momentum investments

in the moment


Herman van Papendorp
Head of Investment Research & Asset Allocation


Sanisha Packirisamy
Economist


Roberta Noise
Economic Analyst

Sona: Strong emphasis on previously addressed themes and an appeal for a social compact to achieve concrete change

Highlights

- The rand weakened on initial disruptions by opposition party, the Economic Freedom Fighters (EFF), but firmed slightly thereafter on welcome announcements on independent power producers (IPPs) and the release of broadband spectrum by the end of the year. While the market is likely to react positively to the developments in the energy sector, there was a notable lack of detail around timelines.
- The focus of the speech, as with the previous two state of the nation addresses (Sona), remained on growth, job (noteworthy focus on youth) and investment initiatives. The speech further highlighted the establishment of a state bank, to bank the unbanked, and a sovereign wealth fund to "preserve and grow the national endowment of the nation".
- In our view, repairing South Africa's (SA) economic future is largely dependent on reviving fragile sentiment. Although there has been an acknowledgment by the presidency that a lot of hard work lies ahead in rebuilding the languid economy, investors have grown impatient with the apparent lethargic pace of reform. Political will is becoming increasingly urgent to turn ambitious reform ideas into concrete action, while the reality of shared sacrifices needs to be more broadly digested to have meaningful discussions between government, business, labour and civil society. The importance of rebuilding a social compact was further highlighted ("social compact" featured eight times in the speech) as necessary to create an enabling environment.
- Moreover, adequately addressing areas of heightened policy uncertainty, including further detail on land expropriation without compensation and the requisite funding of the National Health Insurance (NHI), is necessary to dispel fears and to encourage inward and local investment to drive growth to a higher platform.
- As such, President Cyril Ramaphosa's plan to accelerate SA's growth trajectory remains heavily reliant on the ability of the top leadership to execute on the economic plans put forward. Even though the president's favourability rating remains high with SA citizens, strengthened anti-corruption initiatives and action on politically unpopular reforms will likely be faced with resistance from the anti-Ramaphosa factions within the ruling party.
- Nevertheless, the depth of SA's social and economic ills requires urgent and decisive action.

Economic stimulus and job creation measures

Growth in economic activity has averaged a paltry 0.6% since Ramaphosa took the helm in February 2018 (see chart 1). Weak momentum behind growth has reflected chronic policy uncertainty, stretched government finances, infrastructure constraints and crushed confidence following nine years of misrule under former President Jacob Zuma.

Investors are nonetheless growing frustrated with the apparent slow pace of implementation of structural reforms necessary to revive the economy.

In the past five years, growth in gross domestic product (GDP) averaged 0.9%, while growth in SA's labour force increased by 3%. As such, the anaemic pace of growth has been insufficient to support the growth of new entrants into the labour market, resulting in the headline rate of unemployment reaching 29.1% and the number of unemployed topping 6.7 million in the fourth quarter of 2019.

Chart 1: Muted growth and jobs environment

Source: Iress, Momentum Investments, data up to Q3 2019

Unemployment remains exceptionally high for the youth (aged 15 to 24 years) at 58.1%. This compares unfavourably with a number of emerging market economies, including 27.8% in Brazil, 13.7% in Ghana, 10.5% in India and 18.3% in Kenya. The rate of unemployment has even increased for SA's graduates from 4.1% in the third quarter of 2011 to 8.2% in the third quarter of 2019, further highlighting the weak growth capacity of the country to absorb new entrants into the labour market.

Against this backdrop, Ramaphosa announced a number of labour and education-enhancing initiatives. In early February 2020, government released a draft of the National Youth Policy (NYP) for 2020 to 2030 to improve labour absorption in the economy, provide on-the-job experience, link job seekers to job opportunities, support entrepreneurship and provide business training for youth-owned firms. This strategic document builds on the first and second NYPs which applied to 2009 to 2014 and 2015 to 2019, respectively.

In the Sona, the President stated that the Presidential Working Committee on the 2018 Jobs Summit meets monthly to remove blockages and drive interventions. He further announced the implementation of the Presidential Youth Employment Intervention, which focuses on six priorities for the next five years to lower youth unemployment. This initiative involves shorter courses in fast-growing sectors. The President also shared that the first cohort of the Presidential Youth Service programme would be established. The budget will further allocate 1% towards bringing down elevated levels of youth unemployment.

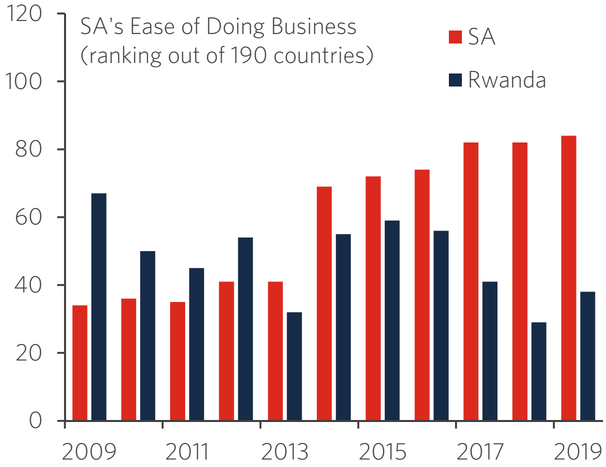
It was revealed that the National Youth Development Agency and the Department of Small Business Development would be supporting and funding 1 000 young entrepreneurs in the next 100 days, as part of a broader effort to assist 100 000 young entrepreneurs in the next three years.

In support of building an educated workforce, a number of positive reforms were outlined, including:

- The introduction of technical vocational specialisations in 550 schools
- The building of nine new technical and vocational education and training (Tvet) colleges in 2020
- The introduction of coding and robotics in 200 schools (full implementation expected by 2022)
- An increase in momentum in early reading programmes

SA has slipped further down the rankings for the World Bank's Ease of Doing Business Index from 41st out of 181 countries in 2013 to 84th out of 190 countries in 2019 (see chart 2).

Chart 2: SA has been overtaken on the rankings for ease of doing business



Source: World Bank, Momentum Investments

In the February 2019 Sona, Ramaphosa noted the presidency aimed to shift SA's ranking into the top 50 countries in three years' time. Since then the presidency announced measures to improve the ease of doing business, including:

- The introduction of a common application form across SA's developmental institutions
- A reduction in time taken to grant licenses and permits
- Working with the World Bank to facilitate an easier process to register a property, start a business and deal with construction permits
- An integrated online platform for faster and more inexpensive business registration (Bizportal)
- Efficiencies involving the payment of taxes
- Easier trade across borders
- The planned expansion of the one-stop-shop approach (single contact points for licensing and regulatory requirements)
- A reduction in port and rail tariffs (the Ports Authority of SA lowered tariffs by 6% in late 2018, while container and automotive cargo duties were also reduced)
- Working closely with neighbouring countries to implement the African Continental Free Trade Agreement to promote trade relationships
- The signing of the Competition Amendment Act in February 2019 to prevent economic concentration
- Tax returns for small and medium enterprises changed from twice a year to once a year

A number of growth-enhancing measures were also outlined in the Sona, including:

- The implementation of the District Development Model to integrate planning and budgeting across all three spheres of government that involves business, labour and communities
- Plans to expand the District Development Model to 23 new districts (after piloting in three)
- Issuing water licenses within 90 days (previously could take up to five years)
- One-day business registration on the Bizportal platform
- Plans to overhaul the Durban port to reduce costs and delays
- Development of a new smart city in Lanseria
- Using R10 billion of funding from the Industrial Development Corporation (IDC) to fund women-empowered businesses
- Market inquiries into data services, the retail sector and health care to reduce costs to consumers
- New regulations to enable investigation and action against buyer power and price discrimination (already effective)
- Competition authorities working to secure deep cuts to data prices and free access to educational websites to stimulate education and online businesses
- Licensing of high demand spectrum to be completed by the end of 2020 and licensing of the wireless open access network (Woan) during 2021

The President revealed a sovereign wealth fund and a state bank would be set up and details would follow in the budget. In July 2018, the African National Congress (ANC) proposed that a sovereign wealth fund (SWF) must be established to "provide a steady resource for national development objectives". This was followed by then Minister of Resources, Gwede Manatashe, objecting to the proposal to use the mining industry as one of the mechanisms to fund the SWF. With SA running extensive fiscal and current account deficits, no excess cash is generated to fund an SWF. In our view, stringent regulations on the governance of the SWF and stipulations on what it may invest in would be necessary to dispel any concerns over potential mismanagement.

Moreover, in early February 2020, National Treasury warned of possible negative effects of a state-owned bank in SA's financial system. BusinessTech reported that treasury stated "international experience and SA's own experience suggests that state ownership of banks has (the) potential to undermine prompt corrective action by prudential regulators".

Despite the extent of social and economic challenges facing the country, the latest Citizen Survey (polled in November and December 2019) suggests Ramaphosa's popularity rating remains high at 61%, which is not far off the all-time high of 64% at the start of his presidency. The survey includes responses from metro, urban, rural and deep rural areas. Ramaphosa's popularity rating remains significantly higher than other senior figures in the ruling party, such as David Mabuza (24%) and Ace Magashule (13%) and higher than the party itself (51%). He has also maintained a significant lead over EFF head, Julius Malema (26%), and Democratic Alliance leader, John Steenhuisen (15%).

Even though the president's favourability rating remains high with SA citizens, strengthened anti-corruption initiatives and action on politically unpopular reforms will likely be faced with resistance from the anti-Ramaphosa factions within the ANC. Nevertheless, the depth of SA's social and economic ills requires urgent and decisive action.

What this means: While the presidency acknowledges the country's stark levels of inequality and poverty, urgent action to bolster sentiment and improve growth and job prospects should allow government to start making the necessary inroads. The District Development Model has the potential to greatly improve service delivery for communities in our view. Ultimately, the realisation of these proposed confidence and growth measures should improve the quality of life for all citizens through an increase in growth in real GDP per capita, which has declined since 2015 and is forecasted by the International Monetary Fund (IMF) to remain negative for 2020 and 2021. Caution needs to be exercised with the proposals for the establishment of a SWF and state bank given potential concerns of mismanagement.

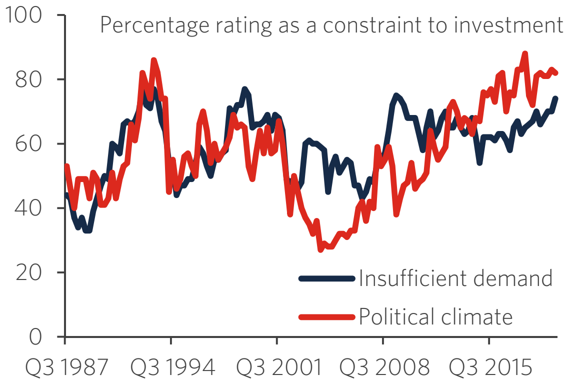
Infrastructure drive and the marketing of investment opportunities

At the November 2019 Investment Conference, the president announced that R238 billion of the R300 billion worth of projects announced at the inaugural Investment Conference in 2018 had been completed (eight out of 31 projects) or were in implementation phase (17 out of 31 projects). A further R364 billion (from 70 companies) was pledged at the second Investment Conference in November 2019 (for advanced manufacturing, agro-processing, mining, services, tourism and hospitality), forming part of government's five-year R1.2 trillion investment drive. A third Investment Conference will be held in November 2020.

In addition, a newly established Investment and infrastructure office, headed by Dr Kgosientso Ramokgopa, to monitor progress and clear blockages in the country's investment drive, has been set up.

Local businesses nonetheless still appear reluctant to invest in the SA economy given concerns about insufficient levels of demand and uncertainty around the political climate (see chart 3). Growth in SA private fixed investment has fallen to an average of below 1% since 2015 relative to the 3.3% long-term average. Given muted growth in SA during this period, the ratio of private fixed investment to GDP has inched higher to almost 14% (one standard deviation above the average since 2000).

Chart 3: Constraints hindering investment



Source: BER, Momentum Investments, data up to Q4 2019

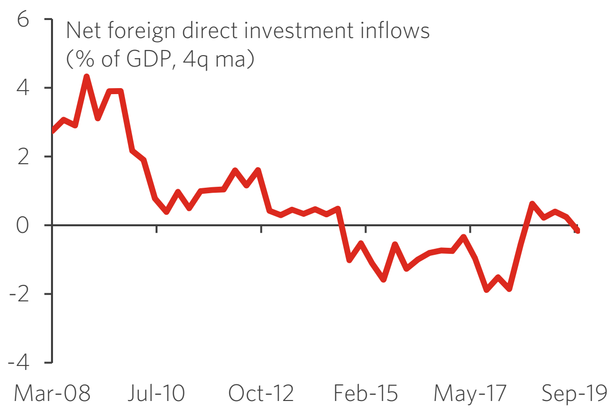
At the November 2019 Investment Conference, the Development Bank of SA (DBSA) mentioned that R700 billion worth of project pipeline had already been identified by the Infrastructure Fund to address student accommodation, social housing, independent water production, rail freight branch lines, embedded electricity generation, municipal bulk infrastructure and broadband roll-out for the next 10 years. Government is set to inject an initial R100 million into the Infrastructure Fund within 10 years, but government's intention is for the fund to leverage off multilateral development banks, investment managers, commercial banks and financial institutions.

The President announced the key priority this year would be to fix commuter rail and modernise the rail network of the Passenger Rail Agency of SA (Prasa). Together with the auditor general, government also aims to redirect irregular expenditure towards investment in infrastructure.

The New Development Bank established by Brazil, Russia, India, China and SA had already disbursed US$2.2 billion for SA infrastructure projects by the end of October 2019 to fund transport (39%), clean energy (33%) and water and sanitation (16%).

After staging an improvement in 2018, net foreign direct investment (FDI) inflows as a share of GDP tapered off again in 2019 (see chart 4). By providing clarity on economic and regulatory policy and progressing on announced reform intentions, SA can improve its operating climate and restore higher levels of net FDI.

Chart 4: Initial improvement in inward investment fizzling out



Source: Sarb, Momentum Investments

What this means: Removing the fog over regulatory and economic policy can raise foreign and local investor confidence, promote investment growth and lift SA's growth potential to a higher trajectory.

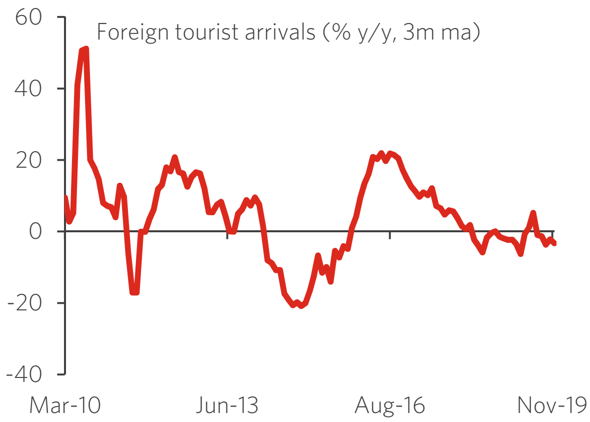
Easing the regulatory environment

During the past six months, a number of regulatory changes were made, which should have a positive effect on growth in due course. These include a number of tourism-boosting measures outlined below, which could lift dismal tourist arrivals (see chart 5):

- Removal of some of the restrictions requiring birth certificates for young travellers
- The introduction of e-visas (pilot scheme run in November 2019)
- Visa-free status extended to 83 countries to attract more visitors to the country
- Lower turnaround times for critical skills, business and general work visas
- Simplified visa requirements for countries such as China and India
- Biometric movement-control systems to speed clearance through busy border posts
- Electronic processing of trusted travellers (e-gates)

- Consideration of 10-year multiple entry visas for business people
- Critical work skills visa list expected in March 2020

Chart 5: Drag on tourist arrivals



Source: Sarb, Momentum Investments

In the Sona, the President further announced that police will increase visibility at identified tourist attraction sites and a Tourism Equity Fund would be launched in 2020 to stimulate transformation in tourism.

In addition, efforts to lower data costs have gained some traction. The Independent Communications Authority of SA (Icasa) announced its intention to start the spectrum licensing process in April 2020, following three months of public submissions (40 have been received so far). Findings from Icasa's report suggest scope for cost reductions of between 30% and 50%.

What this means: **Relaxing visa rules and the usage of e-visas should help grow SA's international tourism industry, which will enhance job prospects.**
The tourism sector makes a larger growth contribution to the economy than the agricultural sector and houses more jobs than the mining sector.
Moreover, lower communication costs should lower the barrier for entry for new entrants and small and medium enterprises.

Creating operational and financial stability at state-owned enterprises (SoEs)

The precarious financial position of many of SA's embattled SoEs pose a grave threat to government's debt profile. Total guarantees to public institutions (excluding the IPPs and the public-private partnerships (PPPs)) amounted to R483.1 billion in fiscal year 2018/19, while the total exposure amounted to R372.4 billion (see table 1).

In support of his social compact mantra, Ramaphosa mentioned meetings between partners on a social compact in electricity. The Congress of SA Trade Unions' (Cosatu) is proposing to avail R200 billion of government workers' pensions to cut Eskom debt. The President noted that the mobilisation of funding needs to happen in a manner that "does not put workers' pensions at risk" and "does not compromise the integrity of the financial system".

A number of investor-friendly announcements were made regarding the energy sector, including:

- No limit to installed capacity above one megawatt
- Procurement of emergency power from projects that can deliver electricity to the grid within three months to a year from sign-off and an acceleration of bid window four projects
- Opening of bid window five of the renewable energy IPP (but no firm timeline)
- Allowing municipalities to procure their own power from IPPs
- Finalisation of the Climate Change Bill to allow opportunities in the green economy

Since National Treasury's latest update on contingent liabilities at the medium-term budget policy statement in October 2019, SA Airways (SAA) was placed into rescue in early December 2019.
Government guaranteed an additional R2 billion, while the DBSA coughed up an additional R3.5 billion in January 2020. Business rescue practitioners have subsequently announced that a several routes would be closed.

In the Sona, the President noted that the Presidential SoE Council is undertaking a process of rationalisation of SoEs, but no announcements were made on which SoEs were under discussion and if any asset disposals were forthcoming.

What this means: While a social compact of this nature may lower the risk of additional government injections in the short term, medium-term fiscal risks remain high in our view. A need for additional government guarantees could increase contingent liabilities even further and raises the issue of moral hazard replacing accountability.

Table 1: SoE guarantees and exposure level

Entity	Guarantee	Exposure
Eskom	350	294.7
Sanral	38.9	30.3
Trans-Caledon Tunnel Authority (TCTA)	43	14.9
SAA	19.1	17.3
Land and Agricultural Bank of SA	9.6	2.5
DBSA	11.4	4.4
Transnet	3.5	3.8
Denel	3.4	3.4
SA Express	1.2	0.2
Industrial Development Corporation (IDC)	0.5	0.2
Sarb	0.3	0
IPPs	200.2	146.9
PPPs	10.1	10.1

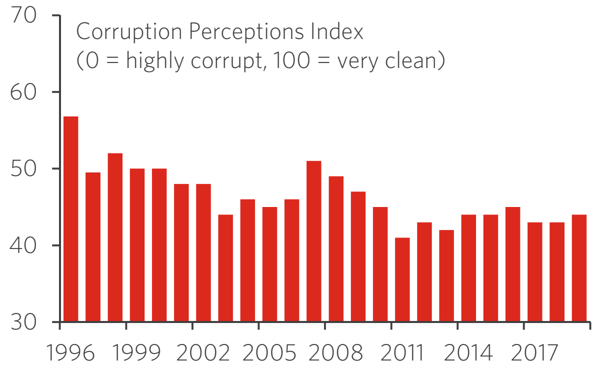
Source: Treasury, Momentum Investments

Building an ethical and capable state

In the 8 January 2020 statement of the ruling party, Ramaphosa acknowledged that "public institutions have borne the brunt of state capture, corruption and mismanagement" and noted the importance of "holding elected representatives accountable". It was further mentioned that "all ANC members and structures should cooperate with the law-enforcement agencies to criminally prosecute anyone guilty of corruption."

Among government's efforts to eradicate corruption, emphasis has been placed on turning around the National Prosecuting Authority (NPA), State Security Agency, SA Revenue Service (Sars) and the Public Investment Corporation (PIC). The President announced the establishment of a Crime Detection University to aid investigations. Moreover, the president suggested anti-gang units would be strengthened further.

Chart 6: SA ranks in the bottom half of the Corruption Perceptions Index globally



Source: Transparency International, Momentum Investments

According to the Economist publication, NPA head, Shamila Batohi, estimated the NPA was running at 70% capacity. In October 2019, Finance Minister, Tito Mboweni announced a capital injection of R1.3 billion into the NPA to boost its prosecuting capacity to step up its fight against corruption, while

Sars was allocated an additional R1 billion for the next two years.

In a further positive announcement, the president revealed he would be making available a detailed report on the Commission of Inquiry into the PIC and a plan on the findings and recommendations would be divulged in the next few days.

Government has in addition been exercising anti-corruption efforts against illegal imports and aims to increase accountability in the state by signing performance agreements with all ministers before the end of the month.

What this means: State capture, corruption and the misuse of public money have tarnished the attractiveness of SA as an investment destination. Rebuilding a capable state will restore trust and confidence over time and will advance SA's score on the Corruption Perceptions Index (see chart 6).

Improving regulatory clarity

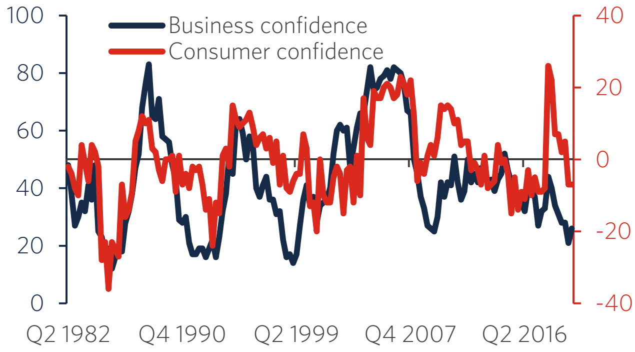
In the ANC's 8 January 2020 statement, Ramaphosa reiterated "the return of the land will happen and it will be done in a manner that promotes economic growth and sustains food security". He further assured "all legislative efforts to accelerate the return of the land to the people will be done lawfully and in line with the provisions of the Constitution." Recently, The Ad Hoc Committee to Initiate and Introduce Legislation Amending Section 25 of the Constitution, extended the deadline for written submissions on the Draft Constitution Eighteenth Amendment Bill to the end of February 2020.

The Land Bank has released R3.9 billion to support black commercial farmers, while more than 1 400 30-year leases have been finalised for productive activities. In the Sona, the president noted government released 44 000 hectares of state land to date for the settlement of land restitution claims and, this year, 700 000 hectares of state land would be released for agricultural production. He also confirmed that key recommendations of the Presidential Advisory Panel on Land Reform and Agriculture (including a narrow range of cases in which no compensation would be permitted) would be carried out.

On the NHI, no indication of funding was outlined and it remains unclear on how the already-strained fiscus will shoulder this financial burden. The president announced government has registered more than 44 million people at more than 3 000 clinics in the electronic Health Patient Registration System.

In our opinion, lifeless business and consumer confidence (see chart 7) require a resolution of uncertainty on policy, which has dampened domestic demand.

Chart 7: Depressed sentiment



Source: BER, Momentum Investments, data up to Q4 2019

What this means:
In respect of land reform, the president has previously admitted to the need for a clear property rights regime to encourage higher economic growth. While short-term efforts will be concentrated on developing publicly owned land, in the long term ensuring a rollout of land expropriation without compensation, in a way that increases agricultural production and food security, would be viewed as market friendly. We view little insight into a funding plan for the NHI as a negative. In our view, an already constrained fiscus faces threats from long-term spending commitments with regards to rolling out an effective NHI.

Reasonable steps have been taken to ensure the validity and accuracy of the information in this document. However, Momentum Investments does not accept any responsibility for any claim, damages, loss or expense, howsoever arising out of or in connection with the information in this document, whether by a client, investor or intermediary. The content used in this document is sourced from various media publications, the Internet and Momentum Investments. For further information, please visit us at www.momentuminv.co.za. Momentum Investments is part of Momentum Metropolitan Life Limited, an authorised financial services and registered credit provider, and rated B-BBEE level 1.