

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing October 2019

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#### South Africa Summary 8 October 2019

*The national executive committee (NEC) of South Africa's ruling African National Congress (ANC) announces it has adopted parts of the treasury department's strategy document for growth, but not the entire document. Mineral and energy resources minister Gwede Mantashe says coal producers need to cut their prices in order to save state-owned energy company Eskom from financial disaster. The national treasury reports that its two bonds were oversubscribed and raised \$5 billion total when released into international capital markets.*

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#### ANC endorses parts of Mboweni's radical growth document

**Enoch Godongwana**, the economic transformation committee head of **South Africa's** ruling **African National Congress (ANC)** party, said on 2 October that the ANC's national executive committee (NEC) has adopted parts of the treasury department's radical strategy document for growth.<sup>1</sup> While the ANC and partners did not completely reject the document, there does not appear to be the political will necessary to implement many of the important suggested reforms, particularly changing state-owned energy company **Eskom** into a sustainable entity. Finance minister **Tito Mboweni** released a paper on 27 August called '*Economic Transformation, Inclusive Growth, and Competitiveness: towards an economic strategy for South Africa*', which outlined plans to reform the economy, including privatising many state-owned entities, focusing on renewable energy, and decreasing bureaucratic red tape (see *ARC Briefing South Africa September 2019*).

It is unsurprising that the NEC did not adopt the entire document, given its recommendations to restructure Eskom and reform the labour market.<sup>2</sup> The paper suggested selling off Eskom's coal-fired power stations, potentially through auctions, which the ANC NEC rejected in favour of the previously introduced idea of unbundling Eskom into generation, transmission and distribution units.<sup>3</sup> There is still no indication of when the government plans to complete this unbundling. The labour market reforms, in particular, were always unlikely to be passed given the ANC's tripartite alliance with the **South African Communist Party (SACP)** and the **Congress of South African Trade Unions (COSATU)**, which rejected the suggestion to review the plans to raise the minimum wage.<sup>4</sup>

The ANC NEC adopted five themes from the document: modernising network industries; lowering barriers to entry for businesses and increasing competition; prioritising labour-intensive growth sectors like agriculture; implementing flexible industrial and trade policies; and promoting export competitiveness and regional growth opportunities.<sup>5</sup> While this is a start, these interventions alone will not be enough to kick-start South Africa's economic motor. There are reports that the ANC NEC resolved to take more drastic steps, such as partially privatising the state-owned airline, **South African Airways (SAA)**, which requires capital of R22 billion (\$1.45 billion) just to break even in the current financial year.<sup>6</sup> However, these are unverified reports and there has been no official statement on the proposed privatisation of SAA, although **Ethiopian Airlines** CEO **Tewolde Gebremariam** said on 7 October that the airline would consider buying a stake in SAA if there was an opportunity.<sup>7</sup>

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<sup>1</sup> Daily Maverick, 2 Oct 2019

<sup>2</sup> Daily Maverick, 2 Oct 2019

<sup>3</sup> Daily Maverick, 2 Oct 2019

<sup>4</sup> Daily Maverick, 2 Oct 2019

<sup>5</sup> Daily Maverick, 2 Oct 2019

<sup>6</sup> Dispatch Live, 3 Oct 2019

<sup>7</sup> MoneyWeb, 7 Oct 2019

Responding to criticism, Mboweni stated that the document has not been finalised and that all parties are welcome to submit written commentary to be considered for the final economic policy.<sup>8</sup> But time is running out – Mboweni will present his Medium Term Budget Policy Statement (MTBPS) to parliament on 30 October. Investors and ratings agencies, such as **United States-based Moody's** (the only ratings agency that has not yet downgraded South Africa to “junk” investment level), will be watching the speech for signs of major economic reforms, particularly regarding state-owned enterprises such as Eskom and SAA. Mboweni, much like President **Cyril Ramaphosa** (2018-present), needs to walk a fine line in placating those in the ANC and its partners – who reject privatisation and other actions that will affect employment as well as the ANC's ability to deploy cadres to high-ranking government positions – and international investors, whose business confidence is decreasing quickly and who want a stable economy and a government fiscus that is not beholden to bailing out state-owned enterprises. As stated in previous *ARC Briefing South Africa*, it is widely accepted that South Africa's economy needs major economic reforms to improve the economy, but the political will to implement them is still lacking. The NEC's decision to adopt only some of the treasury report's suggestions is a symptom of this political malaise. The economy does not appear to be doing poorly enough to motivate the country to take the medicine of reform.

### Mineral and energy resources ministry asks coal producers to cut prices to save Eskom

Mineral and energy resources minister **Gwede Mantashe** said on 3 October that coal producers need to cut their prices in order to save state-owned energy company Eskom from financial disaster.<sup>9</sup> Although producers are likely to give the government a minor break in coal prices, this is a small bandage for a much larger wound that requires forward thinking and major changes to save the economy. Mantashe, speaking at a mining conference in **Johannesburg**, said,

*“At these prices of electricity, this economy is going to collapse. You have got to reduce the prices – what we are saying is coal producers must contribute in ensuring that [lowered coal prices are] actually addressed.”<sup>10</sup>*

In addition to coal producers, government ministries have approached renewable energy producers to ask for lower-cost supplies and electricity to keep Eskom running.<sup>11</sup> Eskom has become too big to fail as it provides 95% of South Africa's electricity, as well as providing electricity to regional members of the **Southern African Power Pool**.<sup>12</sup> However, being too big to fail does not mean that it cannot fail – it means that the government will continue to finance and bail out the state-owned entity until the economy collapses. Considering the government's unwillingness to make difficult decisions, such as reducing the bloated workforce, implementing the restructuring process, or selling coal-fired power stations, this is the path South Africa is on.

The government's attempt to make suppliers take a cut in order to prevent Eskom from failing is not a long-term plan that will help the country. Coal producers do have room to lower prices, which have increased by 17% in the 2019 fiscal year, and by 14% and 9% in 2018 and 2017 respectively.<sup>13</sup> However, this is a short-term solution; South Africa's coal producers are likely to struggle in the future as the price of exported coal drops due to decreased demand in markets such as **India** and **South Korea**.<sup>14</sup> The government needs to look further into the future, making unpopular but necessary reforms now to Eskom's operational structure and preparing for a shift away from coal – with the inevitable social and economic consequences of this shift – in order to save South Africa's economy from collapse.

<sup>8</sup> Business Day, 29 Sep 2019

<sup>9</sup> MoneyWeb, 3 Oct 2019

<sup>10</sup> MoneyWeb, 3 Oct 2019

<sup>11</sup> MoneyWeb, 3 Oct 2019

<sup>12</sup> MoneyWeb, 3 Oct 2019

<sup>13</sup> IOL, 20 Aug 2019

<sup>14</sup> MoneyWeb, 3 Oct 2019

## South Africa raises \$5 billion in bonds on international capital markets

The national treasury reported on 24 September that its two bonds were oversubscribed and raised \$5 billion total when released into international capital markets.<sup>15</sup> While the government is quick to call this a win, it should not become complacent. These bonds increase the risk to the economy, which still requires strong political will to implement the necessary changes to promote growth. A \$2 billion bond matures in 2029 with a coupon rate of 4.85% while a \$3 billion bond matures in 2049 with a coupon rate of 5.75%.<sup>16</sup>

Although the treasury department describes the success of the bond sale as an expression of investor confidence in South Africa, a **Cape Town**-based investment banker says otherwise:

*“The bonds were oversubscribed because they promise a larger yield compared to many other government bonds, most of which have negative real yields. If you look at the credit default swap [CDS] spread – which is basically betting that a government will default – South Africa’s CDS rose to 230 basis points, which is above **Brazil** and **Russia**, while in 2016 we were lower than these two countries.”<sup>17</sup>*

The sale of the bonds thus has less to do with investor confidence and more to do with the poor yield from other government bonds. Despite concerns of what will happen if Moody’s downgrades South Africa’s debt to junk investment status, forcing many major pension funds to sell South African bonds, a high yield will remain, as this downgrade has already been priced into the bond market. The government should not mistake investors’ enthusiasm for a high yield as blind confidence in the economy – major economic reforms are still needed despite this bond sale.

Being US dollar-denominated, the bonds present a major risk to South Africa’s economy, as any weakening of the rand will make debt repayments more costly. There is also the probability that credit ratings agencies will see the push towards more dollar currency debt – around 90% of government debt is currently in rand<sup>18</sup> – as an increased risk and further downgrade South Africa’s economic stability rating.

Country	10-year Yield (Today)	CPI (YoY)	Real Yield
SWITZERLAND	-0.88%	0.30%	-1.18%
GERMANY	-0.53%	1.70%	-2.23%
DENMARK	-0.49%	0.60%	-1.09%
NETHERLANDS	-0.42%	2.70%	-3.12%
AUSTRIA	-0.30%	1.60%	-1.90%
FINLAND	-0.28%	1.00%	-1.28%
FRANCE	-0.26%	1.10%	-1.36%
SWEDEN	-0.21%	1.80%	-2.01%
BELGIUM	-0.19%	1.42%	-1.61%
JAPAN	-0.18%	0.70%	-0.88%
IRELAND	0.00%	1.10%	-1.10%
SPAIN	0.24%	0.50%	-0.26%
PORTUGAL	0.27%	-0.30%	0.57%
UK	0.52%	2.00%	-1.48%
AUSTRALIA	1.03%	1.60%	-0.57%
CANADA	1.24%	2.00%	-0.76%
SOUTH KOREA	1.26%	0.60%	0.66%
NEW ZEALAND	1.33%	1.70%	-0.37%
HONG KONG	1.42%	3.30%	-1.88%
ITALY	1.50%	0.50%	1.00%
US	1.74%	1.60%	0.14%
SINGAPORE	1.80%	0.60%	1.20%
POLAND	2.09%	2.60%	-0.51%
CHINA	3.08%	2.70%	0.38%
PHILIPPINES	4.61%	2.40%	2.21%
INDIA	6.34%	3.18%	3.16%
BRAZIL	7.29%	3.37%	3.92%
RUSSIA	7.31%	4.60%	2.71%
MEXICO	7.43%	3.95%	3.48%
INDONESIA	7.67%	3.32%	4.35%
SOUTH AFRICA	8.38%	4.50%	3.88%
TURKEY	15.10%	16.65%	-1.55%

10-year government bond yields. Source: Charlie Bilello

<sup>15</sup> IOL, 24 Sep 2019

<sup>16</sup> IOL, 24 Sep 2019

<sup>17</sup> Source, investment banker, Cape Town

<sup>18</sup> Business Day, 3 Oct 2019

## Planner

30 Oct 2019 **(South Africa)** Medium Term Budget Policy Statement

4-8 Nov 2019 **Cape Town (South Africa)** Africa Oil Week Conference

19-21 Nov 2019 **(South Africa) South African Reserve Bank** (central bank) **Monetary Policy Committee Meeting**

2-6 Feb 2020 **Cape Town (South Africa)** Investing in African Mining Indaba

2021 **(South Africa)** Municipal elections

2024 **(South Africa)** General election

## Chronology

4 Oct 2019 **Johannesburg (South Africa)** *Reuters*. State-owned defence company **Denel** reports a \$125m loss for the year to 31 March;

3 Oct 2019 **Johannesburg (South Africa)** *Reuters*. Mineral resources and energy minister **Gwede Mantashe** says the government is in talks with coal firms to reduce their prices to lower energy costs for state-owned energy company **Eskom**;

3 Oct 2019 **Pretoria (South Africa)** *Al Jazeera*. President **Cyril Ramaphosa** and **Nigeria's** President **Mohammadu Buhari** agree to set up an early warning system to prevent future xenophobic attacks;

2 Oct 2019 **Johannesburg (South Africa)** *Reuters*. The **South African Reserve Bank** (central bank) says that interest rates will remain high until fiscal problems are addressed;

1 Oct 2019 **Lagos (Nigeria)** *BBC*. President **Muhammadu Buhari** will start a three-day official visit to **South Africa** on 2 October;

1 Oct 2019 **Johannesburg (South Africa)** *Business Maverick*. **African National Congress** economic transformation committee head **Enoch Godongwana** says the ruling party has adopted some parts of finance minister **Tito Mboweni's** growth strategy, but not the entire document;

30 Sep 2019 **Johannesburg (South Africa)** *Reuters*. State-owned logistics company **Transnet** reports R49 billion (\$3.2 billion) in irregular expenditure in 2019, up from R8 billion (\$527m) in 2018;

26 Sep 2019 **Cape Town (South Africa)** *Citizen*. The government extends an army deployment in parts of **Cape Town** suffering gang violence for an additional three months;

25 Sep 2019 **Johannesburg (South Africa)** *Business Day*. The **Association of Mineworkers and Construction Union (Amcu)** says that mining company **Sibanye-Stillwater** plans to lay off up to 5,270 people, which may result in strike action;

24 Sep 2019 **Johannesburg (South Africa)** *Daily Maverick*. The treasury department raises \$5 billion from two international bonds that were 2.7 times oversubscribed;

24 Sep 2019 **Lusaka (Zambia)** *Bloomberg*. State-owned electricity company **ZESCO** will import electricity from **South Africa's** state-owned **Eskom** and will increase tariffs 200% on 1 October;

23 Sep 2019 **Johannesburg (South Africa)** *The South African*. The **South African Society of Bank Officials** plans to strike on 27 September, which could shut down **South Africa's** finance sector during the protest;

19 Sep 2019 **Johannesburg (South Africa)** *Reuters*. The **South African Reserve Bank** (central bank) keeps interest rates at 6.5%;

19 Sep 2019 **Johannesburg (South Africa)** *Business Day*. **South African Reserve Bank** (central bank) governor **Lesetja Kganyago** endorses finance minister **Tito Mboweni**'s structural reforms for government;

18 Sep 2019 **Johannesburg (South Africa)** *Reuters*. State-owned airline **South African Airways** says it will need more government funding despite a \$376m cash injection which is expected at the end of September;

17 Sep 2019 **Abuja (Nigeria)** *The Nation*. President **Muhammadu Buhari** accepts **South Africa**'s apology for xenophobic attacks targeted at Nigerians;

17 Sep 2019 **Abuja (Nigeria)** *ThisDay*. **South Africa**'s President **Cyril Ramaphosa** apologises to Nigeria over xenophobic attacks in a live broadcast on state broadcaster **SABC News**;

16 Sep 2019 **Cape Town (South Africa)** *Reuters*. President **Cyril Ramaphosa** says that the military will patrol township streets in **Cape Town** until the end of March 2020, a six-month extension;

16 Sep 2019 **Johannesburg (South Africa)** *BusinessTech*. The **New Development Bank** approves a R7m (\$476,461) loan for the **South African National Roads Agency** for toll roads;

16 Sep 2019 **Abuja (Nigeria)** *Premium Times*. **South African** special envoy/energy minister **Jeff Radebe** meets President **Muhammadu Buhari** and apologises to Nigeria over xenophobic attacks on Nigerians in South Africa.

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