INVESTMENT REPORT

JANUARY 2022 • ISSUE 440

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FIXING THE FUTURE IS NOT POSSIBLE IF WE DO NOT FIX THE PRESENT

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Every year The Economist publishes a book called a Pocket World in Figures which ranks economies on size and a host of other items. In 1993 the third edition was published and ranked the size of South Africa as the 28th largest economy in the world. Last year the same ranking showed that South Africa was now the 38th largest economy in the world.

This decline took place despite those early optimistic democratic years with investment inflows and the commodity boom of the first decade of the 2000s, more commonly known as the noughties. South Africa is heading towards being an economy outside of the largest 40 economies. Once outside the largest 40 or 50 economies, it will be increasingly difficult to get on the investment and marketing radaar of companies.

However, dropping ten places is probably not the worst thing in the world, but when one considers the trend in per capita value added in the corresponding period the situation becomes substantially more depressing.

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In 1993 South Africans were the 64th richest citizens in the world (out of around 193 countries then) dropping to 88th out of 201 countries in 2000 and in 2020 still lower at 110th out of 212 countries. In a space of three decades South Africans have gone from being in the world richest third of countries into the poorest half of countries.

GDP per capita is a very good indicator of the trend that a country is on. South Africans, while richer than in 2000, are in relative terms far worse off today than ever in the history of the Union of South Africa since 110 years ago. Also, South Africans are poorer in real terms (i.e. if adjusted for the effect of inflation), not just relative terms, than they were in 2012!

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The great relative decline has taken place and is now history.

What can we expect from the future is the real question that South Africans must ask themselves.

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THE GREAT RELATIVE DECLINE HAS TAKEN PLACE AND IS NOW HISTORY. WHAT CAN WE EXPECT FROM THE FUTURE, IS THE REAL QUESTION THAT SOUTH AFRICANS MUST ASK THEMSELVES.

But, as South Africa is now also one of the most unequal countries in the world, this also should be considered. In table 1 we compare South Africa's ranking on GDP per capita on the US atlas method and indicate the percentile the average citizen finds themselves in. The percentile indicates the share of countries earning less than the SA per Capita GDP in US dollars

We also look at the history of SA's net income Gini coefficient (after taxes) per person. The Gini coefficient is a statistical measure of economic inequality in a population. The coefficient measures the dispersion of income or distribution of wealth among the members of a population. The coefficient can be any values from 0 to 100 (or 0% to 100%). A coefficient of zero indicates a perfectly equal distribution of income or wealth within a population. A coefficient of hundred represents a perfect inequality where one person in a population receives all the income, while other people earn nothing. One can see that SA's Gini coefficient has deteriorated with the GDP per Capita Ranking indicating that those at the bottom have fallen even faster than the average, particularly since 1990.

South Africa's unemployment rate has grown substantially. Unemployment is mainly caused by insufficient growth and investment into the South African economy. The same patterns can also be seen with fixed capital formation over the longer term.

There is now fifty years of evidence in South Africa of slowing gross fixed capital formation (GFCF). Growth in GFCF was also slow in the 1980s and much of the 1990s, due to civil war, sanctions and the fear by many companies of investing before the transition, amongst others. The fact that fixed investment and economic growth only flourished for a short period in the 2000s and never fully recovered in the last decade does suggest that's the lack fixed investment in South Africa is leading to ever high unemployment and inequality.

TABLE 1: SOUTH AFRICA AVERAGE GDP PER CAPITA (US$): RANKING IN THE WORLD SINCE 1970

Year	SA Ranking*	No of countries	SA Gini (net Income) out of 100**	Share of countries earning less than average South African	Unemployment rate
1970	48	146	51	67,1%	9,0%
1980	54	160	49	66,3%	9,2%
1990	64	198	63#	67,7%	15,0%
2000	88	201	67	56,2%	25,8%
2010	92	211	73,4	56,4%	24,9%
2020	110	212	67***	48,1%	29,2%
2030F	120	214	N/A	43,9%	N/A

Sources:
World Bank, LIS, StatsSA and research by Schoeman, Christie & Blaauw Phillip 2009 Unemployment in SA 1970 -2002;
**   Calculation of ranking percentile by economistscoza.*
***   = gross income for Gini coefficient?*
**** = 2017 data used for GINI coefficient calculation in 2020.*
2030F is a forecast based on current trends. Note a Gini indicates more inequality. The percentile indicate the share of countries earning less than the SA per Capita GDP in US dollars.

This historical data indicates that South africas inequality is also increasing as slower growth takes hold. **Fewer people employed as a share of the population is the main driving force of inequality and not stating that is dishonest.**

The fact that the dominant narrative in South Africa does not reveal or discuss this at all, is very concerning. The dominant government and academic narrative blame minorities and a few other factors, while the blame should be placed squarely on the inability of the country to attract investment, which would have fostered job creation.

Jobs, either formal or informal, will break people out of poverty and lower inequality. South Africa has, for too long, been fed the wrong narrative and diet of slogans that keeps growth and capital away.

In the rest of this report, we will focus on the reasons why South Africa is not growing. We reason that fixed investment is the factor that is lacking the most. We explore why fixed investment is so low in SA. We look at the profitability of the South African economy and the broader risks direct investors will face here.

FIXED INVESTMENT TRENDS ARE THE BEST SINGLE POINTER OF THE FUTURE

The first and most important indicator of where a country will be in the future, without fail, has been capital formation or fixed investment spending as a percentage of GDP. If you do not invest, you cannot grow as a country. If you do not invest in aeroplanes you cannot have an airline and the same applies across all sectors of the economy.

Sure, one can add population growth, education and confidence, etc., however, capital formation is the best forward-looking indicator of a country's future economic prospects relative to the rest of the world.

To grow an economy a country needs to invest in roads, factories, buildings, trucks, networks, electricity etc. Investment has been the South African indicator with the closest relationship to job creation and overall wellbeing.

Worldwide it is seen as the best indicator of long-term future growth of an economy. Investment sparks growth in providing a supply of goods and services and often also on-demand goods and services.

Fixed investment is observed closely as an indicator by economists because it is important for long-term growth. Chart 1 depicts the close positive relationship between fixed investment and GDP changes.

Moreover, it is one indicator that long-term investors in an economy keep an eye on to see if others also believe in the economic future of that country. Money attracts money - so for example, when a shopping centre is built in an area, it often leads to other investments such as say a fuel station and a restaurant and maybe even a warehouse, which could lead to the formation of a local transport company.

Often the question is asked: "Does the road come because there are cars and trucks in an area or does the road lead to more cars and trucks?" The answer is probably in the middle as some cars would have led to the government saying that perhaps we need a road while the car owners say, "Well there is this road now so perhaps a car is a great investment."

Over the last decade, the world invested 22,6% of its GDP, on average, every year. For South Africa the figure is 19,4%, some 15% (320 basis points) less than the world average.

Important to note is that some of the South African fixed investment during this period was done by State-Owned Enterprises (SOE's), which produced very little results or was expensive due to corruption. Some government projects such as roads lasted a year or two instead of the normal 15 or 20 years, as corruption and inability meant the project was useless to the citizens after a year or two.

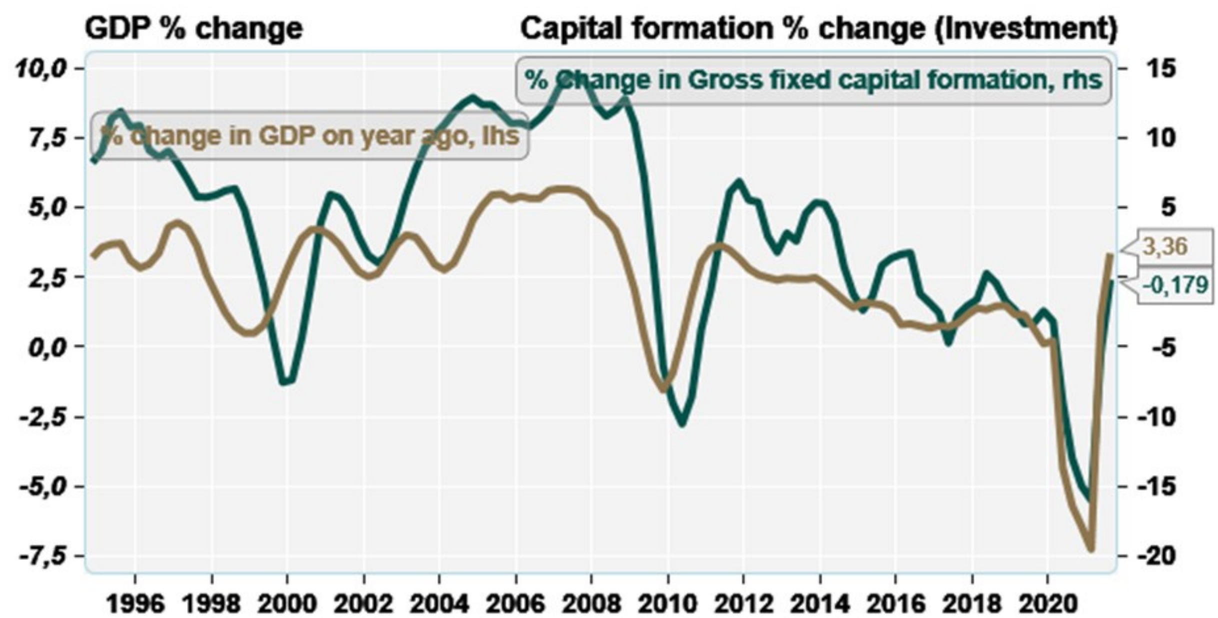
So, effectively fixed investment for South Africa was probably closer to 16% for the last decade, the rate it is at now, without many SOE investments duds and rent-seeking excises that made the few rich, at expense of the majority.

While the world growth averaged 3,3% from 2010 to 2021, South Africa managed only 1,3% on average.

Moreover, when it comes to jobs, South Africa has been a very slow creator of jobs over the past 13 years. By the end of 2020, South Africa had created 1,7% more jobs while the world, in total, created 14% more over the same period. Other emerging markets also created 16% more employment over the period. South Africa's dismally low economic growth has meant that over the last 13 years South Africa has grown jobs at a tenth of the rate of its peers!

CHART 1:
SA GDP GROWTH AND FIXED CAPITAL FORMATION GROWTH (4 QUARTER MOVING AVE)

GDP growth vs capital formation (investment) smoothed trend



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As stated above South Africa invests less than the typical and the average country in the world. In 2020 South Africa recorded the lowest capital formation as a percentage of GDP in at least 50 years! Admittedly, the impact of Covid-19 did play a role in the shocker 2020 data, but it does not change the theme that has been playing out in South Africa over the longer term, as the same was experienced by other countries too.

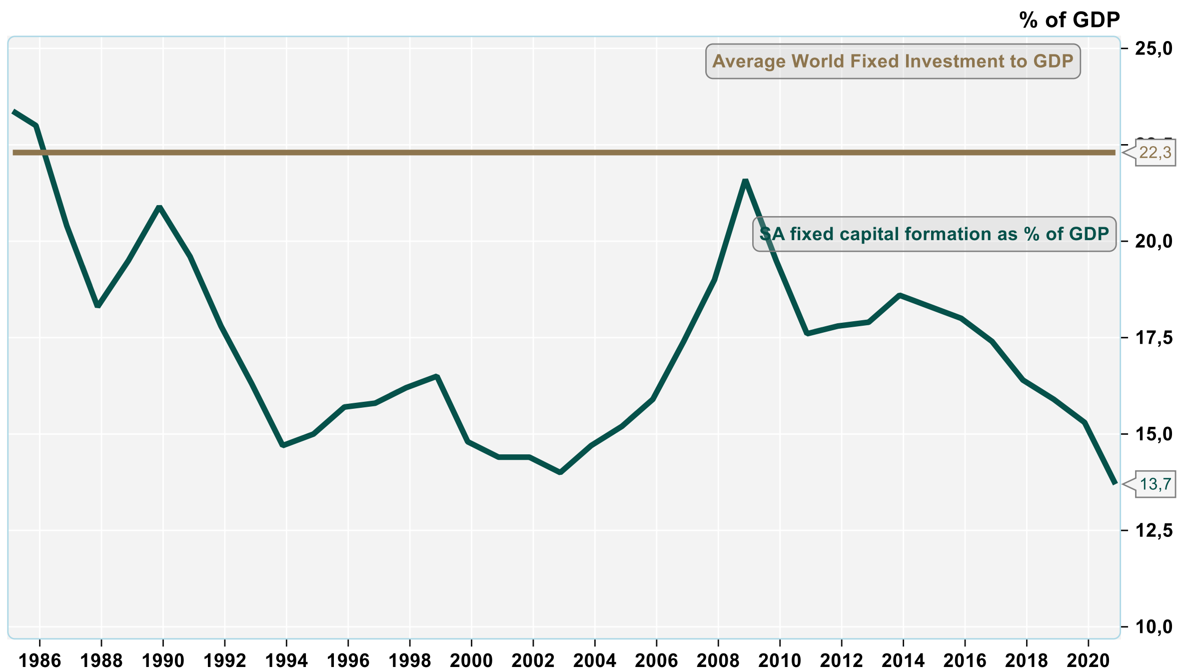
If South Africa had a gross fixed capita formation which was the same as the world average, one could argue a case that SA would have had better growth or at least similar growth to the world average.

Unfortunately, South Africa invested 39% less than the average country in the world did. South Africa has also underperformed world average growth by around 50% over the last 14 years. When South Africa had strong growth of 5 plus percent, the economy (coinciding with the commodity super-cycle) kept up with the world average, which was the case for the six years from 2001 to 2007.

Current under-investment is even worse and should result in South Africa underperforming the average economy in the world with a similar percentage. Moreover, much of South African investment is not effective as power outages impede a growing portion of expected investment returns.

CHART 2: SOUTH AFRICAN GROSS FIXED CAPITAL FORMATION AS A PERCENTAGE OF GDP, COMPARED TO THE 10-YEAR WORLD AVERAGE

South Africa gross fixed capital formation as a percentage of GDP vs world average



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Another interesting statistic is that net new capital formation, after accounting for capital use and depreciation, turned negative for the first time in two decades in 2020. While it was expected during Covid, as the lockdown stopped industries such as construction, future fixed investment needs to increase quickly, or SA infrastructure may become unusable in some cases. (One can only refurbish trains and power stations so often.)

The question is, why is South African fixed investment, expressed as a share of GDP, declining? Why did fixed investment decline in the last decade despite lower interest rates? The average Interbank rate decreased to 5,6% in the last 11 years from 9,6% in the first decade of the 21st century.

Government deficits increased and government borrowing increased too. But the government itself invested far less into the SA economy than ever before. State-Owned Enterprises also borrowed a massive amount of capital, but many of the capital projects were, at least, overpriced if not outright corrupt.

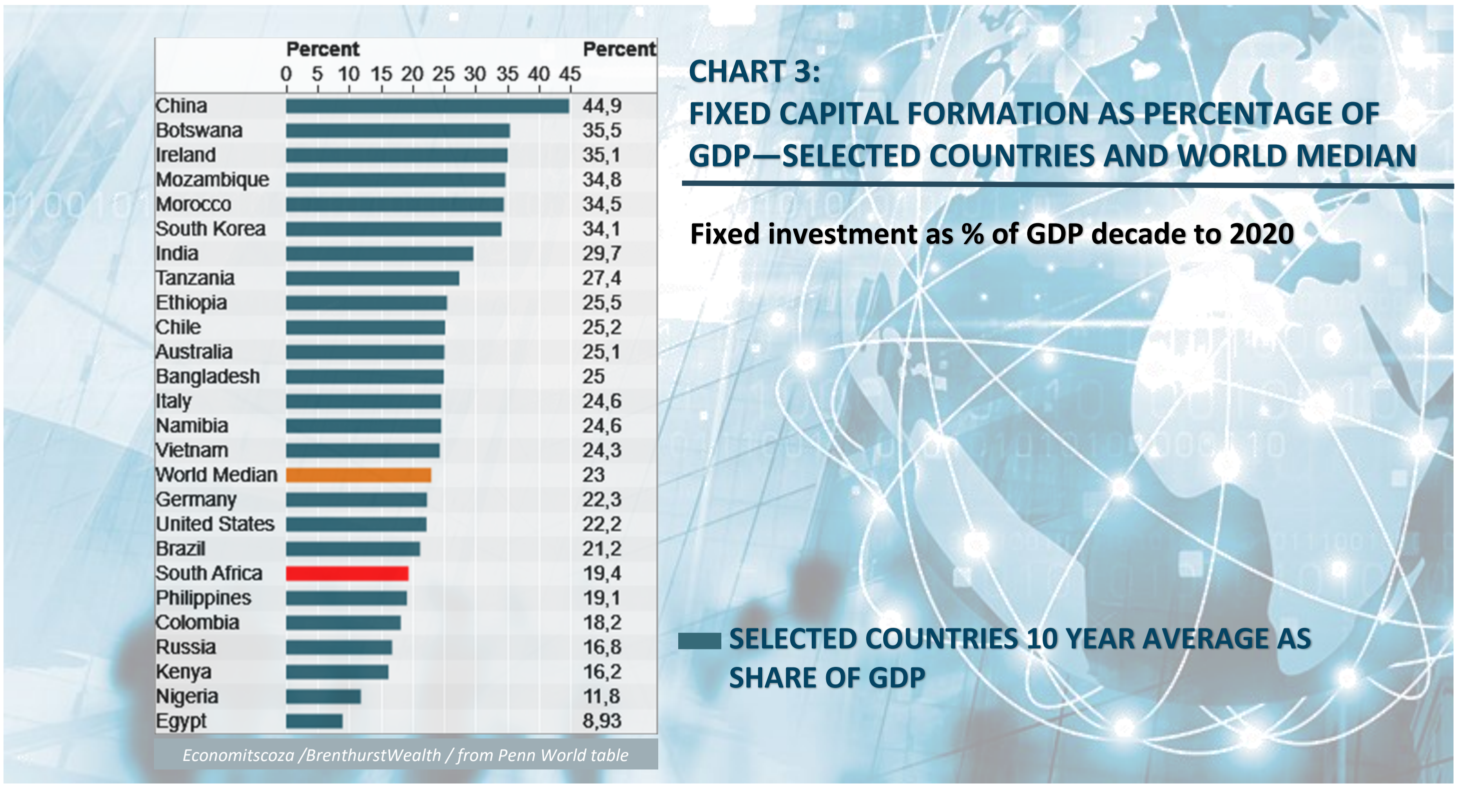
Thus, as illustrated in chart 2, fixed investment as a share of SA's Gross Domestic Product declined. While recently South African government leaders were very vocal about the developmental state, meaning that the state should lead development, the exact opposite took place as government fixed capital formation declined noticeably in real terms and as a share of GDP. This is illustrated in chart 4 below.

Also, in Chart 2, it is noticeable how much less than the recent decade-long world average South African fixed investment as a percentage of GDP is. Not only has Fixed investment remained below the world average of over 35 years, but it dropped further away from the world average. Just the difference between South Africa and the median country in the world over the last decade, as a percentage of GDP, would be equal to about R180 billion per year in today's terms.

As the South African Capital to Labour ratio suggests it costs far less than R1 million to create a job opportunity. On this basis alone South Africa could have created 2 million more jobs over the last decade. Of course, the economy too would have been bigger and that would have created even more employment had the country found or attracted the fixed investment.

South African leaders often go to foreign events to create awareness of the country and promote fixed investment. Often it has been said that the South African contingent at Davos is always one of the largest at the WEF. Government officials often tell of how they went on roadshows to attract fixed investment and how important this is. The data shows that the trips are a complete waste of money as in today's world there is no hiding the poor performance or the failure of the state in developing infrastructure. Yet, every year the South African PR machine goes into overdrive.

Fixed investment into SA remains in decline and the PR is just a nice feel-good event. The promises rarely materialize into reality. While the commodity cycle and Soccer World Cup helped until 2010, everything faded since. Notice that many successful countries have a high level of fixed capital formation as presented in Chart 3 below. Most of the top-performing countries have the highest fixed investment to GDP. Sure, some have corruption problems, like Mozambique, but for a while they had a very high economic growth until the corruption exposure ended it.



THE GOVERNMENT HAS A ROLE TO PLAY, BUT DOES IT?

In many countries, the government is a major contributor to fixed Investment. Often the private sector is the largest but not many have 70% or more private fixed investment, particularly when the state also owns the major of utility companies in water, power and transport.

However, in South Africa since 1994 the government has only accounted for 32% of all fixed investment. Private enterprise has provided over 68% of all fixed investment. Moreover, it is also true that only about 20% of all formal sector jobs are provided by the State while the private sector provides 80%.

At present, the broad government sector invests less than it did at any time since World War 2. This can be seen in the chart below. Currently, the government invests only about 28% of fixed investment while the share of fixed investment has declined by some 18%.

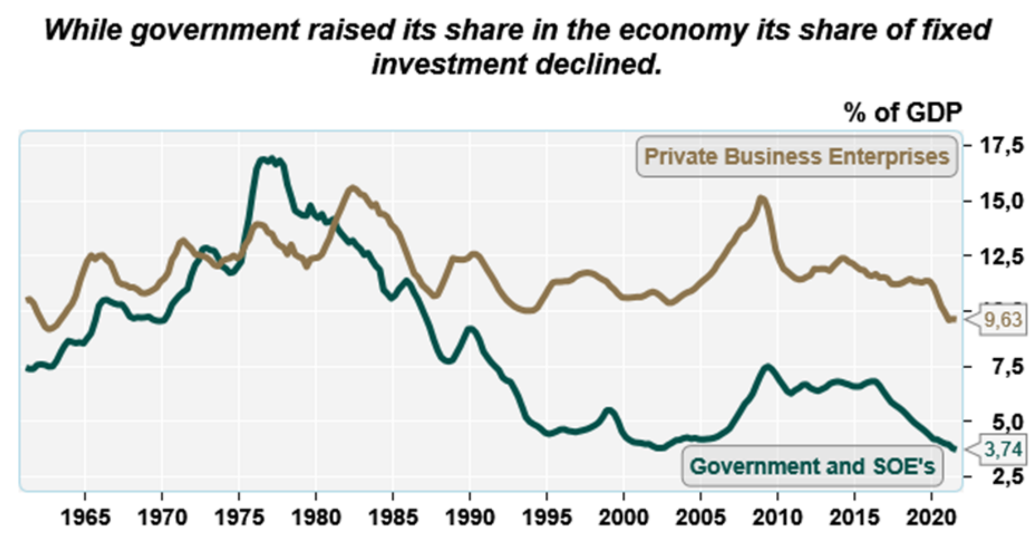
Many have asked the question of how government can have investment conferences when it itself does not invest. Some believe that government does not really believe in the future of the country because it invests so little.

Other's again state that much of government's fixed investment spending has been ineffective, at the least, and probably corrupt, rendering no returns. This is the first area that must change. The style of leadership required is not one of consensus-seeking but outcome-based leadership. The increase in investment and especially the increase in effective outcomes, needs strong, honest and decisive leadership. At present most surveys to business leaders indicate that this is not happening.

Many believe that the current government is too weak to implement what is needed, as it would probably have "undesired" consequences for people who keep the current top leadership in power.

The other end of the stick is that, without decisive and strong leadership, South Africa will fail. It may not fail by a specified date, but its people will continue to get poorer in relative terms to other countries at least. Since 2014 South Africans have became unquestionably poorer and now receive a similar income to that in 2011/2.

CHART 4:
PRIVATE SECTOR AND BROAD GOVERNMENT CAPITAL FORMATION AS A % OF GDP



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With government investment constrained by expenditure on salaries, grants and debt repayment, the state will not be able to provide much fixed investment in the foreseeable future. It is, therefore, the private sector that has and will have to provide the capital for fixed investment spending in South Africa.

There is also little room to increase either taxes or borrowing and the two largest State-Owned Companies can no longer borrow more to invest, as is their duty to the South African economy – it is clear that SOE’s will not be contributing to fixed capital formation.

This begs the question: "Why does the private sector invest in expanding their capital base?”
Part 2: “Why firms invest” to follow.

By Mike Schüssler our consulting economist who provides expert economic insight and analysis to the company's clients and advisory team.

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