What are the SA economy and political landscape indicating?

A view from May 2018

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Economic outlook for SA in a hostile world environment

Current data – What does it mean to us?

- Current period – greatest economic uncertainty since 1994.
- No simple or even complex certain answers.
- Priority to understand current business climate and future risks.
- Proceed within our own “discomfort zone”, only certainty is uncertainty.

Economics-Dismal Science – NO!

- Recent business climate outlook – doom/gloom/rescue – Ramaphosanomics

- Gateway to Africa – Limited potential – diminishing contribution to continent.
- SA becomes isolated in own economic backyard.

- Data analysis – different interpretations
- Art appreciation in eye of beholder – Pierneef/Picasso – No precise rules.
- Will not adopt classic economists’ traditional comments – “on the one/ other hand” not a view but an escape route/weather forecast.
- Or – “all things equal” – SA remains unbalanced, unfair and unequal – still a long journey to equal opportunity for all – right direction?
- Understand challenges in Sub-Saharan African investment infrastructure.
- SA prospects – positive/negative as fixed capital investment destination.

World economic outlook (IMF* 2018) – interesting, terrifying

- Estimates % p.a

	World	Developed economies	Developing economies	SA
GDP -2017	+3.5	+2.1	+4.6	+1.3
-2018 (est)	+3.9	+2.5	+4.9	+1.5 (pvs + 0.9)

- * historically over optimistic – Subject to downside revision.

- GDP/World Economy
  US: 23% - Post 2008 financial crisis recovery slows
  China: 14% - Industrial, consumer led consolidation
  Africa: 3% - Awaiting commodities cycle upturn – oil leads?
  SA: < 1% - Awaiting commodities cycle/ African upturn – likely long wait as technology overtakes traditional cycles eg. 3D printing reduces commodities demand

- 1996/2016 - SA GDP av. Growth +3.0% p.a.
  - Emerging Markets +5.6% p.a.
  - World Markets +3.6% p.a.

- SA electricity shortages, weak domestic demand, labour disruption, drought
- SA Reserve Bank estimate – 2018 growth subdued estimate + 1.4%.
  estimate – 2019 growth + 1.6 %
- Net real negative per person vs population estimates + 2 % per annum.
- Recession prospects remain
- SA MT cycle “no/low” growth
- SARB Dep. Gov. – I.C forecast possible/merit

- Government remains preoccupied with redressing previous social imbalances resulting in inefficient utilisation of resources.
- SA still overwhelmed by corruption, crime and inadequate service delivery - - - social unrest.
- Finance Minister – “What has happened to honesty and integrity in business?” Far too much corruption, but little improvement – public sector correction started.
- Reality check – Municipal elections – Electorate crossing the floor.
- Confirmation of change - started, continuity?
- ANC seeks strategic direction – refer IRR.
- Corruption, bloated gov workforce, wages 40% > private sector, education

- Urgent need for structural changes.
- President Zuma – R900 bn infrastructure development) Undelivered
  + Five million new jobs) Undelivered
  - Fantasy!!
- Budget Feb 2018 – Infrastructure investment – manufacturing, tourism, black industrialists, unemployment relief.
- Remains delayed as does robust growth (Bakkie builders vs M&R)
- Worst case outlook – stagflation?
- Upturn? Commodities super-cycle follows oil – Supply glut (OPEC vs US mineral sands), protect market share, low new development – limited SA export prospects, low domestic growth cycle – MT.

Global view

- Economic activity likely “subdued for longer”, lack of “robust improvement” in advanced economies.
- Following 9/11 US terrorist attacks, 2002/2007 easy credit party and subsequent bank credit crises.
- Still grappling with extended global hangover from 2008/9 global financial crisis, Lehman Bros. failed (nothing too big to fail), global debt accumulation.
- Massive liquidity injections – “No quick fix.” – liquidity remains underutilised, risk appetite withdrawn (QE reversed).

- Risk appetites slashed – skewed values – search for yield in bonds and equities (safe havens – USD, CHF, negative interest rates).
- Investment priority – return OF capital vs return ON capital
- Investor's strategy primarily to avoid loss, rather than bold strategy to maximise profit potential.
- SA foreign capital inflows reversed, JSE net foreign purchases.

  *2018: Bonds = R23 bn
  Equities = R29bn
  Total = R52 bn – "hot money".

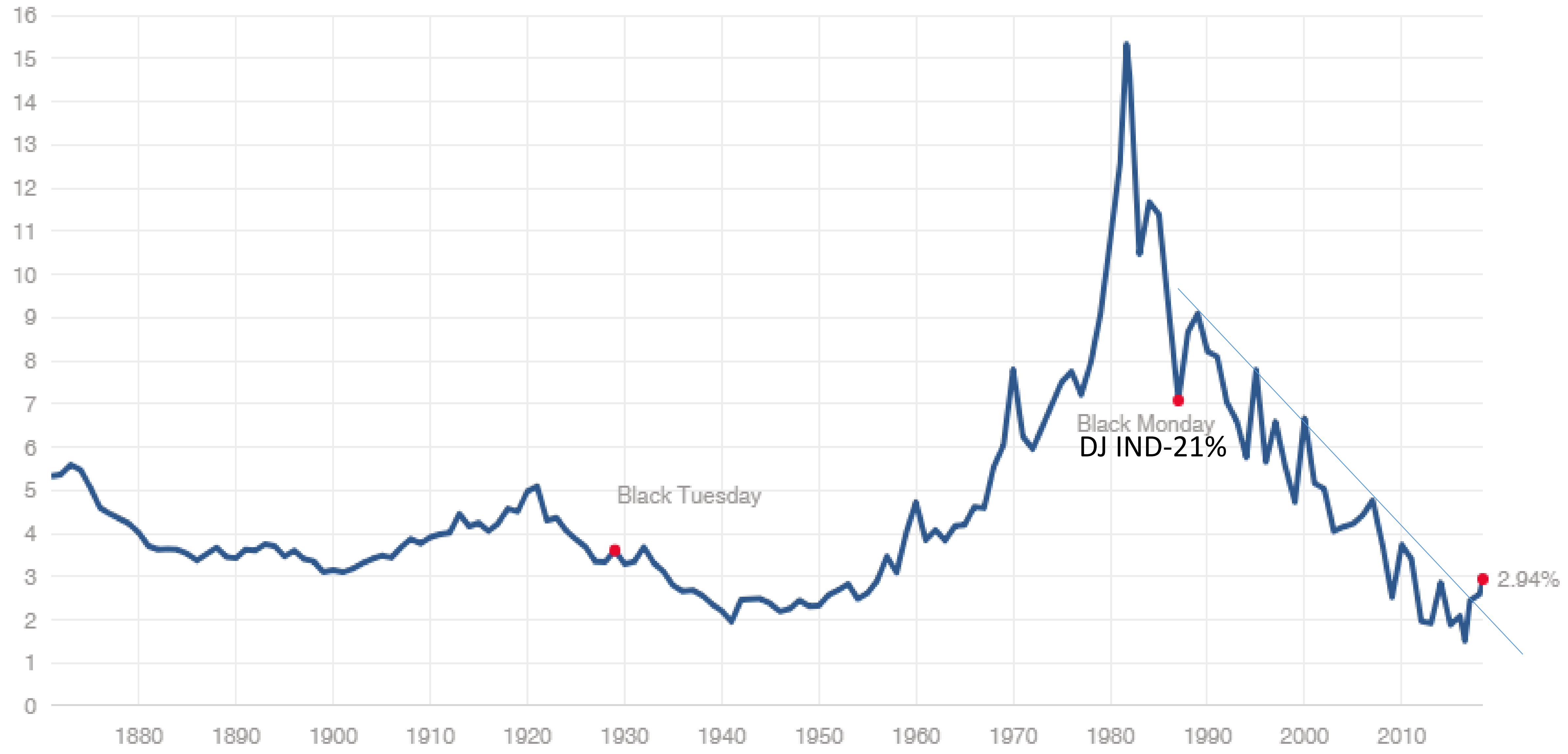
  Investor's strategy primarily to avoid loss, rather than bold strategy to maximise profit potential – not growth preference.

Global Central Banks’ strategy

- US Federal Open Market Committee asset purchase programme – total QE $3TR., awaiting significant economic data recovery (labour market, inflation, economic activity) – rate trend reversal in 2016 – moving goal posts.

- European Central Bank President Draghi “do whatever it takes to preserve the euro”- lower interest rates for longer as low economic activity persists, but must compete for capital.

US leads global declining interest rate trend reversal
US 10 year treasury – 1st trend reversal since 1985



South Africa Domestic Challenges

- Unstable labour force – demand for higher wages for “decent work” not linked to productivity, employment should be a privilege not a right (Asian work ethic).
- Likely ongoing rand depreciation, lower production volumes, rising unit cost, less globally price competitive, risk of less investment, lower profitability, job losses, capital flight (vicious cycle).
- Should be rate for the job based on value creation, no minimum wage. Raise revenue, profitability, attract new capital investment and job creation-benefit consumer spending, financial services, promote growth economy (virtuous cycle) - unlikely short term.

- Industry-challenges - security of assets in doubt, uncertain electricity supply, unstable labour force (reward/productivity).
- Motor industry - largest contributor to the manufacturing sector-SA no longer preferred supplier of BMW, Mercedes Benz, Nissan - Renault, US manufacturer - limited new capex in SA manufacturing sector-ripple impact to components industry – SA assembler not manufacturer.
- Exports rely on government’s MIDP.

- SA downgraded from Africa's largest economy to no. 3 after Nigeria and Egypt in 2015.

- SA recover no.1 African position as currency recovers.
  Nigeria naira collapses, economy shrinks (oil dependency).

- SA remains Africa's financial service centre.
  Gateway to development in Africa.
  Long-term positive prospects?

- Government leads in job creation but with less operating efficiency – job seekers preference (Why?) - 40% total workforce as wages exceed private sector.
- Likely increasing automation - fewer skilled/better paid jobs.
- Unskilled sector facing widespread retrenchments.
- Lose basic operators - petrol jockeys, shopping packers - is SA ready?
- Likely further government business regulation (participation/interference) - less efficiency.
- Inevitable higher unemployment – vicious cycle vs virtuous cycle.

- Foreign companies reduce fixed capital investment

- International car manufacturer lists requirements for further SA fixed capital investment.
  - Capital security (BEE)
  - Electricity supply (Constant cost effective)
  - Wages (productivity vs global standards – SA, US, China)

- Increased demand for social unemployment grants-divert funds away from infrastructural development towards focus on “fair wage and decent work” – inefficient capital utilisation.
- Result-slower growth.
- Higher budget deficit as government revenue moves ex growth.
- Higher production cost base, lower exports, higher trade and current account deficits.
- Weaker ZAR.
- Temporary higher export ZAR earnings, emphasise rest of Africa, but higher capex cost.
- Rising producer / consumer inflation (MT) – Likely higher interest rates following global trend.
- Slower economic activity-stagflation risk remains.

Alternative

- Develop public / private partnership.
- Education-reintroduce trade schools and apprenticeships system-create employment.
- Brick-layers, carpenters, electricians, plumbers.
- Broad base bottom up system vs Pres. Cyril Ramaphosa's top-down – 20 PHD's
- New economic base for consumer spending upturn?
- Restore self-sufficiency and dignity – virtuous circle vs current circle.
- Stimulate new growth era.
- Short term unlikely due to political preferences, will logic prevail?

Political preference

- ANC preference - socialism, centralised control (+SACP, trade unions), marginalised private sector, mining industry contracts.
- ANC losing support – “stay away voters accumulate”
- Alternative – reintroduce apprenticeships, re-open trade schools, teacher training colleges, nurses training colleges
- Restore dignity, consumer spending, enhance wide economic growth potential.

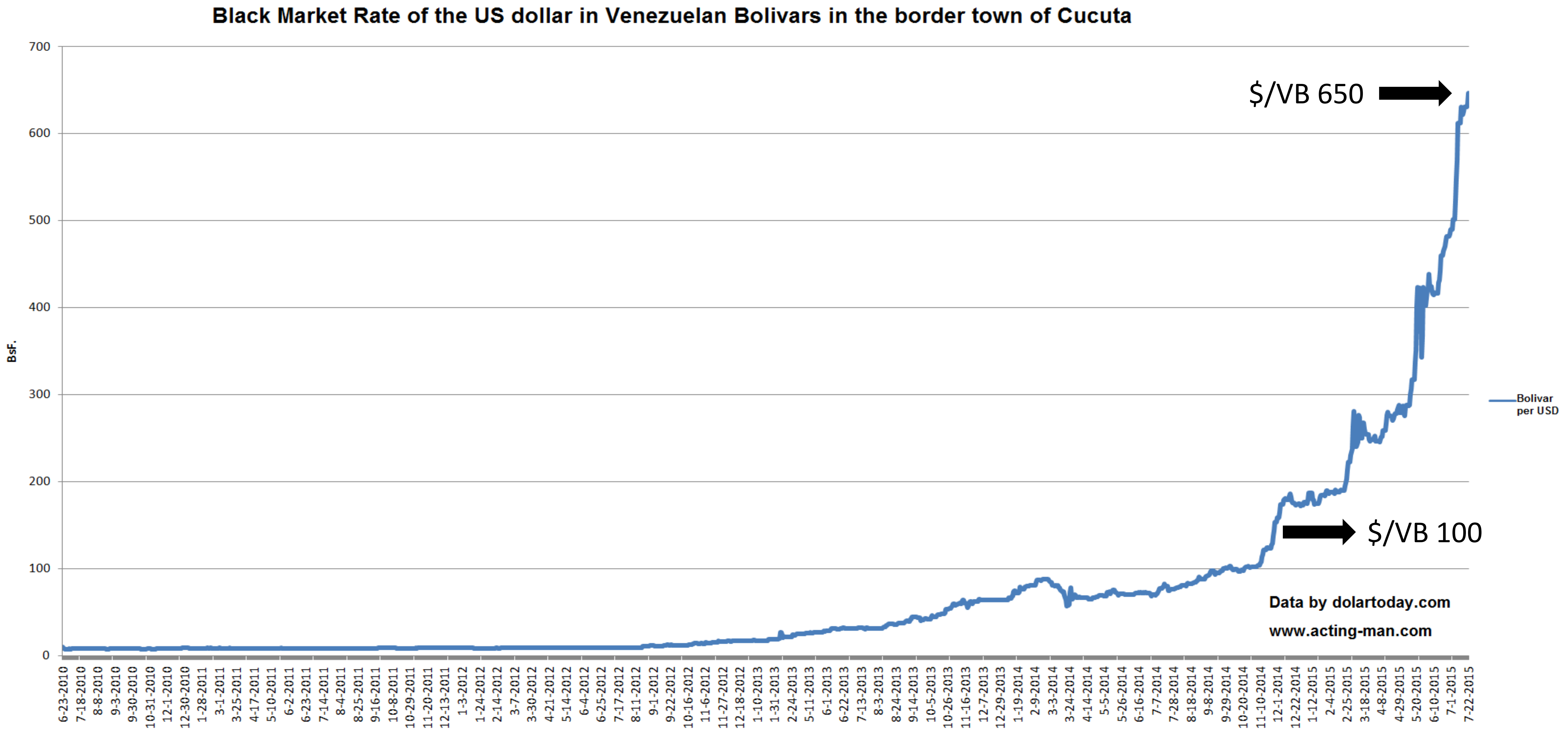
SA Government service delivery achievements - positive

- Formal housing: 13.2 m (1996-5.8m)
- Electricity: 90% (1996 – 58.0%)
- Water 88.8% (1996 - 82.8%)
- Sanitation 80.0% (2002 – 62.3%)
- Long term positive economic/social impact.

But a lot still needs to be done…
Alternative – Expropriation without compensation

Political change

- 1985/1990 - shift from political right to centre, saved SA from isolation.
- 2015/2019 - shift from political left towards centre - positive move.
- Shift further left - economic disaster.
- Socialism, Communism, central planning, failed model (eg USSR & Zimbabwe), but not inevitable.


Black Market Rate of the US dollar in Venezuelan Bolivars in the border town of Cucuta
BsF.
700
600
500
400
300
200
100
0
$/VB 650
$/VB 100
Bolivar per USD
Data by dolartoday.com
www.acting-man.com
6-23-2010
7-18-2010
8-8-2010
9-3-2010
9-30-2010
10-31-2010
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7-22-2015

Government

- Must include more business leaders (private - public partnerships).
- Realise destructive reality of recent policies.
- Adopt commercial possibilities of National Development Plan not National Democratic Revolution.
- Support leadership change.
- Alternative-SA condemned to marginal economic change, rising social desperation-potential unrest. Risk rising unemployment –

SA	official - 27.7%	expanded - 36.6%
youth(25-34yrs)	official - 32.8%	expanded - 41.5%

Investment outlook – financial markets

- JSE reflects global liquidity, SA corporate forex earnings/ cash heavy balance sheets.

- Beware value risk - ALSI long term P/E av. 14.5x, current 20x (L/T range 9/21), inflated by "hot money" flows.

- Risk of rising interest rates-estimate from 2018 H2/2019.

Outlook - Positive factors

- SA-African management record.
- SA “can do” attitude.
- Sandton infrastructure (cranes/development), access to “captains of industry”, Cape Town foreshore developments, financial services, communication, football stadiums, national roads.
- Climate,
- Golf courses.
- Foreign capital flows - may take time to follow.
- Gateway to Africa, SA experience-exploit resources of African continent.
- Timing – await commodities cycle recovery.

Summary

- Outlook short to medium term remains – be prepared further tough times – minimum post-2019 national election.

- Longer term – sense should prevail? Eg 2004/2008.

- Alternative Zimbabwe (failed states) – Absolute control over bankrupt economy preferred to shared democracy, chaos, mass emigration.

- **Thank you for your attention.**

- **Questions?**

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