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South Africa: Lights off, but is the future brighter?

Notes from the road

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> "I distinctly remember the huge pride that South Africans felt for their country and the clear optimism for a brighter future."

I first went to South Africa on a very memorable holiday 23 years ago, where I proposed to my now wife in the most amazing setting in the Western Cape, and a year later returned to Plettenberg Bay for the wedding.

This was just a few years after Nelson Mandela had been elected, and I distinctly remember the huge pride that South Africans felt for their country and the clear optimism for a brighter future. What has followed has been a significant disappointment – pedestrian GDP growth (Exhibit 1), stagnant GDP per capita, consistently high unemployment, rising inequality, poverty, persistent corruption, and more recently, a load shedding (periods of blackouts) crisis.

Exhibit 1: South Africa GDP growth
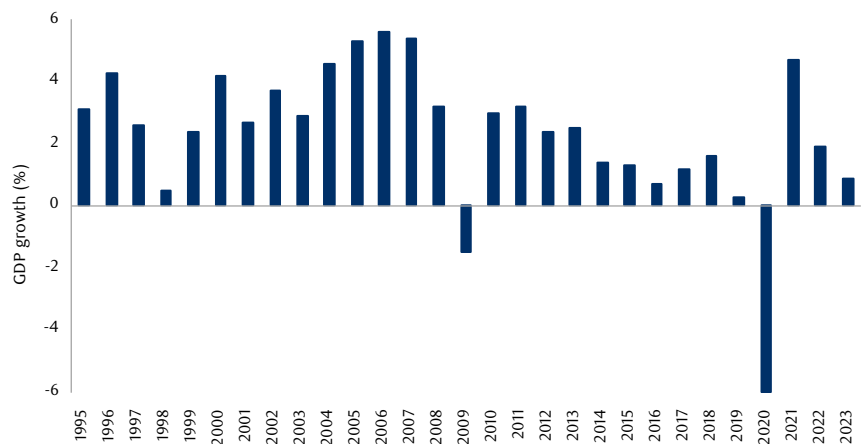
Source: IMF, as at 30 April 2024.

South Africa now faces a general election on 29th May which could well shape its long-term future, and this seemed like an opportune time to visit the country and ask some key questions: why has economic performance been so poor? Is there any hope that the poor performance of the last two decades could be reversed with a new pro-reform/rule of law leadership that represents South Africa's silent majority? Should we expect more of the same from the incumbent African National Congress ("ANC") party? How meaningful and likely are the tail risks?

"Endemic structural issues clearly should not be under-estimated. At the heart of these is widespread corruption throughout the ANC and a lack of investment in infrastructure."

For the first time since Mandela was elected 30 years ago, the ANC could lose power. Under Mandela, the party enjoyed overwhelming support and moral legitimacy. In the last two decades that support has gradually declined, as widespread corruption within the party has caused disillusionment amongst voters and has clearly held the country back. High unemployment, poor health and education, a weak business climate and poverty have followed. South Africa is now moving away from being a one-party state, with the ANC facing a secular decline in popularity. In 2019, the ANC won 58% of the votes[1] and the party looks set to secure significantly less in the coming election.

While there have been question marks over many of the ANC leaders since Mandela, current leader Cyril Ramaphosa was elected in 2019, in a sea of optimism termed "Ramaphoria", given his strong business and anti-corruption credentials. Unfortunately, his term has again turned out to be a disappointment as the economy has flatlined, and in the last two years power outages have had a crippling impact. Endemic structural issues clearly should not be under-estimated. At the heart of these is widespread corruption throughout the ANC and a lack of investment in infrastructure.

This is reflected in the consistently poor performance of Eskom and Transnet, the two key state-owned enterprises supplying power and transport infrastructure. Both companies have suffered from misconduct, excessive procurement budgets and a lack of investment. Interestingly, as I arrived in Johannesburg, I was told that for the first time in two years, there had been no load shedding for three weeks. There were mixed views as to whether this was a genuine sign that the worst of the power crisis was over, or if it was due more to pre-election window dressing. We have also seen little to no progress being made on other structural issues, including poor education, the high cost of low skilled labour, inequality, health, the lack of a social safety net and crime.

One silver lining that has consistently been the case in South Africa is the very strong private sector. I have always been very impressed with the quality of management teams in the country and many companies have been able to handle the challenging political and economic environment.
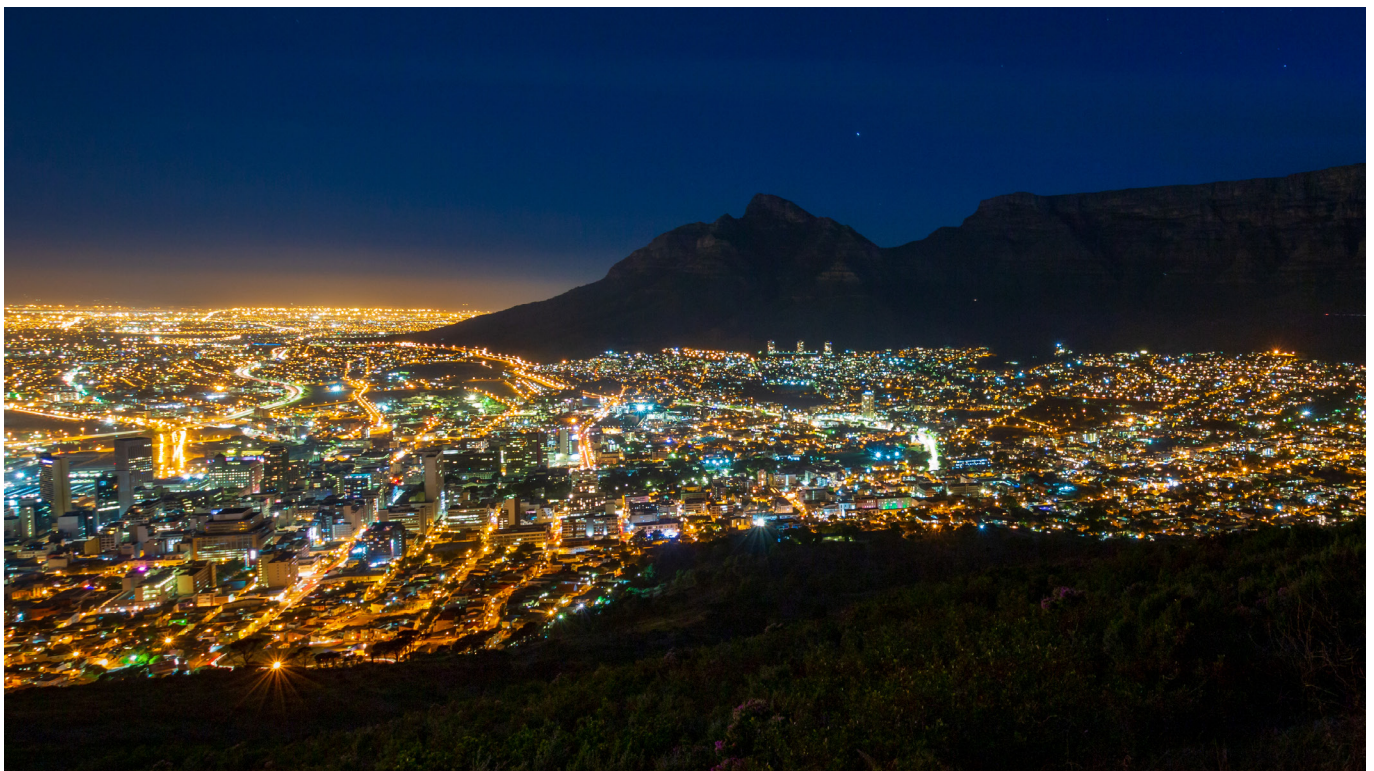
[1] ANC general election results 1994-2019 | Statista.

Indeed, the private sector frequently steps in to provide services where the government fails. A good example, from one of the companies I met, Discovery, is that it has helped in areas such as providing vaccines during Covid, fixing potholes in Johannesburg, and funding and delivering healthcare. The private sector overall has been able to navigate the power crisis by providing its own energy generation.

Solving many of South Africa's issues will require private sector participation. Indeed, Discovery's CEO, Adrian Gore, heads up a group of business leaders who regularly meet with Cyril Ramaphosa and other government officials, and he talked to me about the progress that has been made in recent months. Significant funds and technical expertise from the private sector have been leveraged to help address many of the challenges the country faces and to aim to implement necessary reforms.

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Nonetheless, following the challenges of recent years, discontented voters are increasingly looking outside the ANC, and in this election are likely to have a huge choice, with over 300 parties running, many of them new. I met a leader from the RISE Mzansi party, which views itself as the new ANC and has already garnered a significant following. While it may be too soon for these new parties to play a significant role in terms of the next government, there is a strong argument that the leading opposition parties, the Democratic Alliance ("DA") and the Economic Freedom Fighters ("EFF") are relatively capped and that as the ANC continues to bleed votes, some sort of new party/coalition may well emerge.

In terms of where the current election is heading, the most recent Ipsos poll on 27th April (Exhibit 2) which is seen as the most credible, as well as other similar polls, have the ANC at around 40%. Most political experts I met suggested that the ANC is likely to come in ahead of where it is currently polling and will be likely to secure +45%, maybe even 50%, of the votes. Polls are said to be overestimating the performance of the UMkhonto weSizwe Party ("MK") which has been formed recently by former president, Jacob Zuma, as well as smaller parties. Additionally, the polls are also based on 100% voter turnout which again inflates smaller parties, and they do not reflect an expected surge from the ANC ahead of the election.

If these political experts are right and the ANC can retain power, either through a majority or through coalitions with one or more smaller parties, more of the same can be expected and this is likely to prove a relief, at least in the short term.

The big question marks arise if the current polls prove to be accurate and the ANC needs one of the larger parties (DA, EFF, or MK) to form a coalition. This scenario is widely viewed as being binary for South Africa's outlook – a coalition with either the EFF or MK would be taken very negatively. Both parties are seen as being cut from the same cloth with relatively extreme left-wing policies and would also be likely to expedite corruption concerns. On the other hand, a coalition with the much more centrist and business-friendly DA party would be received very positively. Again, as to which scenario is more likely, the views I heard were quite mixed.

Most commentators thought that an ANC coalition with MK/EFF was very unlikely, as it would have profoundly negative long-term implications for the ANC, and it is also clear that Ramaphosa would do everything he could to secure a DA coalition.

Exhibit 2: Current political party support – Ipsos polls

Ipsos regularly tests political opinions in South Africa (at least every six months), in both election and non-election years

	Ipsos press release 27 October 2023	Ipsos press release 6 February 2024	Latest Ipsos results 27 April 2024
ANC	43%	40.5%	40.2%
DA	20%	20.5%	21.9%
EFF	18%	19.6%	11.5%
MK	-	-	8.4%
IFP	5%	4.9%	4.4%
ActionSA	4%	4.3%	3.4%
FF+	2%	2.1%	1.8%
Other parties	8%	8.1%	8.4%

Source: Ipsos 2024.

Figure 3: MSCI EM Index country performance over the past decade
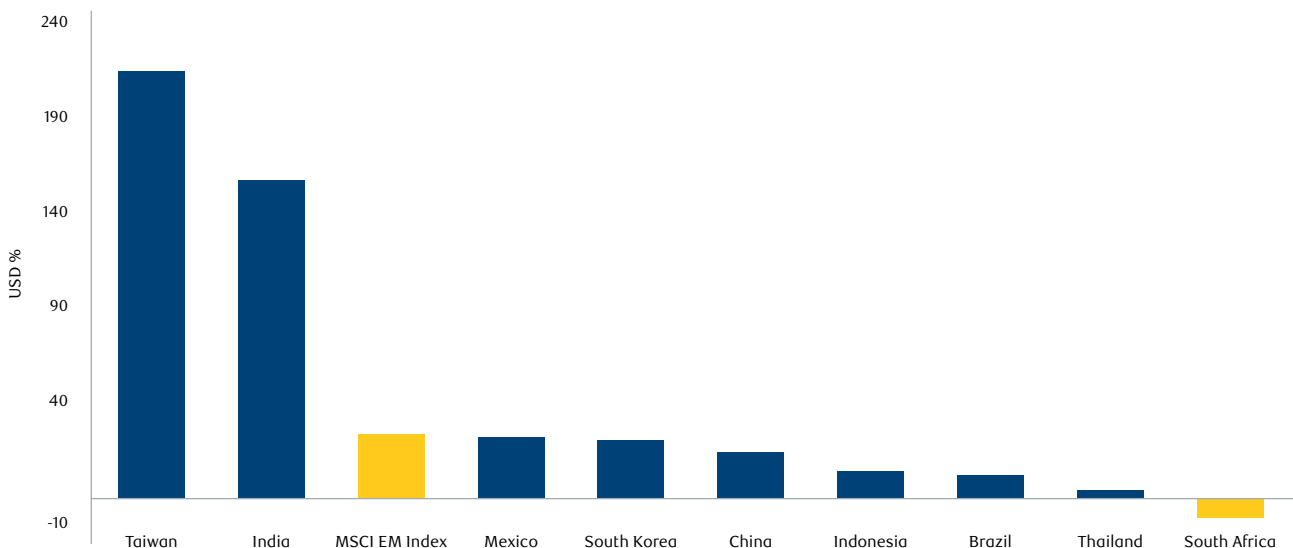
Source: Bloomberg, as at 30 April 2024.

However, there were certainly some interesting dissenting opinions. One view I heard several times was that the DA would be reluctant to form a coalition to support the ANC, fearing the sort of electoral meltdown that was seen by the Liberal Democrats in the UK in a similar situation. A further view was that the DA would be less reluctant to breach its red lines than other parties. Certainly, the lower the ANC vote, the higher the risk that the more corrupt wing of the ANC may push for MK/EFF and this tail risk clearly cannot be ignored.

Having said this, the most likely outcome is an ANC victory without a large party coalition. What does this mean for South Africa? While a short-term relief rally is possible, it is difficult to be particularly optimistic on the market in the medium term. In the last decade, South Africa has been the worst performing major emerging market (Exhibit 3), excluding Russia which left the index two years ago.

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South Africa's structural challenges remain – at their core, corruption in the ANC. Without resolving this, it is difficult to envisage a dramatic change in South Africa's fortunes. Perhaps the next election cycle will offer more hope, but for now we look set for more of the same. In this environment, it will be key to be invested in those companies that have the structural growth drivers and management expertise to overcome the sluggish growth that looks set to persist in South Africa.

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Phil is a senior portfolio manager and head of the RBC Emerging Markets Equity team at RBC GAM. He joined the firm in November 2009 from the asset management division of a large European bank, where he was head of global emerging markets. Phil was previously based at another global financial services firm in Zurich for four years as director and head of emerging markets and Asia in their multi asset class division. Prior to that, he managed global emerging markets, Asian, Latin American and U.S. portfolios for nine years at a sovereign wealth fund. Phil started his career in the investment industry in 1992.

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