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Ninety One

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Investing for a world of change

South Africa back on track?

Malcolm Charles
Portfolio Manager, Emerging Market Fixed Income

Sisamkele Kobus
Economics Analyst

The fast view

- The rand should be more stable now that load-shedding is no longer constraining the economy.
- Inflation remains well behaved, providing room for the South African Reserve Bank to continue easing interest rates.
- We anticipate economic growth of 1.7% next year, thanks to lower inflation, support from two-pot withdrawals, rate cuts and investments in infrastructure, including renewable energy.
- The favourable outlook for the rand, inflation, interest rates and growth supports our bond market.

South Africans are generally optimistic, but the long, dark years of state capture and load-shedding have weighed heavily on the national psyche.

With an energy availability factor hovering in the mid-fifty percent range in 2023, South Africans braced themselves for stage 7 or higher load-shedding as winter approached. The electricity crisis acted as a permanent handbrake on our economy, leaving consumers and businesses idling in the parking lot of SA Inc.

There's nothing like a crisis to force change

Most of the required reforms to alleviate load-shedding were already enacted at the peak of the electricity crisis. The President's establishment of a "war room", in the form of NECOM,[1] allowed government, business, and consumers to all play a pivotal role in finding ways out of the energy crisis. Since late March, we've had no load-shedding, and the energy availability factor is above 70%. Businesses and households have invested substantially in renewable energy, resulting in reduced demand on Eskom generation. It has also allowed the national power utility to perform crucial maintenance at its power stations.

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Renewable energy has become a much larger component of the energy mix, effectively doubling from c. 10% of installed capacity to 20% over the last 2 years. The huge acceleration of private-public partnerships means that NERSA-registered projects are sitting at 9.7GW,[2] with their capacity close to Eskom's Medupi and Kusile power stations. Additionally, rooftop solar energy has almost trebled over the last 2 years to 6GW.[3] While rapid growth in energy generation is helping to get South Africa back on track, we are also seeing much-needed transmission reform.

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1. The National Energy Crisis Committee.
2. Ninety One and NERSA, September 2024.
3. NERSA and Eskom, July 2022 to June 2024.

NERSA renewable project registration (MW)

2021	2022	2023	2024 Q1-Q3	Total registrations
135	1 664	4 530	3 344	9.7GW

Over the past 2 years

Installed capacity of renewable energy has doubled from

c.10% to 20%

Rooftop solar energy has almost trebled

6GW

Cumulative estimated Rooftop PV

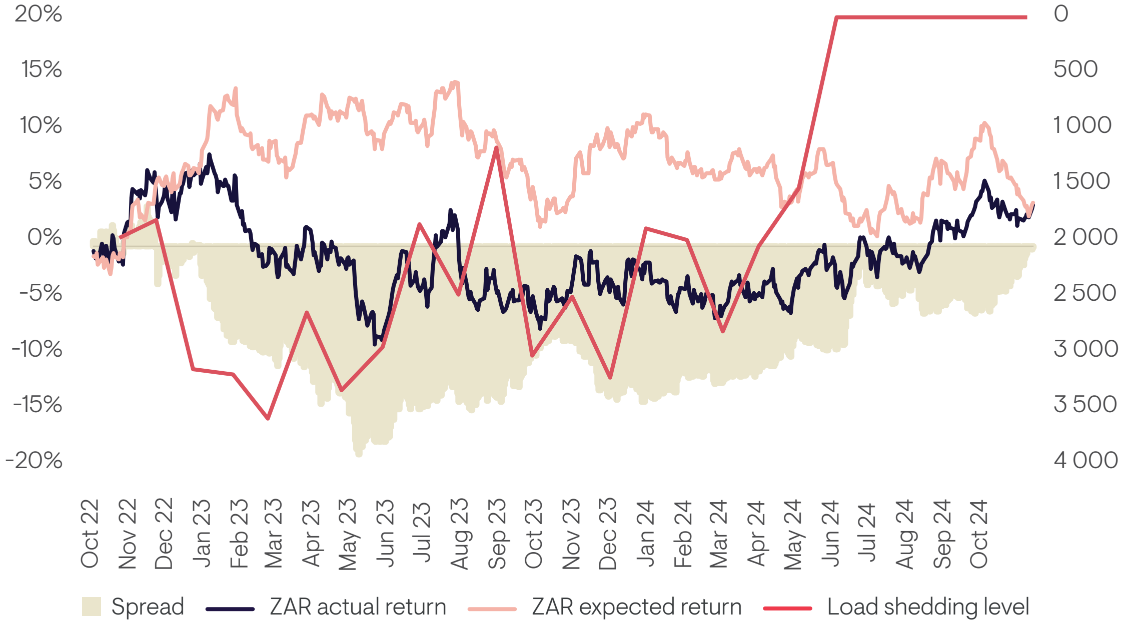
	Estimated Rooftop PV
Jul-22	2 264MW
Dec-22	2 586MW
Jul-23	4 740MW
Dec-23	5 203MW
Mar-24	5 809MW
Jun-24	6 050MW

Source: Ninety One, NERSA, Eskom, September 2024.

Rand bouncing back

Substantial improvements on the electricity front have helped the rand to recover. A staggering 75% of the rand's underperformance over the last 2 years can be attributed to load-shedding. Figure 1 shows how the gap between the currency's expected return and actual return widened dramatically as SA reached record-breaking levels of load-shedding in 2023. The peak of the rand's underperformance was in May last year, but since then, the discount in the rand has steadily closed.

Figure 1: Load-shedding was the key driver of rand weakness



Source: Ninety One, Bloomberg and Deutsche Bank, 5 November 2024.

With the SA election out of the way and no load-shedding since late March, the rand looks fairly valued. We expect the currency to be more stable than in the past. Improving terms of trade, softer oil prices and stronger commodity prices also support the rand.

> The discount in the rand has steadily closed.

Infrastructure spend to provide much-needed 'juice' to SA economy

The government of national unity (GNU) delivered a pragmatic medium-term budget, vowing to get the debt-to-GDP ratio under control. This was in line with the fiscal consolidation path that National Treasury committed to ahead of the 2023 medium-term budget policy statement (MTBPS). In last year's MTBPS significant spending cuts were pencilled in to address revenue slippages. Ahead of the election, there was scepticism about whether politicians would give National Treasury the necessary space to maintain fiscal prudence. The GNU medium-term budget has stayed the course, with debt consolidation an essential strategy for putting government finances on a healthier footing. While the government will have to do some tap dancing to keep investors, rating agencies, and public sector unions happy, a better growth rate will go a long way to help South Africa out of the debt hole.

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Finance Minister Enoch Godongwana outlined additional reforms to support public and private investments in growth-boosting infrastructure, with the MTBPS dedicating a chapter to this important issue. The GNU's strong commitment to infrastructure investment was evident in the MTBPS. The second phase of Operation Vulindlela[4] will build on this foundation, targeting critical infrastructure bottlenecks that stem from municipal capacity constraints. Areas of focus will still be along the broad categories of energy, transport, digital infrastructure and water. These initiatives will not only be a 'life saver' for communities and businesses but will serve as an important engine of growth.

While public infrastructure spending has been largely absent over the last few years, the South Africa National Road Agency (SANRAL) has been carrying the infrastructure torch. The parastatal has reached for its wallet, allocating R26 billion to essential road upgrades from its R42 billion cash pile. Further tenders are in the pipeline. SANRAL's infrastructure projects are already having a powerful multiplier effect across the broader economy, supporting job creation, local businesses, and community upliftment.

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4. Operation Vulindlela is a joint initiative of the Presidency and National Treasury to accelerate the implementation of structural reforms and support economic recovery. Operation Vulindlela aims to modernise and transform network industries, including electricity, water, transport and digital communications.

Can the GNU deliver growth?

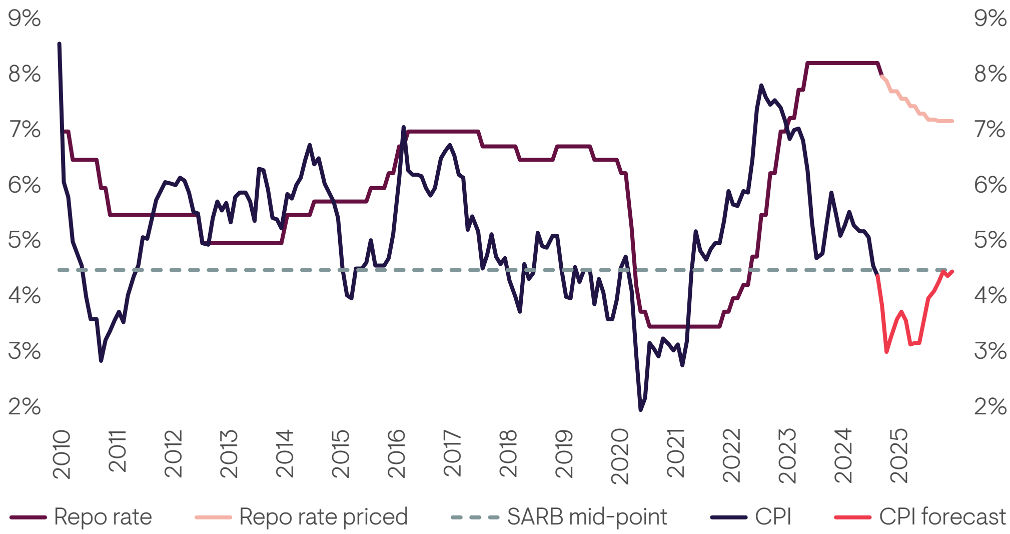
It's too early to tell whether the GNU has moved the growth dial. While there are some policy disagreements among the GNU parties, they are united in getting growth going. Our new system of governance has sparked competition and cooperation among ministers, which should ultimately benefit SA Inc. Some ministries now have a DA minister paired with an ANC deputy minister and vice versa. They have to cooperate to get results. But the GNU ministers are also in competition mode, as they need to sell their party's service delivery success to voters in the next local and national election. This situation has created some healthy competition, and like fund managers, ministers now have to worry about relative performance – how are they faring relative to their peers? Some ministers are already hogging the limelight. For example, Home Affairs Minister Leon Shriver is spearheading visa reforms to boost growth while Trade and Industry Minister Parks Tau is forging a closer relationship with business, focusing on policy reforms that will help to attract investments into the economy.

Benign inflation outlook and rate-cutting cycle bolstering the economy

Growth has been limping along this year, but decelerating inflation and a lower interest rate environment are helping to lift business and consumer confidence. Two-pot withdrawals are also providing a short-term boost to households. CPI inflation has remained comfortably within the target band, and we expect it to move lower, averaging less than 4% over 2025. This should give the South African Reserve Bank room to continue cutting interest rates. SA is now aligned with the global economic cycle for the first time in many years, which bodes well for local assets. Against this backdrop, we anticipate economic growth of 1.7% next year.

Figure 2: More rate cuts are on the table

SA inflation and interest rate expectations



Forecasts are inherently limited and are not a reliable indicator of future results.
Source: Ninety One, October 2024.

A supportive environment for SA bond market

The favourable outlook for the rand, inflation, interest rates and growth supports our bond market. We believe the high yields on SA bonds sufficiently protect against the risks and represent good value over the medium to longer term. Income will remain an important driver of returns, with high yields offering investors the opportunity to earn returns well ahead of inflation.

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In conclusion, South Africa is in a much better place than a year ago, but the GNU needs to ensure it delivers on its promises. Now that the electricity handbrake is being lifted, there's every chance that South Africa will get back on track.

Important information

36 Hans Strijdom Avenue
Foreshore, Cape Town 8001
Telephone: +27 (0)21 901 1000
Client service support: 0860 500 100
Email: clientservice@ninetyone.com

Please contact our Advisor Service Centre on telephone: 0860 444 487.

Alternatively, please contact your Ninety One investment consultant.

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