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Junk status and its influence on agriculture

Dr John Purchase, CEO: Agbiz

As the dust settles on the past month's dramatic political developments and the much publicised investment downgrades by the rating agencies Standard and Poor's (S&P) and Fitch to so-called junk status, reality sets in and we have to determine what the probable impact will be, and more importantly, how we deal with this less than satisfactory situation.

As South Africa's economy is fully integrated into the global economy, and thus dependent on capital inflows into our bonds and equities to support our economy, there is real concern that the Rand will weaken further against major currencies as significant capital outflow will now take effect. This will in turn lead to inflationary pressure and necessitate interest rate increases, which again will considerably constrain economic growth prospects.

From a purely economic perspective it is a real challenge to arrest the indicated downward spiral and knock-on effect. The only way out of this negative trend is to develop and implement a credible growth strategy across all sectors of the economy, and driven primarily by business through well targeted investment strategies. This is essentially what the former Finance Minister, Pravin Gordhan, attempted to do with organised business through the so-called CEO Initiative. Revitalising agriculture and the agro-processing sector was very much part of said initiative.

But even before the downgrades, it became clear that an inclusive growth strategy alone would not stop the then pending downgrades, as the Achilles heel to the economy had become certain State Owned Enterprises (SOE's) and their massive losses and/or commitments that necessitated huge government guarantees to keep them afloat.

Together with the need to address the SOE's debacle, as well as other structural problems constraining our economy, such as policy uncertainty and the labour environment, it becomes clear that for South Africa to regain its investment grade ratings will take any number of years and require economic and political leadership of momentous proportions. Given utterances from certain cabinet ministers, don't hold your breath on this.

But what will the impact be on agriculture and the agro-food value chain as a whole? The current generally favourable agricultural and agribusiness environment, as primarily indicated by a near record maize crop and the positive Agbiz/IDC Agribusiness Confidence Index, will mask immediate and short term effects of the downgrades, as farmers by and large manage to settle accrued and rescheduled debts from the past couple of seasons' droughts.

For the next summer season, however, farmers will in all probability find the cost of capital (interest rates on production loans) higher, while lending institutions will need to revise their credit criteria and cut down on higher credit risk. As always, lending institutions will be mindful of and compliant with the so-called 'affordability assessment' and 'reckless lending' stipulations of the National Credit Act.

Farmers in those industries earning revenue in US Dollars, Euros or British Pounds, directly or indirectly, will be in a better position to attract financing as increased earnings in Rand, due to expected Rand devaluation, will be a recommendation. The downside of the weakening of the Rand will however be significantly increased production costs as dollar-based inputs, such as diesel, agricultural machinery, fertilisers, ag-chemicals and seed, will all probably increase at rates well above the CPIX inflation rate. This will squeeze already tight margins in many industries even further.

But the above scenarios are just from a purely economic perspective and presume a stable political and policy environment. South Africa's political environment has however destabilised considerably over the past couple of years, and especially over the past month or two. Similarly, major uncertainty in the policy environment is strongly coming to the fore. It is especially proposed radical economic transformation policies, such as "Expropriation without Compensation", as stated by Minister Nkwinti in the SONA Debate and confirmed by President Zuma in closing arguments of said debate that impact negatively on investor confidence.

While the ANC's Policy Discussion Document for their Policy Conference in June 2017 does not provide for such policies, it has been stated by the KZN ANC that it will formally propose such policy at the ANC's Policy Conference in June. If this proposed policy was to be adopted, the potential impact, not just on the agro-food system and food security but on the economy of the country as a whole, will be catastrophic. So the greater danger certainly lies in political and policy developments over the next year.

On the positive side, the South African agricultural and agribusiness sectors are extremely resilient and innovative in making the agro-food system work. This has been proven by the manner in which the broader industry has been able to bounce back from the most devastating drought in more than a century. This stress test has enabled the sectors to fully understand the inherent weaknesses, but especially also the strengths of the system. Despite very limited drought support from government, the commercial sector has learnt how to leverage off these strengths to ensure sustainable food production and food security for the country.

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