April 2018

Implications of Land Reform for local investors

Investors and the public at large will note with some anxiety the prospect of *'land expropriation without compensation'* as a targeted policy by the ruling party. In this article we assess the potential outcomes of this policy on investor portfolios, and where both opportunities and threats may exist.

A change to the Constitution

The motion passed in Parliament during February 2018 aims to amend the Constitution with regards to land expropriation without compensation, making it *"possible for the state to expropriate land in the public interest without compensation".*

The expectation of this motion is to fast-track the current land reform processes to address the inequality of land ownership in South Africa as a result of the apartheid regime and the Native Land Act of 1913. Land reform is a complex and sensitive issue and is met with mounting frustration against the backdrop of land dispossession in South African history. The pressing question for most investors and property owners in South Africa is, "How will this affect me?" It should also be noted that the existing Constitution does already provide for this, on a *"just and equitable"* basis.

The stated intention of the government is to implement this policy in a manner which does not endanger food security, economic growth and job creation as well as not destabilise the agricultural sector. No clarification has been provided on which land may possibly be expropriated, however, the government has hinted that the focus will be on vacant land and land held for speculative reasons. The current assumption is that this refers to agricultural land.

Why redistribute land?

There appears to be two main drivers supporting land reform in general across the world:

- Land as a basic human right: countries such as our own and India are pushing for land reform to uplift the large proportion of the population living in poverty. This is generally driven by government policy.
- Economic development: promoting development is often led by agencies such as the World Bank and the IMF who have a mandate to promote global growth and reduce poverty.

In South Africa you could argue for both of these drivers to be relevant.

Lessons from history

Looking back there are multiple examples of land reform which can be seen across the world – with positive and negative consequences. In Eastern and Central Europe land was redistributed post World War I, and in Finland land was reclaimed by the state and held in a fund, all with some success.

In 1930 the Soviet Union instituted a policy of "Collectivised Farms" which was essentially a policy of expropriation without compensation – a nationalisation of land. The projected goal was to increase agricultural production; however, resistance was met with violence resulting in an agricultural collapse, an unprecedented famine and a death toll of around 12 million people.

In Zimbabwe, land reform was highly successful until about 1997, where nearly 30 per cent of commercial farm land was transferred without any loss of production. Politics led to land reform being accelerated aggressively and again, a decline in production and GDP was experienced. Subsequently, Zimbabwe experienced a period of hyperinflation and economic decline which decimated the value of their currency.

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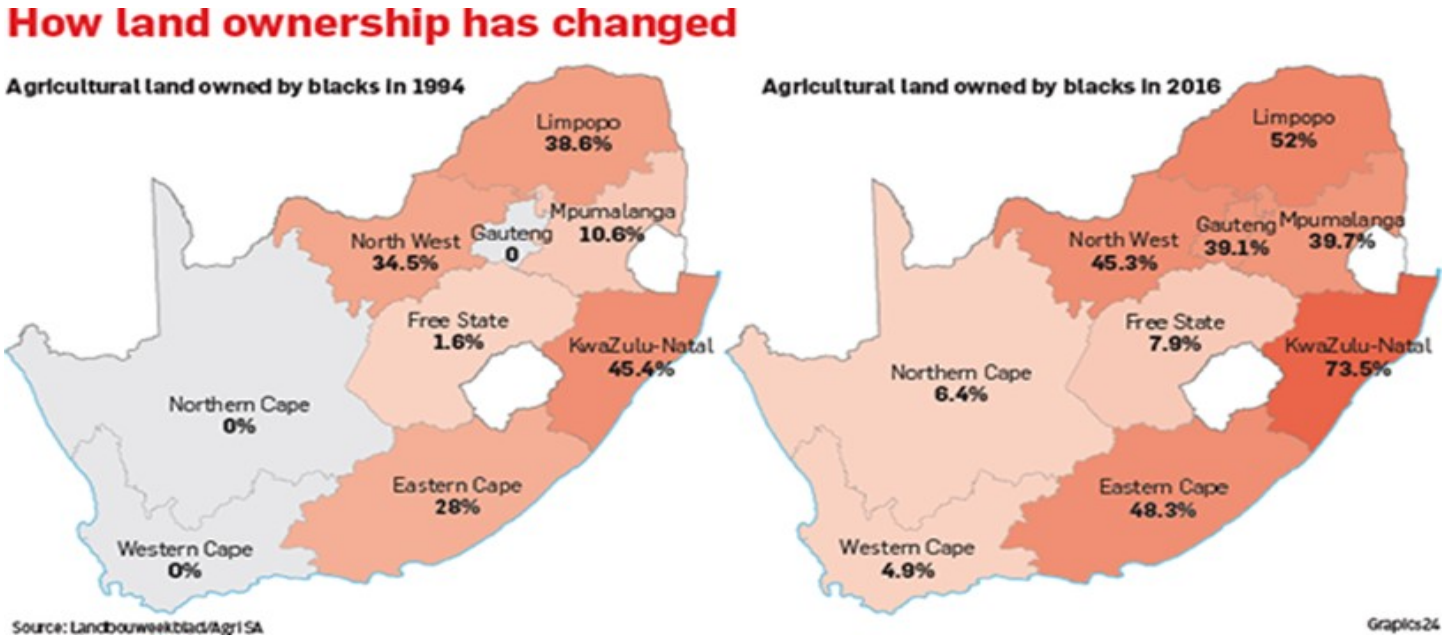
A positive example can be seen in Scotland where land reform has taken place peacefully over the years. A motion was passed giving the state the power to force a sale where land ownership or the behaviour of a landowner is a barrier to sustainable development. Vacant and unused land was also subdivided and sold.

In summary, when handled carefully and done slowly, land reform can have a positive outcome.



Implementation in South Africa

In South Africa, land reform has taken place (generally with compensation) over the years and has increased black ownership significantly, as illustrated in the chart below: (*source: Landbouweekblad/AgriSA*).

We can start to evaluate the potential implications for investors by framing a 'good outcome' and a 'poor outcome'.

Conditions for a good outcome include a stable government, measured implementation of policy, maintenance of balance between private and public stakeholders, and organised support for the beneficiaries of land expropriation, including both industrial and financial support. In addition, a focus on land which at the margin does not materially prejudice the prior owner – in that redistribution does not simply transfer the problem to another party.

In this instance the financial benefits we would hope for include a larger proportion of the population becoming economically active, more food security, and a gradual reduction in poverty.

In the second case - the poor outcome – the evidence we see from history is an accelerated approach destabilising the stability-seeking financial markets, with knock-on effects throughout the economy. Citizens in SA are still smarting from state capture and wide-spread corruption adversely affecting our national development. The level of trust, while improved, is still tenuous and extremely fragile, and this is potentially the most significant risk to this policy being implemented effectively. Can we trust the government to maintain the balance of public and private interests and avoid destabilising the economy given their recent track record?

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Investor Implications

The key investment items to consider relating to the topic of land reform include our currency, bonds, property, inflation and locally oriented equities.

At present our bond market is not pricing in any material degree of risk stemming from land reform, with our country risk premium at relatively low levels as the new leadership has become established. Inflation expectations are also on the low side, in general a positive environment for the domestic economy relative to what we have had over recent years.

What this illustrates is that we would generally expect quite limited upside in the short to medium term from land reform, while downside potential is significant.

In the good scenario – the long-term vision of lower unemployment, higher income levels, and improved food security bode well for stable capital markets and economic growth.

In the poor scenario – heightened risk aversion would have severe negative consequences for local bonds (through our country risk premium), currency, inflation, property (the extent to which is difficult to estimate, but is the asset class potentially most exposed to a poorly executed land reform policy), and domestically dependent shares.

With both outcomes there will be certain consequences common to both:

- **Debt:** there is a significant government financing requirement to support the development of enterprise on the expropriated land. SA already has a large debt burden, and with a weak economy it is difficult to see how this would be financed without impacting financial stability. In addition, it is unclear how private owners financing property with debt would be managed given the potential for financial loss at a personal level and across the banking sector.
- **Investor risk aversion:** this is a substantial risk, as the positive side of the policy will only show in long term effects, while negative consequences will show quickly. This is potentially a self-fulfilling cycle where the risk aversion makes it financially impossible to afford the land reform to begin with.

For investors, risk aversion at this time will be higher than the return potential as a result of this policy, which is rational as the payoffs are not evenly matched. Social benefits and investor returns are not necessarily balancing items for each other.

This points towards ensuring appropriate diversification of holdings, including offshore allocations, to mitigate any negative consequences, bearing in mind that as one increases their offshore exposure, they also create greater disparity between local liabilities (ie: spending) and investment returns (ie: saving). Investors should also consider the extent they are reliant on domestic property holdings (physical and listed) as a core store of wealth given the specific risk associated with the land reform policies.

Lastly, don't underestimate the potential for the good outcome. Should we be at the early stages of a stable local government and a strengthening economy, allied with a measured and sensible approach to land reform as well as other socially focussed projects, we could be in for a golden period of stronger local returns and improved social welfare.

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data provided by Reuters and Datastream

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	-1.0%	-0.9%	11.5%	5.3%	11.8%	9.8%	11.3%	14.6%
FTSE/JSE SA Listed Property	ZAR	-3.9%	-13.4%	-0.5%	2.0%	7.2%	15.3%	14.7%	15.1%
SA All Bond Index (ALBI)	ZAR	5.3%	7.3%	13.8%	8.6%	6.7%	9.6%	8.1%	7.7%
SA Cash Index (SteFI)	ZAR	1.7%	2.4%	7.5%	7.2%	6.6%	7.0%	0.3%	0.5%
Balanced Benchmark	ZAR	0.6%	0.4%	9.5%	6.5%	11.1%	10.4%	7.2%	8.9%
SA Inflation (1 month lag)	ZAR	1.4%	1.8%	3.8%	5.4%	5.3%	5.6%	1.4%	1.3%
GLOBAL MARKET INDICES									
Global Equity (MSCI World)	USD	-5.0%	0.0%	13.8%	8.2%	9.9%	6.1%	10.1%	16.2%
Emerging Markets Equity (MSCI EM)	USD	-6.7%	1.0%	22.1%	6.4%	5.1%	2.5%	15.0%	22.3%
Global Bonds (Barclays Global Bond Index)	USD	-1.1%	0.6%	5.1%	2.4%	0.6%	2.1%	5.5%	6.5%
Global Cash	USD	0.5%	0.7%	1.6%	1.0%	0.7%	0.7%	0.2%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	-1.0%	-0.9%	11.5%	5.3%	11.8%	9.8%	11.3%	14.6%
Global Equity (MSCI World)	ZAR	-0.1%	0.9%	6.2%	9.7%	17.4%	11.6%	14.1%	14.5%
Emerging Markets Equity (MSCI EM)	ZAR	-2.0%	1.9%	13.9%	7.9%	12.3%	7.8%	13.2%	15.6%
SA All Bond Index (ALBI)	ZAR	5.3%	7.3%	13.8%	8.6%	6.7%	9.6%	8.1%	7.7%
Global Bonds (Citigroup)	ZAR	4.0%	1.4%	-2.0%	3.9%	7.4%	7.4%	12.4%	14.4%
COMMODITIES									
Gold (US Dollars)	USD	-2.1%	0.8%	3.6%	3.6%	-2.2%	4.2%	15.3%	18.1%
Gold (Rands)	ZAR	2.9%	1.6%	-3.4%	5.1%	4.5%	9.6%		
CURRENCIES									
Rand / Dollar	ZAR	5.1%	0.8%	-6.7%	1.4%	6.8%	5.2%	14.3%	16.5%
Rand / GBP Pound	ZAR	1.8%	2.7%	-0.7%	-2.2%	4.2%	1.4%	15.4%	15.5%
Rand / Euro	ZAR	2.0%	1.5%	3.5%	4.0%	5.0%	2.5%	13.0%	13.1%

Spot Rates		3-May-18	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	12.73	11.85	13.41	9.17	8.13	5.04
Rand/GBP	Rand	17.25	16.62	16.78	13.93	16.16	8.44
Rand/EUR	Rand	15.21	14.57	14.34	11.78	12.88	-
RATES							
Libor 6m $	US$	2.51	2.45	1.42	0.44	2.61	5.75
Repo Rate	Rand	6.50	6.50	7.00	5.00	11.00	15.00
Prime	Rand	10.00	10.00	10.50	8.50	14.50	18.25
All Bond Index Yield	Rand	8.92	8.62	9.38	7.24	-	-
COMMODITIES							
Gold ($/oz)	US$	1,313.89	1,323.43	1,247.25	1,595.80	932.40	301.35
Platinum	US$	902.00	936.00	940.00	1,576.00	2,040.00	407.00
Oil (Brent Crude) $	US$	73.20	70.09	52.62	109.57	104.27	13.92
INFLATION							
SA Inflation	%	-	3.8	6.1	5.9	11.6	-

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