FRONTLINE AFRICA ADVISORY

SA Political and Economic Report

July 2024

Executive Summary

- The July edition is about political updates, including the formation of a new government and the latest developments in Parliament.
- On the global affairs front, the report delves into South Africa's relationship with the United States as the latter seeks to review bilateral relations with the former.
- The report also zooms into the state of state-owned enterprises, focussing mainly on the latest updates from Eskom and Transnet.
- On the economic front, the report analyses the Purchasing Managers' Index, inflation rates, the repo rate and the economic contraction experienced in the first quarter.
- Finally, the report assesses the risks that the country may face in coming months.

Political Updates

A New Government Formed in South Africa

- With the elections now over two months behind us, a new government (the Government of National Unity – GNU) was formed in recent weeks and the country has seen the appointment of a multiparty national executive, as well parliamentary committees headed by several parties.
- Despite not winning this year's election, the African National Congress (ANC) is the anchor of and a senior partner in the GNU.
- The party secured 22 out of the 34 ministries and retained the Economic and Security clusters: Finance, Trade, Industry and Competition, Small Business Development, Electricity and Energy, Tourism, Transport, Employment and Labour as well as State Security, International Relations, Defence and Police, among others.
- The GNU's strategic posture also shows broad endorsement of ANC policy with perhaps some policy convergence with former opposition parties, on such issues as economic and fiscal policy, *Operation Vulindlela,* spectrum roll-out, local government revitalisation, and just energy transition.
- The former Official Opposition, the Democratic Alliance (DA), also scored several important portfolios across clusters: Public Works and Infrastructure, Agriculture, Communications and Digital Technologies, Home Affairs, Basic Education, and Forestry, Fisheries and Environment.
- Notably, the gender distribution within the Cabinet shows a disparity with 13 female ministers compared to 21 male ministers. The gap narrows slightly among deputy ministers, with 18 women and 25 men.
- While most parties did not have a lot of wiggle room, the ANC explored its gender diversity a bit more (14 men and 8 women) in its Cabinet appointments, while the DA, which has previously faced criticism for mostly appointing men elected 5 men and 1 woman.
- This is similar to how in the DA-run Western Cape, the provincial Cabinet is made up of 8 men and 3 women. The DA's tendency to lean towards male appointees becomes increasingly apparent when compared to provinces like the Eastern Cape, which has 5 women to 6 men split or Limpopo where it is 6 women to 5 men.
- Apart from gender disparities, GNU found itself facing teething problems as the ANC and DA continued to butt heads over Cabinet seat allocations, so much so that the DA was not included in the Gauteng provincial government.
- The interpretation of the GNU Statement of Intent poses additional challenges that the parties had to go through and may still face in the future.
- While the DA might perhaps have been subdued a little as the opposition party, the ANC and its GNU partners will now find themselves facing off against two ANC breakaway parties in Parliament, the Economic Freedom Fighters (EFF) and the uMkhonto weSizwe party (MKP) that might come together to block it at every turn.

Potential Implications:

- The GNU Statement of Intent calls allows for decision-making based on consensus as well as for dispute resolution or deadlock breaking mechanisms, in instances where sufficient consensus is not reached. It is yet to be seen what these mechanisms will work out in practice.
- While it had been feared that there would be tensions between the ANC and the DA, with each potentially overestimating its influence, there seems to be some level of maturity for now. Whether this will be sustained over time remains to be seen.
- The ANC has the advantage of knowing that at the moment it is the only party with enough seats to easily constitute a government via coalition as no other party managed to achieve even 25% of the vote. Furthermore, the chances of the other three large parties, the DA, EFF and MKP ever coming together to form government are slim to non-existent, making it the only truly viable option for most if not all parties.
- Nevertheless, the ANC must recognise that being the dominant partner in the GNU does not equate to unilateral power. Cooperation with GNU partners is essential for passing key policy measures, as observed in local government.
- This is evident in the priorities of the GNU, as seen with how the DA managed to get some of its own policies incorporated into the priorities mentioned in the President's opening of Parliament such as: expanding the basket of food items exempt from VAT and preventing undue political interference in the public services.
- While the ANC can claim to have retained power in the economic cluster, many policies such as fiscal policies cannot be determined by the party alone.
- The same can be said for the security cluster, as we have seen how different parties have different approaches to security. While the DA is unlikely to achieve its goal of a decentralised police services over the course of the next five years, we might start to see some reforms within the police and other state security institutions.
- What will be interesting to see over the coming months and years is how GNU partners will work to keep each other accountable, as it is no longer as simple as a single party choosing to vote against some point of grievance in Parliament.
- The country also currently faces the question of whether the former opposition parties that form now part of the GNU will have lost their teeth, criticising a government one is part of presents new challenges and may impact their traditional role as watchdogs.

The State of State-Owned Enterprises

Transnet

- The African Development Bank (AfDB) has approved a 25-year $1 billion (R18.5 billion) loan to aid Transnet in its recovery plan.
- The loan is expected to facilitate the first phase of Transnet's R152.8 billion five-year capital investment plan "to improve its existing capacity ahead of expansion for the priority segments throughout the transport value chain."
- The loan comes at a time when National Treasury follows through on its word to not give bailouts to overly indebted state-owned enterprises. However, Transnet received a R47billion guarantee from in December 2023 to support its recovery plan and to meet its debt obligations.
- Preliminary and unaudited data suggest that Transnet could announce an improvement in its logistics operations for 2023/24 financial statements in August, with the company not expected to be in a loss-making financial position.
- The last time Transnet "turned a profit was in 2022" was when it recorded a financial gain of R5 billion.
- Preliminary figures show that on its freight rail network, Transnet increased the movement of goods by 1.5% from the previous year, while making an increase of 2.2% at its ports. However, both these figures remain below the targets set in Transnset's recovery plan and the company remains at risk of defaulting on its debt repayments.
- Transnet is also set "to expand the Southern Corridor rail network" to add three 50-wagon trains for use by automotive companies daily between Gqeberha and Gauteng." The company stated it also would expect the private sector to invest in rail infrastructure and trains to boost service.
- In response to the World Bank's 2023 Container Port Performance Index (CPPI), which ranked Cape Town, Durban, and Gqeberha ports unfavourably, Transnet has contested the methodology used, asserting that it does not accurately reflect the ports' current status.
- Juanita Maree, the Chief Executive Officer of the Southern African Association of Freight Forwarders (SAAFF) also argued that the CPPI failed to take into account the corrective action taken by Transnet under new management.

The Seventh Parliament Forges Ahead

- After weeks of back-and-forth negotiations between parties over their roles in the new government, both at national and provincial level, the 7th Administration and Parliament finally forged ahead with their work this month.
- Ministers and some of their deputies delivered their Budget Votes this month, outlining the priorities for their departments in the upcoming 2024/25 financial year.
- The priorities highlighted in the Budget Votes largely resemble those of previous years, which was to be expected considering that these are largely based on the February 2024 Budget. Some of the priorities include:
  - o Driving economic growth, reducing the fiscal deficit and stabilising government debt.
  - o Both social and economic transformation, leveraging upon the Africa Continental Free Trade Area (AfCFTA), Africa Growth Opportunity Act (AGOA) and the European Union Partnerships.
  - o Aligning policies with the National Development Plan Goals, as well as the Sustainable Development Goals.
  - o Fighting substance abuse and work towards improving social services, with the Department of Social Development specifically looking to table a Draft Policy on Basic Income Support.
  - o The implementation of the National Health Insurance.
  - o Prioritising visible policing and strengthening capabilities to fight cybercrime, organised crime, commercial crime, and corruption.
- This month also saw President Cyril Ramaphosa convening a joint sitting of the National Assembly (NA) and National Council of Provinces (NCOP), to deliver the Opening of Parliament Address (OPA) for the 7th Administration and mark the start of the new five-year parliamentary cycle.
- Ramaphosa's address also echoed his previous State of the Nation Addresses, in which he set out the government's three main priorities being (1) inclusive growth and job creation, (2) poverty reduction and tackling the high cost of living and (3) building a capable, ethical, and developmental state.
- He also focussed on several key issues including infrastructure investment, support for small businesses, public-private partnerships, energy, and addressing challenges in municipalities to attract investment and improve service delivery.

Potential Implications:

- An advantage of this new government is that ideas and perspectives from all parties forming government will need to be considered when making decisions as opposed to narrow views of a single party.

- Smaller parties in the GNU have also had some of their members appointed as Chairpersons on several committees, giving them more authority and influence than they ever had before.
- This new Parliamentary set up also makes it less of an uphill battle to hold officials accountable as things will no longer boil down to a vote whereby a single party holds the majority and can determine which direction to take on an issue.
- However, parties within the GNU will probably still try to behave in a manner that does not rock the boat and compromise the integrity of the new government formation and so might be less willing to take up positions against their partners.

South Africa in the Global Context

- A year after resolving Lady R debacle, the relationship between South Africa and US has come under scrutiny once more, following the passage of a bill by the US House of Representatives. This bill mandates a comprehensive review of bilateral relations between the two nations.
- The vote was split with 272 voting for it (211 Republicans and 61 Democrats) against 144 voting against (143 Democrats and 1 Republican).
- While the Democrats (47 seats), working with Independents (4 seats) hold the majority in the Senate (Republicans have 49 seats), the bill could still pass as some within the party might vote in favour of it as seen in the House of Representatives.
- The move is largely seen as a punitive measure the country has chosen to take against South Africa for the latter's decision to take Israel to the International Court of Justice (ICJ) over its conflict with Palestine.
- As of May 31, 2024, according to an article by the Council on Foreign Relations (CFR), the US has provided Israel with billions of dollars in military aid since the beginning of the current conflict in October 2023.
- According to the CFR "Since the start of Israel's war with Hamas on October 7, 2023, the United States has enacted legislation providing at least $12.5 billion in military aid to Israel, which includes $3.8 billion from a bill in March 2024 (in line with the current MOU) and $8.7 billion from a supplemental appropriations act in April 2024."
- The justification for the bill was that the US wants to see whether South Africa has "engaged in activities that "undermine US national security or foreign policy interests," which the US could define as almost anything it wants.
- This development came days after President Ramaphosa and US President Joe Biden committed to strengthening relations between the two countries over a phone call. However, Biden has now stated that he would no longer be running for a second term, which means his successor might not hold the same sentiments, especially if that president comes from the Republican Party. Trade, Industry, and Competition Minister Parks Tau's recent attendance of the 21st AGOA Forum in the US, also seemed to bear some fruit as his department reported that "there was broad support for strengthening bilateral trade and investment relations between South Africa and the United States."
- Tau, along with other Trade Ministers from the continent had used the platform to call for the renewal of AGOA to be concluded by 2024.

Eskom

- Eskom announced that after six months of rigorous testing and optimisation, the power utility had successfully transferred Unit 5 of the Kusile Power Station from the new building programme to operations in the Generation Division.
- The unit, which was first synchronised to the national grid in December 2023 will begin contributing power, increasing Kusile's total output to 4000MW.
- The Unit is one of the largest baseload units contributing megawatts and this transfer marks a significant milestone in Eskom's ongoing efforts to stabilise South Africa's power system, adding a stable and much needed 800MW to the grid.
- This, however, does not mean the country is out of the woods yet, as Energy and Electricity Minister Kgosientsho Ramokgopa has warned that Eskom is at risk of collapse if its debt problem is not addressed, referring to the fact that the power utility is owed R78 billion by South African municipalities and that this debt is growing at an alarming rate.
- Furthermore, Eskom also finds itself in a fight against some private companies as it presented objects to the National Energy Regulator of South Africa (NERSA) granting licences to private companies, in areas where it is already the distributor, essentially taking over its customers.
- This follows the passing of the Electricity Regulation Bill earlier this year, which opens up the electricity market to private players, such as generators and traders. Eskom also argues that this will put further pressure on its remaining consumers.
- Finally, the month of July also saw the signing of the Climate Change Bill into law. The new Act transforms Presidential Climate Commission (PCC) into a statutory body that will exercise its new legal powers to drive a just transition.

Potential Implications:

- Some of South Africa's SOEs such as Eskom and Transnet are starting to show some improvements as the rate of loadshedding as declined and the ports crisis is being alleviated.
- But SOEs still have a long way to go as their debt burdens will not be easy to shake off, especially seeing as how National Treasury is no longer willing to grant them bailouts.
- The hope is that the new management at both these institutions could mean a turnaround for both in the next five years, as long as each does not suffer from maladministration as it had in the past.
- Ailing infrastructure will continue to be a hindrance for SOEs and will likely force the government to continue looking into private-public partnerships to help them recover as it had tried with the South African Airways (SAA).

- The Transnet loan could go a long way in helping the logistics firm as it recovers from a crippling logistics crisis that severely impacted industries such as mining and manufacturing. This will certainly help the weakened economy recover from the blow that the logistics crisis had dealt to exports in the commodities, manufacturing and retail sectors among others.
- Eskom on the other hand also has the unenviable task of having to collect outstanding debt from municipalities that have incurred billions worth of debt over several years, without cutting them off from its electricity supply as this would no doubt lead to widespread protesting from communities who owe billions.
- Eskom, while in the middle of its recovery, finds itself already having to fight competition that could affect its ability to generate more revenue as private competitors could slightly shrink its customer base forcing the power utility to either increase prices or come up with new ways of generating revenue.
- The signing of the Climate Change Bill could lead to South Africa picking up momentum and achieving some of its climate change goals sooner than expected. It also means government will pay greater attention to carbon emissions of the private sector.

Economic Updates

S&P Global Purchasing Managers' Index

- The S&P Global Purchasing Managers' Index (PMI) dropped to below the 50.0 neutral mark for the first time in three months in June, placing at 49.2 from May's 50.4 reading.
- According to S&P the index was "consistent with a marginal deterioration in the health of the private sector. Four of the five sub-components of the PMI (which does not include prices) indicated a worsening of operating conditions during June, including renewed drops in employment and stocks of purchases."
- S&P reported that "output and new orders had fallen at their quickest rates since March, with weaker client demand being due to political uncertainty following the elections." meanwhile employment numbers were also cut, with survey evidence attributing the decrease to the non-replacement of leavers.
- The index did however also signal a cooling in price pressures on businesses, which led to the softest rise input costs since August 2020, at the height of the COVID-19 pandemic.
- S&P added that delivery times faced by companies worsened in June, with firms continuing to mention port delays at Durban and global shipping disruption related to the Red Sea crisis as constraints on their supply lines.

First Quarter Economic Contraction

- Statistics South Africa (Stats SA) revealed first quarter economic data and revealed that real gross domestic product (GDP) had contracted by 0.1% in the January to March 2024 period. This comes after a revised 0.3% increase in the fourth quarter of 2023.
- Stats SA stated that on the production (supply) side of the economy, weaker manufacturing, mining and construction were the driving forces of downward momentum.
- Six of the ten industries on the production side of the economy performed poorly in the first quarter, with manufacturing being the largest negative contributor, declining by 1.4% and pulling GDP growth down by 0.2 of a percentage point.
- Agriculture recorded the largest positive contribution during the quarter, with the industry expanding by 13.5% pushed mainly by a "buoyant" horticulture sector that recorded a rise in the production of fruit.
- The trade, catering & accommodation, personal services and finance, real estate & business services industries also registered positive growth, but only just managed to keep their heads above water. The personal services industry was slightly stronger due to positive growth in health and education.
- On the expenditure side, government consumption, household consumption, investment (gross fixed capital formation and changes in inventories), exports and imports were all down in the first quarter
- The decline in exports was mainly due to weaker exports of precious stones and precious metals, vehicles & transport equipment (excluding aircraft), chemical products, base metals and mineral products. The decline in imports was largely influenced by decreased trade in mineral products, vehicles & transport equipment (excluding aircraft) and vegetable products.
- Gross fixed capital formation remained under pressure for a third consecutive quarter. The 1,8% decline was led by weaker investment in machinery & equipment, residential buildings and construction works.
- Household final consumption expenditure also decreased, with consumers cutting back on spending, particularly on clothing & footwear, transport, miscellaneous goods & services, alcoholic beverages, tobacco & narcotics, and recreation & culture.

Inflation

- Stats SA's latest report on inflation revealed that annual headline inflation cooled down to 5.1% in June, slightly down from May's 5.2%. Inflation has remained within the 3% to 6% range for the past 10 months.
- On food inflation, the annual rate for food and non-alcoholic beverages edged lower to 4.6% in June, declining from its recent peak of 14.0% in March and reaching the lowest reading since September 2020, when the rate was at 3.8%.
- Housing and utilities recorded an annual inflation rate of 5.5% in June, down from May's 5.8%. Housing rentals are reported to have increased by 0.8% in the second quarter of 2024, with imputed rentals edging higher by 0.7% over the same period.

- Annual transportation inflation on the other hand “cooled” to 5.5% in June, from May’s 6.3%, with data showing that there is a lower demand for new passenger vehicles and that sales declined by 9.0% year-on-year in June.
- Fuel prices dropped by 4.6% between May and June, taking the annual rate for fuel to 7.6% from 9.3%. On the strength of global oil price declines, South Africans can expect further fuel price decreases in August. This is according to the Central Energy Fund (CEF)’s data.

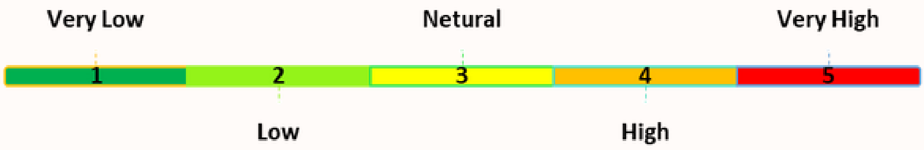
Repo Rate Remains Unchanged

- The SARB’s Monetary Policy Committee (MPC) decided to keep the repo rate unchanged at 8.25%, with the prime lending rate remaining at 11.75%, for the seventh time in a row.
- MPC members agreed that restrictive policy remains appropriate to stabilise inflation at 4.5%.
- The other two members had voted to cut interest rates by 25 basis points (bps) due to an improved inflation outlook.
- The SARB now expects headline CPI to moderate towards the 4.5%, the bank’s midpoint target by the end of Q3, averaging 4.8% for the year. According to the Bureau for Economic Research, (BER), “this is largely supported by a stronger rand and favourable fuel price dynamics.”
- According to SARB Governor, this outlook is supported by the stronger rand and that “the implied starting point for the forecast is now at R18.35 to the US dollar.”
- However, it should also be noted that “global interest rates remain high, especially in the United States, and rates may stay higher for even longer than markets currently anticipate, presenting risks to the currency outlook.”
- The US Federal Reserve (Fed) and the Bank of England (BoE) are expected to cut rates at their upcoming meetings. This follows the People’s Bank of China’s (PBoC) decision to lower reverse repo rate, the seven-day rate used to price short-term lending, by 10bps to 1.7%, to “strengthen the countercyclical adjustments to better support the real economy. This cut was then followed by a 10bps cut in the one-year prime rate to 3.35%, the first such cut since August last year.

Potential Implications on Economic Activity Indicators

- South Africa has managed to just barely avoid a technical recession in the previous quarters; however, the country continues to face the risk as GDP continues to contract, even if it is marginally.
- Continued economic contraction and worsening business conditions could lead to job losses as companies will need to cut down on expenses, including salaries and wages.
- The new GNU will likely continue to cause uncertainty for investors as it is unchartered territory for many of them. Instability in the GNU could lead to decline in investment or complete divestment.
- However, media reports have continuously spoken on how investors were somewhat put at ease by the ANC going into bed with the DA, as opposed to the EFF and MKP. This alignment may potentially boost investment sentiment, contingent upon political developments in the coming months. Progress at SOEs like Tansnert and Eskom will also definitely go a long way towards the recovery of sectors such as mining and manufacturing which have been severely affected by service delivery failures from these entities.

Risk Index



- **Energy: 3**
- **Loadshedding**: **1**
- **Grid Collapse**: **3**
  - The implementation of load reduction across municipalities is an indicator that the grid is under strain as demand for electricity is no doubt higher in the winter season.
  - This could also lead to the return of loadshedding; however this could be kept at stage 2 as Eskom’s generation capacity has improved somewhat over the last year.
  - Eskom’s high debt burden, however, will hinder the power utility from being able to properly action some of its plans, prolonging its recovery. The Electricity and Energy Minister has cautioned that if this debt burden could easily result in a grid collapse if not addressed.
- **Water Crisis: 4**
  - South Africa continues to face a water crisis that could lead several municipalities towards a day zero situation.
  - This will negatively impact not only households, but many businesses that are rely heavily on water usage, especially those in mining and manufacturing, among others.
- **Economy: 4**
  - Not long ago, South Africa was dubbed the largest economy in Africa by the International Monetary Fund (IMF), but this does not mean that the economy is completely healthy as it continues to struggle under the weight of several economic challenges.
  - The IMF’s most recent review of the economy projected its growth level being at below 1%.
  - High crime rates and other factors that lead to worsening business conditions will continue to harm the economy as consumers will face a rising cost of living.
  - However, should inflation continue to decline and stabilise, consumers could find relief in interest rates remaining stable and possibly decreasing in the coming months.

- Furthermore, the President has committed the 7th Administration to the continued implementation of the Vulindlela programme, which has received support from all parties within the GNU.
- The Minister of Finance on the other hand has also pencilled in a primary surplus of more than R60 billion for the current year ending in March 2025, which is a target he is unlikely to deviate from.

- **Socio-political Stability: 2**
  - With elections finally over and South Africa managing a peaceful transition into the 7th Administration, the possibility of political instability is somewhat neutralised as parties have committed themselves to this new GNU.
  - However, socio-economic conditions are unlikely to drastically improve over the short-to-medium term and citizens will likely continue to feel the pinch of a high cost of living, coupled with high rates of unemployment and crime.
  - While service delivery remains a challenge, the GNU seems determined to resolve the issues troubling local government. They will likely attempt to fix as many local government issues as they can as the next local election takes place in 2 years.

END