



Mr H wrote to me asking why I was so strongly opposed to selling shares because of the Capital Gains Taxation issue even, he pointed out, when I knew there was a strong probability of a big share market decline in the offing?

Since ShareFinder suggests that a “second wave” of global market declines is now under way, it is timely to address the vexing question of CGT which is known to bring little benefit to the fiscus since it mostly costs more to administer than it in fact brings in.

So, let's take a practical example in my own portfolio. Like most folk who follow my columns I bought Naspers @ R368.94 a share back in June 2011 and it has done exceptionally well for me, so much so that it represents an uncomfortable unbalanced position in my personal portfolio representing 18 percent by value of a 21-share portfolio.

Most analysts would argue that such exposure, particularly bearing in mind that I, as a consequence of the recent share allocation, also hold Naspers offshoot Prosus making up a further 9.4 percent which makes mine a dangerously unbalanced situation which could severely damage my personal capital position if anything were to happen to these two shares.

Furthermore, bearing in mind that the major part of both of these companies' assets rest in the Chinese company Tencent in an era of rising tensions between China and the West that are being stoked by a maverick US president whose actions could easily lead to an accidental war of quite underestimated proportions, these holdings thus constitute a considerable risk.

Unfortunately, when then Minister of Finance Pravin Gordhan some years ago reneged on a previous promise not to change the level of dividend taxation when we moved from “withholding taxes” to a dividend tax and then a year later doubled both dividend tax and capital gains taxation in South Africa, he made it impossible for investors like myself to properly and safely manage our retirement savings and, more to the point, drove away massive sums of foreign investment capital which this country so desperately needs. Foreign investors inevitably shun countries whose economic policies are unpredictable and, most of all, they dislike Finance Ministers who break their promises.

If you doubt the latter point, just look what has happened to the Rand this week in the wake of South Africa taking a loan from the IMF... simply because investors do not believe South Africa is capable of honoring the promise it made to the IMF ahead of taking the loan.

So, let us examine what CGT means to a potential transaction in Naspers shares. At the market peak recently, they stood at R3 277.70 compared to the price I paid of R368.94 a share. So, my gain has been R2 908.76 per share. I hold the shares through a trust and so 66.6% of the gain is taxed as CGT at 40%.

Thus, were I to sell any of these shares, the Receiver would take 26.64 percent of the proceeds. But of course, it does not end there.

There is brokerage, VAT, Strate STL and IPL to add to the cost of selling which, in round numbers, will add at least another one percent and, of course, when I re-invest the money a further 0.64 percent of costs would be added. All in all, then, I would be in for 28.28 percent of my invested capital if I sold at the current price in order to re-invest elsewhere.

I would thus need to be sure that the share was likely to fall by at least this proportion in any forthcoming bear market in order **just to break even** on the transaction. However, as my graph shows, in the past decade Naspers has fallen only three times below its mean. In 2011 it fell 17.3% from its peak to a price well below its mean. In 2018 it fell 31.4 percent and this year, one of the worst overall market declines in a century, it fell 29.5%.



So, if I anticipated another market decline, I might work with the averages of these three which is 27 percent. So, ahead of an average bear market, I would clearly be worse off if I cashed in my shares.

The problem is, however, though I have, in ShareFinder, arguably the world's most accurate warning system of approaching bear markets, no system yet devised is so far able to quantify the likely extent of a bear market. Thus, it should be plain that, within the current cost structure, selling ahead of an anticipated major market it is rarely if ever warranted.

Now you might argue that Naspers is an exception to the rule, so let us consider the Blue-Chip index as a whole over the past decade. Here, the market has fallen only ONCE below its mean; in the current extended bear market which began in January 2018, so I can obtain no average guidance whatsoever there!



So, what about a well-known Blue Chip like Mr Price which has recently been under-performing the Blue-Chip five-year compound average dividend growth rate of 13.87 percent compound with an average of only 11.09 percent? Well here again the share price has fallen only once below its mean and that is in the current phase which has it now at R127.76 below its 2020 peak value of R192.40. That is 33.6 percent down. However, it is important to note that ShareFinder projects that Mr Price is in a rising trend which could see it around R158 in January. So here again past history could not have offered me guidance and I might miss out on a coming gain!



To be strictly accurate in this calculation let's rather turn to the JSE Overall Index. My table on the right lists EVERY bear market over the past 40 years. As you can see there have been 19 of them with an average decline of 23.5 percent. So again, here it would not pay me to cash in my Naspers shares.

JSE Overall Index bear markets 1987 Onwards										
Hi Date	High	Low	Lo date	Gain %	Decline	Run avg	Weeks to peak	Weeks dwn		
		10070	2 Aug 85							
19 Oct 87	28040	15170	12 Feb 88	178.45	-45.90	-45.90	84.6	16.4		
19 Mar 90	33920	25270	30 Jan 91	123.6	-25.50	-35.70	109.3	45.2		
7 Sep 94	60530	50540	31 Jan 95	139.53	-16.50	-29.30	188	20.6		
6 Aug 97	76140	59900	9 Jan 98	50.653	-21.33	-27.31	131	22.2		
20 Apr 98	83580	46940	11 Sep 98	39.533	-43.84	-21.43	35	20.4		
17 Jan 00	92260	66320	17 Apr 00	96.549	-28.12	-18.30	70.3	13		
18 May 01	94080	73800	21 Sep 01	41.858	-21.56	-16.41	56.4	18		
21 May 02	115400	73612	25 Apr 03	56.369	-36.21	-16.22	34.4	48.3		
3 Mar 04	111785	97481	18 May 04	51.857	-12.80	-10.96	44.5	10.6		
11 Oct 07	315311	251351	23 Jan 08	223.46	-20.28	-9.08	177.2	14.6		
22 May 08	332329	178144	20 Nov 08	32.217	-46.40	-10.52	17.1	26		
14 Feb 11	330941	283912	8 Aug 11	85.772	-14.21	-7.81	116.4	25		
29 Jul 14	522421	466734	15 Oct 14	84.008	-10.66	-7.04	155.1	11.1		
24 Apr 15	551883	476312	24 Aug 15	18.244	-13.69	-6.07	27.2	17.3		
4 Nov 15	546090	462820	21 Jan 16	14.65	-15.25	-3.59	10.2	11.1		
30 May 16	544741	489359	6 Dec 16	17.7	-10.17	-3.11	18.4	27.1		
25 Jan 18	616848	510377	7 Dec 18	26.052	-17.26	-3.32	59.2	45.1		
23 Apr 19	595448	537273	3 Oct 19	16.668	-9.77	-2.91	19.4	24		
20 Jan 20	591046	371749	19 Mar 20	10.009	-37.10	-4.13	27	9		
AVERAGES					68.80	-23.50	-14.69	72.67	22.37	

But what about investors who do not work through a family trust? For the latter CGT is applied at 33.3 percent of their normal tax rate. The problem here is what is "normal?" Well a total of 4.92-million people paid income tax in South Africa in the last tax year of which the largest group were in the income range of R90 000 a year to R500 000+ who were responsible for 14.8 percent of taxes collected. According to SARS, however, the "average" tax rate in South Africa in the last financial year was 41 percent. Thus, one might conclude that these folks would have to pay 33.3 percent of 41 percent or an actual 13.65. Add in the transactional costs of a successive sell and buy and we thus get a total cost of 15.29 percent.

Thus, we might conclude that to justify selling in anticipation of a coming bear market, the average investor would need to expect a decline of considerably more than 15.29 percent which, compared with the average bear market of 23.5 percent, suggests it **might** be a worthwhile gamble. But do bear in mind that such a transaction would only have been really justified in just **seven of past 19 bear markets!**

In short, I have seldom, if ever, seen a good argument for selling a Blue Chip ahead of a pending market decline. But how else can one periodically re-balance a portfolio to take into account the different price growth rates of individual shares within it? My solution is, quite simply, to NEVER draw down more than 50 percent of your dividend income and use all of that saving to invest constantly in new Blue-Chip opportunities. That way, the few underperformers in your portfolio, will in time dwindle into insignificance in their growth-limiting impact upon your total portfolio.

This approach does change the way one goes about building a retirement income portfolio because it implies that you need to create TWICE the capital you would otherwise need to meet your retirement living costs. However, if you start out with this objective in mind it is not an impossible task. It just requires a bigger savings effort.

Alternatively, you might have to budget to live on a lot less in your retirement. But the vital thing to always remember in building your retirement nest egg – indeed arguably the most important objective – is to build in safety and security.

Before I leave the subject of selling shares, there are, of course, always a few long-term good performers which over time lose their gloss. I recently cited Sasol as an example of such and it is these that you should earmark for disposal at such times as a major bear market is anticipated; when you are seeking to create a “war chest.” In such cases I personally try to free up around ten percent of the overall value of my portfolio.

As I recently described in this column, I did exactly that this year ahead of the March Crash, realising ten percent of my portfolio which enabled me to take significant advantage when the market bottomed while simultaneously locking in a significant capital gains loss which I will be able to use to my advantage in the future.

City Lodge

Just a passing note on City Lodge’s fund raiser to sustain itself through the pandemic, if like me you held this share you will be aware that the company has offered shareholders the right to take up new shares on a basis of 13 new shares for every one currently held at a price of R2.12.

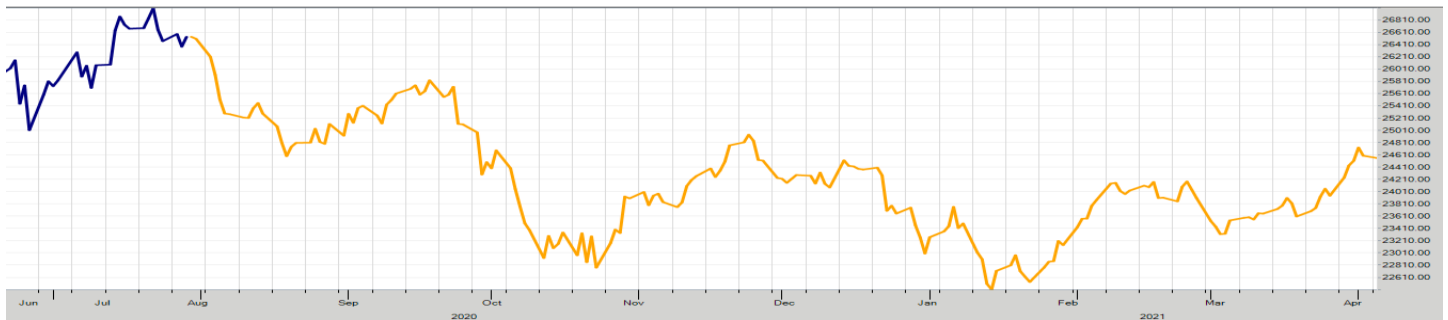
Since this would involve the average shareholder in a costly outlay which, in a time of practically no dividend income many who might be unaware that “Letters of allocation” can be sold in sufficient quantity to fund the purchase of some of your allocation. Trading in the letters opened this week at 60 cents a share.

If you care to do the math, at this price you can get to keep 3.2 of every 13 shares you are allocated at **no cost to yourself**. In effect you get to quadruple your holdings at no cost and, since the shares fell from a ruling price of R18 at the end of July to R4.66 yesterday, you would have been marginally ahead in your total investment if you had adopted this strategy. You have until the close of trading today to take up your rights.

Do enjoy your weekend!

The months ahead:

New York's SP500: I wrongly predicted last Friday would see the start of the next down-hill phase until September followed by a run-up to the end of September before another down-trend to next February. I believe the decline has, however, merely been delayed for ShareFinder still projects its imminence. Note the Dow Jones Index has been declining exactly from the time I predicted it would:



London's Footsie: I correctly predicted the decline which began on June 23 and still see it lasting until the end of August. It is likely to be followed by a recovery trend lasting until mid-October and then down again until late January.

Germany's Dax: I wrongly predicted it would be down-hill until the end of August followed by gains until the third week of October and then a final run down until early December. Again, I believe this has merely been delayed and I expect declines until the 17th at least.

France's Cac 40: I wrongly predicted a decline until mid-August but again I believe it has been delayed. I see it lasting now until the 17th-20th followed by recovery until late September and then a final decline until the end of November.

Hong Kong's Hangsen: I correctly predicted the start of a volatile recovery until late September followed by a decline until mid-month before a long but quite volatile up-trend until the end of December.

Japan's Nikkei: I correctly predicted gains until the third week of September and then down-hill again until mid December.

Australia's All Ordinaries: I wrongly predicted the down-turn would last until the third week of August before the last up-surge until mid-September before going a volatile down-hill until late November. The recovery began on August 3 but the remaining projection is still in place.

JSE Industrial Index: I correctly predicted a brief recovery ahead of a decline until the end of August. I now see the decline beginning mid-week and lasting until the end of the month followed by a three-week recovery and then a volatile decline until mid-January.

JSE Top 40 Index: I prematurely predicted a decline until early September but the beginning is imminent and it will be followed by a very volatile down-hill trend until mid-January.

ShareFinder JSE Blue Chip Index: I correctly predicted a gain followed by a volatile decline starting now until late January. In the short-term I see gains from the 21st until late September within an overall declining trend.

JSE Gold shares: I correctly predicted a volatile down-turn lasting until the first week of September followed by a recovery until early November and I still hold that view.

Gold Bullion: I correctly predicted a brief, possibly month-long, interim decline within a long recovery likely to continue well into 2021.

The Rand/US Dollar: I correctly predicted gains a short period of weakness until the 5th followed by gains until +/- August 24 ahead of a long volatile weakening phase until mid-February.

The Rand/Euro: I predicted the current weakness would last until now. From here I see gains until early November.

The Predicts accuracy rate on a running average basis since January 2002 has been 85.87%. For the past 12 months it has been 95.74%.

Richard Cluver

White Swan threats loom

By Nouriel Roubini

Nouriel Roubini teaches at New York University's Stern School of Business

At the start of 2020, when Covid-19 was barely on anyone's radar outside China, the global economy was entering a fraught phase, facing a range of potentially devastating tail risks. And though the pandemic has since turned the world on its head, all of these threats remain – and some have become more salient.

In February, I [warned](#) that any number of foreseeable crises – “white swans” – could trigger a massive global disturbance in 2020 I noted that:

“...the US and Iran have already had a military confrontation that will likely soon escalate; China is in the grip of a viral outbreak that could become a global pandemic; cyberwarfare is ongoing; major holders of US Treasuries are pursuing diversification strategies; the Democratic presidential primary is exposing rifts in the opposition to Trump and already casting doubt on vote-counting processes; rivalries between the US and four revisionist powers are escalating; and the real-world costs of climate change and other environmental trends are mounting.”

Since February, the Covid-19 outbreak in China did indeed explode into a pandemic, vindicating those of us who [warned](#) early on that the coronavirus would have severe consequences for the global economy. Owing to massive stimulus policies, the Greater Recession of 2020 has not become a Greater Depression. But the global economy remains fragile, and even if a V-shaped recovery from highly depressed output and demand were to occur, it might last for only a quarter or two, given the low level of economic activity.

Alternatively, with so much uncertainty, risk aversion and deleveraging on the part of corporations, households, and even entire countries could result in a more anaemic U-shaped recovery over time. But if the recent surge of Covid-19 cases in the United States and other countries is not controlled, and if a second wave occurs this fall and winter before a safe and effective vaccine is discovered, the economy would likely experience a W-shaped double-dip recession. And with such deep fragilities in the global economy, one cannot rule out an L-shaped Greater Depression by the middle of the decade.

Moreover, as I predicted in February, the rivalry between the US and four revisionist powers – China, Russia, Iran, and North Korea – has accelerated in the run-up to November's US presidential election. There is [growing concern](#) that these countries are using cyber warfare to interfere with the election and deepen America's partisan divisions. A close outcome will almost certainly lead to accusations (by either side) of "election-rigging", and potentially to civil disorder.

The Covid-19 crisis has also severely exacerbated the Sino-American cold war regarding trade, technology, data, investment, and currency matters. Geopolitical tensions are escalating dangerously in Hong Kong, Taiwan, and the East and South China Seas. Even if neither China nor the US wants a military confrontation, increased brinkmanship could lead to a military accident that spins out of control. My warning in February that the Sino-American cold war could [turn hot](#) has become more salient since then.

Why are financial markets blissfully ignoring these risks? After falling by 30-40% at the beginning of the pandemic, many equity markets have recovered most of their losses, owing to the massive fiscal-policy response and hopes for an imminent Covid-19 vaccine. The V-shaped recovery in markets indicates that investors are anticipating a V-shaped recovery in the economy.

In the Middle East, I expected that Iran would escalate tensions with the US and its allies – especially Israel and Saudi Arabia. But, given Trump's increasingly evident weakness in the polls, the Iranians have evidently opted for a policy of relative restraint, in the hope that a victory for Joe Biden will lead the US to rejoin the 2015 nuclear deal and loosen US sanctions. But, sensing that its strategic window is closing, Israel has reportedly been launching [covert attacks](#) on a range of Iranian military and nuclear targets (presumably with the Trump administration's tacit support). As a result, talk of Middle East-related "[October surprise](#)" is increasing.

I also raised concerns that the Trump administration might use sanctions to seize and freeze China's, Russia's, and other rivals' US Treasury holdings, prompting a sell-off of Treasuries as these countries shift to a geopolitically safer asset like gold. This fear, together with the risk that large monetised fiscal deficits will stoke inflation, has since caused a spike in gold prices, which have [risen by 23%](#) this year, and by more than 50% since late 2018. The US is indeed weaponising the greenback, which has recently weakened as US rivals and allies alike seek to diversify away from dollar-denominated assets.

Environmental concerns are also mounting. In East Africa, desertification has created ideal conditions for biblical-scale [locust swarms](#) that are destroying crops and livelihoods. Recent research [suggests](#) that crop failures due to rising temperatures and desertification will drive hundreds of millions of people from hot tropical zones toward the US, Europe, and other temperate regions in the coming decades. And other recent [studies](#) warn that climate "tipping points" such as the collapse of major ice sheets in Antarctica or Greenland could lead to a sudden catastrophic sea-level rise.

The links between climate change and pandemics are also becoming clearer. As humans increasingly encroach on wildlife habitats, they are coming into more frequent contact with bats and other [zoonotic disease](#) vectors. And there is growing concern that as the Siberian [permafrost melts](#), long-frozen deadly viruses will resurface and quickly spread around the world as Covid-19 did.

Why are financial markets blissfully ignoring these risks? After falling by 30-40% at the beginning of the pandemic, many equity markets have recovered most of their losses, owing to the massive fiscal-policy response and hopes for an imminent Covid-19 vaccine. The V-shaped recovery in markets indicates that investors are anticipating a V-shaped recovery in the economy.

The problem is that what was true in February remains true today: the economy could still quickly be derailed by another economic, financial, geopolitical, or public-health tail risk, many of which have

persisted and, in some cases, grown more acute during the current crisis. Markets are not very good at pricing political and geopolitical – let alone environmental – tail risks, because their probability is difficult to assess. But, given the developments of the past few months, we should not be surprised if one or more white swans emerge to shake the global economy again before the year is out.

Apocalypse just now: Can SA's economy still be saved?

By Claire Bisseker writing in Business Live

SA is in a terrible bind. After a decade of economic mismanagement and rising debt, its public finances are hopelessly overextended just as the country faces its worst recession since the 1930s. The national mood has seldom been gloomier. A recovery plan, led by government and backed by business, is the last throw of the dice. But with confidence in tatters, and Covid-19 having hollowed out the economy, many fear it's too late to save SA

For years commentators have warned that SA is at a tipping point, nearing the fiscal cliff, approaching a debt trap or standing at a crossroads where it must choose the high road to faster growth or take the low road to economic Armageddon. The question now, as the country suffers through the peak of the Covid-19 pandemic — and with the national mood soured by the government's bungling of the lockdown rules — is whether it's all over for SA. Can the country pull out of its death spiral or have we left it too late to fix the economy?

In junking SA's sovereign credit ratings, all three of the major ratings agencies have effectively said SA has lost the battle. Put simply, they don't believe enough structural and fiscal reform will occur to raise SA's growth rate sufficiently to stabilise its galloping debt trajectory.

Increasingly, private sector economists are also losing faith in the ability of Cyril Ramaphosa's government to turn things around. Across the 10 economists canvassed for this story, most believe SA will be lucky to implement 20% of the structural economic reforms required to raise the growth rate, and that the debt-to-GDP ratio will probably burst through the 100% barrier in the next few years.

Many think the funding pressure will ultimately push SA back into the arms of the International Monetary Fund (IMF) — next time, for a full structural adjustment programme. Others fear the government will turn instead to quixotic policies that run down the domestic savings base, or adopt coercive levels of taxation, or force the Reserve Bank to print money to bail out the government.

Either way, without a dramatic change in direction, the endgame is that SA's economy will become rapidly smaller and poorer, social tensions will rise and, over time, infrastructure and assets will be run down until the country looks just like any other poor backwater.

"Five years ago, we still had a choice on how to get out of our economic mess," says University of the Free State economics professor Philippe Burger.



"It was a choice between immediately taking a smooth road out of the mess with a more-or-less gentle incline or postponing till later, when the road would become rocky, steep and long.

"We did not take the gentle road and that road is not an option anymore. To get out of the economic mess only the rocky, steep and long road remains, and unless we start walking it, it will become even steeper."

Wits University professor Michael Sachs, the former head of the National Treasury's budget office, says when he was in the Treasury the strategy was "to kick the can down the road" in the hope that political buy-in and consensus would be achieved in time.

"That would've been fine if it weren't for Covid," he says. "The pandemic has completely ruled out a continuation of that strategy. It's a different world now."

His previous view was that SA wouldn't be hit, in the medium term, by a sovereign debt crisis. Now he thinks that is unambiguously where the country is headed.

BNP Paribas economist Jeffrey Schultz says SA is not necessarily past the point of no return, but the risks have never been as big nor the scope for a much larger political, social and economic disaster more real.

To independent economist Thabi Leoka, the future of SA remains "precarious", and "it is increasingly difficult to see how we can execute a U-turn".

"The pandemic should give us an opportunity to start afresh and correct behaviours which led to increases in debt ... Instead, we continue to make the same pre-Covid-19 mistakes of spending unnecessarily and misallocating funds," she says, citing the decision to put more money into SAA, even though air travel has ground to a halt.

If SA doesn't act swiftly, "we'll be knocking on the doors of the IMF by October 2021", she warns.

Crunching the numbers

This surfeit of gloom is not because economists are by nature a dour bunch. The group ranged from Ramaphosa's evergreen economics adviser Trudi Makhaya at the one extreme, to perennial bear Peter Attard Montalto of Intellidex at the other.

The pessimists believe that, after a decade of economic mismanagement, SA is already too far down the low road and that there's no realistic prospect of changing course now. There is a deep, abiding skepticism founded on the government's failure to lift the binding constraints on growth and its inability to discipline the patronage networks and vested interests that make doing business so costly and inefficient.

But opinions and forecasts can be wrong. After all, economists are not fortune tellers, and the future can be full of surprises. So what does the data say? Sadly, there is no denying that SA is in deep trouble.



The country has just completed its worst growth decade on record — averaging just 1.35% since 2009. The slowdown has been particularly pronounced over the past five years. In fact, South Africans have been getting poorer since 2013 on a per capita basis.

Too many people have too much hope — some change might happen if people abandoned hope and started recognising the scale of the crisis to come - Peter Attard Montalto

With the country in a recession since late last year, unemployment continues to rise. In the first quarter of the year it topped 30% for the first time, with only 16.3-million people employed, compared with 18-million on social grants. Adding in discouraged work-seekers, almost 10-million people are effectively unemployed.

The preliminary estimates of the [National Income Dynamics Study: Coronavirus Rapid Mobile Survey](#) are that a further 3-million people have lost their jobs since the coronavirus outbreak. Another 1.5-million have been furloughed and may not all have jobs to go back to.

The steady decline in SA's growth over the past decade has been mirrored by a steady rise in public debt, from a mere 26% of GDP in 2009 to the Treasury's latest estimate of 81% for 2020/2021. Before the virus struck, the debt estimate for this year was 65%. That's a terrifying escalation.

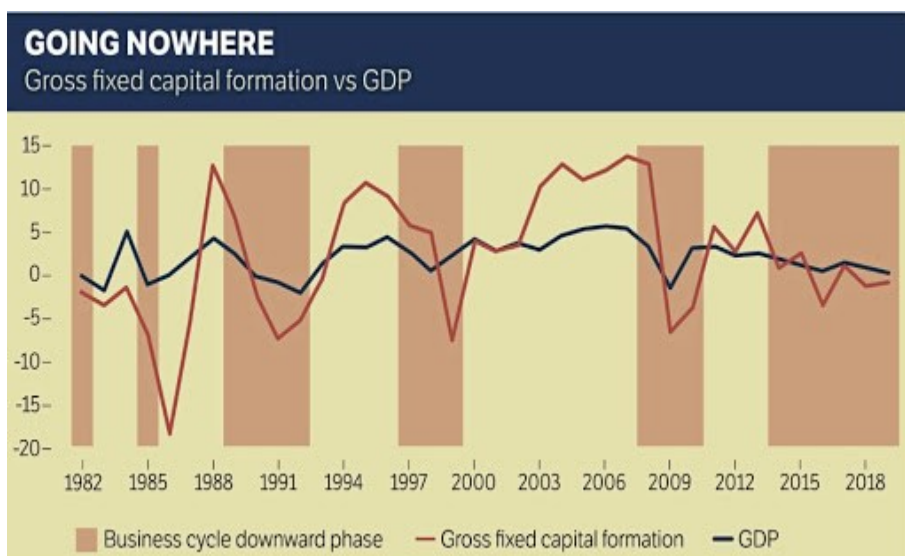
Finance minister Tito Mboweni says public finances are "dangerously overstretched" and unless they are brought under control, SA will shortly experience a sovereign debt crisis (when it can no longer pay back the interest or principal on its borrowings).

The results would be devastating: interest rates would rocket, government spending would screech to a halt, inflation would take hold and everyone would be poorer. The National Treasury estimates that a fiscal crisis could cut more than R2-trillion from SA's nominal GDP over the next decade.

"This is what happened to Germany in the 1920s, to Argentina and to Zimbabwe in the early 2000s, and to Greece in the past few years," Mboweni said in his supplementary budget speech in June. "Argentina had its ships attached. Greek civil servants and pensioners had their salaries and pensions slashed. In short it is doom and despair."

An S&P Global Ratings' "heat map", which provides a comparative risk profile of 16 emerging markets, says only Argentina is currently flashing more red lights than SA.

On a scale of one to six, where one is the strongest score and six the weakest, SA scores two sixes for its fiscal deficit and debt trajectory, and a dismal five for its economic profile. Only Argentina and India's fiscal profiles score as poorly.



SA's debt level and gross financing needs are also flashing red in the IMF's debt sustainability analysis, given that the starting point of SA's debt ratio at 81% is already above the IMF's high-risk threshold of 70% — the level at which other emerging markets have encountered debt distress. When further standard shocks are modelled, SA's debt ratio rapidly shoots over 100%.

For instance, it shows that if real GDP growth were to average one percentage point lower than the Treasury's estimates over the next five years, the debt ratio would reach 104% of GDP in 2025.

We now find ourselves sitting on the highest debt pile in our history, arguing about printing money and waving ideological banners at each other - Lesetja Kganyago

Reserve Bank governor Lesetja Kganyago expressed concern in a recent lecture at Wits University that SA would follow Argentina's path, where ideological conflicts and unstable macroeconomic policies have produced a steady economic decline.

"As a country, we have got ourselves into a lot of trouble," he said. "We are struggling to learn the lessons of these mistakes, and to achieve the consensus to fix them. And we are running out of time."

Compared with SA's early accomplishments post-1994, he said, "we now find ourselves sitting on the highest debt pile in our history, arguing about printing money and waving ideological banners at each other".

Mboweni's and Kganyago's frank assessment of the country's predicament stands in sharp contrast to Ramaphosa's. The president recently asserted that SA possesses "all the ingredients for an economic recovery" and that by the time the global recovery takes hold "our initiatives to reform and improve the business environment will establish a firm platform for industries with high potential to flourish" — as if reform in SA takes a matter of weeks or months, not years.

Ramaphosa's confidence stems from the headway the government is making in finalising a post-Covid recovery plan that builds on the areas of agreement between the road maps of the ANC and Business for SA (B4SA). There are also solid points of overlap with many of the reforms the government has already agreed to, arising from Mboweni's growth document.

For instance, everyone agrees that a joint infrastructure push, which draws in private-sector skills and funding with a strong focus on green energy-related investments, is the place to start.

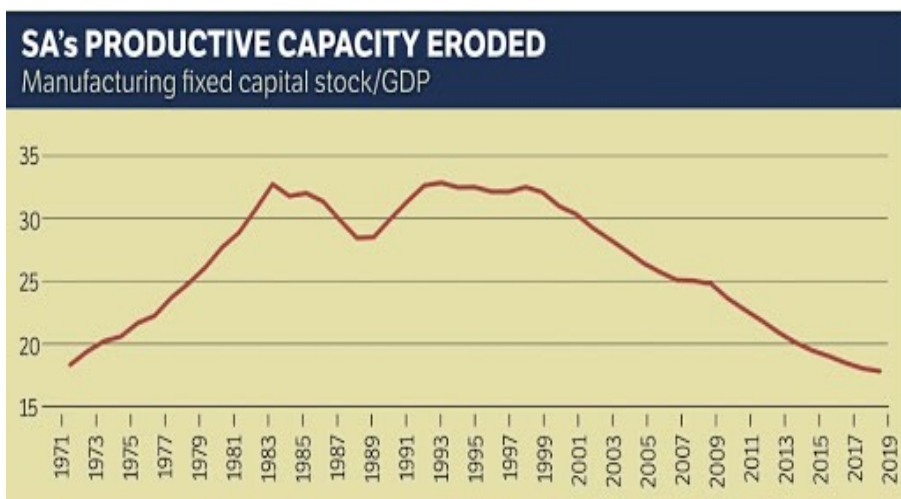
There is also broad consensus that SA must improve the efficiency of all the network industries — energy, rail, water and telecommunications — including by expediting digital migration and spectrum allocation to reduce data costs. Focusing on unblocking the barriers to regional integration to boost SA's flow of exports into the rest of Africa is another area of convergence.

"It would be self-defeating to despair when most of the economic challenges we face are well known and the sets of proposed solutions have a high degree of overlap," says Makhaya.

She agrees that the pace of reform needs to be stepped up, but says the government's response to Covid-19 "has shown what is possible in terms of speed of decision-making and implementation".

To the doomsayers she responds that "government, business and labour need to resist the strong, ever-present temptation to 'boil the ocean' and rather focus on a few catalytic initiatives that will deliver the most impact".

Makhaya stresses that the government has identified a solid pipeline of infrastructure projects and is committed to the policy reforms needed to realise these investments. Working with the government, industry players have whittled the list down to 55 multiyear bankable projects which are close to being brought to market.



Source: SA Reserve Bank

We're no longer at the precipice, we've to a certain extent jumped and we need to begin to apply these [reforms] with urgency to open up some parachutes so that we can have a softer landing - Cas Coovadia

She adds that growth and investment initiatives, or sectoral masterplans, have been concluded as partnerships between business, labour and civil society in the automotive, poultry, clothing and textiles, and sugar industries.

Many others, including on the green and digital economies, are under development.

Regarding SA's fiscal deterioration, Makhaya notes that "expenditure reviews are already under way and a fresh, bottom-up look at the budget [zero-based budgeting] will ensure evidence-based consolidation".

Other commentators have argued that the persistence of load-shedding shouldn't detract from the shift in the government's attitude towards self-generation and the need to accelerate the procurement of renewable energy.

In addition, the spectrum auction is on track for November, while administrative reforms should continue to ease the cost of doing business.

In response to the charge that SA has left it too late to reform, many would argue that it's never too late to do the right thing.

Sanlam Investments economist Arthur Kamp, for instance, still has hope that SA will choose not to self-destruct. He argues that with so much risk already priced into the local bond market, one shouldn't underestimate how quickly things could swing around if SA were to undertake a few of the reforms most likely to have the greatest impact, especially on energy and telecoms.

"These reforms, combined with proper fiscal consolidation focused on reducing consumption, could start to change the narrative about SA and the expectation that it is on a one-way ticket to further ratings downgrades," he says. "If so, we would start to attract foreign capital again, which would lower real interest rates, allowing the Reserve Bank to do more."

This view is broadly shared by B4SA. In its recovery plan, it argues that the nation has arrived at a fork in the road. Protecting the status quo, with only marginal changes, will lock SA into an accelerated downward trend.

But if the government is willing to make difficult choices, and follow a data-driven approach, this could enable "a new narrative" to take hold about SA's potential, spurring confidence and growth.

"The Covid crisis has created a situation where we're at a T-junction and have one or two choices," said Business Unity SA CEO Cas Coovadia, speaking on BizNews Radio. "The wrong choice takes us into a failed state; the correct choice puts us onto a long, hard road to economic recovery to which we all need to contribute."

STARK TRADE-OFFS REQUIRED		
The more departments are excluded, the bigger the cuts required from the remaining ones		
	Percent/ total budget	Percent/ noncompensation budget*
What is needed to achieve the R100bn cuts required in 2020/2021		
Percent cut needed if all departments are included	10%	19%
Percent cut needed if the following departments are excluded:	20%	32%
Health		
Social development		
Police		
Defence		
Correctional services		
Percent cut needed if the following departments are further excluded:	25%	42%
Human settlements		
Transport		
Water & sanitation		
Percent cut needed if the following departments are further excluded:	27%	46%
Basic education		
Higher education		

Source: National Treasury * Note: The noncompensation budget = the total budget minus the wage bill

Business is under no illusion as to how desperate SA's situation has become, with Coovadia adding that "SA is no longer at the precipice, we've to a certain extent jumped, and we need to begin to apply [reforms] with urgency to open up some parachutes so that we can have a softer landing than we otherwise would've had."

Business is hoping for "a new form of partnership" with the government and envisages SA's reconstruction being driven by joint teams of heavy-hitters from both sides.

The ANC is also seeking a new social compact in which "business will be required to look beyond profits" and "workers, beyond the next round of wage negotiations".

While it's positive that both sides want to work together, all that consensual bargaining has achieved under Ramaphosa is watered-down compromises and zero growth. This cannot replace decisive leadership and bold action if SA is to avoid a death spiral.

Debt trap snapping shut?

If SA was spiraling into a debt trap before the pandemic struck, surely the virus, by derailing the economy, must have snapped the trap shut once and for all?

There are at least five reasons to think that this may well be the case.

First, Covid-19, by destroying millions of livelihoods, has caused the need for social support to explode at a time when SA's fiscal position has never been weaker.

To prevent a humanitarian disaster, which would further hamper SA's economic recovery, the government is extending temporary Covid-19 relief and considering a basic income grant. This is despite Mboweni's undertaking to the IMF, in exchange for a R70bn low-interest loan, that these temporary measures would be phased out.

However, without a resurgence in economic growth, there is a real risk that temporary measures will become permanent entitlements. All this will cost money that the government doesn't have.

"I have little doubt that this pandemic will be the straw that breaks the camel's back in SA," says Stellenbosch University researcher Nic Spaull. He fears that without bold, decisive leadership and new ways of sharing wealth, SA "will continue towards a dystopian future with islands of excess sitting precariously on a sea of poverty".

Fiscally, SA is completely outmanoeuvred. Not only is there no money for new spending after a decade of unsustainable fiscal policy, but SA has no choice but to cut existing spending, and raise taxes, into the worst recession since the 1930s.

To unlock the IMF loan and get the debt ratio to stabilise at 87% by 2023/2024, the cabinet has agreed to cut spending by R230bn and hike taxes by R15bn over the next two years.

This will further dampen short-run economic growth and could prove self-defeating. But not doing so would invite a calamitous fiscal crisis that could unravel all the social gains SA has made over the past 26 years. So, we are damned if we do but even more damned if we don't. This is the second reason why SA is completely ensnared.

[The jobs reckoning is here: 3-million jobs lost](#)

The Nids-Cram survey suggests Covid-19 has had a much greater impact on employment than expected: an estimated 3-million jobs lost, and 1.5-million employees furloughed

The only sustainable solution to the funding dilemma is for the government to partner with the private sector. There is widespread agreement that SA's recovery plan should rest on a strong public-private partnership model whereby the private sector builds, operates and finances far more public infrastructure than it does at present.

Only, the partnership solution doesn't quite add up — at least not with a resurgence of capital inflows.

This is the third reason why the trap appears to have sprung shut. Quite simply, the government cannot borrow R761bn this year and at the same time hope to crowd in private sector investment when the country's total savings pool is likely to be only slightly more than R800bn.

"Because the government is absorbing so much of the country's savings, there is not a big enough domestic funding or savings pool for the private sector to sustainably raise investment while also buying up all the government bonds on offer to cover the existing fiscal deficit," says Kamp. "So how is it supposed to 'partner with government' to fund new expansionary plans?"

The fourth reason why SA has its back against the wall has to do with Eskom's inability to sustainably raise electricity production. While SA's power supply is expected to become slowly more reliable, the restoration of full capacity will take years. Until that happens, load-shedding will kick in as soon as growth picks up, muting any recovery — but SA cannot escape its fiscal trap without growth.

Last, the Covid crisis has shut the trap by laying SA's leadership failure bare for all to see. The way in which the government has mishandled the pandemic has ended the denial of those who might otherwise have continued to extend to Ramaphosa the benefit of the doubt.

As a result, confidence has collapsed — and how is a government supposed to promote growth when its credibility hangs by a thread? The danger, should the government not change tack decisively, is that negative economic sentiment will become even further entrenched.

One can hardly blame a president for wanting to put a positive spin on things, but by being so out of touch Ramaphosa just makes himself seem deluded

Politically unpalatable options

Does this mean there is no hope of SA avoiding a sovereign debt crisis?

"Too many people have too much hope — some change might happen if people abandoned hope and started recognising the scale of the crisis to come," says Attard Montalto.

The chief argument among those who don't see any hope of SA extricating itself is that the country has left it too late to get its house in order. They argue that after years of living large, the degree of fiscal austerity required to stabilise the debt ratio is now so huge that the sacrifices required are politically impossible for the government to make while retaining its hold on power.

To put the required R250bn fiscal adjustment in perspective: all SA's fiscal consolidation efforts since 2014 have managed to shave just R70bn off expenditure. It will also require SA to run a primary budget surplus — something it has not achieved since 2008, at the end of a long commodity boom.

In practical terms this will require a major reduction of services to the population and in the state's involvement in the economy. It is doubtful if the cabinet, in agreeing to the cuts, realises they will involve political decisions about whether to continue to provide, for example, free housing, free higher education, or fund an army of 76,000 people of which only 10% are operationally fit.

If there were a blizzard of action on energy reform, or the state pulled the plug on SAA, it would signal that it appreciates the scale of the problem and is prepared to do things differently. But there is no evidence yet that the pandemic and looming fiscal crisis are causing a fundamental rethink or a change in the "soul" of the government.

"The question that really needs to be asked is how reform can happen without a shock with only the same ideas on the table and deep contestation," says Attard Montalto.

"SA's politics and the president's willingness to deploy political capital won't shift until SA has suffered a severe shock that truly disrupts the ANC's vested interests and rent extraction [networks].

"Covid wasn't enough of a shock, load-shedding wasn't enough, falling over the fiscal cliff edge might just be enough. How else are you meant to suddenly adopt all the existing plans on the table?"

For people in the "hopeless" camp, the fact that the government has latched onto zero-based budgeting and a joint infrastructure programme as solutions, signals not hope that the shock of the pandemic is forcing unprecedented collaboration, but more evidence that everyone remains in denial.

While zero-based budgeting (where each year everything is costed from scratch) could be helpful in forcing departments to review and justify their expenditure, the situation is long past the point where scrambling for efficiency gains through better budgeting can save the day.

Pretending there are technical solutions to SA's fiscal crisis simply allows the government to delay making the tough political calls on ending whole programmes, cutting wages, retrenching workers and closing down some state-owned entities (SOEs).

The corruption around PPE contracts demonstrates again the arrogance of the party, which will sink us if it wins in 2024

Similarly, it's all very well as a starting point to say: "Let's build infrastructure together." But that won't get SA far if building more roads, railways and schools becomes another way of avoiding the harder decisions, such as whether to enforce e-tolls, allow private rail concessions, or tackle union influence over the appointment of educators.

So, in all likelihood, the government will believe right up until the final whistle that all the things it is doing — the zero-based budgeting, the infrastructure summits and pipelines, the task teams and SOE advisory councils — are evidence of real, productive change. But there is no dodging this bullet; SA's fiscal reckoning has arrived whether the country is ready or not.

Does this mean SA is already over the fiscal cliff or caught in a debt trap?

Technically, a country with a rapidly rising debt ratio is in a debt trap when the government is unable to raise more revenue through increasing tax rates and/or reduce government expenditure to levels needed to stabilise the debt ratio.

At first, when it is not clear if a country is in a debt trap — the situation in which SA now finds itself — it is still able to sell bonds to finance its debt by offering higher interest rates, even though this will severely increase its interest obligations.

However, as its debt burden keeps increasing, it will probably find it harder and harder to find buyers for its bonds. Once it cannot find buyers, the debt trap shuts.

This means SA's fate will in large part be determined by its creditors. Foreigners do not yet see SA as a basket case. If they did, they would be exiting in droves. Despite the March hiccup, when SA had sizeable portfolio outflows, capital flows have broadly stabilised — though they generally remain below those of our emerging market peers.

However, Rand Merchant Bank chief economist Etienne le Roux warns that it would be a mistake for the government to assume that the status quo will prevail without it delivering on its debt stabilisation plan.

"While for now at least foreigners seem to have bought into the strategy of balancing growth-boosting reforms with fiscal rigour, I cross my fingers that minister Mboweni does not disappoint in October when he is supposed to put more flesh on the bones of his debt-consolidation plan," says Le Roux. "Even diehard investors have a limit to the patience they have shown SA in recent years."

Deputy finance minister David Masondo finds his stride

David Masondo has the unenviable task of championing the National Treasury's pro-growth reforms to a ruling party that has shown little appetite for policy change

Dashing for the exit

The main danger SA faces is a rush for the exit when everyone realises the game is up and starts dumping SA assets en masse. The rand would nosedive, inviting the Reserve Bank to hike interest rates. SA would probably be forced into a recession and would become poorer overnight. To quote Mboweni, it would be "doom and despair".

Of course, the trap might not shut in a dramatic, textbook fashion. In SA's case, because of the favourable currency composition and term structure of our debt, it is more likely to be a long, drawn-out process than a sudden, cataclysmic event. This is especially so if the global monetary policy environment remains as supportive, post-Covid, as it is expected to be.

A likely scenario is that, after an initial rebound in 2021, SA's growth rate will continue to disappoint. This will be partly because of the government's likely failure to deliver the adjustments and reforms promised. It will also be because of the deep scarring caused by the pandemic, coming after a decade during which the country's competitiveness and productive capacity has been steadily eroded.

The prospect of a weaker growth outcome is just one of several "significant downside risks" flagged by the IMF in the statement accompanying its R70bn loan.

It also warns that SA could face higher contingent liabilities from weak SOEs, challenging wage negotiations, and rising borrowing costs, particularly if the government's reform strategy is delayed or lacks credibility with investors.

The IMF practically pleads with SA to bolster the credibility of its reform and fiscal consolidation commitments with steadfast implementation, saying there is "a pressing need" to do so.

Such is the IMF's scepticism that Mboweni and Kganyago have agreed, in their letter of intent backing up the loan application, to consider introducing a debt ceiling.

This is something the IMF has been urging for years but that the Treasury has always dismissed as unnecessary.

Commitments aside, the bottom line is that if SA is unable to shift the needle on growth, investors will at some stage realise that the government is unlikely to have the tax revenues to service its growing debt mountain and they will stop wanting to hold SA debt.

That realisation will be hastened if the government panics and starts to pursue wayward policies such as coercive prescribed asset requirements, confiscatory levels of taxation or widespread quantitative easing.

WHAT IT MEANS:

It's time to stop pretending everything will be OK as long as we work together; more likely is that everything will end in tears

So far, the government has resisted alternative policies, with the Treasury and Bank strongly opposed, though increasingly marginalised. Its preferred route is to negotiate "voluntary" prescribed investments into public infrastructure with SA's R4.2-trillion pension fund industry, mindful that pensioners will not easily allow their savings to be run down in aid of a hopeless project.

Even so, some economists think it's more likely that SA will take the wayward option than secure a complex, conditionality-based IMF structural adjustment programme, or a similar bailout from the Chinese, as neither will loan cheap money to a country that has shown itself unable or unwilling to reform.

Considering how severely the odds are stacked against SA, the time has clearly come to stop pretending everything will be OK in the end as long as we work together. It is far more likely, given our appalling track record of the past 10 years, that everything will end in tears.

As an up and coming but now itinerant chef from Cape Town said recently: "Living in SA now is what it must be like to be married to an addict: there are moments of rare beauty, but mostly all you want is for them to take responsibility and be honest. Unfortunately, it's normally best to leave so that you don't go down with them."