CONVERSATION:
‘Junk status: Different futures, different opportunities?’

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The Banking Association South Africa

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Facilitator: Michelle Constant
Respondents: Everyone!
THIS IS YOUR ASSIGNMENT

FEEL ALL THE THINGS. FEEL THE HARD THINGS. THE INEXPlicable THINGS, THE THINGS THAT MAKE YOU DISOWN HUMANITY'S CAPACITY FOR REDEMPTION. FEEL ALL THE MADNESS PARADOXES. FEEL OVERWHELMED, CRAZY, FEEL UNCERTAIN, FEEL ANGRY, FEEL AFRAID, FEEL POWERLESS, FEEL FROZEN.

AND THEN

FOCUS

PICK UP YOUR PEN. PICK UP YOUR PAINT BRUSH. PICK UP YOUR DAMN CHIN. PUT YOUR TWO CALLoused HANDS ON THE TURNSTABLES, ON THE CLAY, ON THE STRINGS. GET BEHIND THE CAMERA. LOOK FOR THAT PINPRICK OF LIGHT. LOOK FOR THE TRUTH. (YES, IT IS A THING. IT STILL EXISTS.) FOCUS ON THAT LIGHT.

ENLARGE IT. REVEAL THE FIERCE URGENCY OF NOW. REVEAL HOW SHATTERED WE ARE, HOW CAPABLE OF BEING REMAINT. BUT DON'T LAMENT THE BREAK.

NOTHING NEW WOULD BE BUILT IF THINGS WERE NEVER BROKEN. A WISE MAN ONCE SAID: THERE'S A CRACK IN EVERYTHING. THAT'S HOW THE LIGHT GETS IN.

GET AFTER THAT LIGHT.

THIS IS YOUR ASSIGNMENT.
Junk Status – Different Futures, Different Opportunities

Creative Economy and Development Conference
24 May 2017
Willie Sutton committed his first bank heist in 1925, was on the FBI’s Most Wanted List, put him in prison for 33 years, (which included additional time because he kept escaping), six years in hiding and four years of parole. When asked why he robbed banks, Willie is credited with replying, “because that’s where the money is.”
Outline

- The Dark Cloud
  - 2017/2018 Budget challenges
  - Downgrade & its impact
- The Silver Lining
  - Focusing on where the money is
Budget context

- Bottom 20 per cent have benefited from social grants and better access to services,
- Top 20 per cent benefited from rising demand for skills and pay increases.
- Those in the middle have been left behind.
- 95 per cent of wealth is in the hands of 10 per cent of the population.
- Unemployment 35 per cent
- Over half of all children in Grade 5 cannot yet read adequately in any language.
- Half of all school-leavers enter the labour market without a senior certificate pass. 75 per cent of these will still be unemployed five years later.
- Our towns and cities remain divided and poverty is concentrated in townships and rural areas.
- Our GDP growth too slow – just 1 per cent a year in real per capita terms over the past 25 years,
RET, anti-WMC, inclusive growth...

- Transforming ownership, management, promoting competition
- Mobilising private and public investment to modernise and diversify
- Providing workers and poor with access to markets, and social and economic infrastructure.
- Investing in research and development, and innovation.
- Improving education and training for a modern economy.

ANC Strategy and Tactics Document:

- ‘ANC seeks to build democracy with social content, underpinned by a capable developmental state’
- National Democratic Society: Thriving economy, leading edge technology, labour absorbing industrial development, thriving small business, use of ICT, good management
During the first three quarters of 2016, investment in fixed capital fell by 3.9 per cent – the first decline since 2010.

The main driver was investment by private business, which fell by 5.9 per cent.

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**Real growth in fixed investment**

![Graph showing real growth in fixed investment](image_url)
Service sectors for growth, job creation

- Mining and manufacturing employment declined by 80 000 jobs in 2016. The services sector created 119 000 jobs in 2016
- Finance, insurance, real estate and business services sector remain the largest contributor to growth

### Sector growth trends

<table>
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<th>Percentage</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<td>2.0</td>
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<td>3.6</td>
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<td>-5.9</td>
<td>-7.0</td>
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<td>-2.9</td>
<td>4.0</td>
<td>-1.4</td>
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<td>0.1</td>
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<td>-0.6</td>
<td>-1.3</td>
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<td>4.6</td>
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<td>1.4</td>
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<td>1.9</td>
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<td>3.1</td>
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<td>-0.1</td>
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<tr>
<td>Finance, real estate and business services</td>
<td>4.3</td>
<td>3.0</td>
<td>2.5</td>
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<td>Personal services</td>
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<td>1.7</td>
<td>1.1</td>
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<td>2.9</td>
<td>2.7</td>
<td>0.7</td>
<td>1.7</td>
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<td><strong>GDP</strong></td>
<td>3.3</td>
<td>2.2</td>
<td>2.3</td>
<td>1.6</td>
<td>1.3</td>
<td>0.4</td>
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</tbody>
</table>

1. Up to September 2016

Source: Statistics South Africa
Consolidated spending 2017/18

Salaries and interest payments are crowding out other spending elements

Compensation of employees
550 354.7
35%

Goods and services
R 221 742.4
14%

Transfers to households
R 257 982.9
17%

Transfers to municipalities
R 122 192.2
8%

Other transfers
R 128 578.6
8%

Capital spending
R 101 389.3
6%

Interest and rent
R 169 334.6
11%

Other
R 11 552.4
1%
The national budget is strongly aligned with constitutional imperatives.

About two-thirds of the 2017 Budget is allocated to functions dedicated to realising constitutionally mandated social rights – including education, healthcare, social security and housing.
And the news does not get any better:

THE DOWNGRADES
Causes and effects

- Causes - economic deterioration, unsustainable macroeconomic imbalances, a domestic, financial or banking crisis, or neighbours crisis.

- After downgrade:
  - Recession, negative growth lasting almost two years.
  - Budget deficit not turn into a surplus, but deficit does not widen either
  - Current account deficit on average moves into a surplus, due to earlier currency weakness/higher interest rates.
  - Sovereign credit peaks around the time of the downgrade, and then starts to improve.
  - The currency and equities stabilise.
  - As the currency stabilises, CPI tends to move lower.
In South Africa’s case

- SA political issues are paramount. We have slowing GDP growth, growing pressure on the fiscus, weak employment creation and policy uncertainty.
- Currency and sovereign credit risk spiked little ahead of the downgrade by S&P (compared to other EM countries) movement masked by positive sentiment towards EM.
- If South Africa follows the average level of GDP growth, the country is set for a recession, especially if more currency weakness should set in.
- Also, it appears as if South Africa’s real policy rate (or real repo) remains low compared to the average (and perhaps one of the reasons why South Africa’s current account remains wide).
- If South Africa responds to the downgrade in line with the average, it may imply that the country has seen the worst of the currency and bond weakness already.

Source: Standard Bank
Downgrade to junk

- Some funds legally bound to disinvest if downgrade
  - If one downgrade: SA falls out of JP Morgan GBI GD IG index - selling around $1bn
  - If two downgrade: SA falls out of JP Morgan cross-over IG index – selling $1.50bn - $2.5bn.
  - S&P and Moody’s downgrade: SA falls out of WGBI (estimated selling of $8.8bn) and falls out of JP Morgan Treasury Index ($4bn – $5bn forced selling).
  - If all these conditions are met, this would equate to about $17bn (or R230bn with ZAR13.50) of forced selling. This is 18% of South Africa’s total marketable fixed interest domestic debt.
  - South Africa will still remain part of other JPM indices which are not ratings sensitive. Funds in SAGBs tracking these indices may be just below R200bn.

- Banks automatically downgraded to sovereign rating.
- Difference between international and domestic ratings - sentiment turning against emerging markets.
Impact on everyday life

**PEOPLE**
- Credit card payments and interest rates on home and car loans will rise
- Cost-of-living expenses like food and transport will go up
- Income taxes will go up as government tries to raise money from its citizens to fund large projects because borrowing internationally is now more expensive

**SOCIETY**
- Less spending on social projects like housing, education and welfare
- Less spending on programmes to create jobs and alleviate poverty
- Likely job losses as organisations reduce cost and risk

**SMALL BUSINESS**
- Businesses will find it harder to get finance, and loans will come at higher interest rates
- Reduced goods-market efficiency. Prices that don't reflect demand
- Imported goods cost more as the rand loses value

**BIG BUSINESS**
- Reduced confidence
- Reduced expenditure
- Freeze on new positions and less hiring
- Fewer jobs

**THE CONTINENT**
- Reduced access to capital
- Reduced foreign direct investment
- Reduced competitiveness
- Less confidence in the continent as a whole
**Paths to recovery**

- Strategies: fiscal consolidation/austerity measures; political and economic reforms; declining external and fiscal vulnerabilities; debt-restructuring and economic policy reform, privatisation and active intervention by a newly elected government.

- SA’s options:
  - Political stability with a pragmatic centre (inclusive growth)
  - Macro stability – the economy must be anchored by a credible national development agenda e.g. the National Development Plan starting point but is there the political will
  - If above in place firms investment the ZAR 600bn. Note 10 years ago, private investment to GDP = 28%; now 20% falling
  - 2 years is the minimum conceivable time to get out of junk status - a low probability.
  - Average 7 years to recover.
Immediate steps for the country

- Ensure policy continuity
  - Dealing with ‘radical economic transformation’
  - Restore business confidence via predictable policy

- Ensure institutional continuity
  - Problems around Ministers Adviser
  - Replacement of Director-General at National Treasury
  - Ensure experienced staff don’t leave National Treasury
  - Procurement Office remains credible

- Support the effort to ensure well-functioning, financially stable SOEs.
AND NOW FOR THE SILVER LINING
Tourism globally expected to grow 3.3% pa from 2010-2030; Africa has 5% share in worldwide arrivals, 3% share in tourism receipts. Creative economy contributing 2.9% to the SA GDP, employs over 440 000 (global averages 3% GDP). Over 50% owned by Black South Africans, 40% are owned by women and more than 30% by young entrepreneurs.
Win-win partnerships

- Minister Mthetwa set out different models: Grant Funding, A Creative and Cultural Industries Fund, Debt Finance and Equity Finance, supplemented by a catalyst fund, regional funds, accelerators and incubators.

- Push for: Address barrier to greater private sector funding in Section 18A and the Ninth Schedule in Section 30 of the Income Tax Act of 1962, which excludes arts, culture and heritage.

- Locate it in rural, small business, labour creating, innovation, radical economic transformation, green energy, inclusive growth space

- Transit from Second Economy to First Economy
Where is the money?

- **Government spend:**
  - R3.9 billion for small, medium and micro enterprises and cooperatives.
  - R1.9 billion for broadband implementation.
  - An additional R494 million for tourism promotion.
  - Spending on agriculture, rural development and land reform amounting to nearly R30 billion by 2019/20.
  - Average of R10.5-bn per year for arts, sports, recreation and culture.
  - Community library services about R1.5-bn per year for the next three years.

- **Private Sector**
  - R600bn cash pile PLUS HNW individuals
Sourcing funding in First Economy

- Tapping into new demographics
  - Millennials: want to support social causes,
  - Emergence of ‘trust fund’ generation, venture capital
  - Green creative industry: re-use of material
  - Tech savvy: digitisation of creative industries
- Look at getting into the stock market
  - Consider listings
- Better use of international missions
  - My Hlongwane and Eboka experience
- Better use of multilateral funding
  - UNESCO – cultural heritage
  - Global Environment Facility through UNEP - Biodiversity Conservation
  - WEF – Trade/Tourism Council
  - World Bank – poverty alleviation, skills development
“With limited room for stimulus through macroeconomic policies, the priority to stimulate economic growth and job creation rests with structural reforms, notably in product and service markets and in the labor market. The focus should be on sectors that provide crucial inputs for most firms in the economy, such as power generation, telecommunications, transportation, and financial services for small- and medium-sized enterprises.”
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Different Futures, Different Opportunities
Luiz Coradazzi, Brazil
24 May 2017
BR/SA: Population Growth (%)

BR/SA: Population Age (%)

BR/SA: Diversity (%)

Source: NationMaster (http://www.nationmaster.com)
BR/SA: Urban Population (%)

BR: Identity
SA: Identity
BR/SA: crisis
BR: Porto Digital

- 274 companies
- + 800 entrepreneurs
- + 8500 employees
- + US$ 450 million

www.portodigital.org
BR: FLUPP

5 festivals
15 new books
100 new authors

www.flupp.net.br