INTUITION

9 SEPTEMBER 2022

Taking stock of the SA economy

Spring has sprung and Christmas is coming. After the lockdowns and the Covid pandemic we all expected Christmas to come early in economic terms. However, Eskom got there first as loadshedding has put a damper on our economic prospects. Nonetheless, most of us know about the new energy sector infrastructure plans and Transnet's commitment to the ports in Durban as well as the new port at Boegoebaai. Despite the mining sector's woes, Treasury specifically has been helped through additional export earnings to plug holes in the expenditure plans and Covid related support. Despite the feeling that we cannot see the economic engine turning, consumers have kept their wallets open, spending differently to alleviate the impact of rising inflationary and energy pressures. This week, we look at our economy through the official data to make sense of where and how we are going to transform to a higher growth rate.

Willie Pelser

It is hard to believe that we are fast approaching the last quarter of 2022. Spring has sprung and Christmas is coming. After the lockdowns and the Covid pandemic, we all expected Christmas to come early in economic terms. However, Eskom got there first as loadshedding has once again put a damper on our economic prospects. Consequently, the big R-word (Recession) is increasingly being used to hint at what lies ahead for the global economy in 2023. By now you are probably bored by the news of out-of-control inflation and global interest rates rising through the roof. Therefore, I have decided to "take stock" on some of the bigger aggregates behind our GDP numbers (those used to calculate whether the economy grows or not) and what lies in store for the future. The auction of new spectrum in South Africa has come and gone, the energy sector transformation has started, yet this is a large ship that will take time to turn. But it is on track (luckily not on Transnet's!). Although the benefit will have a substantial impact on all spheres of the economy, the one fact we must accept is that it will take time. In the meantime, we will remain flotsam in the ebb and flow of the global economic sea.

The South African economy has come a long way from the all-fall-down 2nd quarter of 2020. The impact of the various lockdowns, the July 2021 riots, the KZN floods, coupled with persistent loadshedding have impacted mainstream economic activity in different and unexpected ways. For example, retail sales have recovered to levels well above 2019 with consumer spending surprising on the upside. The production side (manufacturing and construction) of the economy has unfortunately slipped below the recovery levels we achieved in 2021. Mining is also struggling but we are reaping the benefit of elevated global commodity prices.

SPEED READ

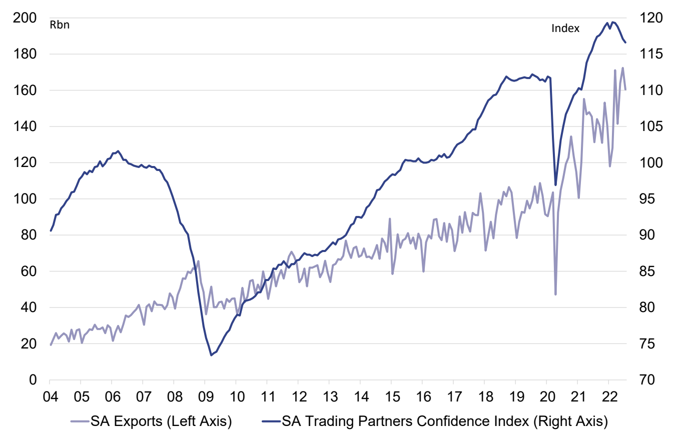
- **The South African economy is stuck in a low-growth rut. We have been struggling to raise the needle consistently above GDP growth of 1%.**
- **Although at street level we sense that it is an all-fall-down environment, the mining sector has bailed out the fiscus with some additional tax income. The consumer remains remarkably resilient despite inflationary pressures and higher interest rates.**
- **Fixed investment to rebuild the economy is showing signs of recovery, helped by new initiatives in the energy sector after a dismal performance by Eskom since the start of 2022. A new port may be coming, and hopefully many other private sector-related projects.**
- **The preparation work is being done which suggests a benefit of a growth dividend down the line. Do not expect miracles overnight, but the foundations are being laid for a different growth trajectory over the next decade.**

Various new initiatives, including infrastructure rebuilding, spectrum auctions, and the multiplier effect thereof do carry a growth dividend. As these come "online" our economy has the ability to grow at a significantly faster rate than the 1% to which we have become accustomed. For clarity, we are not getting carried away with exurberence, but reform does have the ability to change the trajectory. Even a modest change could have a large impact on local investments.

The rest of the article will delve into a few specific statistics that add support to this argument.

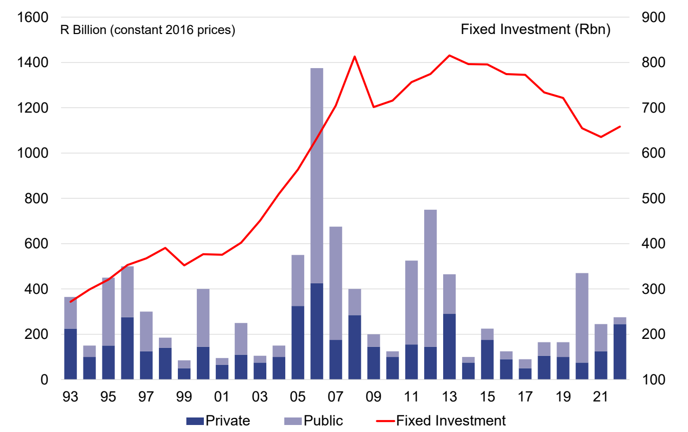
1. Positive trade (export) impact
The chart highlights how SA exports are benefitting from robust global growth. Imports have lagged over the last couple of years and have allowed SA to run a large trade balance. The bulk of these exports come from our mining and mineral base and have helped the fiscus to attract "bonus" tax income from the sector. Mining contributed R42 billion (20.5%) of total revenue, the second largest contributor in the 2020/2021 year. From this sector which contributes less than 10% to overall GDP, personal income tax of those working in the industry contributed a further 5.5% of total revenue and is the 3rd largest contributor. VAT also received a boost and earned R21 billion in the same financial year, but was a smaller contributor to total tax revenue. Herein lies the concern: with talk of a global recession becoming more prevalent, the question is for how long can National Treasury rely on the "bonus income" from the mining houses? Over the last 25 years, Government revenue has exceeded budget by an average of R42 billion p.a, yet expenditure (grants, Covid relief, unauthorized expenses - a growing list in all aspects of the word) has overshot expenditure targets by an average of R171 billion p.a! The net result is a ballooning Debt to GDP Ratio which has accelerated from 27% in 2008/09 to over 70% in 2021/22. If not for the extra taxes due to our commodity exports, things could have been really ugly from a debt trap perspective.

SA EXPORTS VS GLOBAL BUSINESS CYCLE



2. Increased importance of fixed investment
Gross fixed capital formation (GFCF) in South Africa dwindled to a meagre 13% of GDP in 2021. We have to go back to the years prior to the FIFA World Cup in 2010 to find any evidence of meaningful capital investment in SA. Ever since, no major projects have seen the light and we all know that the environment under state capture was not conducive for expansion. In the chart, the bars reflect data from Nedbank's Economic Research Unit, which reflects the value of investment projects underway in the SA economy. The period (mid 2000) leading up to the World Cup is noticeable. The bars for the past few years give reason for hope. Note that the 2022 data only covers announced new projects by the private and public sectors for the first half of the year. We believe the value of new projects is going to increase substantially over the next 2-3 years. The first example was the spectrum auctions in the telecommunication sector, which netted R14 billion for the fiscus. New spectrum and bandwith will finally unlock new technology "infrastructure" to optimise 5G. Transnet has short-listed 10 private companies to invest in critical container ports at Durban and Ngura and then there is the plan for a new port at Boegoebaai! The various opportunities through the bid windows for alternative energy already add to more than R1.2 trillion rand. Hydrogen projects of around R270 billion are also in the pipeline. It is important to focus on the big shift away from reliance on public sector investment in favour of the private sector. As it transpires, it will in itself lead to rising business confidence once these projects see the first "soil" being moved. Underpinning all of this is that Corporate SA sits on record levels of cash that will be deployed if conditions turn more conducive.

APPROVED CAPITAL PROJECTS VS SA INVESTMENT CYCLE

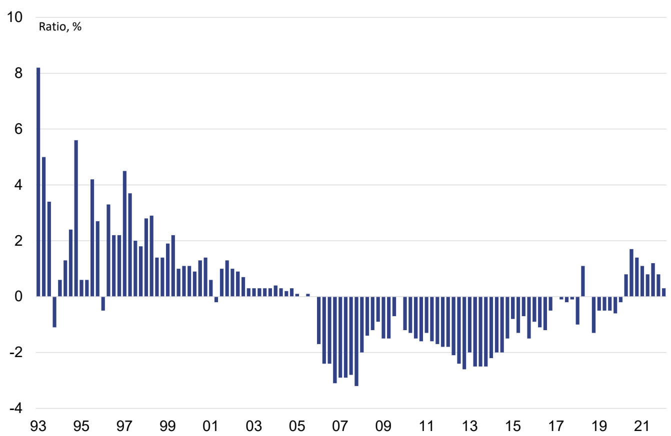


3. Resilient consumer spending makes up 60% of the local economy.
My opening paragraph referred to retail sales continuing to surprise on the upside. We have to remember that South Africa has a vibrant informal economy (such as the spaza-shop, the makeshift table trade next to a taxi rank and the

“vetkoek” trade for truck drivers next to the highway). Yet those entrepreneurs still need to buy their goodies. For example, the spaza shop gets its stock from the formal-sector Cash and Carry’s. I am sure you get my drift! Yet the question remains: if you consider headline GDP statistics, why do they not echo this vibrancy? How does the consumer hold up? We agree that the cost of higher inflation, fuel prices and so forth does put strain on consumer’s pockets. No one can argue that. However, other consumer-related statistics suggest that South Africans have been prudent. Although it took the SA consumer years and some great pain, we have learned to build up some reserves (refer to the chart showing household savings as a percentage of disposable income). Traditionally, we are not great savers, but it looks like Covid did teach us some valuable lessons. Furthermore, the Household Debt to Disposable Income Ratio also ratcheted up to over 80% in the late 2000’s. Now its back to below 65%.

The more interesting chart is the one showing the components of disposable income and more so the line reflecting “other income”. This line references income from investments - a reflection of how disciplined and consistent private investors have built up additional sources of income to weather the storms. (This speaks right to the Harvard House investment approach – be in the market, earn the dividend and let it compound). Although the compensation of employees is not yet back at pre-Covid levels, the other sources of income have pushed personal disposable income above the dreaded pre-Covid levels. We not shying away from the pressures that consumers face, but the numbers offer a valuable overall perspective.

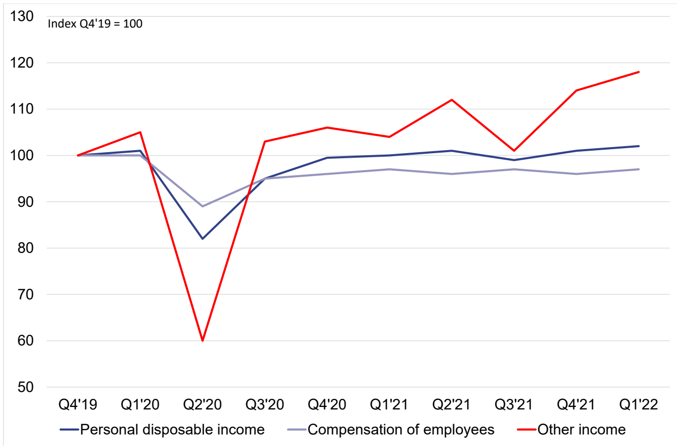
HOUSEHOLD SAVING AS % OF DISPOSABLE INCOME



4.The growth dividend.

Various analysts and economists, including ourselves, have put our calculators and spreadsheets to work. For example, if we amortize the R1.2 trillion of energy-related sector spend as well as the investment into new telecoms

COMPONENTS OF DISPOSABLE INCOME



infrastructure post the successful auction, plus a few “other bits and bobs”, South Africa can achieve a new growth path. What is hard to calculate is the multiplier-effect of these investments - those who will find employment, temporary or permanent positions, then raise their standard of living, sometimes immediately. Furthermore, downstream business development, such as a few new shops (both informal and formal) at Boegoebaai, is hard to quantify at this stage. Be it as it may. The table below highlights these calculations done by National Treasury. What is not in doubt is that the potential impact is well above our recent GDP growth rate. Even if we only achieve half of our new potential, we should still see a growth rate double that of what we have experienced over the past seven years.

Faster Sustainable GDP Growth is Possible

Current growth ceiling	1.5% - 2.0%
Ignite growth through:	
Public employment	+ 0.3%
Spectrum and internet	+ 0.6%
Electricity	+ 0.25%
Plus lifting constraints	*1.00%*
Railways and ports	+ 0.3%
Infrastructure	+ 0.25%
New growth path	3.5% - 4.7%

The only challenge – from an investor’s point of view – is to remember that this will not be achieved overnight. Headlines will continue to scream about a failing state. We suggest you ignore those headlines and stay the course. Even a modest uptick in growth can translate into solid earnings growth and share price performance.

Through a variety of news channels and daily commentators, investors are constantly bombarded with advice on where to invest their money. The most vociferous debates often occur between those who argue that everything should be offshore, and those who argue the opposite. Our next seminar will explore the merits of both markets, through the lens of our identified core themes, and explain why we feel it is wise to hedge your bets.

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Topic: **Why still Local AND Global**

Natal Midlands	
Date:	15th September 2022
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	20 September 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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