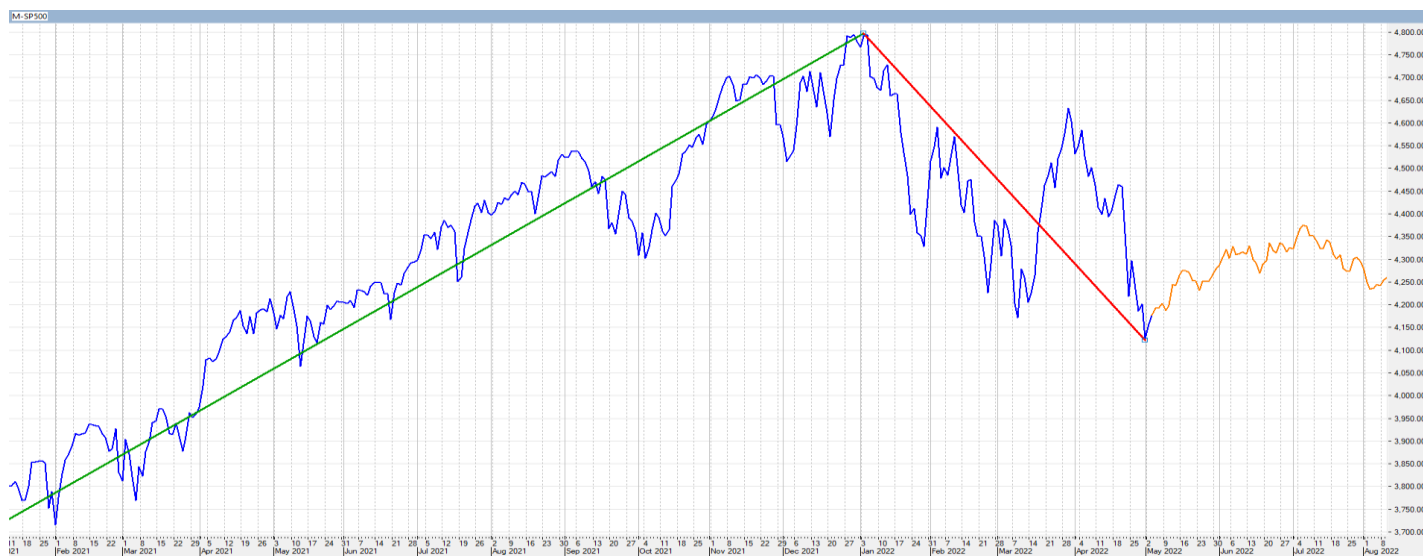


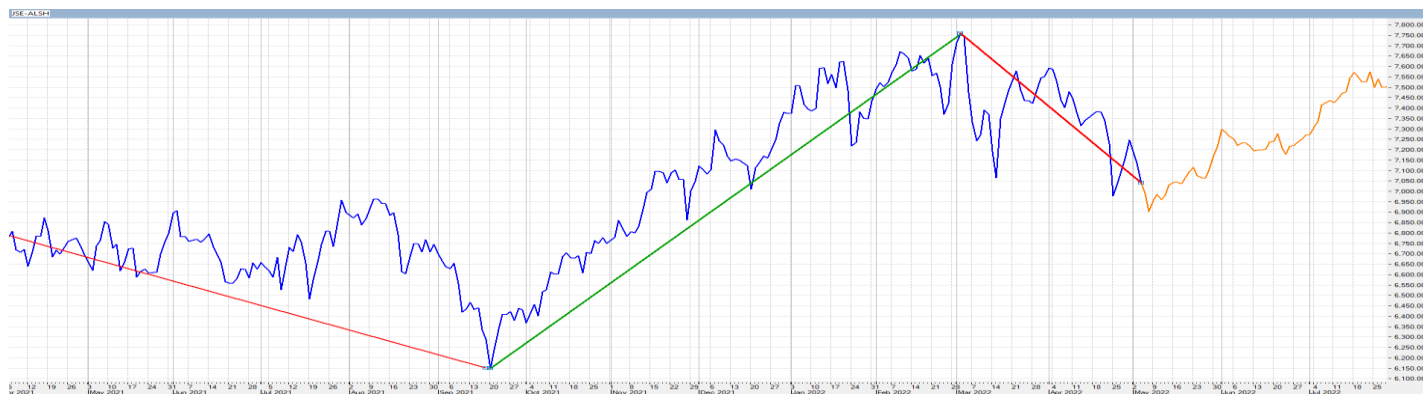


**The US Federal Reserve this week announced its biggest interest rate increase in over 20 years as it has begun to get serious about the North American inflation problem which is currently threatening to get completely out of control.**

Ironically, markets had expected an even steeper increase and so the consequence of the Fed action was a three percent gain of the Standard and Poors 500 Index. However, as the following graph so clearly illustrates, the gain was merely a brief positive blip on a graph which has been headed resolutely downwards and, since the start of the year, has obliterated ALL of the gains of the previous year:



And though the JSE was a little slow to play catch-up, it has also been headed down since early March. However, as the red projections on the right of each of the graphs illustrate, ShareFinder calculates that both are now due for a period of recovery until mid-July. So, if you have been bargain-hunting lately, you are probably running out of time!



Unlike most South Africans whom I speak with, I have become reasonably positive about South Africa's future and particularly so since reading the column by local economist JP Landman which I reproduced in **The Investor** in February and, in case you missed it, I have again reproduced at the end of this column. The gist of Landman's thesis is that the Ramaphosa administration has since early 2019 chosen the route of structural reform and has one-by one been getting rid of the key obstacles which have been holding this country back.

I know most of us are heavily influenced in their thinking by news reports which clearly suggest that the ANC is now totally at war with itself. That being so it is by no means certain that the Ramaphosa faction will triumph in the long term over the forces of darkness that have ensured the re-election to high office of highly tainted individuals such as the former Mayor of Durban. However, most analysts are reasonably confident that Cyril will remain in control until the next election in  $\pm$  May 2024, but that seems to also imply that in order to retain power he is forced to retain allies like Gwede Mantashe in positions of power and that in turn almost guarantees that we will continue to slip down the international rankings in critical areas like the provision of mining rights and our migration to renewable energy.

It is surely untenable that we have slipped down the rankings of organizations like the Fraser Institute from one of the world's top miners to one of the worst. But with a backlog of more than 4 000 mining and prospecting rights applications within Mantashe's Department of Mineral Resources and Energy and the latter's understandable reluctance to end coal's domination of our energy systems given that he is reportedly answerable to a large contingent of heavily-mortgaged black entrepreneurs who have bought up twilight coal mines which global investors have been shedding like leaves in autumn, it is a conundrum which the President needs to solve.

There is clearly a long road to travel, but at the same time as economists bewail things like the burden of an overpaid and often incapable public service, we have our ears pinned back by SARS CEO Edward Kieswetter who obviously feels confident enough to publicly proclaim it is imperative that we replace patronage with meritocracy within the public service. Speaking at a conference on reforming South Africa's public service, he said that the job of rebuilding the SA Revenue Service had not been easy. The Nugent Commission of Inquiry into SARS did not tell the full story of how badly things had declined. "SARS experienced a massive failure in governance and integrity," he said, overseen by "compromised and corrupt leadership".

After visiting SARS offices countrywide, Kieswetter said he had detected "high levels of trauma" within the organisation, and an erosion of employee morale — for those employees who remained. "We had to deal with an organisation which had lost more than 2,000 staff since 2014."

"We are not declaring victory, but we are encouraged by the signs," Kieswetter said, adding however, that the rebuilding project was not all smooth sailing. "We still have those who are in denial of State Capture and provide subtle opposition. We experience opposition to the rebuilding mandate very directly."

Having just returned from ten days in the Cape where we travelled extensively without ever seeing a pothole in the road, saw immaculately clean streets, tidy suburbs and experienced the continued visual experience of provincial and municipal traffic police monitoring a far more orderly system than we have been used to in KwaZulu-Natal, I am refreshed by the awareness that it is entirely possible to return to a system that works.

For those apparatchiks within the ANC who dream that they will misrule forever, the experience of the KwaZulu-Natal based Gift of the Givers Foundation which has been overwhelmed with the generosity of South Africans happy to use them rather than entirely untrusted Government agencies in order to channel donations to our flooded province, the message could not be clearer: Your day in the sun is done!

South Africa is more than ready to move on. What that means for local investors is even more exciting. Given that the average dividend yield of JSE Blue Chip shares is currently 8.2 percent compared with a New York Stock Exchange equivalent of 2.4 percent makes it clear that if we could regain our status as a top grade investment destination the value of the average local share portfolio could rise by 340 percent and the Rand could strengthen by 270 percent.

It sounds like a dream but it is entirely possible. We just need to give South Africans a reason to believe in themselves once more.

# The month ahead:

**New York's SP500:** I correctly predicted an interim decline but wrongly expected a two-month recovery from the end of April. However, I believe it has merely been postponed!

**Nasdaq:** I correctly predicted an interim month-long weaker phase. Now I see a fortnight of gains ahead of a two-week dip, another brief gain and then a prolonged phase of weakness.

**London's Footsie:** I correctly predicted weakness until early May followed by a month of gains ahead of declines until early October.

**France's Cac 40:** I correctly predicted declines until mid-May followed by a brief up-tick to early June within an overall declining trend to the end of the year.

**Hong Kong's Hangsen:** I correctly predicted declines to the end of April followed by gains until the end of June when I see another sharp decline and then a recovery until October.

**Japan's Nikkei:** I correctly predicted the onset of brief weakness until late April ahead of gains until early July.

**Australia's All Ordinaries:** I correctly predicted that the brief recovery would be over by mid-April ahead of declines to the end of September.

**JSE Top 40 Index:** I correctly predicted the decline would continue until late April ahead of a three-month recovery until the end of July ahead of declines for the rest of the year.

**ShareFinder JSE Blue Chip Index:** I correctly projected a decline until the end of August.

**Rand/Dollar:** I wrongly predicted gains until the end of May, but the weakness should now be over with gains likely until the end of June.

**Rand/Euro:** I correctly predicted brief weakness ahead of further gains which have now begun and should last until early-June.

***Predicts accuracy rate on a running average basis since January 2001 has been 86.6 percent. For the past 12 months it has been 94.51 percent.***

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## ***Cyril is quietly getting things done***

By JP Landman

As far as the economy goes, South Africa's State of the Nation address (SONA) dealt primarily with structural reform in sectors like electricity, spectrum, transport and infrastructure. But even the sceptics who supported the announcement asked: it's all very well, but will it be implemented?



The easiest way to answer that question is to look back at the track record of implementation on critical economic issues. As the president himself said “The state of the nation is linked inextricably to the state of the economy”.

There is broad agreement that, without dramatic intervention, the South African economy has a growth ceiling of about 1,5% to 2,0% per year. That is about the same rate as population growth. There is no hope of dealing with the country's triple curse of PUI (poverty, unemployment, and inequality) if this doesn't change.

So, what dramatic intervention could bring revival? Two possibilities are being debated vigorously.

The first, let's call it 'easy money', is to stimulate demand by running bigger budget deficits, financed by printing money, with the central bank buying government bonds. This view states that addressing people's direst needs through more government spending will in itself promote growth. The US, UK, Japan, and others have indeed chosen this route and it has helped them – except for the small matter of inflation. This view also ignores South Africa's current account balance constraint.

The second option, let's call it 'the hard way', is to address the fundamental factors creating the growth ceiling. Stimulating demand while there's no reliable electricity supply, trains that cannot move goods, and exports that cannot leave the harbours will not help growth. It will only stoke inflation, which will hurt the poor and middle classes most. What is really needed is higher productivity in electricity, our harbours and so on. That is brought about by deep structural reform.

This SONA confirmed unequivocally what has been clear since early 2019: government has chosen the route of structural reform. So the policy choice has been made. Can government now implement the required reform? Let's consider their recent track record on the most important issue in the economy: electricity.

#### Reviving growth - electricity

Electricity reform started in **2018**, seven weeks after Ramaphosa took power, when 27 independent power producer (IPP) contracts were signed. These contracts had been suspended by Brian Molefe then at Eskom, causing South Africa's very successful renewable energy programme to simply crash. The signing didn't happen without opposition. Parties with vested interests were livid, blockading Tshwane more than once and going all the way to the Appeal Court to stop government, happily to no avail.

Later in 2018 a draft of the Integrated Resource Plan (IRP) was published for comment and consultation, as is required by law. In **2019**, the final version was promulgated. It opened the door decisively for renewables, storage and gas.

Also in **2019**, the president announced that Eskom would be split up, ending a century-old vertically integrated model built by Hendrik van der Bijl and his successors. As with the IPP contracts, there was vociferous opposition from various interest groups, and the sceptics harrumphed that it would never happen. Three years later not only has the separation taken place, and a free-standing transmission company will be legally constituted by the end of 2022.

In SONA, the president said draft legislation to create a legal framework for such a competitive market would soon be published. It was published the next morning. Among other things, it provides for a free-standing transmission company, as mentioned above. The Eskom break-up paves the way for a competitive electricity market in South Africa, a truly radical reform. The 2019 announcements are coming to fruition.

**2020** was the year of Covid-19. Even so, in October regulations were promulgated allowing municipalities to procure their own power from any source. Johannesburg Metro was first out of the starting blocks with a tender for 220 MW. Currently, eight municipalities are in the process of procuring a total of 1 400 MW.

In **March 2021**, bid window five for 2 600 MW from renewables was opened. Contracts were allocated to 27 successful bidders at the end of October.

In **June 2021**, the president announced that the licensing exemption for power generation would be lifted from 1 MW to 100 MW. Regulations giving effect to that change were published in August. Currently, an estimated 4 000 MW of projects are being pursued by various players under the new regulations. The number is likely an under-estimate as it comes from only one sector (mining) whilst we know of many other companies and private households turning to renewables.



Together with 500 MW from the tail-end of bid window 4 and 800 MW from the risk mitigation programme, this means that 9 300 MW is in the process of being added to the grid. For context, the capacity shortage Eskom wants eliminated to avoid load shedding is 6 000 MW.

In **2022**, three further bid windows will open: bid window 6 for 2 600 MW of renewable generation (end March); a small window for 513 MW of battery storage (April) and bid window 7 for 3 000 MW of gas six months later. That will add a further 5 600 MW.

The only blot on this track record is the Karpowership deal. The allegations of corruption and the inappropriate 20-year contract means it will be a blessing if this falls through.

Understandably, any conversation about electricity in South Africa is completely dominated by load-shedding and the Karpowership deal. It creates the perception that nothing is happening. Yet, under the noise and dust, a revolutionary change is playing out.

### Three other sectors

Private sector participation in **railways and harbours** has long been a goal. Some pre-conditions had to be met: separate operations from the regulatory role in both railways and harbours, determine who carries what risk, who must do the maintenance, and so on. Some of these changes have been made and others are in progress. In SONA, the president set target dates for private sector participation: April for rail (Gauteng/Durban line) and October for two harbours (Durban and Ngqura).

Should the **spectrum** auction indeed proceed on 8 March, as the president confidently stated, we could compile a similar track record on spectrum release. Like so many things under Zuma, migration languished for 10 years, and South Africa missed the 2016 deadline. It was only seriously tackled after 2018 when the relevant minister was replaced, the court fight between him and the regulator stopped, and the matter was attended to as a political priority. The critical pre-condition for release is migration from analogue to digital broadcasting. Last February, the president stated that migration will be completed by March 2022. It has proceeded on schedule and will indeed be completed by end March. Only Telkom and the courts can stop spectrum release (Telkom's application will be heard in April.) There has been more progress in the past four years than in the 10 years before that.

Again, it is however no plain sailing. Vested interests oppose, courts interdict, regulators stumble – but vision, political will and staying power still triumph. We will know on 8 March.

A similar story seems to be unfolding in **infrastructure**. I have been cautious about infrastructure, but things seem to be coming together. The president first announced an infrastructure fund in 2018; it took three years to drive it through the bureaucracy and get it established. (The president's frustration has been palpable.) Covid-19 also reduced the money available for the fund. Still, it is now operational. SONA contained detail on infrastructure projects with clear money commitments from both the public and private sectors. We will assess this track record too a year's time, but momentum seems to be building.

### What we can learn about implementation so far

The changes in the four sectors discussed above are quite radical for South African. Traditionally these sectors have been monopolised by the state. That is now changing and could not have happened without political vision, overcoming opposition, building support, harnessing technical skills and staying the course through setbacks and mistakes. It bodes very well for the implementation of SONA pronouncements.

This track record blows out of the water the notions that Ramaphosa 'just sits on his hands', 'does nothing', that 'he's afraid of his ministers', 'only appoints task teams', and 'kicks the can down the road'. If he did only those things we would be where we are now.

### Reviving investment and employment

The expansion of electricity generation outlined above implies enormous investment. New plants cost money. A back-of-the-cigarette-box calculation points to investment of more than R190 billion over the next three years and more thereafter. All the investment will come from the private sector, with about half from foreign

investors. It will shift the dial not just on investment numbers, but also employment. South Africa will be a most peculiar place if that kind of investment does not create jobs.

Furthermore, award-winning economist Elna Moolman has calculated that load-shedding has cost South Africa 1% growth a year for the last three years. That is a lot for an economy with a growth ceiling of 1,5% to 2,0%. If that constraint is lifted, the effect will be substantial, also on jobs. More investment and more jobs must mean more demand, which means more growth. Add spectrum, railways and harbours, infrastructure, and the IMF is not far out with its view that 3% growth is attainable through reforms.

### **Structural reform: a 25-year view**

The last time South Africa experienced serious structural reform was between 1990 and the early 2000s. Sectors like agriculture, road, rail and air transport, radio and television broadcasting, as well as telecommunications were all turned on their head. Trade tariffs, budgets and tax administration were also subject to drastic reform. Not surprisingly, South Africa's productivity numbers show a concomitant rise for that period.

For four years the economy grew by more than 5% per year and created more than 500 000 jobs per year – that is two million jobs in four years. So much for jobless growth... The numbers speak for themselves. Imagine for a moment if we had carried on creating 500 000 jobs a year... Granted, there was also a commodity super-cycle, but electricity was abundant, trains took exports to the harbours, and the harbours shipped them out. Now there is again a commodity boom, and we struggle to get growth going.

Back in the middle 2000s the Mbeki administration appreciated that more needed to be done and Trevor Manuel appointed an international and South African panel of experts to advise. They made common sense recommendations that are still relevant today. However, the recommendations died an early death when Mbeki was removed at Polokwane, Manuel left Treasury, and the Zuma era started. The 2010 World Cup boosted growth, bringing some reprieve, but by 2014 the game was over. Since then, we have experienced declining investment, job creation and per capita incomes. We got poorer, aggravating the problem of PUI.

Now, electricity is the one sector in which serious structural reform has been undertaken. Announcements on spectrum, rail, harbours and infrastructure in this year's SONA herald a new era of such reform.

### **So what?**

- South Africa needs drastic change to lift the growth rate above the 1,0% to 1,5% ceiling.
- The government has chosen 'the hard way' to make this happen by addressing fundamental factors holding back the economy through structural reform.
- A timeline of reform in electricity shows government has indeed implemented plans and goals over four years despite opposition, setbacks and mistakes.
- Expansion of electricity generation implies investment of more than R190 billion over the next three years, which will mean more growth, more jobs and more demand.
- Spectrum, harbours and rail, and infrastructure are the next areas of focus. We will monitor the developments.