FRONTLINE AFRICA
ADVISORY

Local Political and Economic Report June 2023

Introduction

- The June edition of the local political and economic report takes a look at some of the developments and on-going efforts to extricate South Africa from the current socio-economic doldrums and political existential crisis facing the governing African National Congress (ANC). This is more so as the 2024 general election fever is starting to grip the nation.
- The report covers South Africa's position in world politics as the Russia-Ukraine conflict continues to cause tensions with the United States (US), while there is seemingly not much criticism from the European Union (EU).
- The report also looks at the possibility of political instability stemming from service delivery protests.
- Latest economic indicators such as the Purchasing Managers' Index, inflation and the Gross Domestic Product (GDP) numbers of the first quarter are briefly covered.
- Finally, we sketch out some risks facing the country in both short and medium-term.

Political Updates

South Africa in the Global Context

- South Africa's position in global politics, particularly in relation to the US, remains uncertain as the country digs its heels on its non-aligned stance on the Russia-Ukraine conflict.
- Some US officials have already gone as far as writing to the Secretary of State Antony Blinken and calling for this year's Africa Growth Opportunity Act (AGOA) Summit to be moved from South Africa, which means they will also likely call for South Africa's removal from the programme.
- While the US continues with its "carrot and stick," approach regarding South Africa and the Russia situation, the EU has yet to take any singular stance on South Africa's positioning on the matter.
- If anything, the EU (as seem with the recent meetings between DIRCO Minister and her Dutch and German counterparts) prefers to engage South Africa, as opposed to issuing threats.
- Even French President Emmanuel Macron seems to want to attend the BRICS Summit, which South Africa is set to host in August.
- However, South Africa's foreign policy remains in question as the country does not seem to be able to keep to a single position on international matters, or at least unable to concisely articulate its position, which will continue to put it in conflict with other countries in future.
- While, admittedly, South Africa's stance on the case of the Russia-Ukraine conflict is crystal clear, there have been mixed messages from both the Union Buildings and Luthuli House (ANC's headquarters) on how the country intends to respond to the International Criminal Court (ICC) warrant of arrest for Russian President Vladimir Putin should he set his foot in the country in August.
- The position taken by South Africa on the Russia-Ukraine conflict also seems to be at variance with the stance and posture it takes on the on-going Israel-Palestine conflict.
- Understandably, questions abound regarding the country's moral standing and respect for human rights, the anchors of South Africa's foreign policy since the early days of democracy. This gives rise to yet another question: whether the country has the clout it used to have in global affairs or it has ditched it on the altar of political expediency or, at the very least, economic pragmatism. It is not immediately clear which of the two is worse.

Potential Implications

- Tensions are likely to remain between South Africa and the US over the Russia situation, but it is doubtful the US would impose harsh sanctions on the country considering the many business interests it still has here.
- However, this does not mean South Africa is in the clear as we saw how easily the rand can depreciate based solely on accusations of wrongdoing.
- South Africa might face some setbacks, but it is unlikely that the country will find itself isolated on the global stage. Furthermore, the rising number of states that want to join BRICS could be an indication of new potential trade partners that could eventually lead to the country being slightly less reliant on programmes such as AGOA.
- However, the question does then remain on whether South Africa will continue to be regarded in the same high esteem it has been in the past.

Stability in South Africa

- This month, the Institute of Risk Management (IRMSA) published its 9th Edition of the Annual Risk Report, which flagged possible trouble on the horizon for South Africa.
- The IRMSA stated that the country faced the risk of growing social unrest, pointing to a rise in protests and riots which had been fuelled by social and economic pressures that have continued to persist over the last decade.
- In addition, the report spoke on environmental risks, technological disruptions, the deterioration of infrastructure, corruption and the energy crisis.
- These risks are nothing new to South Africa, but the fact that they have persisted all the way into the 2020s is quite troubling as they pose a major threat to the country's social, political and economic stability.
- Government is now working overtime to try and remedy many of the challenges the country faces, but these efforts are slow and are seen by some as nothing more than "grand gestures" to try and secure an election victory in 2024.

Potential Implications

- With elections coming up, the government will want to avoid any kind of repeat of the July 2021 riots and will work to try and keep any potential riots at bay with the help of law enforcement and other security agencies.
- However, if socio-economic conditions do continue to deteriorate for South Africans, riots might be inevitable, with no way to nip them in the bud.
- Government, as it has done many times before, might be slow to come up with and implement policies that would be able to deal with the risks flagged by IRMSA. If we have learnt anything about the South African government, it is that it tends to be reactionary instead of proactively dealing with challenges before or as they start to arise. The greylisting issue is just one such example of this behaviour.
- Failure to adequately address the flagged issues, may have some negative consequences for the ruling ANC at the 2024 polls.

Will South Africa succeed in its bid to ease the energy crisis?

- With general elections about a year away, the ANC-led government has a lot of ground to cover, to try and keep their governing majority, especially when looking at the state of the country's economy and its run-off effects.
- At the top government's economic priorities is the country's energy crisis, which has led to unrest in the business community as they have had to suffer unimaginable losses over the last year due to power cuts.
- Despite fears of a dark winter, the month of June marked an easing of loadshedding, with power cuts reaching a high of stage 3, which is down from the stage 6 high experienced the month before.
- This easing, however, came with the consequence of higher spending on diesel as Eskom reportedly spent beyond its R8 billion diesel budget to propel its Open-Cycle Gas Turbines (OCGTs) at the Ankerlig and Gourikwa power stations, with a combined energy generation capacity of 2,000MW, which is equivalent to two stages of rolling blackouts. The cost of running these OCGTs is estimated at R3 billion a month, and, if National Treasury stands by its word, the power utility will not be receiving any further bailout from the fiscus.
- These developments come as the Eskom Debt Relief Bill finally got approval from the NCOP and awaits the President's signature. While this means that Treasury will take over R254 billion of Eskom's R400 billion debt, it doesn't mean the power utility is out of the woods yet. Eskom recently approved 7% wage increase for non-managerial employees, increasing their expenses.
- Some economists speculate that there might be no way of saving Eskom in its current form and that it could end up needing a private sector partner similar to South African Airways (SAA), or worse, end up facing provisional liquidation like the South African Post Office (SAPO). This comes as the announced breaking up of the utility into three parts has seemingly stalled.
- What can be seen as a positive however is that South Africa and Mozambique reached an agreement which will see Mozambique supplying us with 100MW of power over the next 3 months and 1000MW over the medium term. It should be noted that South Africa currently has a deficit of 6000MW, which means there is still a long way to go, but the Mozambique deal could knock down at least one stage of loadshedding and help struggling businesses as well as households.
- The DFFE has also granted Eskom a temporary exemption to run Kusile without technology that removes harmful sulphur dioxide emissions. This will allow the utility to recover about 2100MW of generation capacity at Kusile by end of the year.
- The financing of this purchase has not yet been revealed and so we are yet to see how much it will bite into our fiscus or add to Eskom's already high debt.

Potential Implications

- It is all well and good for government to help clear a major chunk of Eskom's debt, but it will do little to help the power utility if it fails to address the mismanagement problems it has been facing over the years.
- With continued reports of corruption and sabotage making the media, it could take a long time for Eskom to recover if these are not addressed.
- The power utility also needs to find a way to collect revenue from those that owe it money, which will also be challenging considering it has allowed municipalities to build up debt over a long period of time and now those municipalities are finding it difficult to settle those debts.
- With Eskom having already gone over their diesel budget, the country could be in for higher levels of loadshedding in the months ahead.

Government Looking to Private Sector Partnership for Solutions

- Government has turned to organised business, establishing a partnership initiative to help tackle obstacles impeding inclusive economic growth and job creation. The priority areas flagged were energy, transport and logistics and crime and corruption.
- President Cyril Ramaphosa's tenure has been characterised by his calls to work with organised business to alleviate the country's challenges, particularly the economic ones. While this is good in theory, government has a tendency of sometimes being unable to deliver on its promises, which is something especially difficult in places where power constantly changes hands like coalition-led municipalities.
- Furthermore, this government has the tendency of shirking some of its responsibilities just to turn around and ask businesses to intervene while also being very critical of business. For this partnership initiative to work successfully, government needs to pull its weight and work to ensure that they fulfil their part, without any corruption or other government-led hindrances.
- Additionally, government needs to engage the business community in good faith and listen to what they have to say without being dismissive, particularly when crafting policies. The National Health Insurance Bill (NHI) has been an example of government being driven by ideology and essentially ignoring stakeholder concerns.
- Moving forward, government will need to stop being reactionary and only choosing to consult or partner with business once they see all hell breaking loose.
- Government has also directed their efforts at the youth, with Deputy President Paul Mashatile delivering a keynote addressing this year's National Youth Development Agency (NYDA) investment roundtable, calling for government to boost youth development investment and the need for better implementation of policies.

Potential Implications

- Considering how reliant government is now becoming on business to solve some of the issues the country is facing, it might need to take the business community's concerns more seriously in future.
- The lack of any proper long-term plan to solve the issue of loadshedding will likely continue to make business nervous and continue to deter potential investment.
- However, these partnerships will garner some good will with organised business and could even help to attract investment if they are seen to be successful.
- Government will also need to start drafting and implementing policies that will make economic conditions more conducive to business growth, because it will be difficult for businesses to make commitments if they are unable to see any growth.

Policy conversations: Towards convergence or divergence?

- This month saw the movement of five important pieces of legislation, the National Health Insurance Bill (NHI), which the National Assembly, thanks to the ANC's majority, has passed on to the National Council of Provinces (NCOP).
- On the other side, National Treasury published the two Bills concerning the Two-Pot Retirement System for public comment.
- The Bills are the 2023 Draft Revenue Laws Amendment Bill and the 2023 Draft Revenue Administration and Pension Amendment Bill.The NHI remains contentious, with the health industry and other stakeholders bemoaning its inapplicability, while others are threatening court action against it if is passed into law in its current form. In the main, many stakeholders hold the view that their concerns have been largely ignored by government.
- It remains to be seen if the NCOP will create space for meaningful public and stakeholder consultation, particularly in light of the three recent Constitutional Court judgements: The one dealing with the Traditional and Khoisan Leadership Act, the other with the South African Iron Steel Association as well as the other dealing with the Zimbabwean Special Exemption Permit.
- In all these judgements, the Constitutional Court underscored the centrality of meaningful public participation in law and government decision making.
- The two-pot retirement system on the other hand has not faced the same uproar as the NHI.
- This is because, in the main, it is a compromise system between financially distressed workers who want to access at least a portion of their retirement savings and government's cautious approach that insists that workers must still have savings for their retirement. The first phase is meant to come into effect on 01 March 2024.

Potential Implications

- If the NCOP does not accord stakeholders and the public opportunity to engage meaningfully on the NHI, there is a greater chance the bill, once enacted, will become a subject of litigation on many fronts.
- The question is whether the ANC, as the majority party in Parliament, has taken heed from the three Constitutional Court judgements referred to above, and understood that in a constitutional democracy, there are rules which cannot be ignored purely on the basis of majoritarianism.
- The two-pot system, according to the Actuarial Society of South Africa, could triple retirement savings in the country. It affords workers a certain level of protection whether they want it or not.
- The way it is designed, however, protects pension funds from financial sustainability challenges, by allowing only a one third of the savings to be withdrawn once a year – a withdrawal is taxable. The two-thirds will be retained in the savings until retirement.
- The other advantage is that the application of the system is not retrospective. It will only apply to retirement contributions from the 1st of March 2024.
- By all accounts, this has been a neat balance between the immediate needs of workers and requirements for insulating pensions from risk of over-withdrawals.

Economic Updates

Economic Activity indicators

Indicator	Rate
PMI	47.9 ▼
CPI	4.6% ▼
GDP	0.4% q-on-q ▲

On Business Activity – PMI

- According to S&P Global, businesses in South Africa suffered from a downturn in May, as the Purchasing Managers' Index (PMI) dropped down to 47.9, its lowest reading in just under two years.
- ·Contraction in businesses activity was experienced in several industries, including construction, wholesale and retail and the services sectors.
- As in the previous months, loadshedding has continued to significantly constrain output and therefore contributed to a renewed fall in new business.
- S&P added that inflationary pressures had also been a contributing factor to the restriction of customer spending, with firms reporting another sharp rise in their output charges in response to substantial increases in cost burdens. The fall in sales was the quickest since January and companies also suffered a decline in new export orders for the first time in four months, amid reports that weaker client confidence and cost cutting measures had hit demand.
- Data also showed a decrease in new order volumes in May, following the small uptick recorded in April. Firms responded by "reducing their purchasing activity and inventories in May, with rates of decrease quickening from the previous month."
- S&P stated that employment levels recovered modestly after a slight cut in April and that when combined with reduced new order intakes, meant that the drop in output had little impact on firms' backlogs.
- On a more positive note, companies signalled that improving import supply assisted in easing supply side challenges, leading to the softest lengthening of delivery times since December 2019.
- Companies also registered another sharp rise in "staff salaries to compensate workers facing a higher cost of living. The price of wage inflation was among the quickest recorded since mid-2015 and consequently, firms raised their selling charges rapidly in May."
- However, despite the challenges faced, businesses are said to have remained optimistic about the year-ahead outlook.

Fuel Prices for June

- The month of June brought about some relief for consumers as fuel prices, with the exception of LPGas, decreased.
- Both types of petrol, 93 and 95 decreased by 71c per litre while diesel 0.05% went down by 84c per litre and diesel 0.005% dropped by 80c per litre. Illuminating paraffin went down by 43c per litre, while LPGas increased of 75c per kilogram.
- The Fuel Levy decreased to 395.0c per litre and 381.0c per litre respectively in petrol and diesel price structures.
- Even though the rand depreciated against the dollar, the average international product prices for petrol, diesel and illuminating paraffin had decreased during the period under review.
- Mid-month data from the Central Energy Fund (CEF) pointed to another slight decrease in both types of petrol in July. Petrol 93 is expected to go down by 13c per litre, 95 by 4c per litre, while diesel 0.05% is set to increase by 7c per litre and diesel 0.005% is set to have no change in price. Illuminating paraffin is set to decrease by 6c per litre.
- June oil prices remained "fairly flat, despite efforts from oil producing nations (OPEC+) to artificially bump prices by cutting supplies."
- According to Bloomberg market analysis, the drop in oil has been driven by a big jump in US crude stockpiles and the US Fed's signal that it's not finished with rate hikes."

Job Losses in the First Quarter of 2023

- StatsSA released Quarterly Employment Statistics (QES), which revealed that employment numbers had dropped once again in the first quarter, with a recorded 21000 job losses, which translates to -0.2% quarter-on-quarter.
- This brought the number of employed people in the country down from 9 991 000 December 2022 to 9 970 000 in March 2023.
- The losses were across several industries, namely trade, business services, transport and construction. However, some industries did record increases, and these were: community services, mining manufacturing and electricity.
- Total employment decreased by 97 000, or -0.1% year-on-year between March 2022 and March 2023.
- Full time employment decreased by 63 000 (-0.7%) quarter-on-quarter and by 24 000 (-0.3%) year-on-year, while part-time employment increased by 42 000 (3.8%) quarter-on-quarter and decreased by 73 000 (-6.0%) year-on-year.
- Gross earnings paid to employees decreased by R34,1 billion between December 2022 and March 2023, while basic salaries/wages decreased by R11,8 billion in the same time period.

Potential Implications

- Should loadshedding and the effects of the stubbornly low global growth, amid the continuing Russia-Ukraine conflict, persist, South Africa is likely to see the worsening of unemployment figures.
- The drop in permanent employment and rise in part-time employment means more households living from hand to mouth as they face the high cost of living which is not looking like it will ease just yet.
- It also means government will have the added pressure of needing to provide for these households through programmes like the social relief of distress grant, which could see another extension or become permanent and therefore add more pressure on the fiscus.
- This could also lead to a brain as skilled South Africans could find themselves migrating to countries that are well equipped to employ them, especially considering the fact that there are already several countries constantly advertising for skilled workers.

Inflation In May

- Statistics South Africa (StatsSA) revealed that the Consumer Price Index (CPI) reached a 13-month low, year-on-year, in May, dropping down to 6.3% from April's 6.8%.
- This brings inflation to just outside the South African Reserve Bank's (SARB) 3% to 6% target range. It is the lowest point since April 2022, when it was 5.9% slightly below the 6.5% that was forecast by economists.
- Food inflation dropped once again, from April's 13.9% to 11.8% in May, which helped cool off the high food prices.

South Africa Avoids Technical Recession

- Statistics South Africa (StatsSA) revealed, that South Africa's GDP grew by 0.4% quarter-on-quarter in the first quarter of the year, following a 1.1% contraction in the fourth quarter of 2022.
- Out of the 10 industries recorded, 8 recorded growth in the first quarter, but none of them expanded by more than 1.5%. Manufacturing, transport, storage, communication and construction were the biggest drivers of growth. Meanwhile, the country's largest industry, finance, real estate and business services only grew by 0.6%. Agriculture, forestry and fishing, as well as electricity, gas and water are the two industries that contracted.
- Had the economy contracted for a second consecutive quarter, it would have been considered to be in a technical recession. However, many economists had expected the growth to happen, with expectations sitting between 0.2% and 0.4%.
- The contraction is also an indication of the country's loadshedding, as the economy only enjoyed day without loadshedding between January and March this year.
- Even with this outcome, the outlook remains rather bleak for South Africa.
- The country's central bank predicts that the economy will grow 0.3% this year, with rolling blackouts hurting businesses of all sizes, especially as Eskom has warned that scheduled electricity outages could worsen in the "coming southern hemisphere winter." Meanwhile, the International Monetary Fund's (IMF) prediction is 0.1% growth.
- Data from the National Credit Regulator (NCR) showed an increasing number of South Africans were seeking credit, with a rejection rate close to 69%.
- Even though food manufacturing saw growth in the first quarter, retailers are warning that they "face immense price pressures that could soon be passed on to consumers."

Potential Implications on Economic Activity Indicators

- Worsening business conditions are making it harder for investors to explain why they should bother bringing their investments to the country or staying in the country.
- While loadshedding has eased in off in June, this status quo could change any time soon as there are still two more months of winter and demand will likely be high.
- However, the easing of loadshedding, lowering of fuel prices and the reduction of inflation could lead to the improving of business conditions in the coming months as some overhead expenses faced by businesses could go down.
- The easing of inflationary pressure will likely signal to the SARB that there is no need to rise the repo rate again, or to rather raise it by 25 basis points (bps) instead of 50bps if they do.
- However, the SARB might need to find other means of stifling inflation as its constant increase of the repo rate has been counterproductive, helping make life more expensive for consumers and failing to curb inflation for almost an entire year.

- South Africa is still not out of the woods yet, as the cost of living is still relatively high, which means consumers are likely to continue battening down their hatches in the face of highly fragile economy.
- If this the country could stay on this trajectory for the rest of the year then creditors will likely see less defaulting and consumers will be able to open up those credit accounts they have been getting rejected from.
- However, as seen in previous months, international politics continues to play a major role in our economy and so the US could cause further damage to the economy over any perceived slights such as the Lady R debacle.

Summation

- The government seems to be feeling the heat, with the risks of strained relations with the United States and possibly the EU, over the Russia-Ukraine conflict.
- Its efforts at the global level are more about diplomacy and trade as they are about the country's domestic realities, which can be summed up in terms of growth, fiscal stability, balance of payments, business confidence, unemployment, poverty and inequality.
- The ANC-led government is cognisant of the fact that any deterioration of these, on account of either external influences or bungling on the domestic front, does not augur well with the electorate.
- At the same time, when one looks at the manner in which the ANC conducts business with the very same electorate poses risks for the party. The way the party approaches policy development and policy conversations, as its posture of the NHI and its lethargic attitude to dealing with service delivery challenges and corruption is showing, is like committing suicide. With this in mind, we turn our attention to some of the risks pressure sub-elements within the overall context of structural country risk core elements.

Risks and Potential Risk Factors

Energy

- There is no disputing that loadshedding is here to stay. The only question is how severe it will be in the coming months. Eskom has managed to ease the situation in June, but this could end as abruptly as it began as the power utility is reported to be using more diesel to maintain the eased blackouts.
- Eskom is already in a world of debt and will unlikely be able to maintain its rising expenses to keep the power on, even with government planning to take on some of its debt.

Economy

- South Africa's growth outlook remains relatively bleak, but the easing of some economic pressures could mean better conditions for consumers and businesses.
- The economy does remain volatile as pressures outside the country could lead to depreciation of the rand, among other issues.
- The fiscus also remains at risk as government wants to try and please everyone, perhaps to try and get votes in next year's election, without indication of how it will cap the country's debt burden. This debt seems likely to grow considering the ambitious NHI, constant wage negotiations and the social relief of distress grants that could be renewed once again next year.

Crime

- The question of whether South Africa is losing the fight against crime remains as the crime rate stays relatively high. While there has been a decrease in certain contact crimes, the number in the first quarter of 2023, it is not enough to make a significant impact as it remains higher than in the same period in preceding years.
- Furthermore, the fight against corruption also does not seem to be going very far as Eskom continues to have reports of corruption and sabotage and the country is yet to see more prosecutions related to the Zondo Commission.
- There has been a decrease in arson and malicious damage to property, however. More is still needed to bring the numbers of these down as damage to economic infrastructure holds the country back.

Socio-political stability

- The country has been relatively quiet in the months since the attempted shutdown by the Economic Freedom Fighters (EFF), but that can all change very quickly. Many South Africans continue to struggle making ends meet, while the unemployment rate remains high. Among other factors, these are conditions that can lead to mass protest and riots.
- As seen in 2021, riots can be started quite quickly and can last long enough to cause severe damage to the economy. They also open the country up to criminal activity. .

International Relations

- This risk remains elevated, but could also drop soon enough depending on how the world responds to South Africa's stance on the Russia-Ukraine conflict. While the US and others have outwardly shown their disapproval, there have been countries that praise South Africa's efforts in peace-building between the two countries.
- Furthermore, international sentiment around the US has been on the decline in the last few years, particularly during the Donald Trump administration, which led to some world leaders discussing the topic of moving away from the "Americanisation" of the world. America could find that it does not have the global support it would like if they were to choose to take action against South Africa. It remains to be seen how these tensions unfold over the next few months.

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