longest business cycle downturn since 1945 and that business and consumer confidence are at historical lows.

*"The economy is operating at stall speed and has done for some years. Growth prospects also look bleak. Although inflation is well contained by our standards at around 4%. Fiscal policy is the key problem. Civil servants have received above inflation increases every year for far too long. The wage bill is now huge. The other big expense is the bleeding at the SOEs and the never-ending bail-outs to keep them afloat. On top of that revenue is way down mostly due to the weak economy but also as SARS under [former tax commissioner] **Tom Moyane** was not interested in*

¹⁴ Daily Maverick, 24 Jan 2020.

¹⁵ Newspaper editor, political commentator, 28 Jan 2020

¹⁶ EIU, Jan 2020

¹⁷ ARC source, former newspaper editor and commentator

going after crooks such as the cigarette smugglers etc. The 'captured' SARS looked the other way."¹⁸

The Treasury has forecast economic growth of 1.2% for 2020, which looks optimistic in the face of continued power outages. These are expected to hold back economic growth to 0.8% in 2020 before rising to a modest 1% in 2021 according to the **International Monetary Fund's** January 2020 forecast. The much worse growth outlook, and further deterioration in the fiscal position and direction mean that Eskom crisis will lead to a **Moody's** downgrade.

"Moody's has been more than generous to South Africa but to not downgrade the country will affect its credibility. The financial markets do not expect any good news on the economic front. In fact a downgrade to junk is accepted as inevitable."¹⁹

A downgrade will result in an immediate and significant outflow of funds from South Africa – which the treasury has already factored into its forecasts, putting South Africa out of consideration for foreign institutional investors. Few expect any fiscal tightening when Tito Mboweni presents his budget in March although financial services group **Absa** says shock tax hikes will be introduced in April, with a 1 percentage point rise in the value-added tax (VAT) rate.

Business confidence is reportedly at its lowest level since 1985²⁰ and a combination of power outages and low confidence saw government revenues shrink in late December. SARS said that, based on 2017 data, 48.3% of companies had taxable income equal to zero and 27.4% reported an assessed loss.²¹ Companies submitting tax returns fell to 36.9% as businesses are mothballed due to poor economic prospects. Moreover, South Africa's major industries such as mining have been unable to take full advantage of increases in world prices. **Anglo American Platinum's** production was up in the fourth quarter of 2019 but would have been higher had it not been for constraints placed on it by Eskom.

*"Power outages resulted in an impact to refined production of 74,700 [platinum group metal] PGM ounces in Q1 2019, and a further 70,200 PGM ounces in Q4 2019. A load shedding-related event, resulting in a total power outage at the **Rustenburg Processing** facilities in December 2019, led to a further impact on refined production of 71,100 PGM ounces, resulting in a total impact on refined production of 216,000 PGM ounces for the year."²²*

... as state spending undermines recovery prospects

Other state-owned enterprises are in trouble, increasing the headache for the treasury as it approaches its March budget. SAA announced on 21 January that it had cancelled a number of flights, saying that the move was in line with its "usual policy of reviewing flights and consolidating services with low demand".²³ However, government officials are reportedly scrambling to work out how they can provide R2 billion (\$138m) of funds they promised when SAA entered a form of bankruptcy protection in December.²⁴

In an addendum to the treasury's 2019 medium-term forecast, the government raises the risk that if it is not able to address SOE debt, it will place the government's ability to meet the country's welfare payments at risk. However, seasoned observers report that it is highly unlikely that an ANC government would ever allow that because it risks causing serious nationwide social unrest. South Africa currently has some 30% unemployed, which is likely to rise further in 2020 due to low growth. According to the treasury statement:

¹⁸ ARC source, fund manager, Cape Town 25 Jan 2020

¹⁹ ARC source, fund manager Cape Town, 25 Jan 2020

²⁰ SA Treasury, medium term statement

²¹ Eyewitness News, 23 Dec 2019.

²² Anglo American statement

²³ Moneyweb, 21 Jan 2020.

²⁴ Reuters, 20 Jan 2020

*'This level of growth is far too low to support meaningful increases in employment and welfare. In this environment, there is little chance of the country's 9.4 million unemployed adults finding a job.'*²⁵

Planner

2-6 Feb 2020 **Cape Town (South Africa)** Investing in African Mining Indaba;
 17-19 Mar 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;
 27 Mar 2020 **New York (US) Moody's** reviews **South African** government's credit rating.
 Apr 2020 **(South Africa)** Opposition party **Democratic Alliance** Federal Congress;
 19-21 May 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;
 21-23 Jul 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;
 15-17 Sep 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;
 17-19 Nov 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;
 2021 **(South Africa)** Municipal elections;
 2024 **(South Africa)** General election

Chronology

28 Jan 2020 **Johannesburg (South Africa) Business Day**. **South African Airways'** business-rescue team say it has been given access to \$239m from the state-owned **Development Bank of Southern Africa** to avert the airline's collapse;

28 Jan 2020 **Johannesburg (South Africa) CGTV Africa**. **South African** mining tycoon **Patrice Motsepe** faces heavy criticism for saying that **Africa** loves **United States** President **Donald Trump** and later apologises for his remarks;

26 Jan 2020 **Cape Town (South Africa) Sunday Independent** **South African Revenue Service (SARS)** launches investigation into income tax affairs of public protector **Busisiwe Mkhwebane**, dating back to 2011;

23 Jan 2020 **Johannesburg (South Africa) FT**. Chrome producer **Samancor Chrome** threatens to cut over 3,000 jobs at its mines and smelters in response to weak prices for the metal and power supply problems;

22 Jan 2020 **Johannesburg (South Africa) Business Day**. Financial services group **Absa** says shock tax hikes will be introduced in April, with a 1 percentage point rise in the VAT rate;

21 Jan 2020 **Johannesburg (South Africa) The South African**. **South African Airways** confirms that ten domestic and two international flight cancellations will last all week amid collapse rumours;

20 Jan 2020 **Johannesburg (South Africa) Reuters**. **South African Airways (SAA)** and government hold talks on further bail-out of R2 billion (\$138m);

20 Jan 2020 **Johannesburg (South Africa) Business Tech**. **Statistics South Africa** says it will overhaul economic output data in November and revise the weights of the various sectors that are used to calculate GDP;

²⁵ EIU, 14 Jan 2020

19 Jan 2020 **Johannesburg (South Africa)** *Financial Times*. Factions within the ruling **African National Congress** push for public enterprises minister **Pravin Gordhan's** removal over crisis at state power utility **Eskom**;

16 Jan 2020 **Johannesburg (South Africa)** *Financial Times*. **South African Reserve Bank** (central bank) says it will cut its benchmark interest rate by 0.25% to 6.25%, to the surprise of the investment community;

15 Jan 2020 **Johannesburg (South Africa)** *Business Day*. Telecoms company **Telkom SA** tells unions it could cut up to 3,000 of more than 15,000 staff due to declining performance in fixed voice and fixed data services;

13 Jan 2020 **Harare (Zimbabwe)** *Business Day*. State electricity utility **Zesa** is in talks with **Egypt**-based **African Export-Import Bank** to help clear \$70m of arrears it owes **South Africa**-based state-owned power utility **Eskom** and **Mozambique**-based **Electricidade de Mocambique and Hidroelectrica de Cahora Bassa**;

12 Jan 2020 **Addis Ababa (Ethiopia)** *Borkena*. Prime minister **Abiy Ahmed** asks **South Africa's** President **Cyril Ramaphosa** to intervene in his country's dispute with **Egypt** over the **Grand Ethiopian Renaissance Dam**;

10 Jan 2020 **Johannesburg (South Africa)** *Business Day*. State-owned utility **Eskom's** chairman, **Jabu Mabuza**, resigns after apologising for failing to halt power cuts over the Christmas and New Year public holidays;

8 Jan 2020 **Johannesburg (South Africa)** *Nasdaq*. Markets are jolted by the news of heightened tensions between **United States** and **Iran**, as the South African rand falls 0.23% against the dollar;

8 Jan 2020 **Johannesburg (South Africa)** *CNBC Africa*. **Reserve Bank** data shows net foreign reserves rose to \$44.90 billion in December from \$44.42 billion in November and gross reserves increased to \$55.06 billion at the end of December from \$54.89 billion in the previous month;

8 Jan 2020 **Johannesburg (South Africa)** *News24*. State power utility **Eskom** says it will continue to cut power until 10 January after losing generating capacity;

7 Jan 2020 **Johannesburg (South Africa)** *Bloomberg*. **National Association of Automobile Manufacturers of South Africa** data shows **South African** vehicle exports reached a record high in 2019, with 386,863 units shipped compared to 351,000 the year before;

2 Jan 2020 **Johannesburg (South Africa)** *Business Day*. **MTN Group** agrees to sell its 49% holdings in **Ghana Tower Interco** and **Uganda Tower Interco** to **AT Sher Netherlands Coöperatief** for \$523m as it refocuses on high-growth markets on the continent and in the **Middle East**;

30 Dec 2019 **KwaZulu-Natal (South Africa)** *Business Day*. **United Kingdom**-based **Rio Tinto Group** resumes operations at its **Richards Bay Minerals** mine that was shut on 4 December because of escalating violence in surrounding communities;

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.

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Getting in touch

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

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