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The macros that matter: South Africa's politics, structural challenges, and ratings outlook

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2024 will see a substantial proportion of the globe head to the ballot box for presidential and parliamentary elections. Elections are always a key litmus test, even for the oldest democracies (as the US saw with the insurrection following Trump's defeat in 2020/21). For SA's still young but maturing democracy, this year's elections come at a critical time, given the state of the nation amidst shifting political tectonic plates. As these have played out in recent years, they have most starkly been encapsulated by the performance of the Rand (Figure 1), which has played its role as a pressure valve in an economy beset on all sides by worrying signs of an irreversible path to permanent decay.

Many have used the term "failed state" as SA's likely destination if it does not reverse course. While alarmist, it has increasingly become hard to dismiss such monikers, especially if the election outcome potentially brings forth an administration that fails to arrest SA's decline or, worse, even accelerate it.

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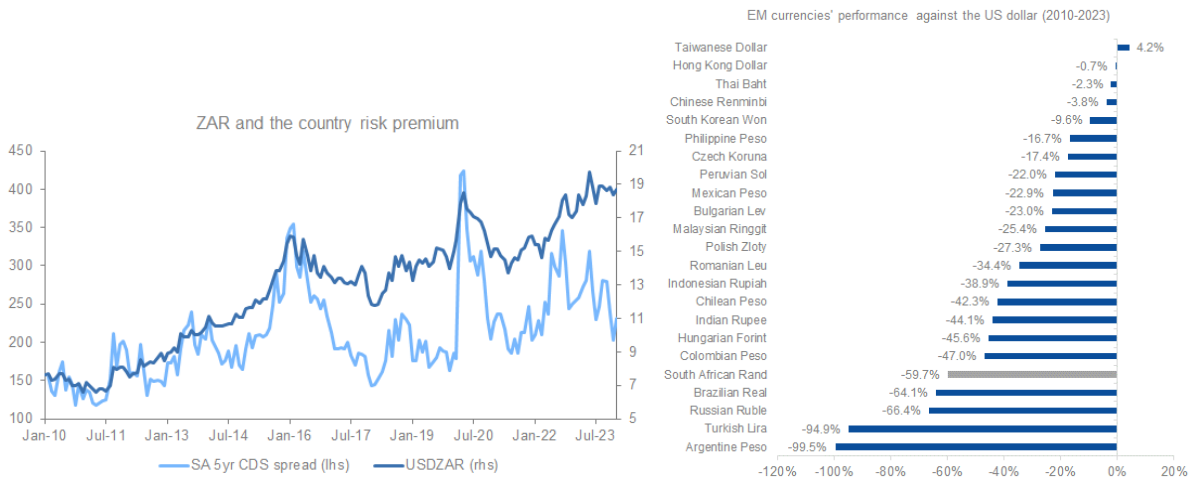
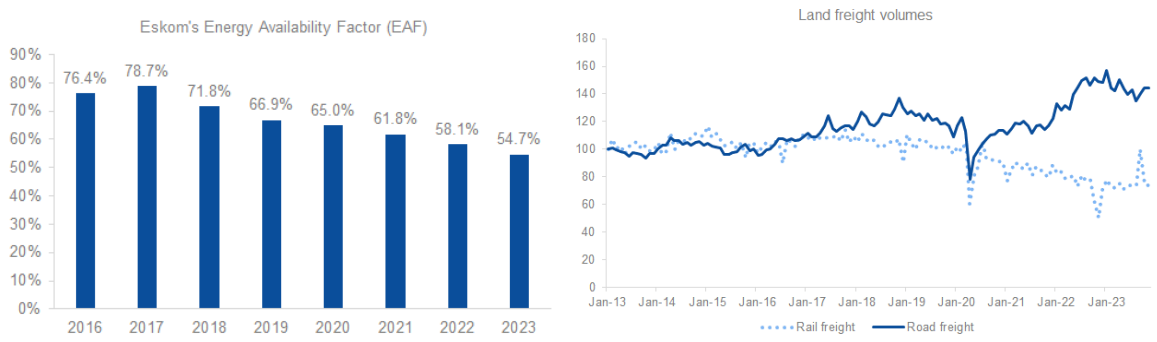
Figure 1: A rising country risk premium has been a key driver of the Rand's weakness



Source: Bloomberg, Terebinth Capital

South Africa's headwinds remain plentiful, and this year will bring these squarely into focus as the country heads to its 7th democratic elections. This occurs amidst the most challenging structural constraints, which have kept a lid on potential and actual GDP growth. While growth is expected to double this year, rising to 1.0%-1.5% in 2024 after an estimated 0.6% in 2023, insufficient power supply (Eskom) and throttled rail and port infrastructure (Transnet) will severely limit the upside (Figure 2). A silver lining is that private-sector generation from renewables is expected to pick up some of the slack on the energy side. Structural reform through Operation Vulindlela has delivered some wins, but the pace at which this has taken place has been too slow to support a sustainable recovery in GDP growth to levels which would address the numerous socioeconomic challenges the country faces, including an elevated unemployment rate.

Figure 2: Eskom's deteriorating plant performance and Transnet's declining rail shipments



Source: CSIR, Eskom, Stats SA, Terebinth Capital

The anaemic growth backdrop resulting from these structural challenges, alongside unfavourable terms of trade over the past year, presents a revenue challenge for the National Treasury. Add to this pressure from the expenditure side, including last year's wage bill settlement, the extension of the SRD grant, perennial SOE financial injections (a decision on Transnet's application still needs to be made); as well as the likely signing of the NHI bill into law this year; it is no wonder that the task of controlling the country's purse strings is as

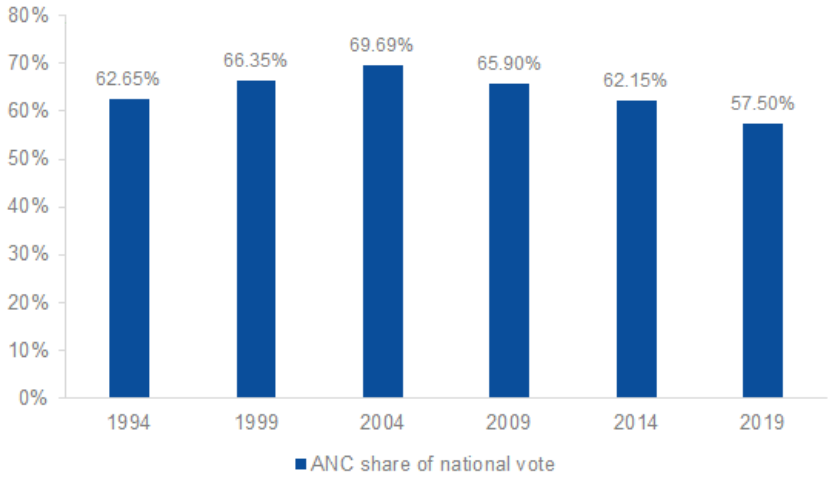
daunting as it looks. National Treasury's projected 4.7% main budget deficit for 2023/2024 underscores the difficult position it finds itself in.

The Minister of Finance has committed to expenditure restraint with a fiscal rule poised to be introduced in this year's Budget. In the context of an election year, this would demonstrate welcome resolve from the Treasury. Over the medium term, the expectation for the debt-to-GDP ratio to peak at 77.7% before trending lower would also be key but is largely conditional on the achievement of the projected primary surpluses in each year of the Medium-Term Expenditure Framework (MTEF).

For the bond market, the decision not to increase fixed-rate bond issuance at last year's Medium-Term Budget Policy Statement (MTBPS) was a positive. Assuming it is executed responsibly, the partial drawdown of the R500bn in unrealised gains in the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) could arrest the accumulation of debt and stave off increases in issuance in the near term (potential moral hazard issues aside). However, for fiscal consolidation to be credible, the lacklustre growth outcomes in recent years have to materially improve, which will require the successful implementation of structural reforms.

Returning to the importance of SA's national elections, numerous polls over the past year point to the governing party losing its outright majority in 2024. The baseline projection is for the loss to be marginal, thus requiring only a few of the smaller parties to form a coalition government. However, should the ANC fare even worse than expected, a less predictable coalition outcome may materialise. Should the resulting coalition government be centrist, then a commitment to fiscal discipline under the new administration could be underpinned by accelerated progress on reforms. However, should a more left-leaning, less market-friendly administration emerge, the progression of fiscal debt metrics over the medium term would likely deteriorate materially against Treasury's projections. Additionally, with the less-than-savoury experience of coalitions at the local government level, the stability of any coalition government at the national (or even provincial) level involving the larger political parties could be a source of policy uncertainty.

Figure 3: The ANC's falling electoral fortunes since the peak in 2004



Source: Independent Electoral Commission of South Africa, Terebinth Capital

The South African Reserve Bank (SARB) has been a bulwark in an environment where many other public institutions have fallen short. The SARB's Monetary Policy Committee (MPC) has, through repeated messaging, appealed to other areas of public policy to help address the key issues ailing SA's economy. The SARB's persistent raising of the alarm is well within its mandate; an increased country risk premium has weighed on the Rand, which is a key variable for the evolution of the inflation outlook.

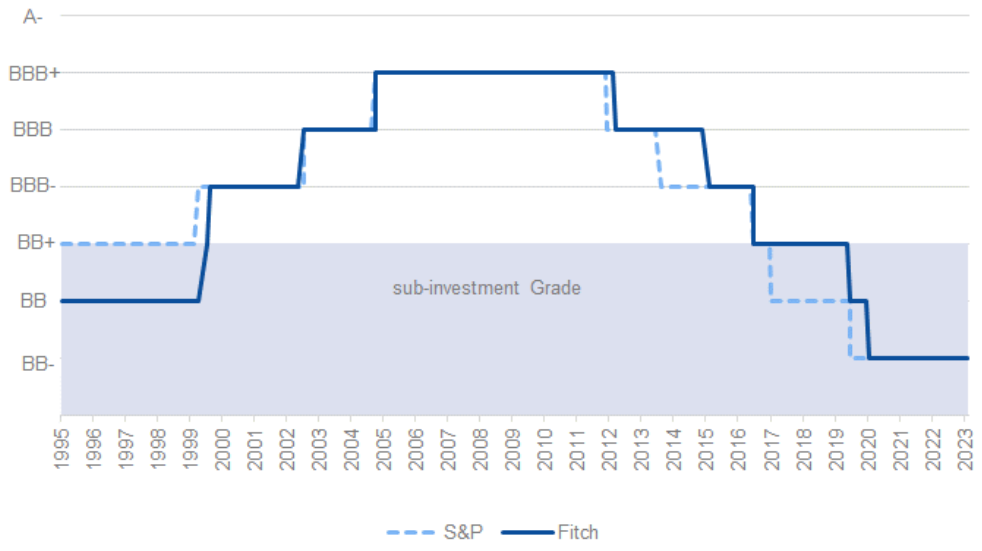
While headline inflation outcomes above the mid-point of the target band over the past two years have seen the SARB adopt a restrictive monetary policy stance to guide inflation back to target and anchor expectations, this stance was also necessitated by the neutral real interest rate drifting higher on the back of stretched fiscal metrics. Even as headline inflation is forecast to trend towards the mid-point of the target towards the tail end of 2024, the scope for rate cuts will be limited by these concerns around the country's elevated risk premium, especially in an environment where the global cost of capital has increased.

Following 475bps of repo rate hikes from admittedly low levels since late 2021, the easing cycle is likely to deliver only 125bps of cuts (100bps of which will likely take place during 2024). While not the best news for consumers, from an institutional framework, this conservative stance by the SARB is one of the few remaining marks of credibility within the public sphere.

With a foreign currency long-term rating of BB- (stable outlook) from both Standard and Poor's (S&P) and Fitch, SA is already in sub-investment grade territory (Figure 4). Of some comfort is that S&P and Fitch both project the debt-to-GDP ratio to exceed 80% over the medium term. While this means that the current rating bakes in worse assumptions than the 77.7% peak expected by the Treasury over the MTEF, it also casts a spotlight on the credibility of the government's projections.

The bar to delivering fiscal consolidation remains high. The projected achievement of primary surpluses over the MTEF will need to hold, with better real GDP growth outcomes than currently being achieved as a key underpinning to that. To this end, both rating agencies highlight reform progress and growth performance as key factors which would drive either an upgrade (or a downgrade) to the credit rating. On balance, it appears that the bar for a credit rating change is quite high unless a material shock sees deviation from baseline expectations.

Figure 4: The history of SA's foreign currency long-term sovereign credit rating



Source: Standard & Poor's, Fitch, Terebinth Capital

SA needs to reverse course promptly. The new administration post elections will need to drive reforms at an accelerated pace and arrest the deterioration in SA Inc's balance sheet. Akin to a company whose share price has been punished by the market for poor operational performance, a major restructuring will need to be delivered to convert doubters into believers. This will require immense political willpower, and this year's national elections will be instrumental in whether the journey towards that restructuring takes off in earnest.

Glacier Research would like to thank Kanyane Matlou for contributing to this week's *Funds on Friday.*

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Kanyane is responsible for listed property investments at Terebinth Capital, as well as being part of the macro unit and a member of the asset allocation committee. He joined the company in 2022 and has over a decade of industry experience, the bulk of which was gained as an investment analyst and co-portfolio manager on listed property mandates at Coronation Fund Managers. Kanyane holds a Bachelor of Business Science (Economics Honours) degree from the University of Cape Town. He has previously worked as an economist at the South African Reserve Bank (SARB) and as a trainee economist at the Bureau for Economic Research (BER).