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## The Macro Research Desk

### Where will you take us, Mr President?

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When the global financial crisis hit in 2008, South Africa was sitting on reasonably strong macroeconomic fundamentals, including a healthier fiscal position and solid levels of business and consumer sentiment. The economy had grown by an average of 4.2% between 1999 and 2008, while the headline rate of unemployment had fallen to 22% under the presidency of Thabo Mbeki. Although the country managed to ride out the global storm given its sound fiscal management and coherent policy formulation, South Africa has since struggled to emerge from a period of economic stagnation.

During the Jacob Zuma administration, between 2009 and 2017, growth plummeted to an average of 1.8%, similar to population growth, and the headline rate of unemployment reversed to 27%. Low growth prospects, stark inequality, a mismanagement of resources and a degradation of institutional credibility damaged business confidence, which languished below neutral for much of this period. The regulatory environment for starting a business also worsened during Zuma's tenure. South Africa dropped from 34<sup>th</sup> place out of 181 countries on the World Bank's Ease of Doing Business ranking in 2009 to 82<sup>nd</sup> out of 192 countries in 2018, leaving the country trailing behind its African peers, including Mauritius (20), Rwanda (29) and Kenya (61). Similarly, perceptions of corruption according to Transparency International deteriorated for the country, with South Africa dropping from 55<sup>th</sup> position (out of 180 countries) to 73<sup>rd</sup> in the same period.

Upon entering office in 2018, President Cyril Ramaphosa inherited a multi-faceted socio-economic crisis. Dysfunctional municipalities, incompetent leadership at key state-owned enterprises and criminal allegations against members in the executive complicated the task of addressing the enormous challenges facing the country, more so given the country's limited fiscal room to manoeuvre. Nonetheless, citizens shared a new optimism for an economic revival when Ramaphosa took office. For the first time since former president Nelson Mandela in 1994, the residing president polled at a more favourable rating than his party.

In Momentum Investments' view, the 57.5% majority win by the African National Congress in the 2019 national elections should be significant enough to promote reform, but low enough to prevent complacency. Ramaphosa is likely to implement some economic, political and regulatory reforms to rebuild a fragile foundation and restore state capacity in the next five years. The magnitude of the reform agenda will determine how high and sustainable SA's growth trajectory will be in the coming years and whether the broader population will be better off.

Against the backdrop of moderate global growth and reduced policy uncertainty in key industries in South Africa, Momentum Investments expects the economy to grow at an average of 2.0% in the next five years, reaching above 3.0% in the outer years.

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While positive political momentum should have a favourable effect on confidence, populist political posturing and factional tensions within the ruling party could be stumbling blocks for the implementation of more contentious policy reforms, such as national health insurance and land expropriation without compensation. Under this base-case scenario, government is likely to continue dismantling patronage networks built under the previous administration. Similarly, institutional credibility is likely to be restored, while financial and operational inefficiencies at state-owned enterprises are expected to be addressed. These measures are anticipated to drive a recovery in the investment climate over time, stemming the depreciation in the local currency caused by poor relative growth differentials, structurally high twin deficits and perceived policy risk. Reconstructing an inclusive economy that addresses the country's social ills will take time and, as such, the unemployment rate could stay elevated as growth is initially insufficient to meet the needs of a growing labour market. Fiscal sustainability (returning to a positive primary balance) is likely to be achieved in the medium term, but in Momentum Investments' view stress about contingent liabilities will likely remain a threat to the sovereign ratings outlook.

In an alternative best-case scenario, average growth in the next five years is likely to recover to its longer-term rate of 3.25%. A revival in consumer and business sentiment should lead to higher consumption and investment, while an increase in competitiveness and an improvement in the ease of doing business should buoy economic activity. Moreover, external investment inflows would likely improve on a significant reduction in political noise and a more stable economic environment. Higher growth and healthier tax revenues should lead to an improvement in the country's fiscal and debt ratios, which could gradually guide South Africa's sovereign rating back into investment grade. Under the best-case scenario, government is expected to accelerate its reform efforts in the product and labour markets and collaborative

efforts by government and the private sector would begin to resolve the country's challenges. At this level of growth, the country is better enabled to dent unemployment and make inroads into poverty and inequality.

Meanwhile, in the worst-case scenario, against a weaker global economic setting, heightened factionalism causes the president to shelve his reform plans and a faster implementation of economic reform is hampered. Consequently, an inconclusive policy environment persists and internal business sentiment and external investor confidence remain in the doldrums. Workstreams between the private sector and government reach a stalemate and growth in investment continues to lag. Growth paralysis sets in and economic activity fails to grow meaningfully above 1% on average in the next five-year period, exacerbating an already-high level of unemployment and rampant poverty. The fiscal burden would increase under this scenario, as fruitless and wasteful expenditure continues and revenue collection comes under pressure. Additional bailouts to failing state-owned enterprises, with ongoing operational and financial inefficiencies, would lead to a worrying rise in the level of government debt, placing downward pressure on the country's sovereign rating. With institutional strength remaining questionable and little progress on the policy and governance front, South Africa's attractiveness as an investment destination fails to improve, giving rise to external risks.

Ultimately, in Momentum Investments' opinion, building a more prosperous future for South Africa and ensuring an improvement in living standards for all its citizens will require President Ramaphosa to effect political and economic stability, a strengthening of state institutions and law enforcement agencies, an alignment of priorities, an effective social compact and a commitment to implement initiatives that promote long-term inclusive growth. While the challenge is great, a better future for South Africa's people depends on it.

