JOHCM Funds

Emerging Markets Spotlight

James Syme, JOHCM Emerging Markets Opportunities Fund

"Ramaphosa inherits stagnant economy and divided party"

Financial Times headline, February 15, 2018

One of the unfortunate facts of emerging market investing is that emerging market political leaders who come to power with promises of much-needed reforms tend to disappoint. Even in the last few years leaders from Jokowi in Indonesia to Enrique Peña Nieto in Mexico have started their leaderships with significant progress but subsequently disappointed ("Jokowi's 35,000 MW program only reaches 3.8 percent progress" – Jakarta Post, 4 March 2018; "Release of jailed union boss reveals Mexican president's empty promise" – Guardian, 21 December 2017).

The latest new national leader to promise a break with the past is South Africa's Cyril Ramaphosa, elected the country's president in February following the resignation of Jacob Zuma after a raft of corruption allegations. From the December 2017 confirmation that Cyril Ramaphosa would replace Jacob Zuma to the February 2018 transition of power, the South African rand rallied 14.0% against the US dollar, reflecting optimism for political and economic reforms under a Ramaphosa administration. [1] In particular, his decision to recall previous ministers Nhlanhla Nene and Pravin Gordhan (both sacked by Zuma), suggests improved prospects for economic policy and governance.

It is our view, however, that South Africa faces serious economic challenges with no obvious solutions, while the broad political grouping that is the ANC will further constrain the new government's ability to act.

The most serious problem for South Africa is its failure to generate economic growth. The National Development Plan requires a 5.4% economic growth rate to make a serious dent in the country's 27% unemployment rate. Growth in the last five years has averaged 1.4%, and consensus expectations are for 1.5% in 2018 and 1.7% in 2019.[1] There are various reasons for the poor growth rate, but South Africa's failures in the last 20 years to support both infrastructure and education are particularly to blame. Whilst the recent water supply shortage in Cape Town has attracted the most news coverage, a chronic undersupply of electrical power has had far worse effects on business and the economy. To address either the infrastructure or education problems will take large sums of state investment, as well as considerable time, and this seems simply impossible.

The South African fiscal budget remains highly stretched. The fiscal deficit is estimated to have been 4.3% of GDP in 2017, Fitch and S&P cut South Africa's sovereign credit rating to junk last year, and Moody's put the country on review for a credit downgrade in November 2017 (expected to be confirmed later this month). Meanwhile, parastatals like electricity power utility Eskom face financial distress. Eskom has recently sought ZAR 20bn (US$1.8bn) in emergency credit from the government simply to remain operational. The higher education sector needs an additional ZAR 12bn (US$ 1.1bn) in financing this year.

In addition, the good news of the appointments of Nene and Gordhan is balanced by the problematic appointment of David Mabuza as deputy president. An old ANC insider from the struggle against Apartheid, he has been the subject of very serious allegations in the last few years, including links to corruption and violence. The Ramaphosa administration is emphatically not a clean break from the Zuma years.

We regard all incoming EM political reformers as 'show-me' stories, but this is particularly true of Cyril Ramaphosa, as we cannot even see the reform path that would turn South Africa round. We remain cautious on the South African economy and currency, and prefer to invest instead in South African companies doing most of their business in other emerging markets.

[1] Source: Bloomberg

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