MARCH 2023

Implications for Aotearoa NZ as South African economy slows

A MARKET INTELLIGENCE REPORT

Summary

- South Africa faces a bleak economic outlook in the near future, with GDP growth slowing to 0.3-0.9% in 2023 depending on whether the electricity crisis resolves (highly unlikely) or worsens (very likely).

- In this year's Budget, the government is continuing on its path of fiscal consolidation, using an increase in tax revenue to improve state power utility Eskom's credit profile and provide tax incentives for solar energy in the hopes that this will contribute to solving the electricity crisis.

- South Africa has been grey listed by the Financial Action Task Force, the full impacts of which are still unknown. Of primary consideration is how long South Africa stays on the grey list.

- For Aotearoa New Zealand, the impacts of rolling blackouts remain manageable for New Zealand businesses located in South Africa due to their smaller footprints. Scheduled blackouts (referred to as load shedding) are a preventative measure to avoid grid failure, and their frequency/length increases as the demand for electricity outstrips supply. In the last year, load shedding has reached uprecedented levels. Despite the challenge load shedding poses, there are potential significant opportunities in the renewable energy space for companies with a high risk appetite.

Report

Bleak forecast and falling confidence in South Africa's economy

Delivering his 2023 Budget speech in Parliament on 22 February, South Africa's Finance Minister Enoch Godongwana has slashed South Africa's economic growth forecast for 2023, citing the impact of load shedding (rolling blackouts) as the single biggest risk factor alongside high inflation, higher interest rates and weak global economic activity. However, he said that the reopening of the Chinese economy might offer some reprieve by supporting a stronger rebound in global trade and demand.

Godongwana's best-case scenario would see GDP growth slowing to 0.9% in 2023 from an estimated 2.5% in 2022, before averaging 1.7% per annum in 2024 and 2025. This is based on an assumption that load shedding is "eliminated" in 2023. The worst-case scenario – where the electricity crisis worsens – sets growth at 0.3% in 2023, in line with the Reserve Bank's forecast. There is widespread agreement by energy analysts that load shedding will not be eliminated this year. With average population growth running closer to 1.3% per annum and food inflation accelerating to 13.8% in January from 12.7% in December, these growth rates imply that the average South African citizen will become poorer in 2023 and unemployment will continue to rise.

Even South African business, typically demonstrating resilience despite ongoing and chronic infrastructure and government challenges, is showing signs of falling confidence. Industry organisation South African Chamber of Commerce and Industry's (Sacci's) Business Confidence Index fell to 112.9 in January from 117.3 in December. As for the manufacturing industry, the seasonally adjusted Absa Purchasing Managers' Index (PMI) fell to 48.8 points in February, from a seven-month high of 53.0 points in January. In another indicator of lack of confidence, the South African rand is down 4.7% this year while most other emerging markets globally are holding firm.

Budget 2023: key announcements

As with previous years, this year's budget benefited from high commodity prices and increased tax collection. The government will use this to:

- As previously announced in last year's mini-budget, **cover Eskom's entire debt servicing requirement** over the next three years to the amount of ZAR254bn (NZD22.5bn). This will be in the form of interest-free subordinated loans to be settled in Eskom shares and a direct takeover of ZAR70bn (NZD6.2bn) of Eskom's debt in 2026. This will allow Eskom's credit profile to improve and undertake the investment maintenance needed to address the electricity crisis.

- **Tax incentives for renewable energy**: From 1 March businesses can reduce their taxable income by 125% by investing in renewables for two years. Individuals who install rooftop solar panels can also claim a tax rebate of 25% of the cost, up to a maximum of ZAR15,000 (NZD1,300) for one year. Solar-related loans will also be boosted for small and medium enterprises.

- **Extend the Social Relief in Distress grant** for another year. Originally intended to provide support during the COVID-19 pandemic, the grant has been extended every budget in lieu of a permanent basic income. It has also not increased for inflation since April 2020, unlike other social grants (such as the old age and disability grants).

- **Avoid tax increases**, including the general fuel levy, which remains unchanged. The health promotion levy will also remain unchanged due to the difficulty operating environment for the sugar industry.

This Budget continues the government's consistent strategy of fiscal consolidation to reign in debt. National Treasury intends to meet its target of achieving a primary budget surplus by the next financial year, however, the consolidation target has been pushed out to 2025/26 due to the Eskom relief. Debt servicing costs continue to be astronomical at ZAR400bn (NZD35.4bn) per annum.

Godongwana's Budget has been received positively from the markets and business community. Immediately after the Budget was announced, the rand strengthened against the US dollar. Political consultants Paternoster described it as a "sensible and cogent Budget", while Business Leadership South Africa said it was "solid", commending the Minister's "fiscal discipline… the hallmark of both his and his predecessor Tito Mboweni's time as finance minister". Momentum Metropolitan economist Johann van Tonder said that it was good news that revenue exceeded non-interest expenditure, and that "the government is back to being a going concern".

More bad news: South Africa grey listed

As foreshadowed by Godongwana in his Budget speech and anticipated by most, South Africa was added to the Financial Action Task Force's (FATF) grey list on 24 February, with the FATF plenary adopting the October 2021 Report on South African Anti-money Laundering and Counter Terrorist Financing Measures. Being grey listed indicates that a country is financially unsafe, in that it has inadequate safeguards against money laundering and terrorist financing. The Report concluded that South Africa is partially compliant with 17 and non-compliant with three of 40 recommendations, and that while the country has a "solid legal framework for combating money laundering", it needed to implement this system more effectively.

The Report specifically referred to the erosion of financial criminal prosecution and corruption, which has plagued the implementation of South Africa's AML/CFT laws.

The implications of grey listing are reputational and economic. It “warns” members of the international community that conducting business with the impugned country could facilitate terrorism financing and money laundering. In practice, South Africans will face more due diligence from international banks when they want to transact, which could make it more expensive for locals to trade and have bank accounts or investment accounts abroad. The compliance burden on companies in terms of due diligence also increases by an estimated 25% to 50%, according to LexisNexis Risk Solutions financial compliance expert Vincent Gaudel.

However, the full impacts are still unknown, with the primary consideration being how long South Africa stays on the grey list. The real-world effect of the grey listing depends on how the rest of the world responds. Unlike a credit rating downgrade to junk, which forces some funds and investors to disinvest in a junk bond, grey listing does not come with any similar specific restrictions. The economic impact could range between less than 1% and 3% of GDP depending on how quickly South Africa can exit the grey list, according to the report compiled by consultancy Intellidex.

President Cyril Ramaphosa said that while being added to the grey list is concerning, it is “less dire” than some suggest. He stated that the government knows what it needs to do to get off the list and that it is “determined to do this as quickly as possible”. He noted that “the strategic deficiencies identified by the FATF do not relate directly to the country’s financial sector… [meaning] that financial stability and costs of doing business with South Africa will not be seriously impacted by the grey listing”.

Implications for Aotearoa New Zealand

The economic outlook for South Africa continues to be turbulent, with the electricity crisis at the forefront of risk. The cost of doing business will continue to increase as businesses are required to factor in the cost of alternative electricity generation internally and compensate for the wider external ramifications for logistics and supply chains. However, the profile of most New Zealand businesses in South Africa (where the South African office is comprised of a single South African representative servicing the region more broadly) and focus on services rather than goods means that the impacts are low. Cape Town-based businesses conveyed that with their back up power set up was sufficient to allow them to continue operations.

To a lesser extent, the grey listing also presents additional costs for those needing to transact with overseas banks, although according to analysts this was not a shock to markets that have been dealing with South Africa and its risk profile for a long time.

As with many high-risk-high-reward locations, the challenges of doing business in South

Africa may simultaneously presents opportunities. South Africa has extensive resources of renewable energy, especially in solar, wind, and hydro. Investment in renewable energy is now a fundamental business decision as the most direct solution to ensure energy security. Tax incentives for private businesses and households to invest in solar energy will also spur greater demand. At a country-level, the amount of money required to facilitate South Africa's decarbonisation is in the billions, including the international USD8.5billion Just Energy Transition Partnership.

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