INTUITION

28 APRIL 2023

Economic reflection

We have long been waiting for inflation to subside or to even to decline as fast as it accelerated. Unfortunately, the latest release was higher than consensus and perhaps confirmed that the unexpectedly large increase in interest rates by the Reserve Bank in March was the right move. The money market now expects yet another move higher. South Africans (both businesses and consumers) are under pressure as the cost of doing business and spending patterns remain under strain. Often a picture can tell a thousand words. We have chosen 3 economic indicators to assess how the first quarter of 2023 might turn out from the perspective of GDP growth. They suggest another sluggish performance. Nonetheless, results by various companies suggest that management teams are making the right moves to mitigate some of the challenges.

SPEED READ

- **The rising cost of doing business is reflected in some key economic statistics and suggest slow GDP growth in the first quarter of 2023.**
- **Retail sales are weak, but consumers have adjusted their spending from "nice to have's" to necessities and sometimes to something special like a new item of clothing.**
- **The investment cycle is proving slow to turn, but the private sector is stepping up to get the needle moving. The manufacturing sector is still lagging as power supply remains a critical factor.**

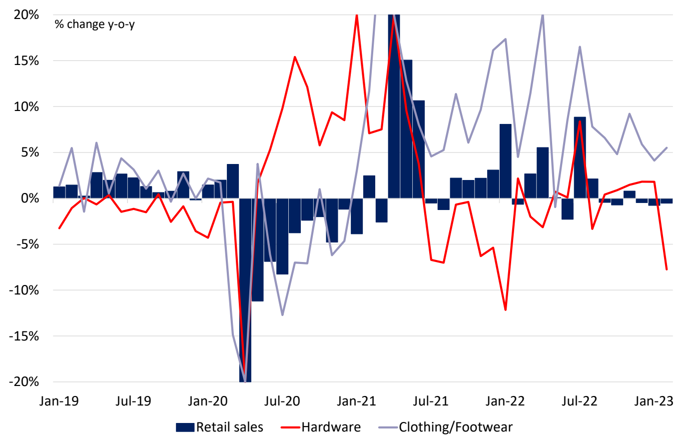
Willie Pelser

Two weeks ago, Michael wrote about the markets, recapping what transpired over the first 3 months of the year. In this update we will take stock of what is happening "on the ground" by looking at three fundamental indicators around economic activity, which also tie back to our investment themes focusing on the consumer and infrastructure at large. Stubbornly high inflation and the unexpectedly large interest rate hike by the Reserve Bank last month are contributing factors to the performance of these indicators, which we all want to wish away. (In early May, Jana will look at the health of the SA consumer, which will provide additional insight into this sector). Headline CPI rose to 7.1% y/y in March from 7% in February, an increase that was slightly above consensus estimates of 6.9%. Unfortunately, this has prompted an upward adjustment in SA's implied forward rates. Interest rates are expected to rise by a minimum of 0.25% at the next MPC meeting scheduled for the end of May.

Indicator 1: Retail sales

On average, globally consumer expenditure makes up almost 60% of GDP. Retail sales, alongside other indicators such as consumer debt to disposable income, is therefore a good indicator of the state of the consumers' wallet. We are all aware of the impact of interest rates and soaring inflation on the price of general goods as we all try and keep the wallet closed. Growth in retail sales has therefore been slowing over the last year and actually fell by 0.5% in February 2023. The DIY space is feeling the brunt of a lack of spending as we prioritize food on the table over a leaking roof and peeling paint. The latest results by Cashbuild with revenue down 9% and volumes falling by 13% support these statistics. Any spare cash is tending towards anti-Eskom products such as solar and batteries. What has always intrigued me, and the growth statistics in good and bad times confirm this, is how South Africans love to dress well. Clothing retailers have become masters in gaining share of wallet even in constrained times. For example, as consumers trade down due to cost pressures, Shoprite has just launched an alternative clothing range in a new shop format called "Uniq" to grow its overall share of consumer spending.

GROWTH IN RETAIL SALES



Overall, retail sales are slowing. After a bumper period during the Pandemic when DIY projects were all the rage, that trend has now collapsed, with consumers opting to spend their precious cash on clothes and other necessities (which includes energy products).

Indicator 2: Investment

The latest release of South Africa's economic statistics by the South African Reserve Bank contained some positive news about fixed investment. Big-ticket investment does not happen overnight, just ask a new mining operation for example. SA's real capital expenditure only grew by 0.2% in 2021 and then by an additional 4.7% in 2022. This followed five consecutive years of contraction. The growth in 2022 was bolstered by higher investment activity in machinery and transport equipment, as well as in non-residential buildings and albeit small, some construction works. Unsurprisingly, the increased investment was mainly by the private sector with little additional investment by public corporations. What is encouraging is the increase in the ratio of Gross Fixed Capital Formation as a percentage

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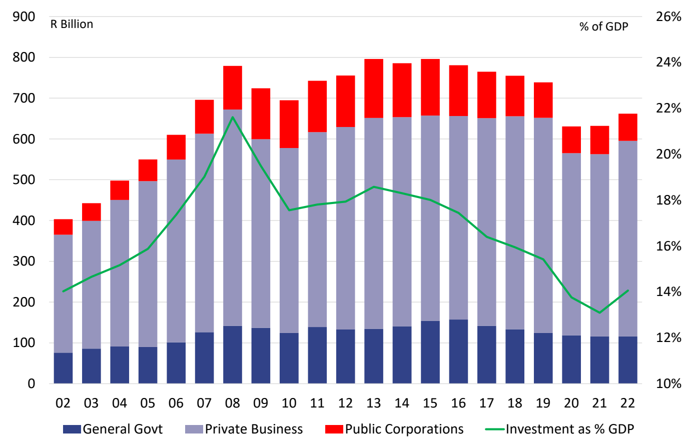
of GDP to 14.1% in 2022 from 13.1% in 2021. This is still far short of the levels required to get our overall growth rate to 3%, but at least it is a step in the right direction. Comments from Raubex that its Roads and Earthworks division has been awarded contracts from SANRAL worth R2 billion might be small but is encouraging in the current climate. What came as a surprise in Afrimat's latest results was the comment that trains from Transnet are becoming more consistent and reliable. I am not sure if they are new or old equipment but at least they are "rolling stock" that the economy needs desperately.

SA FIXED INVESTMENT SPENDING



The private sector is largely responsible for the rising momentum in fixed investment in this country, as companies take it upon themselves to provide their own basic infrastructure.

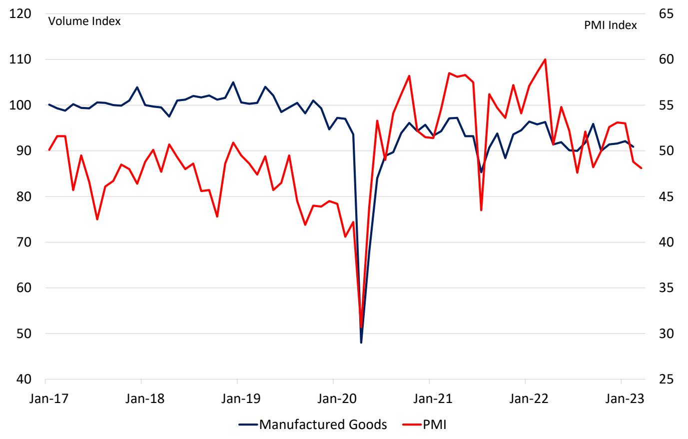
Indicator 3: Manufacturing

On the flip side, the volume of manufacturing production chart does not make for happy reading. The impact of loadshedding is well documented and can clearly be seen in this sector well before the impact of Covid. Over the past six years, the volume of goods manufactured in Sa has dropped by about 10%. Since Covid, rising input costs, lower export demand due to a slower global economy as well as constant labour issues have disrupted supply chains and logistics. The largest contributors to the overall manufacturing statistics are manufacturers of food products, basic metals

Toyota has a manufacturing plant in Durban but it is one of far too few manufacturers in South Africa.

(steel and other) and petroleum-related goods. The closure of various oil refineries has not helped. Confidence in the manufacturing sector (as expressed by ABSA's Purchasing Manager's Index) has also been waning after a great recovery since Covid. Domestic demand is struggling, with some comments referring to local demand faltering due to load-shedding. Indeed, in contrast to overall business activity, the subindex that tracks new sales orders has performed worse recently, contributing to the lower overall confidence.

SA MANUFACTURING SECTOR



The trends are broadly negative across the manufacturing base. We need power and confidence to make stuff.

Although we are well past the end of the first quarter of 2023, GDP data for that quarter will only be released in June. There are various other indicators that we track that release data more frequently but based on these three examples, it suggests that the first quarter might again reflect an economy struggling to gain momentum. In the interim, company results continue to reflect how management teams are tweaking their companies to cope with the challenging environment. In many instances profit growth from local companies is far outstripping that of the economy in general. As we have always said, "companies are not countries." They continue to prove our point.

South Africa's overall economic picture is one that is of an economy that is struggling to gain momentum.

Our next Insight seminar will take place in June and provide an update on what has driven markets over the first six months of the year, and what might lie ahead for the balance of the year. We are very excited to be expanding our seminar program to Cape Town.

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Topic:	Mid Year Market Update
Natal Midlands	
Date:	Thursday, 22nd June 2023
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	Tuesday, 13th of June
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town	
Date:	Wednesday, 14th of June
Venue:	To Be Confirmed
Time:	To Be Confirmed

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