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MARKET MATTERS

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FEWER OWN GOALS

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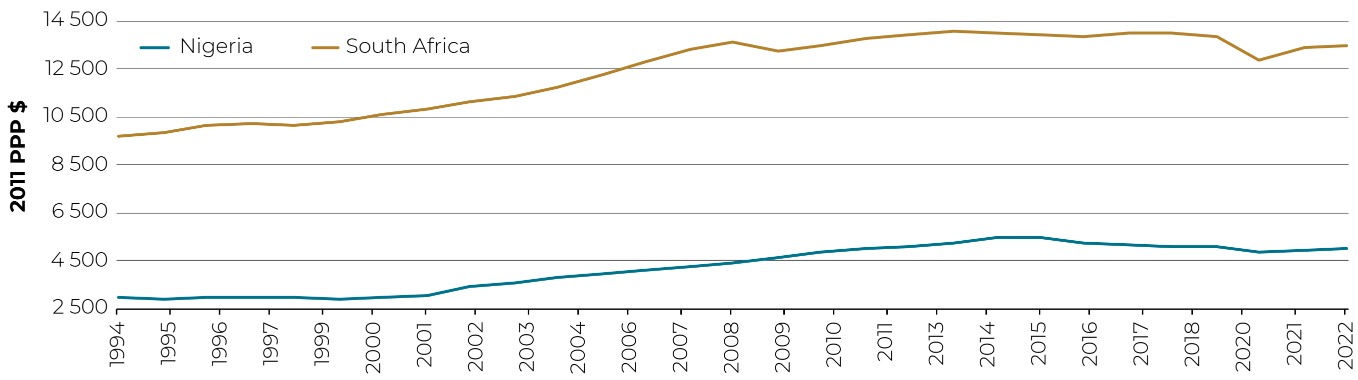
It was a nail-biter, but in the end, Bafana Bafana lost the Afcon semi-final to Nigeria on penalties. It was South Africa's best showing at the continental competition since 2000, when it came third, and defied expectations of another poor run. Well done Bafana! The reality, however, is that South Africa punches well below its weight in African football. It should be a regular semi-finalist – as Nigeria is – based on its resources and talent.

Similarly, South Africa's economy also underperforms. It vies with Nigeria (and Egypt) for the title of largest economy on the continent. The holder of this somewhat meaningless crown depends on how it is measured. Nigeria is a bigger economy when measured in purchasing power parity terms in US dollars. This accounts for cost-of-living differences between the two countries – a dollar goes further in Nigeria. Similarly, on this basis, China is a bigger economy than the US. But measured at market exchange rates, the US remains much bigger, partly because of the strong dollar and weaker yuan. Nigeria recently devalued its naira by 40%, which puts South Africa in the lead again when measured this way.

The devaluation of the naira is part of a series of reforms under the new president Bola Tinubu to revitalise the struggling Nigerian economy. Its economy is also a chronic underperformer. With a massive population of 213 million and rich endowment of oil and gas and other natural resources, it should be one of the biggest economies on earth, never mind Africa. But years of corruption and mismanagement means most Nigerians are still very poor, and real income per head has not grown over the past decade.

CHART 1: REAL GDP PER CAPITA, PPP US$



Source: World Bank

Where it gets really interesting is that markets seem to have bought into the Nigerian reform story and lost faith in South Africa's. The heady days of "Ramaphoria" are a distant memory. A Bloomberg article from last week summarised it as follows: "Nigeria's dollar bonds have turned into one of the world's top performers in the past year, with a 25% return, as investors buy into major reforms in Africa's biggest economy. By contrast, bonds from South Africa... have only returned 4.4% and foreign investor holdings are at a record low in the face of its political and fiscal challenges."

Three things to note here. Firstly, off a depressed base, the slightest bit of good news can lead to a sizeable market rerating as the Nigerian example shows. However, returning another 25% is going to be extremely difficult because the improvement in Nigerian fundamentals is now largely priced in. Secondly, economic reform is hard. If it was easy, everyone would do it. There are usually low hanging fruits to pick, but beyond that it is a slog. The status quo exists because it suits some people, and they will resist change, particularly because the benefits of these reforms are often widespread and slow to materialise, while the costs can be concentrated and upfront. Moreover, while some reforms can be sold as bold, exciting change, most of the important changes are technical, dry and bureaucratic, and unlikely to capture the public imagination. Naturally, politicians gravitate towards initiatives where they can claim maximum political mileage, not maximum long-term economic return. Thirdly, investors have short attention spans. They've largely given up on South Africa and the reform process underway. This has resulted in South African assets trading at a discount. At some point though, the market will notice progress and be pleasantly surprised by it.

This brings us to last week's State of the Nation Adress (SONA). It is an election year, and as expected, the speech delivered by President Ramaphosa was long on feelgood and short on anything new.

There will be another SONA after the election, and hopefully it will focus more on plans for the future. It still appears likely that Cyril Ramaphosa will be sworn in for another term (his last) in a few months' time, possibly with the help of a small coalition partners. The main thing from an investor point of view is that there will be broad continuity with the reform agenda.

STOP SCORING OWN GOALS

While for most of us it seems that little has changed and indeed much has gone backwards, there have been very important shifts that will alter the long-term growth potential of the country. In simple terms, the stranglehold that government maintained on key economic sectors – notably electricity, ports and rail freight – is being broken. The failures of the State-Owned Enterprises that operate in these sectors, notably Eskom and Transnet, have emerged as the biggest constraints to economic growth in South Africa. In football terms, we have consistently been scoring own goals.

Letting go of the idea that the State must own and run these key network industries as has been the case for more than 100 years (Eskom was founded in 1923, while Transnet's predecessor, SAR&H dates from the creation of the Union in 1910) is a major change that has taken place under the Ramaphosa presidency. This might not amount to putting the ball into the opponent's net yet, but to stop kicking the ball into our own net is an important start.

The process of unbundling Eskom and decentralising the electricity market is underway. Not only have we seen countless homes and small businesses put up rooftop panels, but large businesses can now purchase electricity directly from private producers. So can municipalities. Electricity trading platforms are springing up, and trading

in electricity futures contracts could become lucrative. Eskom itself still faces the challenge that its fleet of power stations are old and prone to breaking down. Unfortunately, it means we will be a country of electricity haves and have nots. But at least the haves can continue to be economically productive.

Electricity is not just about generating it, but also about transmitting it from point A to B. The President noted in his speech that around 14 000 kilometres of transmission lines will have to be built to connect the sunniest and windiest parts of the country where renewable energy potential is best to the grid. This will also be done with help from private capital, facilitated by the new National Transmission Company.

Opening Transnet's ports and railways to private participation is trickier, but it is also underway, and is being guided by the Freight Logistics Roadmap. Like Eskom, Transnet is likely to be a very different entity a few years from now. It will still be the owner of transport infrastructure – effectively the landlord of ports, railways and pipelines – but with private companies doing much of the running of day-to-day operations. Crucially, this will also involve large scale investment.

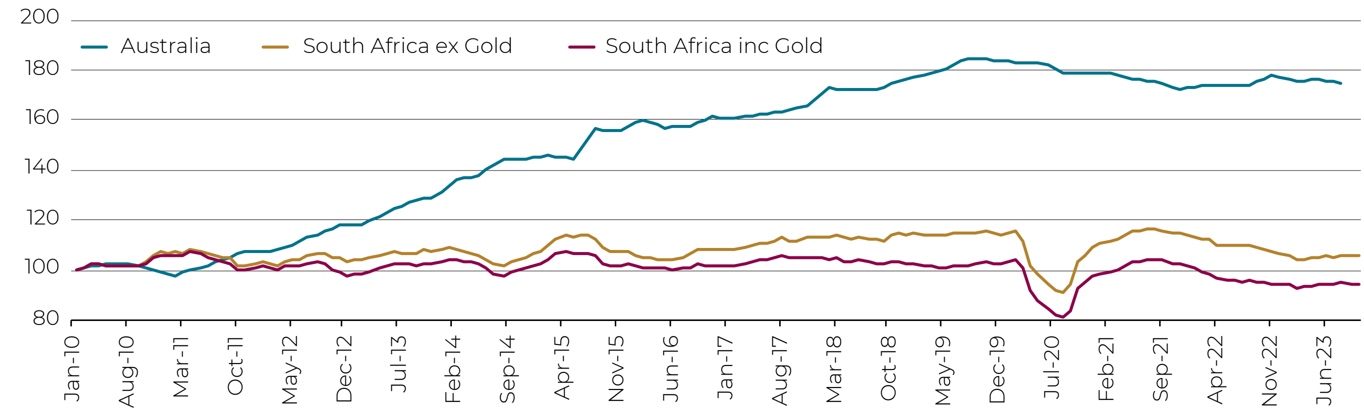
Bulk water provision is another key area where private sector participation is set to rise. South Africa is a dry country and needs world-class infrastructure to manage this most precious of natural resources.

Electricity and logistics are not the only constraints on South African growth. Service delivery in many municipalities is weak, and this affects all businesses who are based in those areas. There is also too much red tape for most businesses. It is difficult for skilled foreigners to get work permits, even when they are employed by multinationals with offices in South Africa. This is finally addressed.

The mining industry is probably the most affected by government inefficiency, with massive backlogs of licence applications sitting with the Department of Mineral Resource and Energy. The announcement that a Canadian-led consortium will build a new online mining rights portal (called a cadastre) is long overdue, but welcome.

South African mining production has moved sideways for years and is in fact lower than when the current mining minister took office. South Africa has failed to capitalise on the last two commodity booms since production could not be ramped up, due to red tape and infrastructure bottlenecks. In contrast, Australia – which faces the same wild swings in global commodity prices but has a much easier operating environment – has seen mining output grow strongly. We cannot miss the next boom, whenever it may arrive.

CHART 2: INDEX OF MINING PRODUCTION VOLUMES



Source: LSEG Datastream

Footballing rivalries aside, the rest of Africa already accounts for a quarter of South Africa's export revenues, and this number can grow strongly as the new African Continental Free Trade Agreement is implemented. We should cheer any economic success north of our borders, because it will ultimately also benefit South African companies.

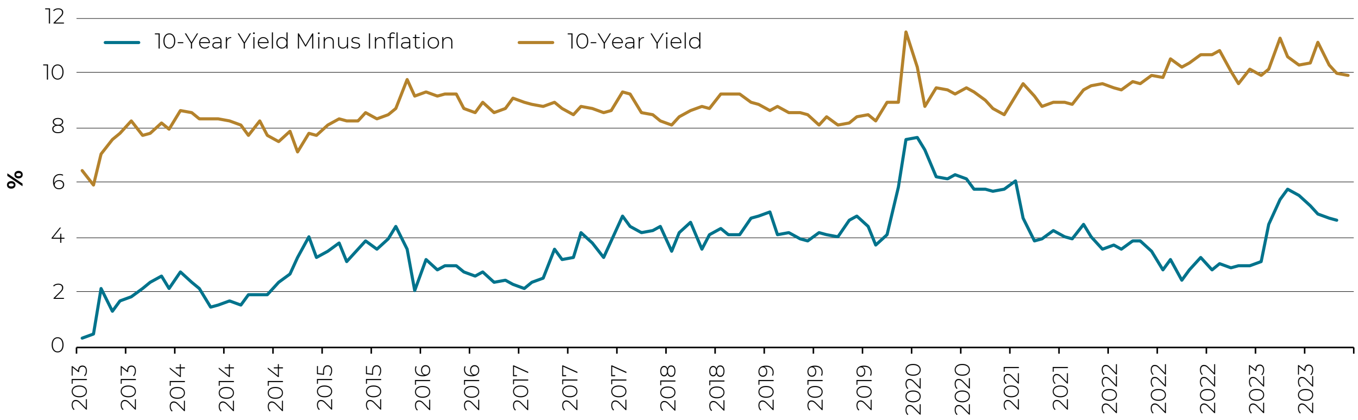
All the above suggests that we shouldn't project the low growth of the past few years – less than 1% on average – into the future. It will happen over time, but South Africa's potential growth rate is set to rise.

This is not to suggest that all is hunky dory. Two days after SONA, Eskom announced that we are back to stage 6 loadshedding. And while there are concrete plans on the table and active involvement by the business sector to deal with some of the economy's major challenges by crowding in private sector skills and capital, this is not the case for many other areas where we still need an effective and caring government to intervene. Ultimately, the private sector only solves problems where its bottom line is affected. Most social problems require a broader societal solution.

HIGH YIELDS

The other big headwind is the cost of capital. South African interest rates are high. This is good news for lenders, but not for borrowers. Local interest rates have always been relatively high, since inflation is usually elevated. However, in the last decade, real interest rates have increased because of the rising fiscal risk premium.

CHART 3: SA GOVERNMENT BOND YIELDS, %



Source: LSEG Datastream

This means that government borrowing costs (bond yields) are high due to deteriorating perceived creditworthiness. It is a negative spiral, because higher rates also cause the market to further reduce its assessment of creditworthiness since the government has to spend more on making interest payments. As it stands, almost the entire budget deficit of 5% of GDP is taken up by interest payments. Non-interest spending is broadly equal to tax revenues. This so-called primary (non-interest) balance is likely to move into surplus in the years ahead.

This is one area of reform that is unfortunately deeply unpleasant and unpopular, and therefore risks being abandoned. But it is also one of the most important. Almost nobody benefits from fiscal consolidation – less government spending and higher taxes – in the short term. But in the long run, everybody loses if there is a debt crisis. For now, the fiscal crisis is not in the markets but out in the streets, where frontline service delivery is deteriorating due to ongoing budget cuts, as illustrated by recent news reports of unemployed young doctors. But history shows that when the fiscal crisis hits the markets, things really spiral out of control.

In SONA, the President only devoted one line to the matter, “We will continue the work to improve the country’s fiscal position.” It falls on the finance minister to spell out what that means in next week’s Budget Speech. He needs political cover from the President to dish out the bitter medicine. A stronger statement would therefore have been welcome, but let’s not forget that it is an election year. The Budget Speech is still expected to show ongoing commitment to fiscal consolidation and eschew populist gimmicks and give-aways.

In summary, investor perceptions of South Africa emphasise the slow growth, crime, corruption and infrastructure decline and not the reforms underway. This is reflected in the depressed prices – and hence upside potential – of South African assets. However, like any tense football game, we don’t know when exactly winning goal will be scored. If you get up, you might just miss it. Similarly, you need to stay invested to benefit when the market turns. There is no TV replay. But then just as you wouldn’t want a football team made up of only strikers or only defenders, a portfolio should have balance, and that means not being overexposed to any one country, including your own.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	3 281.0	1.02%	2.37%	3.53%	17.56%
United States	S&P 500	US$	5 027.0	1.37%	3.74%	5.39%	23.15%
Europe	MSCI Europe	US$	1 999.0	0.00%	-0.89%	-1.04%	5.21%
Britain	FTSE 100	US$	9 563.0	-0.60%	-1.22%	-2.87%	-0.26%
Germany	DAX	US$	1 583.0	0.06%	-0.31%	0.02%	5.60%
Japan	Nikkei 225	US$	247.2	1.42%	0.12%	4.17%	17.86%
Emerging Markets	MSCI Emerging Markets	US$	996.0	0.81%	2.05%	-2.73%	-2.83%
Brazil	MSCI Brazil	US$	1 689.0	0.66%	-0.24%	-6.17%	17.45%
China	MSCI China	US$	51.1	2.86%	3.01%	-7.95%	-28.04%
India	MSCI India	US$	954.6	0.34%	1.12%	3.54%	28.48%
South Africa	MSCI South Africa	US$	376.0	-2.34%	-3.84%	-9.40%	-13.76%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	73 423.0	-1.29%	-1.52%	-4.51%	-8.25%
All Share	All Share (Total Return)	Rand	12 954.0	-1.29%	-1.52%	-4.41%	-4.74%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	31 847.7	-1.13%	-1.21%	-4.02%	-3.51%
TOP 40/Large Caps	Top 40	Rand	11 677.0	-1.45%	-1.73%	-5.14%	-6.53%
Mid Caps	Mid Cap	Rand	20 635.0	-1.86%	-2.55%	-5.28%	-0.06%
Small Companies	Small Cap	Rand	32 831.0	-0.59%	-1.20%	0.52%	7.63%
Resources	Resource 20	Rand	4 201.2	-6.67%	-8.21%	-13.58%	-30.25%
Industrials	Industrial 25	Rand	22 462.0	1.42%	2.53%	1.17%	2.62%
Financials	Financial 15	Rand	12 353.0	-0.61%	-1.47%	-4.32%	10.45%
Listed Property	SA Listed Property	Rand	1 930.6	-0.31%	-0.43%	3.57%	14.37%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government Overall (USD Unhedged)	S&P	US$	75.6	-0.97%	-1.58%	-3.56%	-3.75%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	942.1	-0.57%	-0.59%	0.18%	6.55%
Government Bonds	BESA GOVI	Rand	928.5	-0.57%	-0.59%	0.17%	6.50%
Inflation Linked Bonds	BESA CILI	Rand	348.8	-0.30%	-0.26%	-0.14%	8.01%
Cash	STEFI Composite	Rand	553.3	0.16%	0.20%	0.95%	8.21%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	82.2	6.28%	1.47%	6.74%	-3.31%
Gold	Gold Spot	US$	2 025.0	-0.74%	-0.69%	-1.84%	7.48%
Platinum	Platinum Spot	US$	873.0	-2.02%	-6.33%	-11.55%	-8.39%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	19.04	-0.71%	-1.84%	-3.86%	-6.65%
ZAR/Pound	ZAR/GBP	Rand	24.04	-0.67%	-1.37%	-3.08%	-10.40%
ZAR/Euro	ZAR/EUR	Rand	20.53	-0.66%	-1.54%	-1.59%	-7.05%
Dollar/Euro	USD/EUR	US$	1.08	0.00%	0.19%	2.22%	-0.93%
Dollar/Pound	USD/GBP	US$	1.26	0.03%	0.56%	0.56%	-4.19%
Dollar/Yen	USD/JPY	US$	0.01	0.61%	1.57%	5.85%	13.49%

Source: I-Net, figures as at 9 February 2024