

# SA Junked – again by Nolan Wapenaar

As you probably know by now, we've been junked again. S&P have pushed us down one notch to BB whilst Moody's have put a negative outlook on our Baa3 rating. This was to have been expected, however, it still comes as a blow.

The immediate impact is that South Africa will be removed from the Barclays Government Bond index, triggering what we estimate to be about R50bn of bond sales. We remain a part of the Citibank World Govt Bond Index by virtue of the Moody's rating. One further downgrade from Moody's will trigger the avalanche of bond sales that everyone is fretting over.

It's been a challenging month for Flexible Income Funds as an asset class though we hope to report a small gain (touch and go) for the month. Our overweight US Dollar position means that we are well positioned for last night's rating actions and I don't foresee massive fall out for our clients. Bonds were already cheap in anticipation and whilst they will get cheaper, it's unlikely to be too dramatic.

The rating agency commentary from S&P centers around our lack of growth. Policies have focused too much on how to give money away and less on growing the economy (basically the populist stance). It is bizarre that they are concerned about quality job creation and the quality of education whilst our government decries them to be agents of western capital. For S&P it's all about growth and fiscal consolidation. They openly say that indirect taxes will not address the problem and it is clear that government made some representations about reducing the deficit. With our credibility shot, S&P just didn't buy what they were told. Moody's seems to have heard the promises of fiscal consolidation, have whipped out the Sword of Damocles and said they wait for Feb's full budget. Clearly that means higher taxes for South Africans cause the message that government is too big for our country is not being received well by the ANC. There will be no appetite to cut the govt wage bill headed into 2019.

The ANC has failed to grasp that politics is about economics. If you keep the economy growing then the population is happy and the party keeps power. If you throw a wet blanket over your economy it slows and dissent arrives. If you destroy the economy then the population cheers the downfall of Mugabe (eventually). On the growth front the ANC's NDP (5 years later and I doubt 10% of our cabinet have read it), the Nine Point Plan our new Ten Point Plan and that seven point action plan from Gordhan all deserve the bin. Those lofty plans have become relics that we dust off when we need to placate the rating agencies or the investors who have been financing our government excess.

Government seems to have lost sight of what they're trying to achieve. The mining charter is a great case in point. The mining sector is saying no, labour unions are saying no, all independent analysts are saying no and the ANC is saying that we are not to tell them what to do. They can push through legislation if they want. The irony is that labour unions are now siding with business in an attempt to curtail destruction of our economy. Perhaps this will become the new normal? It has become apparent that even the unions are accepting that continued low economic growth leads to further job losses. The problem with corruption is that politicians are so busy jostling for survival and positions that they just do not have enough time to do their jobs. We find ourselves rudderless with opportunist policy making aimed at surviving to another day.

If economics and politics go hand in hand then the February budget is vital for the ANC. A downgrade by Moody's (who will have an itchy trigger finger) will cause a massive sell off of bonds and another wave of consumer pessimism and job losses. There is a realistic expectation that the ANC will find themselves campaigning for 2019 in the midst of a recession of their own making.

All is not lost. There are two key aspects of economics that we need to accept and embrace. Firstly, free markets are the most efficient allocators of resources and growers of an economy. Free markets are not the same as pure capitalism. We should allow businesses to grow with a profit motive (whilst preventing exploitation). We should break Eskom into parts creating a number of independent power producers to compete, delivering power to the grid at a fair price. If the Russians want to come build a nuclear plant to produce power then let them. They can own their plant, finance their plant and manage their plant. We will buy the electricity as long as it's cheaper than we get elsewhere. By embracing this concept that society will act in its best interests, we get away from this concept that our inexperienced Energy Minister is smarter than all the rest of society combined.

The second aspect of economics we need to embrace is that people respond well to incentives and poorly to threats. It's fun for politicians to denounce the private sector. Thing is these threats just alienate job creators. We note that last week the ANC's Jesse Duarte made a speech about needing someone to stand up to mining bosses. How does this end? Again, the ANC is courting job losses and reduced tax income. This ends with the ANC cutting social grants cause they can't finance them without those taxes. We can't keep beating down employers and then finding ourselves mystified when there are no jobs. Perhaps it's time to incentivize growth and education. Time to celebrate success and grow success.

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