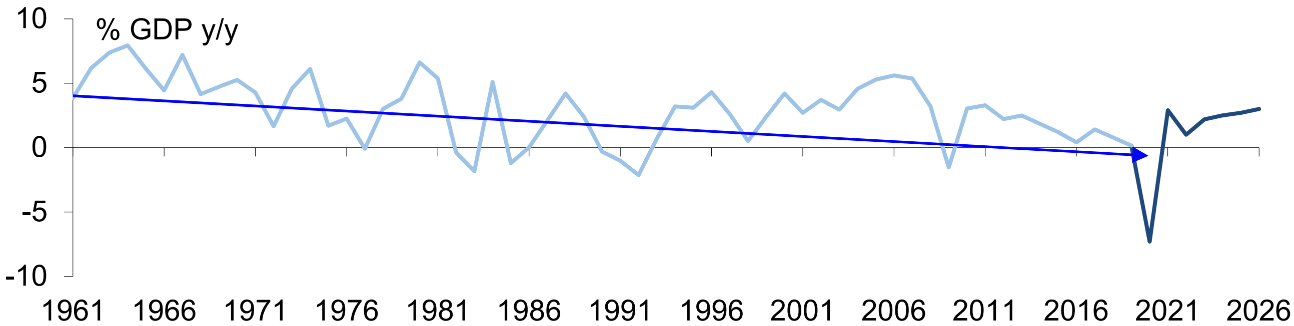
Investec

SONA preview: with insufficient progress on quickening growth, or cutting expenditure, SA increasingly faces collapse of its unsustainable finances

Tuesday 9 February 2021

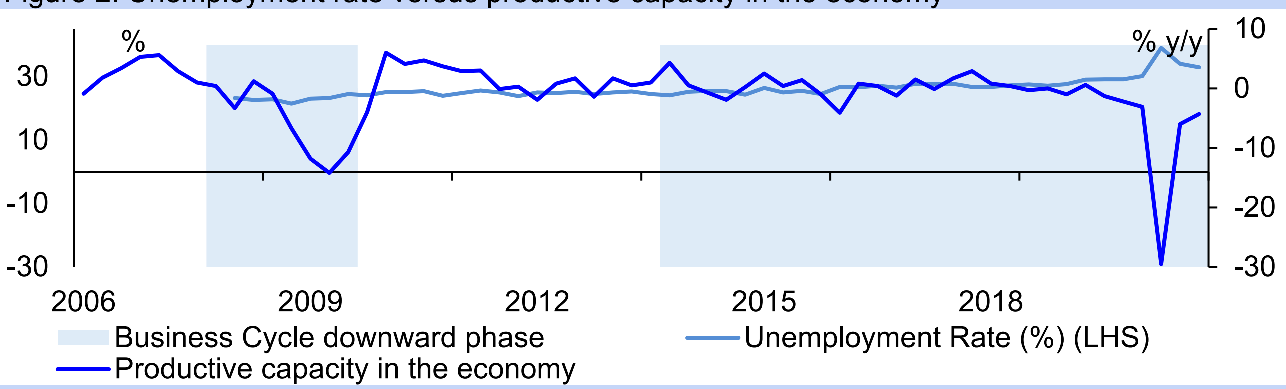
Figure 1: GDP growth (y/y %)



Sources: SARB

- The State of the Nation Address (SONA), taking place on 11th February this year, is key in the updates it provides on government's policy focus, and while COVID-19, its impact and the State's plans (delayed by the new variant) to contain the epidemic will take up a lot of airtime, an update on the ERRP's (Economic Reconstruction and Recovery Plan) goals is critical.
- However, the concern is that nothing new will be announced that meaningfully shifts the smothering regulatory burden, and so makes it easier to do business (along with rapidly actually changing the capacity of electricity production, and so improving the economic growth outlook).
- Indeed, Government's latest growth plan, the ERRP has seen few immediate goals achieved since its detailing in mid-October last year, and those that were made are mainly diagnostic, establishment of committees/funds or increased state employment. The harsh lockdowns of Q2.20 occurred before, not after, the ERRP targets were made and so some of its immediate goals should have been less optimistic.
- SA is likely to see economic growth of 2.9% y/y in 2021 as it rebounds from the -7.3% y/y collapse of last year, with an unstainable widening in government borrowings and its fiscal deficit, which provides a drag on growth. Planned government borrowings for 2021/22 sit at R4.6trillion (86% of GDP), reaching R5.5trillion by 2023/24 (93% of GDP) and 95% of GDP by 2025/26, as SA sinks deeper into a debt trap, and will garner lower credit ratings if these debt ratios are reached, moving then towards the C grade categories to reflect the increased risk of default. SA's credit ratings are likely to fall into the single B grades this year already.
- Failure to achieve, as opposed to plan, rapid economic growth and cut state expenditure is the key risk.

Figure 2: Unemployment rate versus productive capacity in the economy



Source: Stats SA, IHS, Investec (imputed Q2.20 and Q3.20 unemployment rate on consistent methodology)

Annabel Bishop • Investec Bank Limited • Tel (2711) 286 7188 • email: annabel.bishop@investec.co.za •

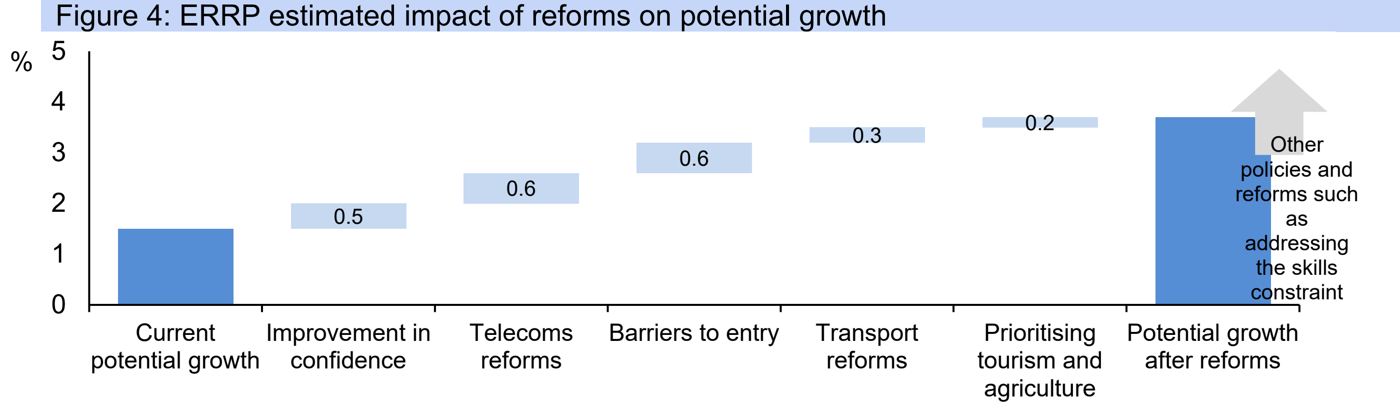
Figure 3: State of the Nation – repeating the same themes

Feb 2016 - Zuma	**Feb 2017 - Zuma**	**Feb 2018- Ramaphosa**
> Fight back against corruption	> Fight against corruption continues	> Investment drive
> Act against state capture	> Change institutions in economy	> New growth path, jobs summit
> Improve education	> Change structure of economy	> Improve education, skills
> Better life for poor	> Change systems in economy	> Improve living conditions for poor
> NHI, land reform	> Change ownership of economy	> NHI, land expropriation
> Build capable state	> NHI, land redistribution	> Fight gender based violence
> Stimulate growth, save jobs	> Reignite growth and job creation	> Strengthen capacity of state
> Reduce debt	> Education more accessible	> Fight corruption, state capture
Feb 2019 - Ramaphosa	**June 2019- Ramaphosa**	**Feb 2020- Ramaphosa**
> Economic transformation	>Transformation and job creation	> Infrastructure and Investment unit
> Job creation, education	>Education, skills and health	> Inclusive growth, create jobs
> Skills, health, social wage	>Reliable quality basic services.	>Improve education, skills
> Spatial integration	>Land expropriation, spatial integration	>Improve living conditions for poor
> Fight gender based violence	>Social cohesion, safety	> NHI, land reform
> Ethical capable state	>Capable ethical state	> Fight gender based violence
> Local government	>A better Africa and world	> Strengthen capacity of state
> Economy grow faster than population		>Fight corruption, state capture

Source: SONA

- South Africa continues to fall behind on the ease of doing business (mainly by not achieving as much as other countries in its regulatory reforms) and so loses competitiveness as a result, lessening South Africa's ability to achieve sustained, accelerating economic growth. In particular, the World Bank's latest Ease of Doing Business report shows "115 economies implemented 294 business regulatory reforms across the 10 areas measured by *Doing Business*. Most of these reforms addressed aspects of starting a business, dealing with construction permits, getting electricity, and paying taxes; the least reformed area was resolving insolvency".
- "The most common reform features included advancing the functionality of credit bureaus and registries, developing or enhancing online platforms to comply with regulatory requirements, improving the reliability of power supply, reducing certain taxes, strengthening minority investor protections, streamlining property registration processes, and automating international trade logistics. Low-income economies accounted for 11% of all the regulatory changes, with Togo implementing the highest number of reforms (five)".

Figure 4: ERRP estimated impact of reforms on potential growth



Source: Based on estimates from the Modelling and Forecasting Unit's SAGE model

Annabel Bishop • Investec Bank Limited • Tel (2711) 286 7188 • email: annabel.bishop@investec.co.za •

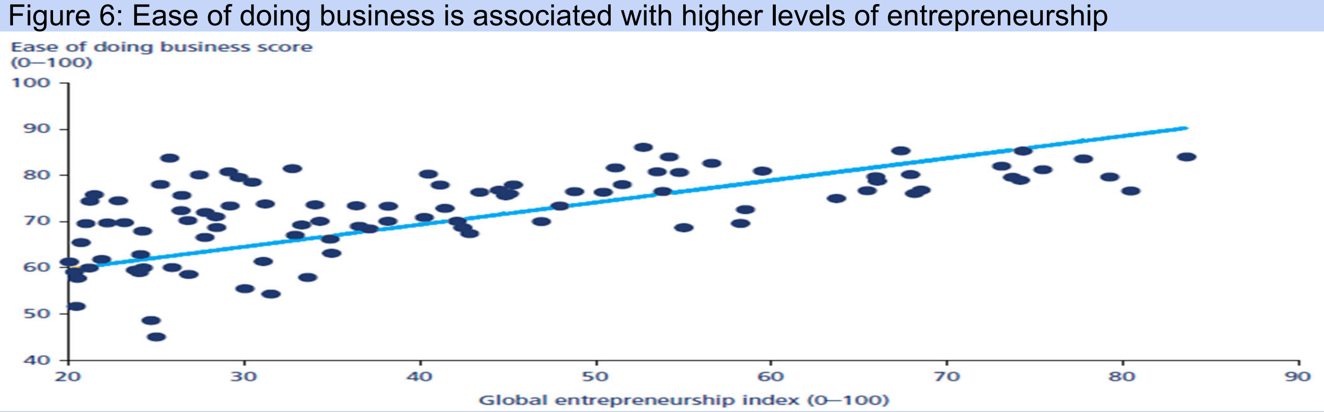
Figure 5: The 10 economies improving the most across three or more areas measured by Doing Business in 2018/19

			Reforms making it easier to do business									
Economy	Rand	Change in DB score	Starting a business	Dealing with construction permits	Getting electricity	Registering minority investors	Getting credit	Protecting minority investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Saudi Arabia	62	7.7	✓	✓	✓		✓	✓		✓	✓	✓
Jordan	75	7.6					✓		✓			✓
Togo	97	7.0	✓	✓	✓	✓	✓					
Bahrain	43	5.9		✓	✓	✓	✓	✓	✓	✓	✓	✓
Tajikistan	106	5.7	✓				✓			✓		
Pakistan	108	5.6	`✓	✓	✓	✓			✓	✓		
Kuwait	83	4.7	✓	✓	✓	✓	✓	✓		✓		
China	31	40	✓	✓	✓			✓	✓	✓	✓	✓
India	63	3.5	✓	✓						✓		✓
Nigeria	131	3.4	✓	✓	✓	✓				✓	✓	

Source: World Bank, Doing Business database

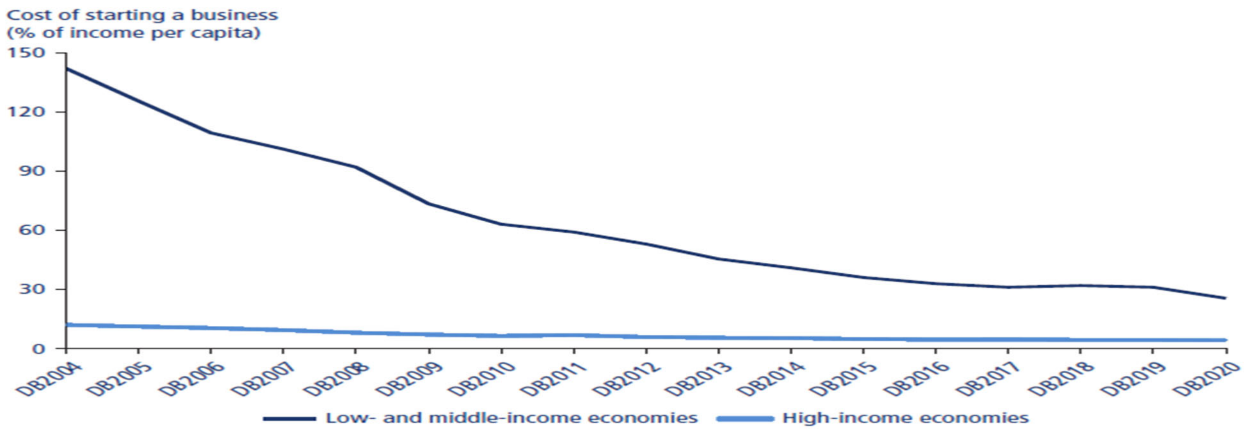
- "Bahrain implemented the highest number of regulatory reforms (nine), improving in almost every area measured by Doing Business. China and Saudi Arabia follow Bahrain with eight reforms each." The "underlying factors (that) drive economies to reform" "can be either political or economic or both. The economic advancement of neighbouring countries is also an important motivational factor. Research on the effects of market-liberalizing reforms in 144 economies over the period 1995–2006 finds that the most important factor in transmitting reforms between countries is their geographical and cultural proximity. The spill over effect is magnified when more countries adopt reforms that boost economic development.".
- "Furthermore, mass media coverage affects political decisions. A recent study finds that economies with higher media coverage of *Doing Business* tend to carry out more business regulatory reforms, with one- and two-year lags between media coverage and reform implementation." South Africa has seen mass media coverage contribute to ousting President Zuma but has also seen its press extensively used to block economic reforms by opponents to the Ramaphosa presidency, with market friendly reforms aimed at boosting economic growth even labelled "neo-liberalism" at times as factions opposing the Ramaphosa Presidency seek to undermine any economic successes, particularly those opposing real efforts to eradicate corruption and state capture.
- While this still heavily fractured and heavily oppositional political climate exists, South Africa sees a low chance of achieving sustainable economic growth of 5-6% that meaningfully works down its unemployment rate towards 10%, and allows sustainable government finances through cutting its bloated civil servants' renumeration.

Figure 6: Ease of doing business is associated with higher levels of entrepreneurship



Source: World Bank, Doing Business database

Figure 7: The cost of starting a business has fallen over time in developing economies



Source: World Bank, Doing Business database

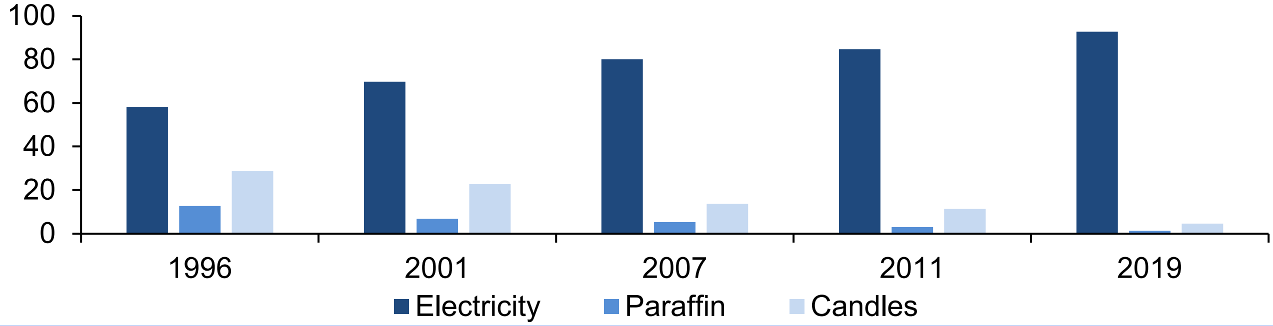
- The World Bank adds "(a)lthough *Doing Business* does not capture corruption and bribery directly, inefficient regulation tends to go hand in hand with rent-seeking. There are ample opportunities for corruption in economies where excessive red tape and extensive interactions between private sector actors and regulatory agencies are necessary to get things done." This is particularly true of both South Africa's onerous regulatory environment and its high levels of corruption. South Africa lakes true, unified outrage against corruption.
- "The 20 worst-scoring economies on Transparency International's Corruption Perceptions Index average 8 procedures to start a business and 15 to obtain a building permit. 5 Conversely, the 20 best-performing economies complete the same formalities with 4 and 11 steps, respectively. Moreover, economies that have adopted electronic means of compliance with regulatory requirements— such as obtaining licenses and paying taxes—experience a lower incidence of bribery." South Africa needs to quicken the time taken to start a business, as it also means it quickens economic growth. All these factors above stated by the World Bank seem self-explanatory, and yet many South Africans still ask why is economic growth so low, what can be done?

Figure 8: What Doing Busines measures – 12 areas of business regulation

Indicator set	**What is measured**
Starting a business	Procedures, time, cost and paid-in minimum capital to start a limited liability company
Dealing with construction permits	Procedures, time, and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system
Getting electricity	Procedures, time, and cost to get connected to the electrical grid; the reliability of the electricity supply; and the transparency of tariffs
Registering property	Procedures, time and cost to transfer a property and the quality of the land administration system
Getting credit	Movable collateral laws and credit information systems
Protecting minority investors	Minority shareholders' rights in related-party transactions and in corporate governance
Paying taxes	Payments, time, and total tax and contribution rate for a firm to comply with all tax regulations as well as post filing processes
Trading across borders	Time and cost to export the product of comparative advantage and to import auto parts
Enforcing contracts	Time and cost to resolve a commercial dispute and the quality of judicial processes for men and women
Resolving insolvency	Time, cost, outcome, and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency
Employing workers	Flexibility in employment regulation
Contracting with the government	Procedures and time to participate in and win a works contract through public procurement and the public procurement regulatory framework

Source: World Bank, Doing Business 2020

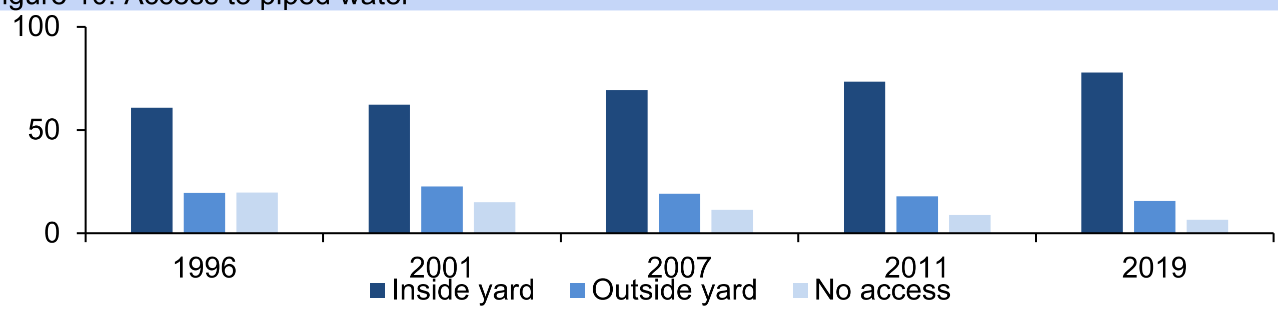
Figure 9: Energy source for lighting



Source: Stats SA

- The IMF notes, "(t)he pandemic has further exposed vulnerabilities of the South African economy. Thus, tackling long-standing fiscal and structural challenges is more critical than ever to set the stage for a robust recovery and pursue strong, durable, and inclusive growth. As per our previous advice, creating conditions to boost private investment, redefining the role of the public sector in network industries to facilitate competition, and tightening fiscal policy to rein in rapidly increasing debt are imperative." EM debt around 60% of GDP is sustainable, SA is however already borrowing to meet its current expenditure including interest payments on debt. A debt default imperils the provision of social services.
- "A growth-friendly but sizable fiscal consolidation effort over the coming years will be required to stabilize debt and put it on a declining path, thus reducing country risk premia and improving investor confidence. While phasing out COVID-19 outlays once the pandemic subsides, we encourage the government to make transfers to SOEs conditional on meeting ambitious but realistic performance targets; rationalize compensation; dismantle ill-targeted subsidies; and improve enforcement of tax compliance. This would reduce sovereign borrowing needs while preserving fiscal space for well-targeted outlays for infrastructure, health, education, and social protection." Rationalisation of all civil service renumeration, including at SOEs remains paramount if fiscal consolidation is actually to be achieved, versus default.
- "The government is rightly prioritizing the response to the pandemic. Plans to provide adequate public funding to ensure a successful vaccination process are welcome. Fiscally responsible measures to support vulnerable households and businesses would mitigate the impact of tighter mobility restrictions. We welcome the authorities' commitment to transparently disseminate the roll out of support. At the same time, and considering the challenging fiscal situation, reducing the pressure on the budget from inefficient outlays is crucial." The provision of the social wage in SA is also threatened by the rise in credit risk.

Figure 10: Access to piped water



Source: Stats SA

For readers of this report in Ireland: this report is produced by Investec Bank plc (Irish Branch) and was prepared by the analyst named in this report. Investec Bank plc (Irish Branch) is authorised by the Prudential Regulation Authority in the United Kingdom and is regulated by the Central Bank of Ireland for conduct of business rules.

For readers of this report in Australia: this report is issued by Investec Australia Limited, holder of Australian Financial Services License No. 342737 only to 'Wholesale Clients' as defined by S761G of the Corporations Act 2001.

For readers of this report in Hong Kong: this report is distributed in Hong Kong by Investec Capital Asia Limited, a Securities and Futures Commission licensed corporation (Central Entity Number AFT069) and is intended for distribution to professional investors (as defined in the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)) only. This report is personal to the recipient and any unauthorised use, redistribution, retransmission or reprinting of this report (whether by digital, mechanical or other means) is strictly prohibited.

For readers of this report in India: this report is issued by Investec Capital Services (India) Private Limited which is registered with the Securities and Exchange Board of India.

For readers of this report in Singapore: this report is produced by IBP and issued and distributed in Singapore through Investec Singapore Pte. Ltd. ("ISPL"), an exempt financial adviser which is regulated by the Monetary Authority of Singapore as a capital markets services licence holder. This material is intended only for, and may be issued and distributed in Singapore only to, accredited investors and institutional investors, as defined in Section 4A of the Securities and Futures Act, Cap. 289 ("SFA"). This material is not intended to be issued or distributed to any retail or other investors. ISPL may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Singapore recipients of this document should contact ISPL at the above address in respect of any matters arising from, or in connection with, this report.

For readers of this report in Canada: this report is issued by IBP, and may only be issued to persons in Canada who are able to be categorised as a "permitted client" under National Instrument 31-103 Registration Requirements and Exemptions or to any other person to whom this report may be lawfully directed. This report may not be relied upon by any person other than the intended recipient.

The distribution of this document in other jurisdictions may be prohibited by rules, regulations and/or laws of such jurisdiction. Any failure to comply with such restrictions may constitute a violation of United States securities laws or the laws of any such other jurisdiction.

This report may have been issued to you by one entity within Investec in the fulfilment of another Investec entity's agreement to do so. In doing so, the entity providing the research is in no way acting as agent of the entity with whom you have any such agreement and in no way is standing as principal or a party to that arrangement.