COMMISSION OF INQUIRY INTO STATE CAPTURE

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DAY 51

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CHAIRPERSON: Good Morning Mr Mokoena, good morning everybody.

ADV PHILLIP MOKOENA: Good morning Mr Chair. Mr Chair the second witness for the Treasury is Ms Catherine Julia MacLeod. We are ready to proceed leading the evidence of the witness. Could the witness be please sworn in?

CHAIRPERSON: Ja that is in order.

REGISTRAR: Please state your full name for the record?

MS CATHERINE JULIA MACLEOD: Catherine Julia MacLeod.

REGISTRAR: Do you have any objections to taking the prescribed oath?

MS CATHERINE JULIA MACLEOD: Nope.

REGISTRAR: Do you consider the oath to be binding on your conscience?

MS CATHERINE JULIA MACLEOD: I do.

REGISTRAR: Do you swear that the evidence that should be given the truth, the whole truth and nothing but the truth; if so please raise your right hand and say, so help me God.

MS CATHERINE JULIA MACLEOD: So help me God.

REGISTRAR: Thank you.

ADV PHILLIP MOKOENA: Mr Chair for the purpose of leading the evidence of Ms MacLeod we will be working and referring only on one bundle. It is – we have taken the liberty of marking it Exhibit P1. It is in the blue folder next to you Mr Chair.

CHAIRPERSON: Okay.

ADV PHILLIP MOKOENA: We have marked it…

CHAIRPERSON: Sorry – so the letter from the Director General is marked P1A?

ADV PHILLIP MOKOENA: Yes and…

CHAIRPERSON: Is that how it is supposed to be?

ADV PHILLIP MOKOENA: And the numbering continues Mr Chair up until P1G. That will be the last page of the bundle before you.

CHAIRPERSON: The P1A is a letter from the DG and then after that P1B is a certain document that – and then P1C and then P1D is written at the top Annexure Supporting Information but seems to be…

ADV PHILLIP MOKOENA: It is part of the report Mr Chair.

CHAIRPERSON: A continuation of the document.

ADV PHILLIP MOKOENA: Yes.

CHAIRPERSON: Is that…

ADV PHILLIP MOKOENA: Even the graphs that follow from P1E.

CHAIRPERSON: The report up to P1G?

ADV PHILLIP MOKOENA: Yes.

CHAIRPERSON: Is that – but where does the report start? Does it start where it says background?

ADV PHILLIP MOKOENA: It starts at P1B yes Mr Chair.

CHAIRPERSON: Oh. Okay it does not start in the usual way that I am used to but okay alright. So P1A is the letter from the DG to the commission and P1B up to the end is the report on which the witness will be testifying?

ADV PHILLIP MOKOENA: Yes Mr Chair.

CHAIRPERSON: Okay alright. Thank you. Can I have the spelling of the surname?

MS CATHERINE JULIA MACLEOD: It is…

CHAIRPERSON: Because I do not see it here.

MS CATHERINE JULIA MACLEOD: Sure it is M-a-c-

CHAIRPERSON: M-a?

MS CATHERINE JULIA MACLEOD: C.

CHAIRPERSON: C capital or not capital?

MS CATHERINE JULIA MACLEOD: L-e-o-d.

CHAIRPERSON: Is C capital or not capital.

MS CATHERINE JULIA MACLEOD: No the L is capital.

CHAIRPERSON: Oh M-a-c.

MS CATHERINE JULIA MACLEOD: Capital L.

CHAIRPERSON: Ja.

MS CATHERINE JULIA MACLEOD: E-o-d.

CHAIRPERSON: E-o-d. Okay thank you.

MS CATHERINE JULIA MACLEOD: Thanks.

CHAIRPERSON: Yes you may proceed Mr Mokoena.

ADV PHILLIP MOKOENA: Mr Chair the evidence of Ms MacLeod will be corroborating the evidence of Mr Mogajane. You would recall Mr Chair that Mr Mogajane the DG of Treasury did give evidence before the Chair and there was certain information that he was requested to compile for the commission.

CHAIRPERSON: Yes.

ADV PHILLIP MOKOENA: And Ms MacLeod is here to do exactly that.

CHAIRPERSON: Okay.

ADV PHILLIP MOKOENA: Her evidence does not implicate anyone.

CHAIRPERSON: Yes.

ADV PHILLIP MOKOENA: He will be simply quantifying the economic ramifications of what we have now come to know as the NeneGate.

CHAIRPERSON: Okay. Thank you.

ADV PHILLIP MOKOENA: Ms MacLeod on the 23 November 2018 Mr Dondo Mogajane the Director General of Treasury testified before this commission, are you aware?

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: Yes. And at the conclusion of his testimony the Chair gave him some homework to do. He was requested to provide information pertaining to the impact of the - what we now know as the NeneGate to the SA Economy, do you recall? That is what is…

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: Yes. Would I be correct that your evidence today will be corroborating that evidence and you are the person that has been nominated by Treasury to provide that quantification of the impact of the NeneGate?

MS CATHERINE JULIA MACLEOD: I will be corroborating the impact of NeneGate on national debt.

ADV PHILLIP MOKOENA: Yes. Now where are you currently employed?

MS CATHERINE JULIA MACLEOD: At the National Treasury.

ADV PHILLIP MOKOENA: And in what capacity?

MS CATHERINE JULIA MACLEOD: I am the Chief Director for Macro Economic Policy.

ADV PHILLIP MOKOENA: And then in that capacity what are your responsibilities and functions?

MS CATHERINE JULIA MACLEOD: I am responsible for providing policy advice to the minister and DG in matters relating to Macro Economic Policy. So that has got to do with monetary policies, savings and investment. We discuss a lot about what the financial market impacts are on South Africa's overall vulnerabilities and what policies we should be undertaking to try and manage those. And then we are also responsible for Labour Market Policy advice to the minister.

ADV PHILLIP MOKOENA: Yes. When did you join National Treasury?

MS CATHERINE JULIA MACLEOD: In 2010.

ADV PHILLIP MOKOENA: In 2010. Now from 2010 can you simply briefly just sketch for us your employment history within the department itself?

MS CATHERINE JULIA MACLEOD: Sure. I was the director for Demand Analysis.

CHAIRPERSON: Well maybe before you do that what are your qualifications?

MS CATHERINE JULIA MACLEOD: I hold a Masters in Economics from Pompeu Fabra it is a university in Barcelona, Spain. I have my Honours in Economics from the University of Stellenbosch and I completed my Batchelor of Economics at the University of Stellenbosch.

CHAIRPERSON: Okay thank you.

ADV PHILLIP MOKOENA: And that was going to be my next question Mr – Ms MacLeod but can you then go back to the initial question just to contextualise your answers in relation to your employment history?

MS CATHERINE JULIA MACLEOD: Sure. So I joined Treasury in 2010 as the Director for Demand Analysis. This position is responsible primarily for the monetary policy framework and what can be done to raise savings and investment in the country. There I did not a lot of work on inflation targeting. On – again a lot of the work that we do is around what happens to financial markets and what the implications are for the fiscus in our macro policy framework and working a lot with the Reserve Bank on issues relating to vulnerabilities in South Africa's growth policy.

ADV PHILLIP MOKOENA: Ms MacLeod if you may be slowly in your evidence I am trying to capture some of the essence so that I can be able to clarify some of the – some of your evidence. You said that you are also working hand in glove with the Reserve Bank?

MS CATHERINE JULIA MACLEOD: Well National Treasury and the Reserve Bank obviously co-operate on matters relating to managing fiscal and monetary policy co-ordination to reduce the overall vulnerability of South Africa's economy and growth to financial market shocks or other areas.

ADV PHILLIP MOKOENA: Yes.

CHAIRPERSON: Now let me just check whether she is audible to everybody. Ja it looks like everyone can hear you. Okay thank you.

ADV PHILLIP MOKOENA: Yes. Now may I refer you to Exhibit P1 it is in a blue folder next to you?

CHAIRPERSON: Before that you started at National Treasury in 2010 you said, is that right? Before that had you worked in any other government department or company where you were also dealing with something similar to what you are dealing with at National Treasury?

MS CATHERINE JULIA MACLEOD: I worked for a – I worked for a private asset management company for four years where we focussed on where I did economics and strategy trying to understand what financial market implications would mean for investor portfolios. So we had pension funds and high nett worth individuals who we were advising how best to invest their money to protect their savings. And before that I worked for – not for a profit organisation I worked for a specific area within it that managed developing countries, central banks, asset management arms so it helped them manage their bonds and did a lot of training with them to capacitate themselves to run that training – to run the fund management for themselves.

CHAIRPERSON: So how many years would you say you have been exposed to dealing with the type of issues that you are going to talk to us about today?

MS CATHERINE JULIA MACLEOD: 16 years.

CHAIRPERSON: 16 years?

MS CATHERINE JULIA MACLEOD: Yes.

CHAIRPERSON: Thank you very much.

ADV PHILLIP MOKOENA: I have referred you to Exhibit P1. You will see that that document runs from PA – P1A up until P1G. If you can turn over just the page to P1B could you please identify that document for us?

MS CATHERINE JULIA MACLEOD: Yes this is a note for the Zondo Commission on estimating impact of NeneGate on government debt which I compiled along with some colleagues from National Treasury.

ADV PHILLIP MOKOENA: Yes. Now before we even deal with the contents of that report may I preface your evidence by requesting you to deal with two issues? The first one if you can elaborate on the context of the report itself and secondly if you may deal with what were the immediate impacts you know of the NeneGate on the financial markets. If you can deal with them in turn please?

MS CATHERINE JULIA MACLEOD: Okay great thank you. So I think the DG already submitted in evidence about the impact of NeneGate on the economy as a whole. But the question before us was, what was the specific impact on government debt and borrowing? So government borrowing costs are determined by the difference between expenditure and revenue right? In the report in paragraph 2.6 we note that the eventual outcomes are the results of making decisions on what should happen to revenue, borrowing and expenditure. But for the purposes of this report to help the commission understand what is the impact of NeneGate on long term debt. We have held revenue and expenditure constant. Okay and we have just looked at what were we planning to borrow in the 2015 Medium Term Budget Policy segment so that was in October 2015 before NeneGate happened. And then it looks at what did we plan to borrow in 2016/17 and then after NeneGate happened what were the costs on that borrowing? How much did that increase by? And that is the context for the report before us.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: We are all aware that NeneGate was on the 9 December 2015 and immediately we saw financial market impacts. When we woke up the next day on Friday financial markets – on Thursday rather financial markets were all over the place. So we saw the rand – it was previously R14,59 to the dollar on the 9 December that went to R15,27 against the dollar on the 10 December reaching R15,90 on the 11 December against the dollar.

ADV PHILLIP MOKOENA: Ms MacLeod while you are still dealing with the impact on the rand there is a document that you have also prepared – Mr Chair I beg leave to hand in the document that would demonstrate the witness' evidence even much more clearer than what she is you know now doing without us understanding the impact itself. I beg leave to hand in the document?

CHAIRPERSON: Ja no that is fine. Thank you.

ADV PHILLIP MOKOENA: We have marked it to be P1H in order to follow on the sequence on the last numbering of Annexure P1.

CHAIRPERSON: Okay thank you.

MS CATHERINE JULIA MACLEOD: Thank you very much for that.

ADV PHILLIP MOKOENA: I am sure that when we look at this graph it will illustrate better what you were conveying to the Chairperson.

MS CATHERINE JULIA MACLEOD: Yes. Thank you.

ADV PHILLIP MOKOENA: Please take us through that to the – am I correct that the blue line that one sees running from top to the bottom it indicate what we refer to as the

NeneGate – a NeneGate event of the 9th the 12th 2015?

MS CATHERINE JULIA MACLEOD: Yes. That is correct.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: This chart here shows the rand against the dollar. So the number of rands that we must pay for every dollar. In this case when the line goes up it means the rand weakens because we have to pay dollar – more rands for any given dollar. What we saw from NeneGate and which is perhaps not completely easy to appreciate on the scale of this graph is that on the 11 December it reached R15,90 not the 10 December. The 10 December it reached R15,27. Obviously there was trading happening during the day as well I am just quoting the close of business. Now when you see – we did not just have the currency moving sharply we also saw the price of bonds fell sharply. So that is also included in the annexure and Annexure P1E.

ADV PHILLIP MOKOENA: Yes Ma'am.

MS CATHERINE JULIA MACLEOD: And P1D explain a little bit it is possible to see some of the moves in financial markets. But if I could perhaps just say you know one of South Africa's most heavily traded bonds the R186 the yield rose from 8.82% on the 9 December to 9.87% on the 10 December. That is a full percentage point higher. And again with bonds when the interest rate goes up it means that when the yield goes up it means the price has gone down. So this means that investors view our bonds as more risky. On the 11 December so two days after the yield and the R186 was 10.38%. So even higher. Now Minister Gordhan has already given testimony to the commission about the impact on equity markets which fell sharply and the banking sector has also given testimony in response to the sharp – the need to sell assets in order to cover their capital adequacy ratios. So these were all the immediate impacts because the market was surprised at NeneGate. But as government when we are trying to manage the impact of this on long term debt the short term movement for a day or two or three can be managed to an extent because we would issue – we think about what it is that we issue into the market. So government holds a certain amount of cash that we keep for emergency situations and to manage if we are not able to go to the market on a particular day. But what matters for the overall cost on government debt is when these financial market movements are sustained and that is really what we have tried to look at in this report is focus on what was the sustained impacts of financial market movements because that will give us what the ultimate impact is on government as debt.

ADV PHILLIP MOKOENA: Yes. Now if I may refer you to your report. On page P1B.

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: You introduce your report by referring to the background. I am not going to bore you with paragraph 1.1 and to 1.3 but of interest to me it is paragraph 1.2 where you say that this tact resulted in an increase in bond yields and a depreciation of currency when markets opened the next morning as investors reprised and risk associated with investing in South Africa. The change in ministers increased perception of the risk that South African government commitments to fiscal [indistinct] was weakening.

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: Can you simplify that to us and elaborate on what you are saying in paragraph 1.2?

MS CATHERINE JULIA MACLEOD: I think Mr Fuzile gave detailed statements yesterday and previously as have others about what the change in the ministers might mean. The investors were also aware of what those perception – well what a change in ministers might mean for the fiscus. As Mr Fuzile pointed out yesterday National

Treasury was attempting to caution and to stop certain projects from coming through that were fiscally unsustainable and to the extent that the change in minister was seen as an erosion of National Treasury's attempts to stop unsustainable policies from being implemented. Investors also saw that and they were concerned that the change in ministers would weaken National Treasury's ability to fight those policies within cabinet.

ADV PHILLIP MOKOENA: Yes. Now you are also mentioning another economic factor here by saying that as investors reprised the risk associated within this thing in South Africa.

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: It can also {indistinct] on that?

MS CATHERINE JULIA MACLEOD: Sure. So whenever an investor buys a bond they are assuming they will get a certain amount of money back from the borrower every year in interest payments and then when the loan comes due then they will expect to get a big lump-sum at the end okay. Investors are like banks when they look at you with a mortgage. They assess how likely is it that you are going to pay lots of – pay me back every year and ultimately pay back that lump-sum. And similarly to banks if you are borrowing from lots of different places it raises a question about what is the affordability or your ability to pay back those loans. So to the extent that a change in minister is – means that the government may borrow more it changes investors' perceptions of how willing or how able the government will be to pay back debt. Because if you are going to be borrowing lots there is a question mark then about the sustainability is. There is also the question mark though about whether or not and this touches on DG Mogojane's initial inputs around the impact on growth. Investors are also worried to the extent that the change in ministers signals a change in perceptions around what we are going to do to raise growth which also affects government ability to repay. So all of these factors come into their consideration and their negative in this instance.

ADV PHILLIP MOKOENA: Yes. And in paragraph 2 of your report you begin now to give details in relation to the quantifying the impact of the NeneGate and you do so in paragraph 2.1 and 2.2.

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: I know that you might have superficially touched on some of the things but do you wish to take us through the other components of the paragraphs

MS CATHERINE JULIA MACLEOD: I think if I could just …

CHAIRPERSON: Well before you do that let us just go back to what you testified about a minute or so ago. The perceptions of the markets and the investors when there is a change of ministers. Would I be correct to say that ordinarily if the investors and the markets know that the change of ministers is not the change of government, is not the change of the ruling party, is not the change of the president? The President is still the same President. The Deputy President is still the same Deputy President. The cabinet is still the same cabinet except for one or two ministers who might have been dismissed. Would I be right to say it is likely that if they trust that the president, the cabinet, the executive, the government and the ruling party its policies have not changed their implementation is not going to change just because there is a change of one or two ministers then their perceptions are likely to reveal any concern. But if they think that the government may be the ruling party, may be the executive, the cabinet, the president might – the absence of one or two ministers might make a change of – in terms of implementation of policies then they would be worried. I hope that I am – what I am asking is clear enough but…

MS CATHERINE JULIA MACLEOD: Yes.

CHAIRPERSON: I am just wondering why ordinarily they should have that concern in circumstances where one is not talking about a new government coming in and they do not know maybe what it will do. I ask that knowing that sometimes perceptions have got nothing to do with right or wrong. Yes.

MS CATHERINE JULIA MACLEOD: Ja thank you Chair. I think that NeneGate – ordinarily as you point out a change in Finance Minister should not cause a big change if the path of government is well set and there is confidence in the ability of the minister. So that is absolutely correct. I think what made NeneGate slightly different was that there were concerns about the manner in which the minister was replaced and the individual who was replacing him as markets did not know – were not familiar with him and it was not clear that there was a good reason for firing Minister Nene and equally there were concerns that Minister Nene had been fired because of the timing of events mentioned by Mr Fuzile yesterday. So I think also the thing to bear in mind is that financial markets price according to risks. Nothing is certain until it has happened. So what you will find is that certain events can stack up and start to change perceptions and increase so we have this term tail risk you know if something has a small probability of going horribly wrong but if that tail risk increases even if it is only a five or ten percent chance financial asset prices will adjust to reflect that risk. Because if you are invested in a bond and you are hoping that that is going to look after a pension fund you do not want the risk that – although it may be small probability that everything goes wrong. And so that is why you will find that a financial market respond to perceptions rather than an actual event because their pricing in this cumulative risk. It is almost thinking about what are the relative risks associated with investing in a given asset.

CHAIRPERSON: In your consideration of the issues I wonder whether you were able to look at other events in the past where maybe the markets had responded in a negative way to a change of ministers in the country I seem to have read something recently probably just in the media that when Mr Trevor Manuel was appointed as Minister of Finance way back I cannot remember if it was '96 or '98 that there was some negative reaction from the markets. I have no idea I suspect that it probably was not anything near what we saw when Minister Nene was dismissed. I think I also read something to the effect and I may be wrong in this regard that when Minister Gordhan was also appointed Minister of Finance there was some uneasiness in the markets. I am almost sure that with regard to Mr Gordhan it was not anything near the, when Mr Nene was dismissed. So I just wonder whether you have had a chance to look at that and compare and see how big the difference was in the reaction of the markets or is that something you might not have had a chance to look at?

MS CATHERINE JULIA MACLEOD: Chair we have not done that in this response. What we have tried to do though again because it is not just necessarily about an individual, right. I think as we point out in the documentation Nenegate is a point, a very visible point in the State Capture Project, but it was reinforced by a series of events leading up to Nenegate and then also after it and I think that it is not just about the Ministers appointment. It is the context within which [intervenes].

CHAIRPERSON: The context in which the dismissal happened caused the markets to react in the manner in which they reacted and with the intensity with which they did so?

MS CATHERINE JULIA MACLEOD: Exactly.

CHAIRPERSON: Hm.

MS CATHERINE JULIA MACLEOD: And then Chair what we have tried to do in the evidence is that we have, we have, we have tried to look at the longer term impact on financial markets as I mentioned as a way of accepting that there were initial spikes in financial asset prices as a result of Nenegate, but if we took out that volatility and saw the differences and the levels that is what we base the evidence on. So I think you know if you look at that P1H chart with the, with the Rand/Dollar exchange rate. Financial asset prices are influenced by a range of factors not just what is happening domestically from a political perspective, but also what is happening internationally and so and you can see from the chart that it spikes a lot and the point in time that you choose on the chart could have a very big impact on the estimate of what you are seeing the effect of Nenegate would be, because I could pick a very low number and compare it to a very high number.

CHAIRPERSON: Yes.

MS CATHERINE JULIA MACLEOD: Hm.

CHAIRPERSON: Yes.

MS CATHERINE JULIA MACLEOD: And then overstate the impact. So what we chose to do in the evidence was that we said what we would do is we would look at averages of what has happened to them. So we take away this short term volatility and the daily prices and what we have done is we have looked at what is the average of the Rand/Dollar exchange rate a month before Nenegate and the average of the Rand/Dollar exchange rate a month after and compare them. Then we did that for a bunch of different periods in order to sort of smooth the overall financial market volatility.

CHAIRPERSON: Well you, it maybe that this is something you would, you are still going to deal with but let, let me say this and hear what your comments maybe because you have worked for a long time on, on these issues and markets investors and their reaction to different situations in a country. Without passing any judgment on Mr Nene's replacement at the time, but it does seem to me that logically the reaction of the markets and the investors to the dismissal of Mr Nene must to a very large extent have been influenced among other things by maybe for lack of a better word their lack of confidence in the replacement, because I am thinking that if Mr Nene had been dismissed, but had been replaced for example Mr Trevor Manuel it is unlikely that the markets would have reacted in the way they, they, they do and I am saying Mr Trevor Manuel because he had been Minister of Finance for a long time.

MS CATHERINE JULIA MACLEOD: Hm.

CHAIRPERSON: He was quite popular as far as I understand with the markets and so on. So if Mr Nene had been dismissed, but had been replaced by somebody who the markets had confidence in it is, I seem to think it is unlikely that the, they would have reacted in the way they did.

MS CATHERINE JULIA MACLEOD: Chair that is likely provided that the person and this is not to say anything about Minister Manuel, but I think it is about the context in which Minister Nene was dismissed as well, because there were question marks about why he was dismissed given the pressure on the fiscus and from various projects that were being pushed from the then Presidency. So if there were and now that you put a name to it then it is a bit harder to, to, to say one way or the other, but if somebody else not Mr Van Rooyen was, was put in that position if that individual were associated with the State Capture Project in any way then I think even if they was seen to be a, a, a good investor I think they would be question marks raised about it.

CHAIRPERSON: *Ja*, know obviously the choice of the name that I have put in has a reason because and the issue of the context is important. What I am thinking is that then the markets might have, would have had a certain perception about how Mr Nene was doing his job and it seems they were quite happy.

MS CATHERINE JULIA MACLEOD: Hm.

CHAIRPERSON: And, and maybe the question of who he was replaced by made them think that it was somebody who was unlikely to continue to do what they believed was the right thing and if the replacement was somebody who they believed would do the right thing then they are unlikely to have, they would have been unlikely to react in the way that they did.

MS CATHERINE JULIA MACLEOD: Yes that is that is possible. I think what is important to note as well though is that after Nenegate Minister Gordhan was reappointed as Finance Minister and because of the continued pressure that Minister Gordhan remained under which investors saw there was still pressure on financial asset prices. So you can see again there with the Rand/Dollar exchange rate there was there was still pressure, because the State Capture Project it had a very visible impact with Nenegate, but it was a risk that was building over time as the events that were described yesterday for example.

CHAIRPERSON: Thank you very much. Mr Mokoena.

ADV PHILLIP MOKOENA: Ms MacLeod am I correct that in, as part of your evidence you have also provided the Commission with some graphs and figures?

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: Which we will be dealing with in due course where you are also referring to specific events that might have an impact on the economics of the country?

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: Yes. We will deal with them in due course in order to properly contextual your evidence in relation to the Nenegate. For now may I refer you back to page P1B?

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: And where you begin to quantify the impact of the Nenegate you do so in paragraphs 2.1 and 2.1. Could you please elaborate on those paragraphs?

MS CATHERINE JULIA MACLEOD: Sure. So I think we covered 2.1 in our discussions.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: Relating to 2.2 this is what we have tried to estimate. So economists always have two hands and they say on the one hand this and on the other hand that and in the sense that is what we presented for you here. We have given a range of potential impacts on bond yields of between 0.5.

CHAIRPERSON: Well I can, I can tell you lawyers also like on the one hand.

MS CATHERINE JULIA MACLEOD: [Laughing].

CHAIRPERSON: And on the other, [laughing]. Yes.

MS CATHERINE JULIA MACLEOD: So, so what we have said is that we have, we have estimated that the Rand was about 10 percent weaker against the US Dollar and then we have presented a range of estimates for how much weaker bond yields were. So we have got 0.5 percentage higher or 1 percentage point higher from the typical borrowing rate. So Chair to explain how we got to these two numbers. If I could refer you to P1D which is a table in the annexure which just talks to changes in financial market prices.

ADV PHILLIP MOKOENA: Are you referring Table 1?

MS CATHERINE JULIA MACLEOD: Table 1.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: And this is what we were talking, what I was talking about earlier about looking at averages rather than a point in time and, and what this table basically does is it says okay if we go to, if you look at the second column we have got the generic two year bond yield for the South African Government and what we did was we took the average yield for a month before Nenegate and the average yield for a month after Nenegate and we looked at what is the difference in that cost and what we can, it was about a percentage point, 1.03 percentage points different, okay. If we, if we average two months before and after it was 1.19 percentage points different and so on. So that is the way that the table has been constructed and you can see in that second column that is the two bond yield. So that is when Government would pay back the money in two years and then the 10 year bond yield, a longer term. The third column there is the South African Sovereign spread that is produced by J P Morgan. Now what a spread is, is that it says how much riskier would it be to, well how much more expensive is it for the South African Government to borrow compared to the US Government and this difference in the, in, in those yields is what, what the spread is okay and that gives an indication of how risky investors perceive being in South Africa. So when a spread rises people think that it is more risky investing in South Africa and when it falls they think it is becoming less risky relative to the US. So we have looked at that difference between us and, and the US again using the same methodology and you can see that what has happened is that spread has basically increased by between either 0.8 percentage points or 1.10 percentage points.

ADV PHILLIP MOKOENA: And, and you are doing that with reference to the period before the Nenegate?

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: And the period after the Nenegate so that we can appreciate the risk factors as perceived by the international markets?

MS CATHERINE JULIA MACLEOD: That is correct and then you can see next to that we have the emerging market spread. Now why would I bother to put emerging markets if we are focusing on South Africa? Obviously our bond prices are affected not just by what is happening domestically, but also what is happening globally and South Africa is seen as a key emerging market. So when things go horribly wrong in Brazil and Turkey sometimes it has an impact on our financial market prices. So we wanted to be sure that what we were picking up was not just global trends in South African prices and so what you can see there is that there was an increase in emerging markets spreads over the same periods of Nenegate much less then the South African spreads though, okay and in essence these are the, these are the basis of having this range. So if you were to subtract the emerging market spread from the South African spread you can see that it is about 50 basis points, 0.5 percentage points, sorry and so that informed the lower end of the estimate and then we have also shown that, because all of our bonds have increased by a full percentage point over the different time periods compared that is why we have got the 1 percentage point increase in the cost of, of yields. On the final right hand column we have got the changes of the Rand/Dollar exchange rate, okay. So a depreciation in the Rand means that the Rand is less valuable. It takes more Rands to buy one Dollar and here contrary to the bonds where you see a stabilisation the Rand, the Rand depreciated quite dramatically. If I can refer you again to P1H.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: The picture of the Rand versus the Dollar. The Rand does it [intervenes].

ADV PHILLIP MOKOENA: It is a separate document Mr Chair.

MS CATHERINE JULIA MACLEOD: Yes.

CHAIRPERSON: Thank you.

MS CATHERINE JULIA MACLEOD: The Rand weakens quite substantially through until *Ja*nuary 2016 and then regains and then you see the line coming down. Means that the Rand is strengthening again from a point of weakness, but I think the important thing to note with the Rand is that it is still much weaker than it was. So a year after Nenegate the Rand was a lot weaker than a year before Nenegate, because Nenegate yes we have used it as a point in time, but you can also see the Rand depreciation starting to pick up before Nenegate, because people were worried about the State Capture Project before Nenegate itself hit. It was just a, it was, it was a point in time and so this is why we have come up with a Rand/Dollar depreciation rate of 10 percent for our estimate in terms of what we think has, has impacted on long term Government debt.

ADV PHILLIP MOKOENA: Yes. You also provide two scenarios in order to allow, in order to illustrate the impact of the Nenegate and you do so in paragraphs 2.3 and 2.4. Can you please explain to us those two scenarios?

MS CATHERINE JULIA MACLEOD: So those two scenarios are the 0.5 percentage point and the 10 percent Rand depression and the 1 percentage point increase in Government buying costs plus the 10 percent depreciation. I, I think in, I think those are reasonable conservative estimates in terms of the overall impact on, on Nenegate. We, so we present those results. Now I do not know if you would like me to go through.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLED: The figures of if you want to go through; so in terms of the results for the first scenario we have the stock of debt rising by R26 billion compared to what we had projected in the 2015 MTBPS and then what we find is that our overall debt service costs would be R3 billion higher in2016/2017 relative to projections in the MTBPS of 2015 and then under scenario two we have that the stock of debt would rise by R33 billion in 2016/2017. Well it will be higher and then debt service costs would be about R5 billion higher as well.

ADV PHILLIP MOKOENA: That is post the Nenegate?

MS CATHERINE JULIA MACLEOD: That is post Nenegate, yes. So what we have done is we have taken what national, we have taken what we had originally projected in the 2015 MTBPS and seen what would that 0.5 percentage points higher in overall borrowing costs mean for the Government or, and, and a 10 percent weaker Rand. If I could maybe just point out that you know this is based on a model, a funding model from National Treasury that we use to consider the impact of various risk factors on our bond issue and strategy. So we before every MTBPS and budget we plan where are we going to be able to issue Government debt in the most cost effective way for taxpayers taking into account financial market movements and so our funding model basically helps us think about different fiscal planning scenarios because although we present in budget we present a central case and then we also present different scenarios. We have to figure out how our borrowing strategy would change and where are the pressure points. So that is the model we have used here. We use that model to communicate with ratings agencies and the IMF and actually we have started to publish results from that model for example on the 2018 MTBPS. So just so that you know there is some context to where we have come up with this, with this, with these numbers here and so we have used that model given the assumptions that we have detailed to you on interest rates and currency moves.

ADV PHILLIP MOKOENA: And how, how does this impact you know on the budget of the country when you have the rand taking a dive as you have already illustrated and taking how the, the, the stock debt would rise to those figures that you have already mentioned to the Chair? How does that impact the budget?

MS CATHERINE JULIA MACLEOD: *Ja*. So I think you know the thing with Government is that when you are borrowing you are having to lock in those rates, right.

ADV PHILLIP MOKOENA: Hm.

MS CATHERINE JULIA MACLEOD: So the problem is that we, we then, we have increased the stock of debt say by R33 billion okay, but that stock of that increase remains in your Government debt stock until such point in time that you can pay down that debt which basically means that you are bringing in more revenue than you are spending. As you are all aware we, we have not run a budget surplus since the time of Nenegate. Our revenues have underperformed and it is put pressure on our borrowing. So any increase in that Government debt stock remains. So I think it is important to bear in mind that especially for an issuer when we increase risk perceptions of South Africa has real effects on the fiscus which also means that it is money that we are not spending on, it is money that we are not spending on overall social priorities. Instead we wind up spending more on debt service costs.

ADV PHILLIP MOKOENA: Yes and in paragraph 2.7 you further illustrate the point and it appears to you are actually talking to the issues that when you did highlight the short, earlier on in your evidence, but in far much more details and figures.

MS CATHERINE JULIA MACLEOD: Yes. So in paragraph 2.7 I outline what actually we, we presented in the Budget Review 2016 for 2016/2017 outcomes relative to what we had expected at the October MTBPS and there you will see that our actual debt service costs rose by R5 billion. They were higher by R5 billion between February 2016 and the MTBPS 2015 which means that debt service costs in 2016/2017 were 11.4 percent of our total spend. In the MTBPS 2015 they were meant to be 10.9 percent. Now the reason why we do not ascribe this simple difference between budget review 2016 and MTBPS 2015 to Nenegate alone is because, they will in terms of borrowing costs, is because there were lots of other decisions that had to be made about what are we going to do with revenue? What are we going to do with expenditure and total borrowing? So that 5 billion is the outcome of a number of decisions around, well not just the 5 billion, but also the overall budget balance decision or a number of decisions. We chose to raise revenues and so on to try and reduce the budget deficit faster. So that investors would, to try and encourage confidence in overall fiscal latitude.

ADV PHILLIP MOKOENA: Yes. On, may I refer you to page P1H?

MS CATHERINE JULIA MACLEOD: Sure.

ADV PHILLIP MOKOENA: You are dealing there with different figures and graphs in order to illustrate the point that you are making to the Chair about the impact of Nenegate?

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: Mr Chair we have prepared the colour, the colour pages of the, of the same document in order for you to be able to follow the evidence of the witness. We beg leave to hand that in.

CHAIRPERSON: Thank you.

ADV PHILLIP MOKOENA: We are not going to refer them to any different number. It is the same document that you are having.

CHAIRPERSON: Yes.

ADV PHILLIP MOKOENA: They are just in colour.

CHAIRPERSON: Thank you.

MS CATHERINE JULIA MACLEOD: *Ja*. I think.

ADV PHILLIP MOKOENA: If, if you can take figure one in relation to the currency movements and how the Rand remained weak following the Nenegate?

MS CATHERINE JULIA MACLEOD: Okay, sure. So what we have done on figure one is different to what you looked at on P1H. This is not the Rand/Dollar exchange rates written as R15 to the Dollar for example. What we have done is we have taken the average 2014 level of the Rand and calculated that as a 100 and then you can see how the Rand has moved relative to that and then what we have done here is we have done the same thing for an index of emerging market currencies. That is just to make again this point that what happened to emerging markets you can see that they, although they weakened, they weakened slightly in 2016 relatively to the 2015 levels. It was nowhere near what happened to the Rand.

CHAIRPERSON: Hm.

ADV PHILLIP MOKOENA: Yes, but now help us to understand. Be careful that you are talking to lawyers here. You have a red line and a greyish line that on, the bottom. What do they represent?

MS CATHERINE JULIA MACLEOD: Sorry. The red line is the Rand/Dollar exchange rate.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: But represented as an index and the grey line is the emerging market currency index also represented as an index.

ADV PHILLIP MOKOENA: Yes and the blue line that cuts across that would be?

MS CATHERINE JULIA MACLEOD: Nenegate.

ADV PHILLIP MOKOENA: The Nenegate event and you have done that by taking the position before and the position after the Nenegate event?

MS CATHERINE JULIA MACLEOD: *Ja*. I think here we, this is just to illustrate the difference between the, exactly it is a year before and a year after on either side of that blue line.

ADV PHILLIP MOKOENA: Now the figure two.

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: What does it illustrate in relation to the bonds?

MS CATHERINE JULIA MACLEOD: Sure. These are generic bond deals. So the Government issues specific types of bonds, but these are generic. So.

CHAIRPERSON: Hm.

MS CATHERINE JULIA MACLEOD: So that you can always compare what is a two year look like and a 10 year. The red line is the 10 year and the grey line is the two year bond yield. A year before up till a year after Nenegate which is represented by the blue line and it should be clear to everybody that there is a shift change upwards in, although the price has recovered from the initial spike they remain well above what they were prior to Nenegate.

CHAIRPERSON: Hm.

ADV PHILLIP MOKOENA: So the Nenegate effects were felt even beyond the one year period that you are talking about?

MS CATHERINE JULIA MACLEOD: Yes, absolutely. Hm.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: I, I, sorry.

ADV PHILLIP MOKOENA: You can go to P1F. You have the figure three.

MS CATHERINE JULIA MACLEOD: Okay, so.

ADV PHILLIP MOKOENA: You can please explain it to us?

MS CATHERINE JULIA MACLEOD: Sure. So bear with me on figure three. I know it has got five lines. So and this is violating the roles of how many, how many lines you are supposed to put on any chart but what it is, is it is the yield curve. So you will see along the x-axis it says maturity and then, so it will plot what is the yield for a given, for a given maturity yield bond, okay and the shape of that is the yield curve and what we have done here is we have shown that a month, two months before Nenegate which is the light grey line underneath you can see that for borrowing across all different types of Government bond instruments the, the yields were much lower than for the very dark black line which is Nenegate itself. You can see that one month after Nenegate which is the red dotted line yields were very, very high. They were, they were almost a full percentage point or more higher, percentage and a half point higher than Nenegate and then they came down somewhat two months after Nenegate, but were still well above Nenegate and well above the times before.

ADV PHILLIP MOKOENA: And figure four?

MS CATHERINE JULIA MACLEOD: Figure four just puts the, the yield for the R186 which is a specific Government bond, not a generic bond that matures on 21 December 2026 and you can just see what, the point here is really that there are multiple shocks that affect financial asset prices and political developments affect bond yields and as you have mentioned some can be positive as well as negative for financial asset prices. It depends on what the context is.

ADV PHILLIP MOKOENA: But concentrating on the Nenegate what was the picture in relation to figure four?

MS CATHERINE JULIA MACLEOD: It, this simply illustrates a very visible point in the overall state capture project but its impact was long lasting because of subsequent events as well. We have just here given the impact of NeneGate on government borrowing costs. The other thing to bear in mind is that the ultimate incidence of these borrowing costs will depend on the spending and taxation choices of government. But ultimately South African citizens and tax payers are worse off as a result of these financial market movements and ultimately they cause bad political – they have been caused by political uncertainty. I think what we see is that econometric evidence generally suggests that the cumulative impact of many events that raise political and economic uncertainty raise the costs of borrowing, they reduce investments, they reduce growth and this together hampers our efforts to raise employment and fight inequality in the country.

ADV PHILLIP MOKOENA: Yes. Now having regard to her evidence he also refers to a report to the work of Hlatshwayo and Sacsa Guard.

MS CATHERINE JULIA MACLEOD: Yes.

ADV PHILLIP MOKOENA: And in their book if I am correct they say that the – that policy uncertainty it is unique in that it can be pro-actively managed. If not all together avoid it. Do you agree with that statement and can you share with us in what manner could that be avoided?

MS CATHERINE JULIA MACLEOD: I think policy uncertainty can be pro-actively managed. I think that efforts to engage with investors, to maintain fiscal transparency, to create the social compact which the President Ramaphosa has been seeking to do and to take demonstrable actions to resolve outstanding policy issues are all manners in which policy uncertainty can be actively managed.

ADV PHILLIP MOKOENA: How can it be avoided?

MS CATHERINE JULIA MACLEOD: So here I think it can be – I think by actively managing that it does reduce policy uncertainty. Can it be avoided in an absolute sense?

ADV PHILLIP MOKOENA: Let us take that – let us take the evidence in relation to the Nene Gate?

MS CATHERINE JULIA MACLEOD: No, no absolutely.

ADV PHILLIP MOKOENA: Yes.

MS CATHERINE JULIA MACLEOD: I think that it – I think that it can be managed. I do not believe – nothing is ever a hundred percent certain. But I think that the levels of uncertainty that we faced here there was definitely room to reduce those dramatically and that could have – and I believe that a large part of the political uncertainty that generated these financial market movements could have been avoided.

ADV PHILLIP MOKOENA: Yes. And I am posing this question having in mind that accommodations that might be made at the end of this commission if you can assist I mean what are the known consequences of policy uncertainty?

MS CATHERINE JULIA MACLEOD: Look I mean as I have already highlighted what I think the – the policy uncertainty it has real costs but there will always be some element of uncertainty in what we do. Because we have – we have changing priorities as a country we may have changing leadership. So I do not think that it is possible to say that you want no policy – that it is an achievable goal to have absolute, complete policy certainty in every sphere. But that said I think that there – that by acting decisively it is possible to really minimise the impact that policy uncertainty has. So for example National Treasury has made a number of recommendations that we should – we should follow through on policies that we say we are going to make and we need to have those policies need to be designed after consultation with all relevant parties and they need to take into account the overall policy environment. You need to have transparency about the fiscal – the policy you making process and it is important as well to underline the certainty around the Macro Economic Policy framework as well.

ADV PHILLIP MOKOENA: Yes. We have heard your evidence and we appreciate you know its context in relation to the illustrations that you have made. What would you say I mean having regard to your evidence in totality to a comment that you know if the rand was to fall it can simply be picked up?

MS CATHERINE JULIA MACLEOD: The sanitised version of what I would say to that is that it is easy to be glib about these sort of things but there – financial market asset prices – asset prices may recover eventually but the thing is, is that between the point at which they have fallen and when they finally recover government has to go out to the market and convince people to borrow – to lend us money. Okay and during that period of time we have to pay more in order to convince them to lend money to us so that we can continue to fund our social spending programmes. Between the time when the asset price is low and when you manage to pick it up at some point you have pensioners who are retiring and cashing in their pension funds and those pension funds will be of a low value. Between the time that it falls and you pick it up again you have banks having to meet their capital adequacy ratios which means that they are having to sell other investments in order to meet those adequacy requirements. By them selling those other assets it puts those assets under pressure as well. So I would say that – I would say that that is the statement of somebody who neither appreciates the impact of financial asset prices on ordinary citizens and certainly not on government borrowing.

ADV PHILLIP MOKOENA: Mr Chair that concludes the questions for this witness.

CHAIRPERSON: No that is fine. Ms MacLeod thank you very much for coming to assist us with regard to these issues that have been raised with the DG before. It may or may not be that it is the last time you are here. If you – there is a need we will ask you back to clarify some of the things but so far I think that I can release you.

MS CATHERINE JULIA MACLEOD: Thank you.

CHAIRPERSON: Something that has got nothing to do with the substance of your evidence in P1F. The bottom column there you and your team overlooked the fact that you on the right hand side with regard to the month of October you referred to Mr Nene as Simply Nhlanhla.

MS CATHERINE JULIA MACLEOD: Yes thank you.

CHAIRPERSON: It is not appropriate.

MS CATHERINE JULIA MACLEOD: It is…

CHAIRPERSON: And certainly not in a forum such as this. So would I ask you to arrange for an amended document if possible to replace that page and the replacement can be made in every copy of the same document or bundle. Just check if you have not been [indistinct] just to somebody else in the same way throughout the document. I just picked up this one.

MS CATHERINE JULIA MACLEOD: Thank you Chair it is actually just the boxes have shortened in the thing so it actually says Nhlanhla Nene and then also the – you will see on the bottom one it says returns as and then it is Minister of Finance which has also been cut off but we will adjust those. So thank you for the spot.

CHAIRPERSON: Well are you saying Nene appears somewhere other than where one expects it to appear?

MS CATHERINE JULIA MACLEOD: It is just the box. The box cut off the last two lines of text. So – but thank you for the spot and we will adjust it.

CHAIRPERSON: But you will? Ja.

MS CATHERINE JULIA MACLEOD: Thank you.

CHAIRPERSON: It is Mr Nhlanhla Nene.

MS CATHERINE JULIA MACLEOD: Yes.

CHAIRPERSON: Okay thank you very much.

MS CATHERINE JULIA MACLEOD: Thank you.

CHAIRPERSON: You are excused.

MS CATHERINE JULIA MACLEOD: Thank you very much.

CHAIRPERSON: Thank you for coming.

ADV PHILLIP MOKOENA: Mr Chair I am told that it is technology Nene was there but it just got cut off when they were trying to do the structures.

CHAIRPERSON: Ja well I think that is what she was …

ADV PHILLIP MOKOENA: We will pick up the surname Nene somewhere we will make sure of that.

CHAIRPERSON: Just make sure that nothing appears to not give people proper respect. Okay thank you, you are excused.

ADV PHILLIP MOKOENA: Mr Chair that concludes.

CHAIRPERSON: That is the only witness we have for today.

ADV PHILLIP MOKOENA: The witness for today. Yes and tomorrow the Eskom team will be proceeding with the leading of the evidence of matters related to Eskom.

CHAIRPERSON: Ja okay. Okay we are going to adjourn for today and we are going to resume tomorrow. Before we adjourn there is a need that this week I use the time from three o'clock upwards for another meeting – a meeting of the commission and the legal team and the investigators. Now in order for us not to lose not from three o'clock I think from two o'clock not to lose those two hours we may have to start early one of the days or more than one day and or finish one hour or so later than four just to make sure that by end of – by the end of the week we have not lost any time in terms of the time that we must use for hearings. So but tomorrow I think we could start at normal time and then we can look at whether we should finish – we should continue beyond four up to five or whether we do that on Thursday and Friday only. So but we can finalise tomorrow. So we adjourn now until tomorrow at ten o'clock. We adjourn.

INQUIRY ADJOURNS