MENTENOVA

ECONOMIC OVERVIEW

QUARTER 1, 2023

Contents

EXECUTIVE SUMMARY

Investors were taken on a rollercoaster ride during the first quarter, with the market decisively higher during the first half before coming under pressure, only to stage a recovery at the end of March. Shifting monetary policy expectations were behind most of these moves as the market reacted to mixed economic data and signs of stress in the banking sector after two US banks collapsed and a brokered takeover of Credit Suisse was announced.

Despite some volatility, global equities ended the quarter broadly higher, with the likes of the S&P 500 up by nearly 7% in USD terms for the quarter, supported by the strong performance of the tech sector. Global fixed-income markets were also broadly higher for the quarter as the World Government Bond Index (WGBI) climbed around 3% in USD terms.

Unlike last year, SA assets underperformed against global asset classes in the first quarter, with country-specific risks weighing heavily on investors' appetite for SA assets. Specifically, SA equities gained just 2.4% for the quarter compared to returns of over 8% recorded by emerging markets, while the bond market saw large outflows by foreign investors. South Africa's energy crisis continues to put a serious damper on the outlook for the economy, evidenced by the 1.3% contraction in the economy in the final quarter of 2022 and the weaker growth projections for 2023.

At the same time, the domestic energy crisis has had broader effects on the cost of living and doing business, placing additional upside pressure on domestic inflation. It is against this backdrop that the South African Reserve Bank (SARB) surprised the markets by hiking interest rates by an additional 50bps at its March MPC meeting, taking the repo rate to 7.75% – the highest level since 2009. While there is concern that this was yet another blow to the fast-ailing economy, the SARB remains committed to bringing inflation back within the 3–6% target band and protecting the value of the currency, which has come under renewed pressure for the year to date. Specifically, the ZAR lost close to 5% against the USD during the first quarter, making it the third-worst-performing emerging market currency in Q1.

Heading into Q2, global inflation remains sticky, financial conditions continue to tighten and geopolitical risks remain elevated. The IMF recently revised its outlook for global economic growth downwards, with advanced economies expected to lead the slowdown as monetary policy conditions continue to tighten. Stresses in the banking sector have meanwhile highlighted the vulnerabilities that exist amongst institutions that are unprepared for tighter financial conditions.

With the outlook remaining highly uncertain and central bank decisions expected to remain data-driven, volatility may persist in the coming quarters.

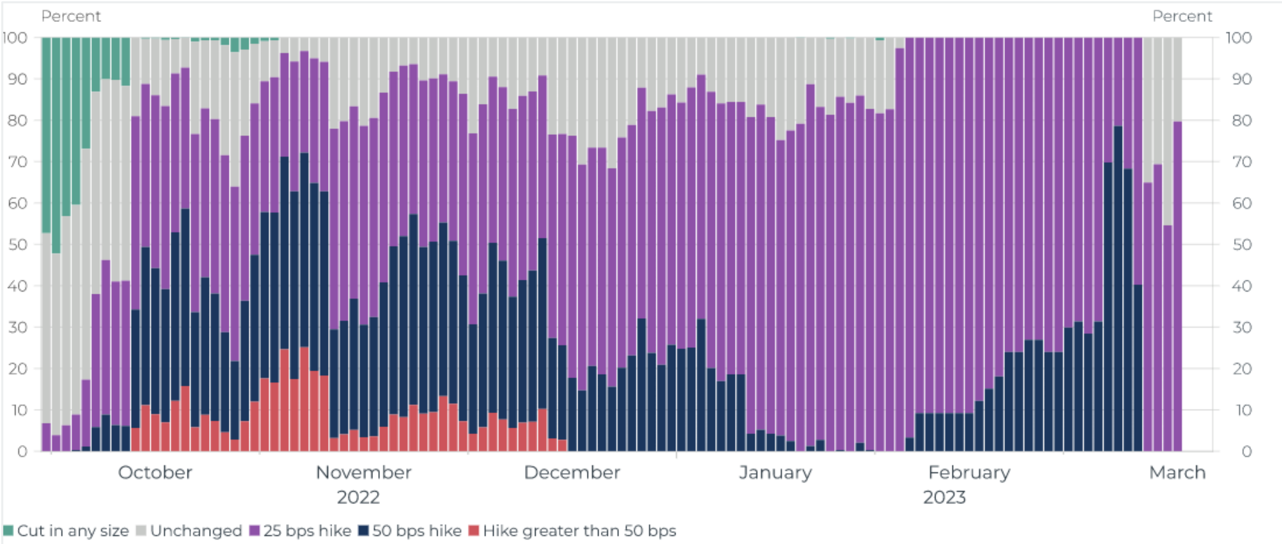
It is often difficult to sift through the day-to-day noise in the financial markets, especially at a time when macroeconomic conditions appear fragile and volatility is pronounced. However, it is these times that highlight the importance of being in a well-diversified portfolio that can withstand an uncertain macroeconomic environment.

ECONOMIC AND MARKET OVERVIEW

A TURBULENT QUARTER AS BANKING SECTOR STRESSES EMERGE

Investors were kept on their toes in the first quarter of the year as expectations around inflation and central bank policy shifted frequently. The first half of the quarter was characterised by hopes that inflation was easing and that a 'hard landing' could be avoided. However, conflicting economic data and turmoil in the banking sector skewed this picture in the latter half of the quarter. The chart below shows the sharp rise in expectations in February for larger rate hikes by the US Federal Reserve, followed by a sharp decline during March as pockets of stress in the financial sector emerged.

Chart 1: Fed Fund Futures Rates for March FOMC 2023 Meeting



Macrobond, CME Group

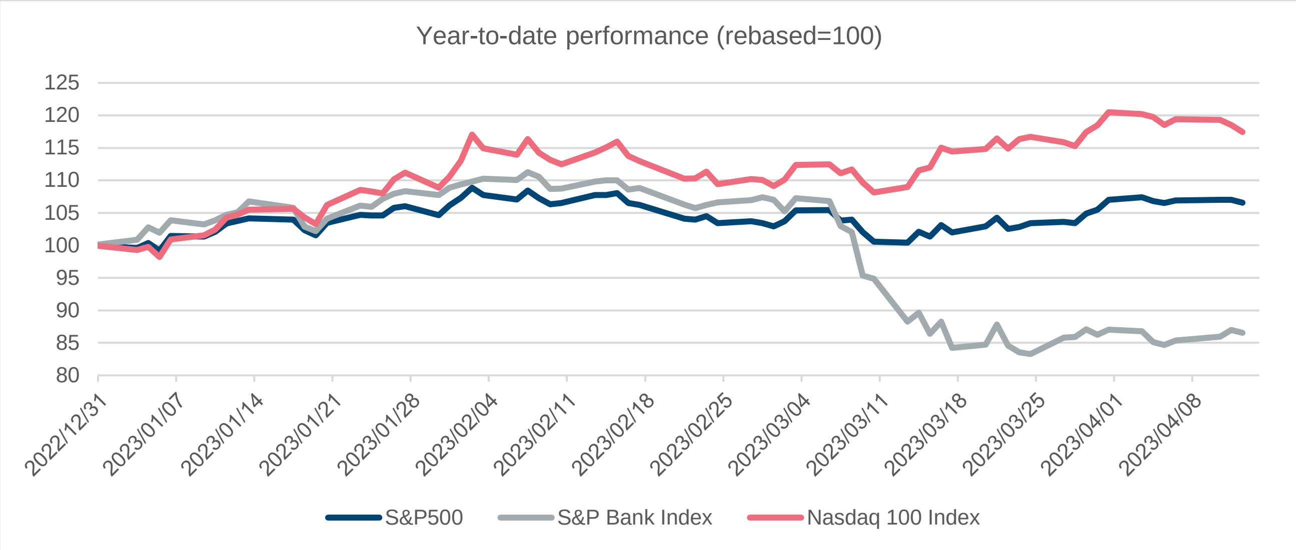
A key catalyst for the shift in monetary policy expectations late in the quarter was the failure of two regional banks in the US, as well as a breakdown of confidence in one of the most significant global banks, Credit Suisse.

Silicon Valley Bank was one of the two regional US banks that unexpectedly collapsed in the first quarter, becoming one of the first major fallouts from rising interest rates. In brief, the bank saw a surge in deposits by venture capital and technology companies during the pandemic, which the bank invested mostly in US government bonds. However, the recent deterioration of conditions in these sectors saw customers drawing on their deposits, forcing the bank to sell these bonds at big losses to meet these withdrawals, ultimately leading to the bank's collapse.

These events roiled markets during the quarter, with banking stocks coming under severe pressure and investors becoming increasingly wary of vulnerabilities that exist amongst financial institutions that are unprepared for tighter financial conditions. However, policymakers stepped in by guaranteeing deposits and extending emergency funding for distressed banks, helping settle nerves.

Despite the sharp downturn in the financial sector in Q1, broader markets had rebounded by the end of March, buoyed by expectations that interest rate cuts may be brought forward to stabilize financial conditions and avoid a more pronounced economic slowdown. This meant that most equities finished the quarter in the green, with the likes of the S&P 500 up close to 7% in USD terms for the quarter, supported by the strong performance of the interest-rate sensitive tech sector, as reflected by the performance of the Nasdaq index.

Chart 2: Year-to-date performance of the S&P 500, S&P Bank Index and Nasdaq 100 Index (rebased to 100)



Source: Bloomberg

MIXED ECONOMIC DATA KEEPS THE MARKET ON ITS TOES

Policymakers continue to face the serious challenge of trying to bring inflation down while also maintaining financial stability and preventing a sharp economic downturn. This has been complicated by mixed signals emanating from the global economy with respect to inflation and growth.

Although inflation has been trending lower across most parts of the globe, both headline and core inflation remain at more than double their pre-2021 levels and well above the target for most countries. This is depicted by the heat map below, showing that inflation remains elevated across many emerging and developed economies, albeit down from recent peaks.

Chart 3: Headline inflation for select developed and emerging market economies since Dec 2020

	Dec 2020	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021	Oct 2021	Nov 2021	Dec 2021	Jan 2022	Feb 2022	Mar 2022	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022	Oct 2022	Nov 2022	Dec 2022	Jan 2023	Feb 2023
Global	2.1	2.1	2.2	2.6	3.1	3.6	4.1	4.2	4.2	4.3	4.6	5.2	5.7	6.0	6.4	7.0	8.0	8.8	9.1	9.7	9.8	10.0	10.3	10.0	9.7	9.0	9.0
France	0.0	0.6	0.6	1.1	1.2	1.4	1.5	1.2	1.9	2.2	2.6	2.8	2.8	2.9	3.6	4.5	4.8	5.2	5.8	6.1	5.9	5.6	6.2	6.2	5.9	6.0	6.3
Germany	-0.2	1.2	1.5	1.8	2.0	2.2	2.4	3.7	3.8	4.1	4.4	4.8	4.9	4.2	4.3	5.9	6.3	7.0	6.7	6.7	7.0	8.6	8.8	8.8	8.1	8.7	8.7
United Kingdom	0.6	0.7	0.4	0.7	1.5	2.1	2.5	2.0	3.2	3.1	4.2	5.1	5.4	5.5	6.2	7.0	9.0	9.1	9.4	10.1	9.9	10.1	11.1	10.7	10.5	10.1	10.1
United States	1.4	1.4	1.7	2.6	4.2	5.0	5.4	5.4	5.3	5.4	6.2	6.8	7.0	7.5	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5	6.4	6.0
Japan	-1.2	-0.7	-0.5	-0.4	-1.1	-0.8	-0.5	-0.3	-0.4	0.2	0.1	0.6	0.8	0.5	0.9	1.2	2.5	2.5	2.4	2.6	3.0	3.0	3.7	3.8	4.0	4.3	4.3
Brazil	4.5	4.6	5.2	6.1	6.8	8.1	8.4	9.0	9.7	10.3	10.7	10.7	10.1	10.4	10.5	11.3	12.1	11.7	11.9	10.1	8.7	7.2	6.5	5.9	5.8	5.8	5.6
China	0.2	-0.3	-0.2	0.4	0.9	1.3	1.1	1.0	0.8	0.7	1.5	2.3	1.5	0.9	0.9	1.5	2.1	2.1	2.5	2.7	2.5	2.8	2.1	1.6	1.8	2.1	1.0
India	4.6	4.1	5.0	5.5	4.2	6.3	6.3	5.6	5.3	4.4	4.5	4.9	5.7	6.0	6.1	7.0	7.8	7.0	7.0	6.7	7.0	7.4	6.8	5.9	5.7	6.5	6.4
Russia	4.9	5.2	5.7	5.8	5.5	6.0	6.5	6.5	6.7	7.4	8.1	8.4	8.4	8.7	9.2	16.7	17.8	17.1	15.9	15.1	14.3	13.7	12.6	12.0	11.9	11.8	11.0
South Africa	3.1	3.2	2.9	3.2	4.4	5.2	4.9	4.6	4.9	5.0	5.0	5.5	5.9	5.7	5.7	5.9	5.9	6.5	7.4	7.8	7.6	7.5	7.6	7.4	7.2	6.9	6.9

Source: Bloomberg

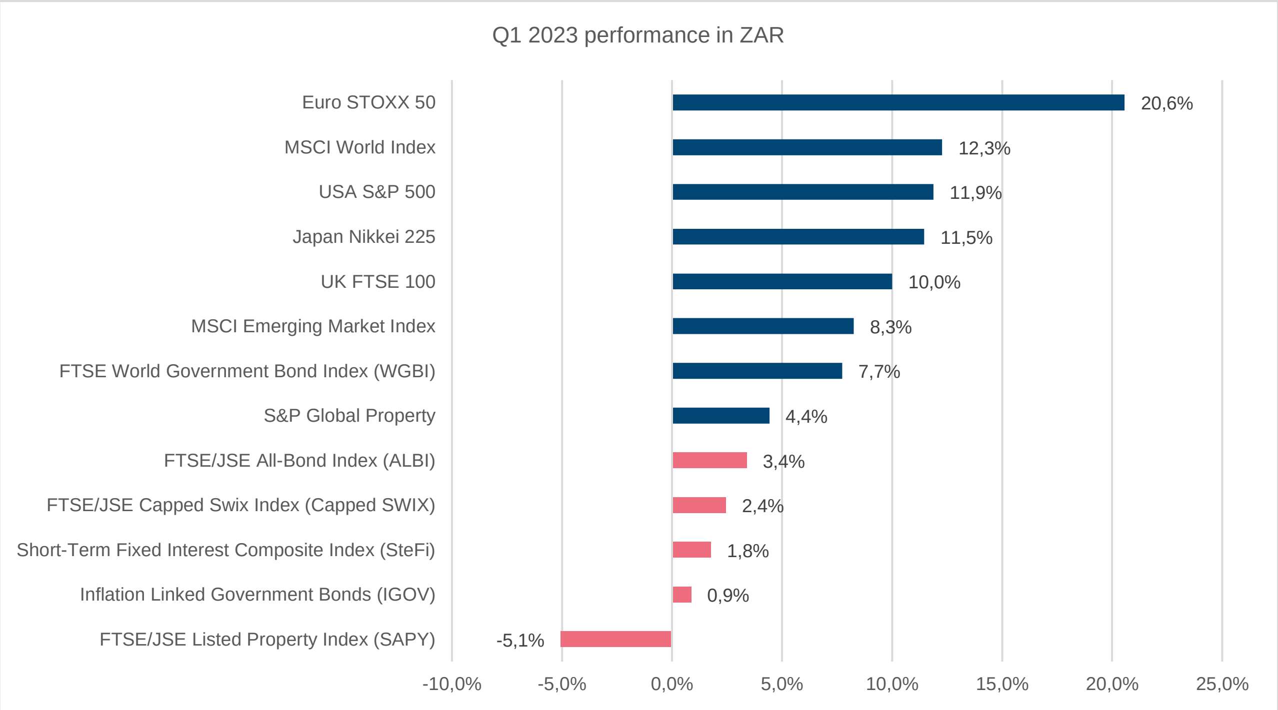
At the same time, labour markets in major developed economies remain tight, with unemployment rates in the likes of the US hovering around historical lows. This tightness in labour markets is another factor keeping the pressure on central banks to continue tightening monetary policy.

Central banks will continue to be guided by the data in their rate decisions and may need to step in where necessary to preserve financial stability. Markets thus remain sensitive to the interplay between growth and monetary policy, which continues to be a major source of market volatility.

OUTPERFORMANCE OF SA ASSETS COMES TO A HALT

In contrast to 2022, SA assets have underperformed against global asset classes in 2023, with country-specific risks weighing heavily on investors' appetite for SA assets. Specifically, local equities (+2.4% in Q1) underperformed against EM equities (+8.3% in Q1) and developed market equities (+12.3% in Q1) in ZAR terms for the quarter, weighed down by both the resources sector (-4.4% in Q1) and financials sector (-0.3% in Q1). Meanwhile, local bonds managed to gain 3.4%, in line with stronger international bond markets.

Chart 4: Performance of major local and international asset classes for the quarter ended 31 March 2023 (in Rands)

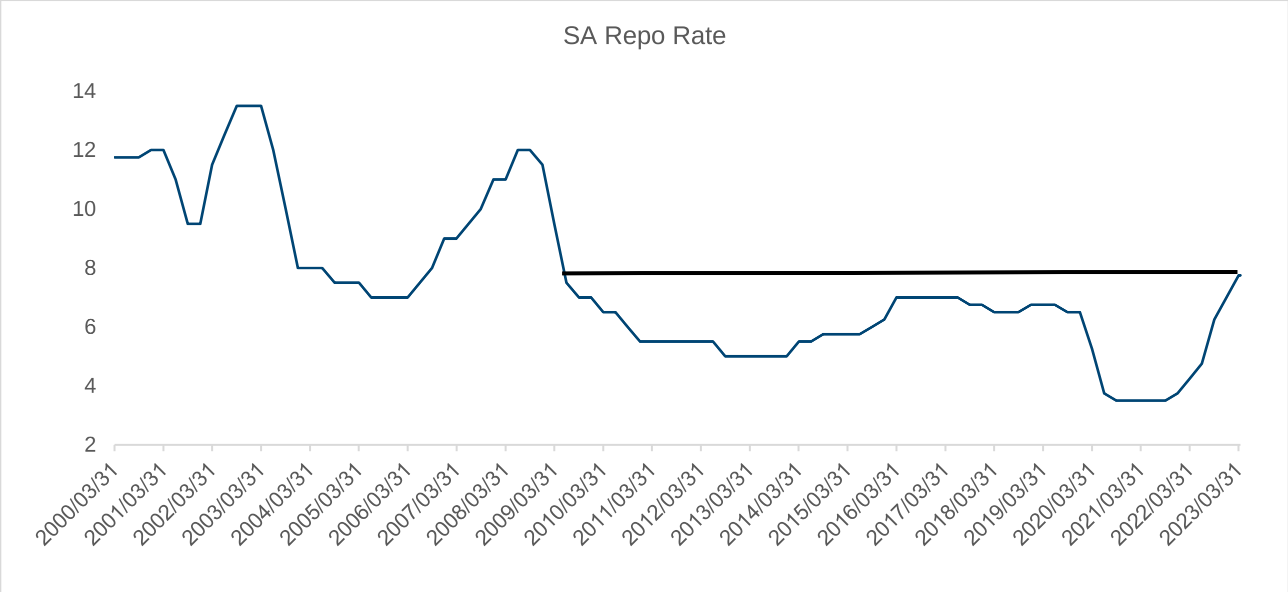


Source: Bloomberg

South Africa's energy crisis continues to put a serious damper on the outlook for the economy, evidenced by the 1.3% contraction in the economy in the final quarter of 2022 and the weaker growth projections for 2023. Specifically, the IMF revised its projections for the South African economy for 2023 downwards by 1.1% to just 0.1%, while the SARB expects the economy to grow by 0.2% this year. At the same time, the energy crisis has had broader effects on the cost of living and doing business, placing additional upside pressure on domestic inflation.

It is against this backdrop that the South African Reserve Bank (SARB) surprised the markets by hiking interest rates by an additional 50bps at its March MPC meeting, taking the repo rate to 7.75% – the highest levelsince 2009.

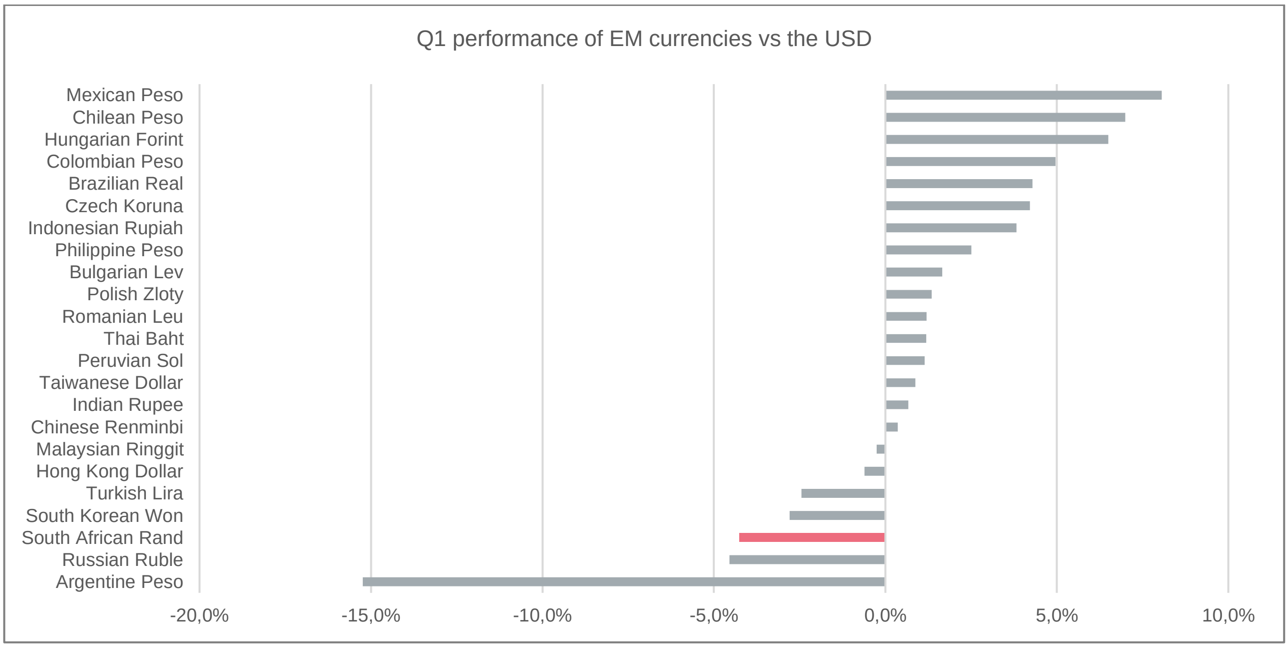
Chart 5: South African Repo Rate since South Africa formally introduced inflation targeting in February 2000



Source: Bloomberg

While there is concern that this was yet another blow to the fast-ailing economy, the SARB remains committed to bringing inflation back within the 3–6% target band and protecting the value of the currency, which has come under renewed pressure in the year to date. Specifically, the ZAR lost close to 5% against the USD during the first quarter, making it the third-worst-performing emerging market currency in Q1.

Chart 6: Performance of emerging market currency basket vs the USD for the 3 months ended 31 March 2023



Source: Bloomberg

The underperformance of the Rand also came as the Financial Action Task Force (FATF) confirmed that it had placed South Africa on its greylist, essentially classifying the country as a 'high-risk' jurisdiction and flagging the need for increased due diligence. While this outcome had been mostly priced in by the markets, it raises concerns amongst investors about the longer-term consequences for foreign investment and flows. For this reason, policymakers and other stakeholders are under pressure to work quickly to address and resolve the concerns raised by the FATF.

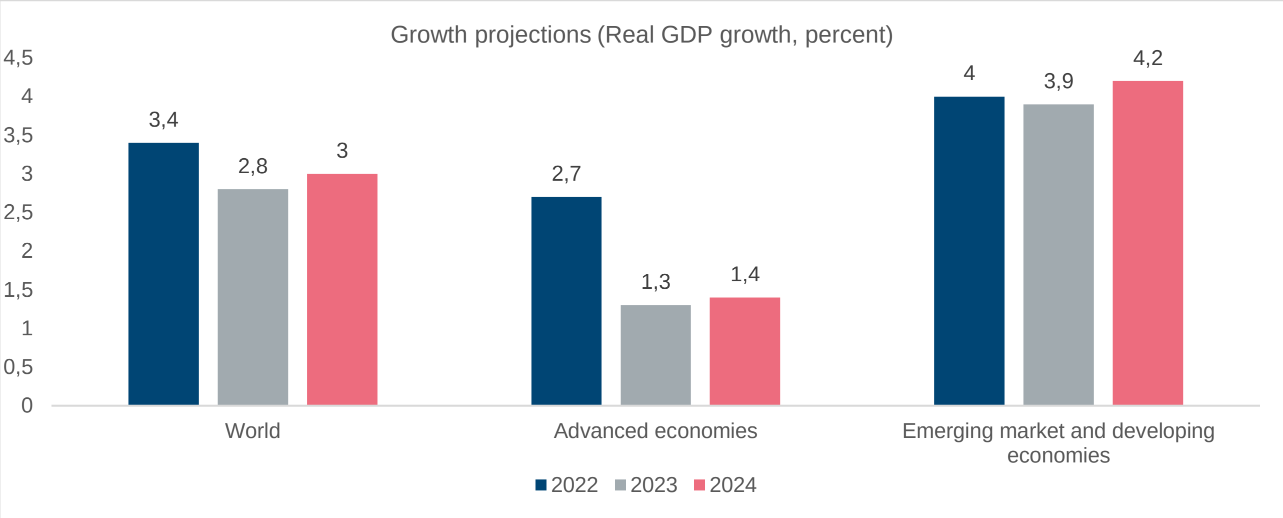
LOOKING AHEAD

The road ahead is uncertain as inflation remains sticky, economic growth conditions deteriorate and financial sector conditions remain fragile. That said, opportunities for long-term investors continue to present themselves, and a robust, diversified portfolio remains the best strategy for weathering any market turbulence in the quarters ahead.

Global growth forecasts have worsened

The latest economic projections released by the IMF show that global growth is forecasted to slow to 2.8% in 2023, down by 0.1% from the projections in January. Developed economies are expected to see an especially pronounced slowdown, with growth expected to slow to 1.3% from 2.7% in 2022, reflecting tighter financial conditions, the ongoing war in Ukraine and geopolitical risks. Emerging market economies are meanwhile expected to grow by 3.9% in 2023.

Chart 7: World Economic Outlook April 2023, growth projections for the global economy



Source: International Monetary Fund, World Economic Outlook April 2023

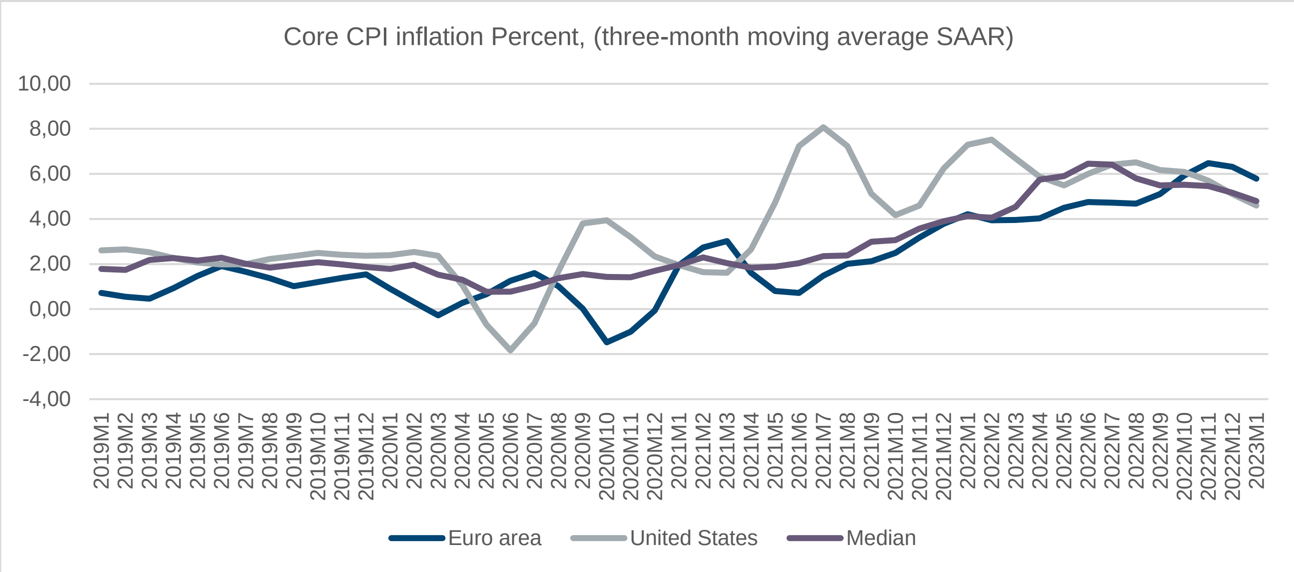
The rebound in economic activity and pent-up demand following the reopening of China is expected to have positive implications for China and its major trading partners, including South Africa, which are reflected in the projections for a less pronounced slowdown for emerging markets and developing economies.

While there are pockets of strength in the global economy, the overall outlook for weaker growth in 2023 has worsened. The market is still concerned about a recession, with yield curves still signalling concerns about a recession as central banks continue to tighten monetary policy. This has implications for corporate margins and earnings, which could come under further pressure if the global economy fails to avoid a recession.

Rates continue to trend higher, at least for now

Global supply chain pressures have eased, which suggests that supply chain conditions and delivery times have improved considerably. This, together with the rotation between goods and services consumption, has caused goods disinflation. However, services inflation (such as shelter, insurance, etc.) remains elevated and core inflation (prices excluding food or energy) remains sticky, keeping overall inflation elevated.

Chart 8: Core CPI inflation across developed and emerging economes since 2019



Source: International Monetary Fund, Haver Analytics
Median is based on 35 economies (17 advanced and 18 emerging market and developing economies) which account for 81% of 2022 world output

Still-elevated inflation points to higher interest rates for longer to tighten credit, reduce consumption and moderate wages, with the goal of bringing inflation down to countries' target ranges. Central bank decisions will, however, remain data dependent, and the markets are expected to remain sensitive to any new information that indicates what central banks may do next.

Barriers to global trade are increasing

As the war in Ukraine persists, geopolitical tensions across the world remain heightened. The world is becoming more and more fragmented and barriers to trade are increasing, posing downside risks to the global economy and financial markets. This is reflected by the increase in the geopolitical risk index since the start of the Ukraine war, as well as rising trade restrictions.

Chart 9: Geopolitical risk index

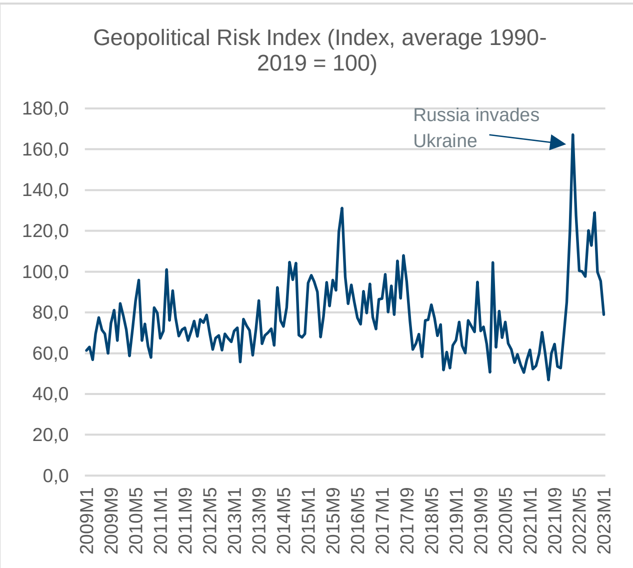
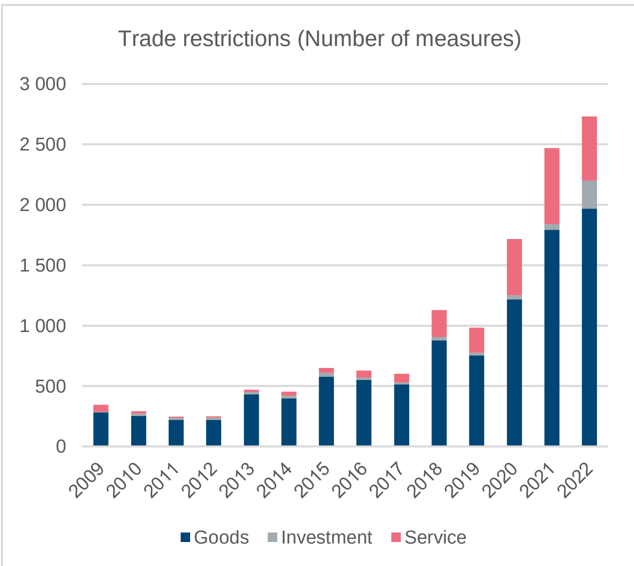


Chart 10: Harmful trade restrictions imposed



Source: International Monetary fund, Caldara and Iacoviello and Global Trade Alert

APPENDIX

Financial market performance as at 31 March 2023 (in ZAR)

	1 mth	3 mths	YTD	1 yr	3 yr (p.a.)	5 yr (p.a.)	7 yr (p.a.)	10 yr (p.a.)
Local Equity Indices								
FTSE/JSE All-Share Index (ALSI)	-1.3%	5.2%	5.2%	4.9%	24.2%	10.4%	9.1%	10.2%
FTSE/JSE Resources 20 Index	2.9%	-4.4%	-4.4%	-14.1%	29.2%	19.8%	18.0%	7.8%
FTSE/JSE Industrials Index	-0.8%	13.6%	13.6%	25.9%	19.2%	8.6%	6.9%	10.5%
FTSE/JSE Financials Index	-6.2%	-0.3%	-0.3%	-8.6%	22.5%	1.2%	2.9%	6.8%
FTSE/JSE Shareholder Weighted Index (SWIX)	-1.9%	2.7%	2.7%	0.7%	19.9%	6.5%	6.2%	8.6%
FTSE/JSE Capped Swix Index (Capped SWIX)	-2.0%	2.4%	2.4%	0.2%	23.0%	6.5%	5.9%	8.4%
FTSE/JSE All-Share Top 40 Index	-0.8%	6.2%	6.2%	6.8%	24.6%	11.5%	9.8%	10.6%
FTSE/JSE SWIX Top 40 Index	-1.5%	3.5%	3.5%	1.9%	19.3%	6.7%	6.2%	8.8%
FTSE/JSE Mid Cap Index	-4.4%	-0.9%	-0.9%	-5.9%	19.9%	3.8%	4.1%	6.7%
FTSE/JSE Small Cap Index	-2.2%	0.8%	0.8%	4.2%	36.6%	7.4%	6.7%	9.0%
FTSE/JSE Listed Property Index (SAPY)	-3.4%	-5.1%	-5.1%	-3.4%	18.2%	-4.1%	-3.8%	1.3%
FTSE/JSE Capped Listed Property Index	-3.9%	-4.8%	-4.8%	-5.4%	16.8%	-6.6%	-6.8%	-0.2%
Local Interest-Bearing Indices								
FTSE/JSE All-Bond Index (ALBI)	1.3%	3.4%	3.4%	5.8%	11.6%	6.9%	8.8%	7.3%
FTSE/JSE All-Bond Index 1–3 years	1.1%	2.4%	2.4%	6.9%	7.5%	7.5%	8.1%	7.4%
FTSE/JSE All-Bond Index 3–7 years	1.6%	3.3%	3.3%	7.8%	11.0%	8.4%	9.3%	7.9%
FTSE/JSE All-Bond Index 7–12 years	2.1%	4.4%	4.4%	8.1%	12.8%	7.9%	9.3%	7.5%
FTSE/JSE All-Bond Index +12 years	0.6%	2.6%	2.6%	3.5%	12.1%	6.0%	8.4%	7.0%
Inflation-Linked Government Bonds (IGOV)	1.5%	0.9%	0.9%	4.9%	10.7%	4.5%	4.7%	4.9%
Short-Term Fixed Interest Composite Index (SteFi)	0.6%	1.8%	1.8%	6.0%	4.8%	5.8%	6.3%	6.2%
Inflation Index								
Consumer Price Index (1 month lagged)	0.7%	1.0%	0.7%	7.0%	5.2%	4.8%	4.9%	5.1%
International Indices								
MSCI World Index	-0.2%	12.3%	12.3%	13.2%	16.8%	17.7%	13.3%	16.8%
MSCI Emerging Market Index	-0.3%	8.3%	8.3%	8.7%	8.1%	7.9%	8.2%	9.3%
FTSE World Government Bond Index (WGBI)	0.4%	7.7%	7.7%	9.6%	-5.4%	5.9%	1.6%	6.1%
S&P Global Property	-6.0%	4.4%	4.4%	-3.7%	6.2%	9.2%	4.9%	10.0%
USA S&P 500	0.3%	11.9%	11.9%	11.8%	18.5%	20.5%	15.5%	19.8%
UK FTSE 100	-3.7%	10.0%	10.0%	20.0%	14.0%	11.5%	7.7%	10.5%
Euro STOXX 50	1.1%	20.6%	20.6%	34.9%	17.7%	13.9%	10.2%	13.2%
Japan Nikkei 225	2.0%	11.5%	11.5%	14.4%	8.3%	11.7%	10.1%	14.1%
Currency Movement								
Rand/Dollar (R17.8 = 1 Dollar)	-3.1%	4.5%	4.5%	21.8%	-0.1%	8.5%	2.7%	6.8%
Rand/Euro (R19.29 = 1 Euro)	-0.6%	5.7%	5.7%	19.3%	-0.7%	5.7%	2.0%	5.0%
JPY/Rand (7.47 Japanese Yen = 1 SA Rand)	0.6%	-3.1%	-3.1%	-10.4%	7.4%	-3.6%	-0.3%	-3.1%
Rand/Pound (R21.95 = 1 Pound)	-0.5%	6.6%	6.6%	14.3%	-0.3%	5.8%	0.5%	4.6%

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