ANC ELECTIONS
IS THERE LIFE AFTER THE VOTE?

There is nothing new under the sun. What we are witnessing in South Africa - higher debt levels and political leaders showing cronyism - is reminiscent of countless other outcomes in emerging market countries.

Of particular interest is the Indonesian case of the late 1990s. Prior to the financial crisis in 1998, the second president of Indonesia, Hajji Suharto, presided over the country’s economy for 31 years and birthed a patronage system, which was his tool to maintain power. In exchange for political and financial support, Suharto gave powerful positions to his family, friends and enemies.

The lesson here is that it is easy for an emerging market country (including South Africa) to slip into an undesirable spiral of political cronyism and credit ratings downgrades — it took Indonesia almost two decades to return to investment grade.

What is clear for South Africa in particular, however, is that negative political and economic outcomes would need to worsen before the country arrives at the crisis levels seen in Indonesia. South Africa is unique in that it has strong and functional institutions — an independent central bank and auditor general, an active judiciary, a free press, corporate businesses with solid balance sheets, a financial system of world repute and a constitutional democracy. The foundations, which were absent for Indonesia during its crisis, are solid and safeguard South Africa from adverse shocks, including those of a political nature.

The Indonesian example demonstrates that systems of patronage and cronyism do not work — they fail spectacularly. Suharto’s unsustainable system was met with the Asian Financial Crisis in 1998, which exposed his economy to major losses — a sharp depreciation in the currency, a contraction in the GDP of close to 14%, the need for an external injection of funds from the International Monetary Fund to boost the fiscus, the systemic failure of the banking sector and a significant sell off of Indonesian assets by foreigners. By mid-1998, confronted with this reality, Suharto resigned from office.

Systems can withstand pressure only up to a certain point and even the strongest in the world can begin to erode and eventually crack. Political leaders have the power to nurture the country’s strong foundations, or destroy them completely.

It is hoped that the two prominent, or maybe more, ANC presidential candidates—Cyril Ramaphosa (CR), Dr Nkosazana Dlamini-Zuma (NDZ), or a ‘Unity personality’—will safeguard the institutional strengths of South Africa, whoever wins.
But the scenarios associated with each candidate are starkly divergent (at least in terms of how they have been perceived by markets), which indicates the importance of the ANC conference:

CR has put forward the need for a new deal on jobs, growth and transformation, which might have positive short and long term effects:

- Rand strength
- A potential increase in GDP growth
- Fiscal prudence
- Conventional monetary policy remaining entrenched

Less state intervention in the private sector is envisaged, with private sector fixed investment to be boosted.

NZD's economic stance is less known because she has spent little time explaining it ahead of the conference. Without such information, it is assumed:

- The status quo will prevail where fiscal policy continues to be weakened
- State-owned enterprises are used for personal gain by those in authority
- Patronage is protected
- Populist viewpoints taking root on major issues (e.g. land expropriation)

In order to defuse factions within the ANC, there is an increasing ambition to elect a unifying candidate. Numerous names have been punted for this ‘Unity vote', but Dr Zweli Mkhize has consistently positioned himself as such a personality.

In the event he wins, market reaction will be muted but policy uncertainty will persist. Additional credit ratings downgrades would still ensue but the outcome would remain consistent with a ‘muddle through’ scenario with much less economic reform taking place.

It will be up to the three candidates to define their stance on the economy, but markets have already made firm assertions, with potential negative responses if NZD wins.

It is worth noting that if NDZ wins, it will take a lot to materially change the foundations of the country. Given the existing checks and balances at play in the economy, it would require a heavy hand to completely annihilate the architecture on which South Africa was founded - including the constitutionally entrenched independence of the central bank.

Financial markets have the ability to adjust and find a new form of expression, even during difficult political and economic times. Despite the tumultuous period where the Indonesian economy languished in non-investment grade for almost two decades, the Jakarta Stock Exchange Composite Index increased in value 12 fold between 1998 and 2017.

There is no need to panic about the outcomes from the ANC elective conference. Whatever the situation, there are always opportunities in difficult political environments. Equity markets can, perversely, become a hedge against cronyism and corruption - money is better invested in private markets, which have an effective self-correcting mechanism, as opposed to the public sector.

Keep calm and stay invested in markets. Alexander Forbes Investments manages money through cycles with a long-term view, within our Living*Investing approach.

Sources: Bloomberg & Indonesia Investments