South Africa enters uncharted waters

The ANC loses its majority for the first time in the post-apartheid era

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- Base-case scenario: unity government where the ANC retains budgetary control
- The new government should rationalize fiscal policy, but is unlikely to, barring a change to the status quo via the DA or other influences.
- Long-term outlook: South Africa has demography on its side.

With the incumbent ANC party enduring a crushing defeat in South Africa's election on May 29th, President Cyril Ramaphosa has called for the formation of a unity government. These are uncharted waters in the post-apartheid era, as the ANC has lost its parliamentary majority for the first time in three decades and now finds itself constrained to seek partners.

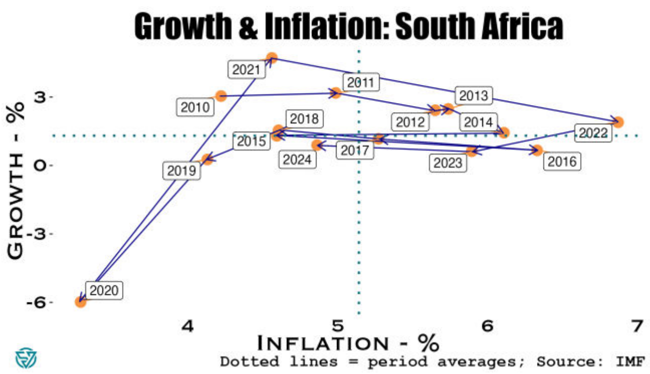
UNITY GOVERNMENT?

The final tally shows the ANC receiving 40% of the votes and 159 of the parliament's 400 seats, a sharp drop from the 230 held previously. The market-oriented, center-right DA continues on as the assembly's next-largest party with 87 seats and is amenable to coalition talks, as parties seek to strike a deal before a parliamentary session begins in mid-June. Ex-president Jacob Zuma's MK party is in third position with 58 seats, while the populist EFF and regionally-focused IFP parties secured 39 and 17 seats, respectively.

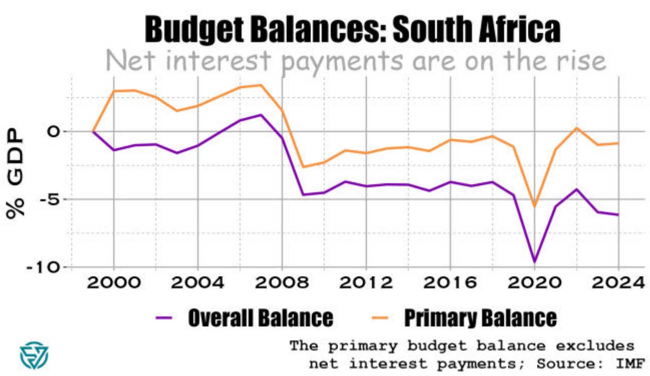
The ANC's unity government proposal is more flexible than the formal policy trade-offs of a coalition and would entail opposition support in key areas, including votes on the budget. Such an arrangement would unlikely lead to a rapid overhaul of economic policies, though it remains to be seen if any opposition parties will join. Investors should consider the unity government outcome as a base-case scenario, with potential upside and downside scenarios linked to coalition outcomes with the DA and the EFF, respectively.

MACRO MALAISE

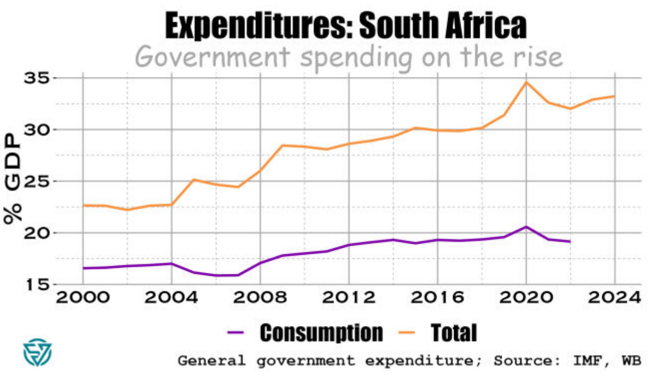
As the dust settles over this result, macro variables help explain why the ANC got thrashed and where South Africa might be headed. Since 2010, average annual real GDP growth has been lackluster, at less than 1.5%, while inflation has been above 5%.



Budget deficits hovered around -4%/GDP from the global financial crisis until COVID and have widened further post-pandemic. Worryingly, net interest payments on public debt have already risen significantly, to around 5%/GDP, even before higher global interest rates have fully begun to bite.



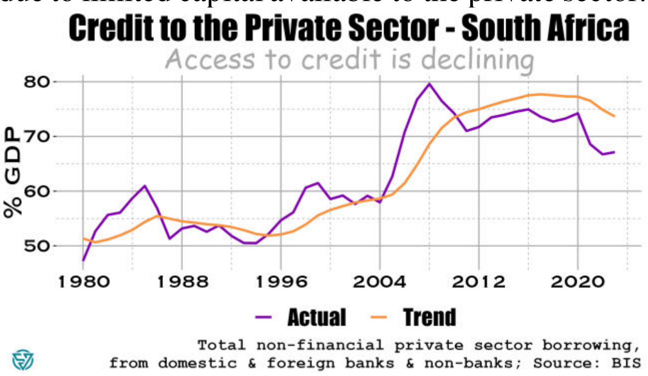
Government spending as a share of GDP has risen steadily over the past two decades, which is also a concern because part of the increase is in general government final consumption expenditures. Government consumption refers to the purchases of goods and services, including employee compensation.



While the gap between total and consumption spending has widened to around ~12%/GDP, recall that net interest payments currently stand at 5%/GDP. This leaves only about 7%/GDP for other spending categories, including social benefits, grants, and capital expenditures. Higher public investment is needed, as exemplified by deficiencies in national electricity grid maintenance. This corresponds to a secular decline in overall gross capital formation, which dropped from 21%/GDP in 2008 to a low of 13%/GDP in 2020 before a slight rebound since then.

CROWDED OUT

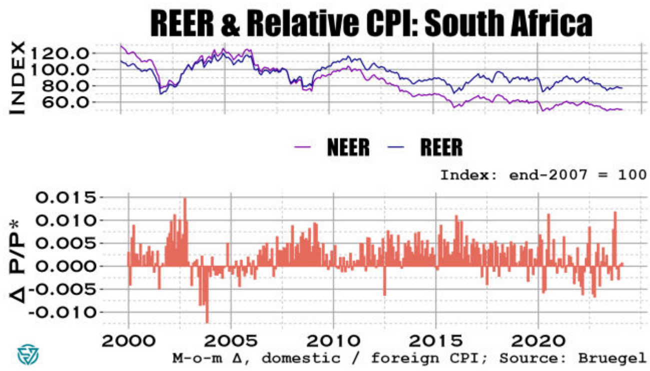
Yet it is the government's budget balances and expenditure mix that stand in the way of achieving higher investment rates in the economy, partly owing to limited fiscal space for capex and partly due to limited capital available to the private sector.



General government debt stands at 75%, which - despite excluding other public debt categories such as SOEs - is even higher than all private borrowing. Running lower budget deficits and thus decreasing public borrowing would enable the financial sector to lend more to productive firms and households.

EXTERNAL RESILIENCE

In addition to the low-growth, high-inflation, and credit-constrained outcomes domestically, South Africa's economic policies have resulted in a weakened currency. In nominal trade-weighted terms, the rand is effectively 45% weaker than in 2008, but mostly positive inflation differentials with trading partners have eroded more than half of that competitive gain.

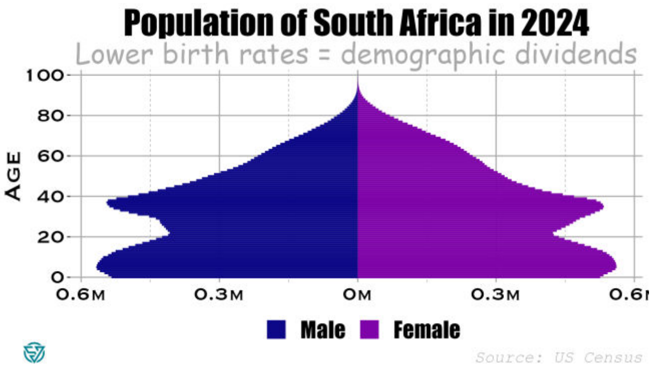


Even with a lower real effective exchange rate, exports-to-GDP stagnated during the 2010s, followed by a small post-pandemic spike. Still, the current account generally remains negative, aside from recent exceptions in 2020 and 2021. At -1.6% and -1.8%/GDP in 2023-2024, the current account deficits have moderated since the first half of the 2010s and pre-global financial crisis. With international reserves standing at 16%/GDP, external accounts are sustainable even if competitiveness appears to be an issue.

DEMOGRAPHIC DIVIDENDS

One outcome from the ANC's economic policies is that GDP per capita has failed to rise significantly over the past two decades: the $6800 recorded in 2022 isn't far above the $6100 registered in 2006. Real output growth has barely been able to outstrip annual population growth, which after dropping sharply in the 1990s, rose from the 2000s until peaking above 2% in 2015.

Thankfully, annual population growth has moderated in recent years, and the fertility rate stands at a reasonable 2.37 births per woman, slightly above the replacement rate of 2.1. As such, South Africa has a demographic advantage with a relatively small and declining share of the population that is outside the working ages of 15-64. At 53%, this is on par with the US and much lower than elsewhere in Africa (e.g. 80% in Senegal).



The numbers of young South Africans set to enter the workforce over the short- and medium-terms is large compared to the overall numbers of young and elderly residents, meaning that the country has a demographic tailwind to be harnessed - but only if the new government gets its policies right.

APPENDIX