INTUITION

4 OCTOBER 2024

Tailwinds for the SA economy and markets?

After deforestation across the road from my home, the land looked barren. It was unimaginable that it would ever recover. However, new growth as summer approaches has left us stunned at the changes. During 2023, the JSE and the economy had a similar feel. Investors and economists kept asking whether we would ever see higher GDP growth and a recovery in the stock market. Wow, it has come quickly after the GNU! We are of the opinion that SA is enjoying a few tailwinds that bode well for the next 18 – 24 months.

SPEED READ

- **During 2023, excessive load shedding and various other negative economic outcomes framed the news, convincing us that gloom and doom was the only scenario.**
- **The election period had its own anxiety and concerns about whether SA could survive.**
- **The consumer sector is now enjoying a few tailwinds which we expect will result in higher GDP growth and underpin financial markets.**
- **Sentiment around gross fixed investment has improved substantially. More and more big-ticket spending projects have been announced and will commence soon.**

Willie Pelser

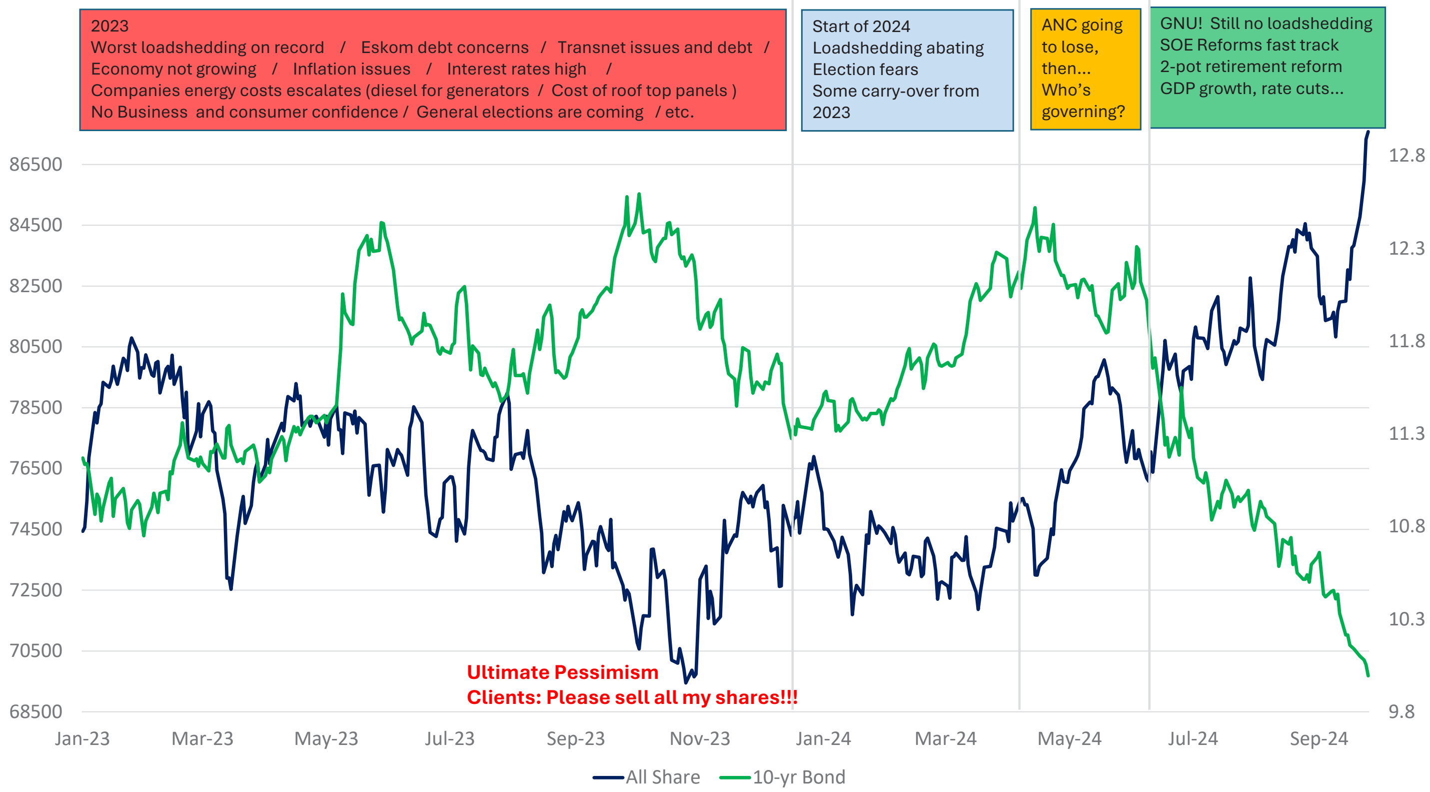
Sitting in my study overlooking the new growth in the garden, I realised a lot has happened over the last 18-24 months. The trees in the forest adjacent to where we live were all harvested. We were left stunned as to how barren the landscape had become. It just looked ugly! "Will it ever recover?" we continuously asked ourselves. Following some hard work by my wife and her helpers, the garden was rearranged to make use of the new source of natural light (sunshine!) that was hidden by the huge trees previously. Rows of new trees and shrubs were planted over the past few months. As I stared through the window, I could almost "hear" the growth, and truth be told, some growth was already measurable in centimetres. We do live in Hilton, so the natural moisture (mist) and the early spring rains have played their part.

The South African economy and markets bore a close similarity to my landscaping issues. Quite a lot has happened over the past two years in South Africa. If we cast our minds back a year or so, it was all doom and gloom (it felt like the forest was flattened and the landscape was bare – GDP growth was almost zero!) Listening to a presentation a few days ago, the presenter commented that a year ago when international investors attended an SA presentation, they said it was like visiting a patient in ICU. Fortunately, this patient has subsequently made a miraculous recovery - we can almost hear the bandages falling off. The new growth is already measurable in larger "percentages". For example, the JSE All Share Index is climbing the "all-time high" ladder and SA bond yields are running faster than Little Red Riding Hood trying to escape the Big Bad Wolf.

In the chart below, the blue line is the All Share index while the green line represents the yield on SA's 10-year government bond. The four textboxes above the chart summarise what was on South Africans' minds over the periods indicated. (Readers might include their own additional issues.) Undoubtedly, we could write an essay in each box, but I think you will agree that it speaks to the uncertainty during 2023 and leading into the May elections. The third box is way too small to reflect on the election propaganda machines, the MK scare factor and whatever else you can remember around that time. Markets remained uncertain and volatile.

Hopefully, we have all moved on and can now focus on the new "growth" - the new opportunities stemming from the elections and the impact that a few tailwinds could have to help SA grow at a faster pace and further underpin local financial markets. There will be ups and downs – that I can promise – but the promise and potential that higher growth could unleash should not be underestimated.

SA FINANCIAL MARKET PERFORMANCE



This chart tracks the performance of stocks (blue) and bonds (green) over the past 18 months. There was doom and gloom, an election full of surprises and more recently, a reaction from markets contrary to perceptions and expectations. Headwinds have turned to tailwinds.

I will not bore you again with the equation to calculate GDP (or the economic growth rate). However, I will focus on two components within this formula – consumer spending and fixed investment - which will hopefully give credence to our view that South Africa could achieve a higher growth rate in the quarters and years to come. We presently have some tailwinds. It might not be the high economic growth rate that we so desperately need, but any rate sustained at more than 1.5% or at the 2% level which we believe is possible over the next few years, will be a welcome relief.

Consumer Tailwinds

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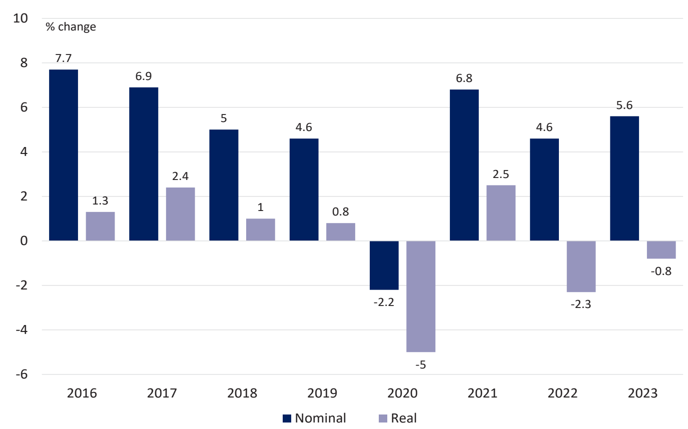
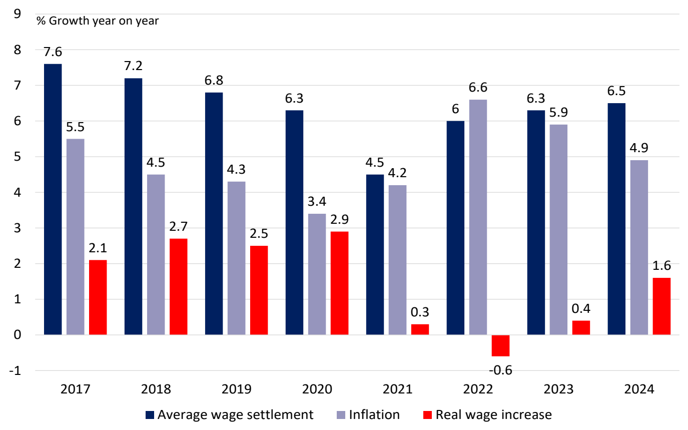
1. **Positive inflation impact on wages and disposable income.** After two years during which inflation wiped out nominal income growth, the tide has now turned in Q2 of this year. In the first chart, the light blue bars show that there was in fact no "money" left to spend. Total compensation growth, after adjusting for inflation, was negative. Fortunately, inflation has abated sharply. The second chart shows average salary increases as measured by consulting group Andrew Levy. Real wage increases are expected to follow through into 2025. We all know South Africans are not shy when it

COMPENSATION IN THE SOUTH AFRICAN ECONOMY



After two years during which inflation wiped out nominal income growth, real income is on the up comes to spending and these real salary increases will find a till in a clothing or grocery shop. Nothing attracts a consumer like a shopping mall, and we have plenty of

WAGE GROWTH IN SOUTH AFRICA

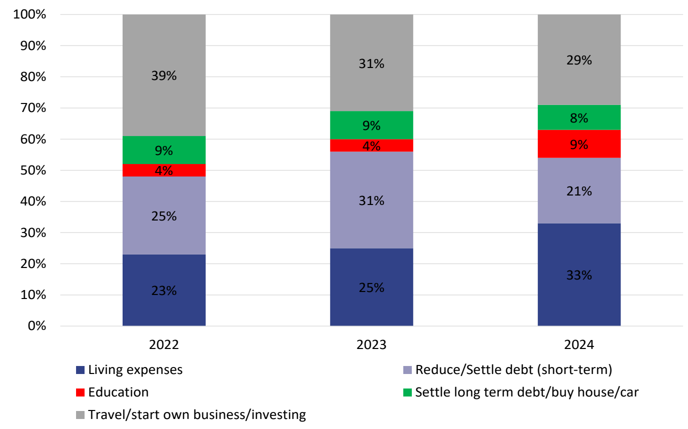


With inflation abating, higher salary increases result in real wage growth and hence more spending money.

these around South Africa!

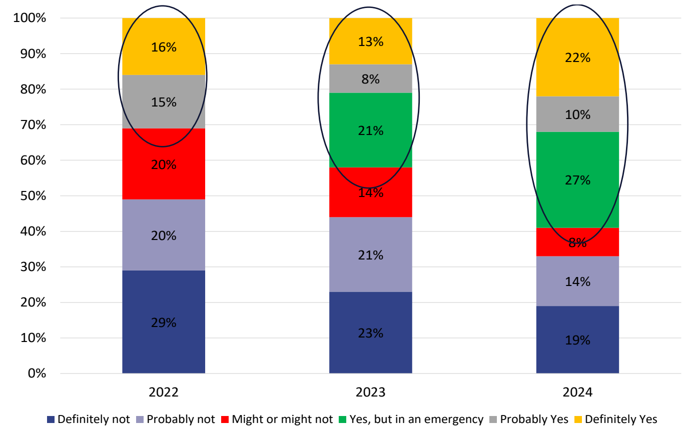
2. **A "bonus pot"** (the new 2-pot system following pension reforms.) The verdict is still out as to how much South Africans will withdraw from the newly reformed retirement regime. Before we speculate on numbers, it is worthwhile contemplating that historically 9 out of 10 people accessed their retirement savings when they changed employment (as per data from Alexander Forbes.) Consequently, they were quite confident that South Africans will access the savings "pot" and probably take the maximum available. The following charts are from surveys by Sanlam showing the spending application of these funds. Over the last 3 years, consumers used more of the proceeds for living expenses and less to reduce or settle short-term debt obligations. Furthermore, over the same survey period, more and more respondents indicated that they would be accessing the funds available under the new 2-pot retirement structure. We are therefore of the opinion, based on these survey results, that more and more people will access and spend the money now available from the 2- pot system, which initial estimates suggest between R40 billion and R70 billion. An article in The Citizen newspaper quoted an ABSA economist: "Malukele expects the taxman (SARS) to get between R8 billion and R10 billion in extra taxes from the estimated R44 billion in withdrawals in the first four months of the new system (September to December 2024)". They further estimate another R34 billion will be accessed before the end of August 2025. The final value of funds accessed might surprise on the upside. There are Black Friday sales approaching and Christmas is around the corner.

SPENDING PATTERN WHEN DRAWING DOWN RETIREMENT SAVINGS



Surveys show that those who access their pension products spend a large portion on living expenses and less on repaying debt

WILL I ACCESS MY RETIREMENT FUNDS IN THE NEW 2-POT SYSTEM?



Since the initial proposals of creating the 2-pot retirement regime, an increasing percentage of people have indicated that they will access cash from their retirement savings.

3. **Immediate "wallet effect."** Two examples spring to mind. Firstly, the steady decline in petrol prices. South African motorists are lined up for more petrol price relief in October. By the time you read this article, the price will have been reduced by more than R1 per litre. This brings relief of more than R4.60 for petrol and R6.60 for diesel since October 2023. The feeling of more money in your pocket is felt monthly as you spend less on fuel. The second effect, by its nature, will take longer to manifest. After the 0.25% reduction in interest rates by the Reserve Bank, your next vehicle instalment or mortgage repayment will leave a bit extra in your pocket. Forecasts of how many more rate cuts we will be blessed with, vary. However, on the positive side,

we do have a few cuts coming our way over the next year – possibly another 1% in total as inflation surprises further on the downside. Last month's producer price inflation index already printed a low of 2.8% and the latest consumer inflation came in at 4.4%. We expect inflation to hover around the SARB's midpoint of 4.5% over the next two years.

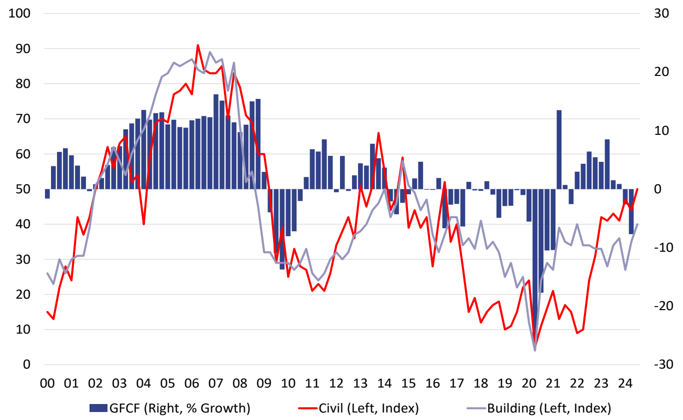
Investment Tailwinds

1. **Sentiment.** We have commented, written and presented many times in the past on how South Africa's infrastructure and capital investment has fallen behind. Years of crime, the rail, road and port woes, and risks associated with big capital investment have seen even the demise of previously listed construction giants. However, those who have followed companies like Afrimat and Raubex will recall how their management teams over the last two years have commented that things are looking up. Their results, especially over the last 12 months, have confirmed their prior expectations about South Africa's investment and construction cycle and the respective share prices have rallied on the news

Echoing these companies, more and more participants in the building and civil engineering sectors are dusting off their shovels - i.e. saying they are becoming more and more confident. Sentiment, which we believe is one of the most critical parts of decision-making when it comes to big-ticket expenditure, has changed. The Bureau of Economic Research, based at Stellenbosch University, compiles surveys from role players in these respective industries.

The Building Confidence Index measures the business confidence of all the major role players and suppliers involved in the building industry such as architects, quantity surveyors, contractors, sub-contractors, retail merchants, and manufacturers of building materials. The index is compiled quarterly from the building, manufacturing, retail and wholesale opinion surveys undertaken by the Bureau for Economic Research (BER) at Stellenbosch University. Following an eight-index point rise to 35 in Q2 this year, the FNB/BER Building Confidence Index increased further to 40 in Q3 2024. The residential building sector continued to underperform this quarter, while work for non-residential builders showed a noticeable improvement. Activity at the start of the building pipeline was also encouraging. After slipping to 44 in Q2 '24, the FNB/BER Civil Confidence Index reached an eight-year high of 50 in Q3 '24 and momentum is now well above the long-term average. The chart shows the confidence indices relative to the growth in Gross Fixed Capital Formation.

CONFIDENCE AND INVESTMENT CYCLE



The latest Building and Civil Engineering confidence indicators are upbeat reflections for big-ticket capital and investment projects to start

2. **Announced Projects.** Nedbank publishes annually a list of Capital Expenditure Projects - they have been compiling this since 2006. The latest report shows a sharp increase in plans for new fixed investment projects in 2024. The value of new projects announced in the first half of the year increased to R793.7 billion, up sharply from R193.2 billion in 2023. The true value and multiplier effect of these projects being implemented will only be felt from 2025 onwards, therefore hinting at a positive upward trend in economic growth when these are published over the next couple of years. Investment momentum definitely has an upward feel to it.

A last note in this regard is from a few newspaper headlines:

- ArcelorMittal SA reversed a decision to shutter two steel plants that support 80,000 jobs, soon after the GNU was formed.
- Qatar Airways bought a stake in South African airline SA Airlink Pty Ltd
- A $70 million auto-parts facility to supply Toyota Motor Corp., which just three years ago said it might leave the country, has since opened

We certainly hope that you share our sentiment that the current tailwinds are pushing us forward and the pace of change will have a positive effect on the South African economy and financial markets. Hopefully the words of the GNU: "(We) have committed to accelerating reforms to boost economic growth that's remained stagnant for a decade", will not be idle.

We remain positive and focused to take advantage of the opportunities at hand.

By the end of November, it will have been six months since our election ushered in the GNU. This presentation will focus on the outlook for 2025, and delve specifically into whether the SA story is still intact.

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Topic:	Outlook for 2025. Is that SA Story Intact?
Natal Midlands	
Date:	05 December 2024
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	04 December 2024
Venue:	Rosebank Union Church, Cnr Winne Mandela Drive and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	2 December 2024
Venue:	SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor
Time:	7.30am
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

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