

## Deeper into the morass

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Before we talk political economy, let's first go technical and unpack the S&P and Fitch downgrades.

(I would like to give recognition to Elna Moolman at Macquarie Equities, the number one rated economist on the JSE, for her generous help and insights on this section. All mistakes are mine.)

S&P has downgraded SA's foreign currency debt; and Fitch both foreign and local currency debt to sub-investment grade or "junk status". The distinction is important. Foreign currency debt is now junk; local currency debt not (yet).

### Local and foreign currency debt

The SA government issues bonds both in local and foreign currency. Most debt issued by government is in local currency. Foreigners thus bring in their currency, convert it to rands and then buy bonds issued by government. Foreign currency debt is incurred when the SA government issues bonds in a foreign currency like dollar or euro or yen. Of the two the local currency category is by far the biggest and most important for financing ourselves. Local currency debt is about 90% of all debt, whilst foreign debt sit at about 10%.

Local currency debt is still investment grade according to two of the three ratings agencies, Moody's and S&P. That may change. Moody's has SA on a negative watch and is reviewing the country's (local and foreign currency) ratings; S&P also has a negative outlook. So at this stage we have mixed ratings: junk on foreign currency and still investment grade on local currency; with reviews hanging.

### The music has not stopped yet

As long as local currency ratings by S&P and Moody's are not sub-investment or junk, SA still qualifies for inclusion in the World Government Bond Index (WGBI). (In a funny hierarchy of relevance, Fitch does not count for the WGBI.) Foreign funds can still buy SA bonds and money will still come into the economy.

However, if those two downgrade our local currency debt, the country will be dropped from that index; and big investment funds will be barred from buying SA bonds. In fact they will be obliged to sell what they hold – in effect disinvest. That is when the music stops.

### So what is the impact?

Even although local currency debt is not junk, the interest payable on it has increased from less than 8.5% before Pravin Gordhan was recalled from London to 9% on Friday.

Hmm... half a percent is not much, I hear some people say. On a full year's borrowings by government it amounts to about R2.6 million per day... for 365 days. That is about 8 000 RDP houses (21 houses a day) or support for about 24 000 students from the "missing middle" to go to university. Small change it is not.

Furthermore, the currency has also moved from R12.33 against the US dollar the morning before Pravin was recalled from London to R13.75 on Friday - a depreciation of about 11.5%. The petrol price will probably have to increase next month.....

### Economic growth

The biggest impact is of course on economic growth. Imagine if the governor of the Reserve Bank were to announce an interest rate increase of 0.5%. That would really hit the economy in the stomach. Effectively that is what has happened. The cost of borrowing long term money has gone up and in due course the consequences will work through the economy.

Apart from the cost of money, the reshuffle is a massive blow to confidence, as we are certain to see from confidence measurements over the next few months. Confidence is a precious ingredient of growth. Foreigners and their inflow of money are important to cover the current account deficit, but most investment still comes from locals. Losing their confidence is not a great way to get their investment. Less investment, less growth.

We go deeper into the morass of low growth and stagnant incomes. Wrong direction, period.

## The Long View

Per capita incomes in SA are now where they were in 2013. 2017 is the fourth year in which population growth will exceed economic growth and 2018 will now probably become the fifth – essentially Zuma's second term will be one of stagnating and declining incomes. With stagnant incomes, a key pillar of societal progress has been knocked over.

In the long run no society can endure income stagnation, as Brexit and Trump indicate. In SA the manifestation of the consequences of stagnation may well be a swerve to populist politics.

## Zuma in charge

In the aftermath of the cabinet reshuffle Zuma proved his complete dominance of the ANC. All his opponents had to back down, the ANC closed ranks behind him and the parliamentary caucus issued a press statement to say its members will not vote for a motion of no confidence. Precisely what happened in those Top 6 and National Working Committee meetings on Monday and Tuesday of 3 and 4 April for Mr Zuma to get such complete control is unclear, but that it was two days that changed SA's trajectory, is certain.

## Policy conference

The ANC policy conference is scheduled for the end of June. Conference will consider the policy papers already released for discussion and adopt policy positions, which must then go to the elective conference in December for final approval.

The policy papers are moderate and did not create a stir when released. Even some rightwing-ish think tanks nearly welcomed them. Given the Zuma faction's newly established power, to what extent will they impose more radical policies on the ANC?

The most concrete possibility is a proposal that the Constitution be amended (sec 25) to allow expropriation without compensation. Currently the Constitution allows for expropriation at a just and equitable price. Mr Zuma himself has proposed this change and although he has recently walked back from that position, he or his acolytes can put it back on the table.

The policy conference is where the fight between the two sides of the ANC will play out. The side that wins, or the compromise that is reached, will be vital for SA's future.

## Further political upsets

It is unlikely that there will be any further pushback against Mr Zuma inside the ANC over the next few months until the elective conference. At conference his base will support Mrs Dlamini-Zuma and it will likely come down to a contest between her and deputy-president Cyril Ramaphosa.

The motion of no confidence in parliament on 18 April is unlikely to succeed.

Several court cases involving Mr Zuma are still outstanding and they will probably be concluded towards yearend. They may or may not have a political impact.

## Longer-term impact

In the 2014 election the ANC got 62% of the vote; in the 2016 local government elections just under 55%. What could it get in two years' time, in 2019? That we do not know, but the variables are clear.

With the Zuma faction firmly in control in the ANC it is unlikely that Julius Malema and the EFF will return to the fold by 2019. The EFF will fight the election in opposition to the ANC. Cosatu's and the SACP's calls for Zuma to resign may cause some alienation and persuade some people to vote differently. As for a possible split in the ANC, let's wait for it to occur.

If the EFF and DA can navigate their own internal divisions and avoid possible implosions, they should gain further ground in 2019 at the expense of the ANC.

In fact, for both parties Zuma is the gift that keeps on giving, and they probably welcome the ANC keeping him in power. I think it is therefore unlikely that the ANC will go from 55% back towards 60% - rather the other way, down towards 50%. But for confirmation we will have to wait for 2019.

## Treasury

The cabinet reshuffle ten days ago was not just a reshuffle, it was also the fifth attack on the Treasury, starting with Nenegate in December 2015. And it was successful. Zuma's are now in complete control of the Treasury and they will no doubt gain further control when filling the vacancy of the director-general. Like Pravin Gordhan, Lungiza Fuzile is an honest and competent man, and a trained economist to boot.

Whether SA's local currency debt also gets downgraded will largely be determined by how the "new Treasury" conducts itself. Time will tell.

It is a supreme irony that an institution which was 100% built up in and by democratic SA is now being attacked and undermined by forces in that same democratic SA.

### So what?

- The cabinet reshuffle and consequent foreign currency downgrades were an unqualified set-back for SA's development. If it is followed by local currency downgrades, SA's growth path will become even harder.
- Even at this point, before any further downgrades, the cost of borrowing has gone up and the currency depreciated.
- SA's development has been retarded by four years of stagnant incomes; shovelled us towards a morass; further stagnation will get us deeper into it.
- Stagnant incomes create room for populist policies and Zuma's control of the ANC has increased the risk of that, particularly on land. Precisely how it will play out we will have to wait for the policy and elective conferences to see.
- The ANC has reached a precarious cross road; its internal contestation over the remainder of the year will be critical for SA's future direction.