Magni Client Commentary

Talking Points on International Governance Research and Investing

August 2016

Country Ranking Trends

- August was a quiet month with no changes in Magni Country Scores. One month does not form a trend so the lack of change should not be considered significant. To the extent that a trend is forming, Magni is watching promising developments in India and China which could become positive reforms and/or provide greater transparency, and thus cause future increases in their respective country scores.

Is South Africa's Leadership at Risk?

- The recent local elections were widely seen as a referendum on the performance of the ruling African National Congress, which has led the country since the end of apartheid in 1994. The vote resulted in the ANC's worst losses ever in municipal elections and reflected a negative assessment of the ANC's stewardship of the economy along with the culture of corruption under President and ANC Party head Jacob Zuma. He recently had to repay $16 million in state funds he had used to upgrade his private residence.
- Observers see a shift in South Africa's politics where voters are now more interested in issues rather than race. In addition, the emergence of real alternatives for voters and growing accountability of political parties are all positive steps for South Africa's democracy. However, there are fears the ANC led government will enact populist changes to win back votes. The next general election will be held in 2019, and if growth remains sluggish, there is the prospect of another ANC defeat.
- South Africa has a high country score within the emerging markets. Delaying reforms required to accelerate growth, or even worse reversing prior reforms, would place the score at risk of downgrade. For now, Magni's assessment of South Africa is unchanged.

India's Modi has Big Success

- Once implemented, the new goods and services tax (GST) will result in a big reduction in compliance costs for manufacturers that have factories in multiple states. This tax reform represents a significant victory for Prime Minister Modi and will be hugely consequential for the ease of doing business in India. Manufactured goods are currently subject to excise duty, value-added taxes, and a central sales tax, all of which will be unified as part of one GST. The result will be a more predictable, transparent, and consistent tax climate. The reform is described as the most important economic measure since India opened its markets in 1991. Dozens of states must still sign off on the law before it can be implemented and the rollout for this new tax system will be difficult. This accomplishment represents an important step in fulfilling the promise of significant 'big-bang' reforms from the Modi government.
- To further improve India's prospects, Modi should now focus on strengthening shareholder rights and increasing market integrity, while reforming financial services regulation. If successful, India could move into a leadership position within the emerging markets.

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Will This Time be Different for Thailand?

- The new military-drafted constitution passed with more than 60% support, though the legitimacy of the poll has been questioned given the military's suppression of political dissent prior to the vote. The military says that it aims to eradicate corruption and bring stability. These events are part of a recurring cycle with 19 coups and 20 constitutions since its absolute monarchy ended in 1932.
- The new constitution empowers the military to select all 250 members of the Thai senate; until now, the military had been appointing just under half of them. The new charter weakens political parties and ensures the military a role in overseeing Thailand's economic and political development. The economy is in poor shape and the passage of the new constitution has been welcomed on the expectation that it will lead to a more stable business environment, at least in the short-term.
- The military government and new constitution inherently neither improve nor weaken the climate for business. If the military-backed government was to complete implementation of reforms passed by previous governments, Thailand could see a stronger economy and better investment prospects.

Further Opening of Chinese Markets

- China has announced the opening of the Shenzhen-Hong Kong Connect for the trading of stocks between the two markets. The Shenzhen market with a capitalization exceeding 3 trillion dollars is already the world's seventh largest and boasts some of the fastest growing Chinese companies. Regulators have also said there would no longer be an upper limit on foreign ownership of Chinese shares. Investors are still waiting for details on which stocks will be traded through the link and what restrictions will apply to their purchases. The opening advances China's cause to have yuan-denominated Chinese A shares included in MSCI's Emerging Markets Index, but hurdles remain.
- The Shenzhen-Hong Kong link-up follows 18 months after the Shanghai-Hong Kong Connect was launched. There the market connection is not yet working perfectly and similar challenges are expected in this new launch as well. However, the move reaffirms China's commitment to reform following the market tumult of the past year.
- Magni views these actions as helpful to China, though the connections do not directly impact country scores. Expanding foreign ownership of Chinese companies will increase pressure on the government for key reforms, such as strengthening regulatory regimes and providing greater transparency in both businesses and government operations.

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