MENTENOVA

ECONOMIC OVERVIEW

QUARTER 4, 2023

Synopsis

- Risk assets experienced a Q4 rally fuelled by market optimism, driven by the anticipation of falling inflation triggering global rate cuts in early 2024.
- Labour markets in major developed economies exhibit resilience, maintaining stability despite a cooling and moderating demand environment.
- South Africa observes a rebound in economic activities, while India stands out as the fastest-growing economy among emerging markets.
- China faces challenges of disinflation, weak demand, and a slowdown in corporate financing, placing additional pressure on the People's Bank of China (PBOC) and the Chinese government to implement more aggressive easing policies.
- Domestic economies grapple with persistent challenges surrounding state-owned enterprises (SOEs), energy constraints, and logistical infrastructures. An imperative task lies in addressing these structural challenges through comprehensive reforms to sustain growth and manage fiscal debt effectively.

Economic and Market Overview

United States	**US Economy's Triumph** Despite facing challenges, the US economy continued to grow in the final quarter of the year, following a strong real GDP growth rate of 4.9% in the third quarter. While there were some dips in October, most economic data rebounded in November and December. The labour market remained robust on the surface, with non-farm payrolls initially falling short of market expectations in October but then exceeding them in November and December. **Labour Market Unmasked** Similarly, unemployment initially increased from 3.8% to 3.9% in September and October respectively, but then declined to 3.7% in November and December. Additionally, the weekly averages of initial jobless claims in the fourth quarter were better than those anticipated by the market. However, upon closer examination, there are signs of cracks in the US labour market. Job growth was largely seen in non-cyclical sectors like healthcare, social assistance and government, while cyclical sectors such as transportation and warehousing experienced notable job cuts. Jobseekers are encountering greater difficulties in securing new positions, evident from the rise in unemployment duration and the decline in job openings and quit rates. The increase in part-time work and the holding of multiple jobs indicate people’s struggle to find full-time employment that matches their skill set or the fact that they have settled for reduced hours due to the economic slowdown. This reduction in hours is further supported by the data on the disposable personal income growth contribution. While the manufacturing sector has faced challenges globally since late 2022, contributing to cooling inflation, the US services sector has continued to expand. However, in December, both the ISM Services Index and its Employment Sub-Index plummeted due to economic uncertainty and declining consumer demand. These indicators suggest a cooling trend in the labour market, which is expected to persist into 2024. Housing market data was largely negative, with strong housing starts numbers for October and November but a persistent decline in new home sales and lacklustre existing home sales due to higher refinancing rates. There has been a persistent

uptick in loan delinquencies since Q4 2022. Despite these cracks, the overall robustness of the labour market and positive real wage growth drove the improvement in consumer confidence and retail sales growth over the last quarter.

Figure 1: Unemployment duration, job Openings quit rates

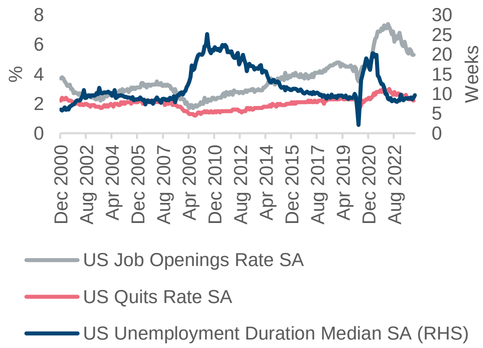


Figure 2: Part-time work and multiple jobs

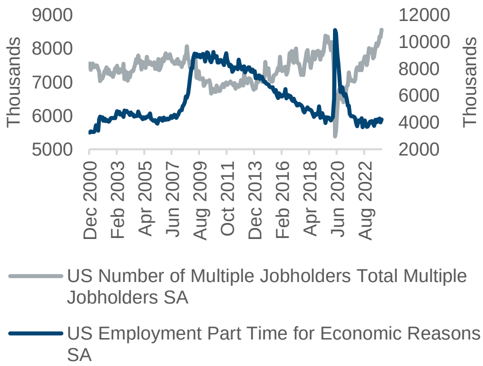


Figure 3: Personal Income growth contribution.

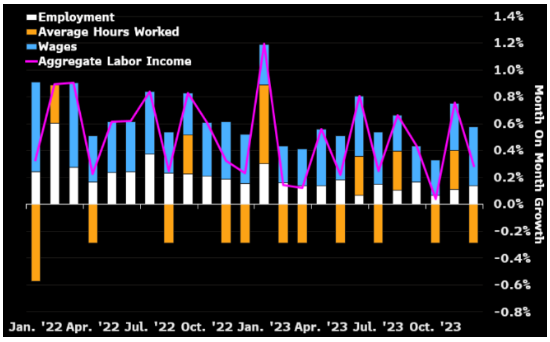


Figure 4: ISM Manufacturing and Services PMI, Services employment PMI.

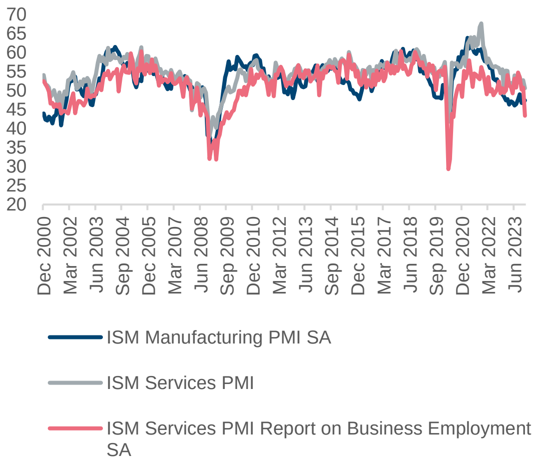


Figure 5: Wage growth

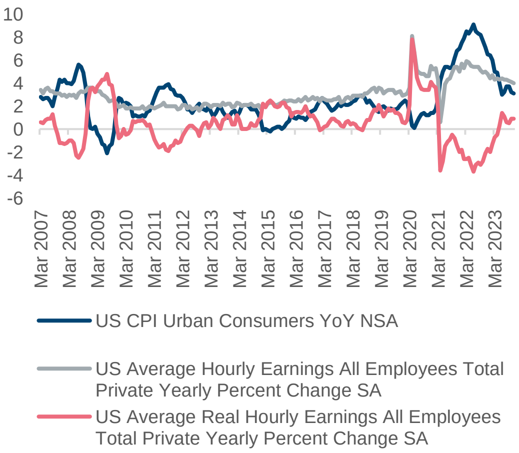
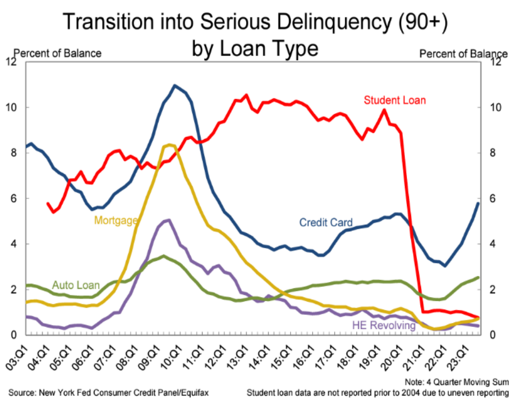


Figure 6: US Consumer loan delinquency



Source:Bloomberg, Bloomberg Intelligence, New York Fed

Optimistic Markets: Early Rate Cut Anticipation

While the Fed kept the upper-bound target rate unchanged at 5.5% on 13 December, the market has been growing increasingly excited about the prospect of central banks cutting rates sooner in 2024 than previously expected. The end of the higher-rates-for-longer fears that hurt risk assets in Q3 boosted risk assets across the board.

The market is now pricing in six rate cuts, compared to the three cuts guided by the Fed. Inflation in the US slowed from 3.7% in September to 3.1% in November, although it remains above the target of 2.0%. The Fed's stance has shifted to a more dovish one, considering the ongoing disinflation in goods, a significant slowdown in economic activity and a weak outlook for the labour market. US equities also received a boost from the productivity gain that increased corporate profit growth.

Figure 7: US FRA Rates

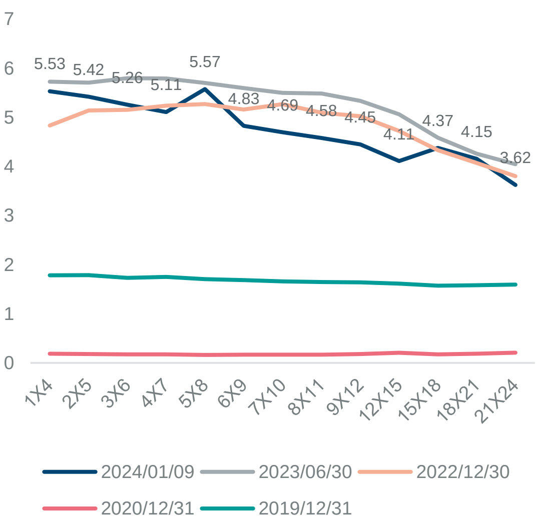
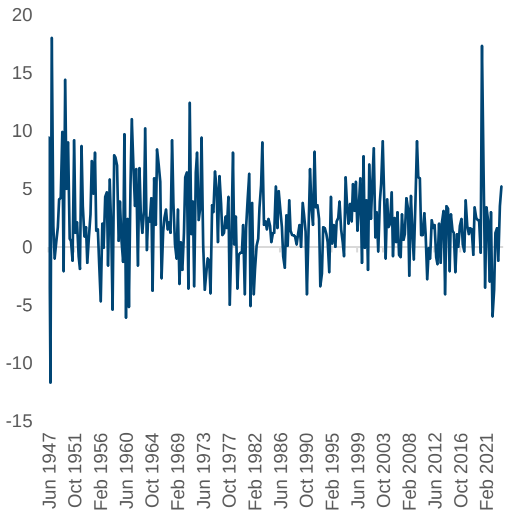


Figure 8: US Labour Productivity Output Per Hour QoQ SA



Source: Bloomberg

UK and Eurozone

UK Balancing Act

The UK faced concerns over high inflation and borrowing costs over the quarter. Even with the continued rate hikes, the market ended the year on an optimistic note as equities rallied. This optimism continues to prevail as markets anticipate rate cuts at the end of Q1 2024. UK inflation moderated to 3.9% in November. However, persistent wage growth pressures continue to contribute to inflation. Concurrently, the Eurozone experienced a decline in inflation to 2.4% in November from 2.9% in October. However, the previous quarter's consecutive falls were reversed as the figure for December was 2.9%. Despite inflationary concerns, the underlying trend is considered relatively benign, with the market anticipating a return to the European Central Bank's (ECB) 2% inflation target soon.

Figure 9: Eurozone Inflation YoY

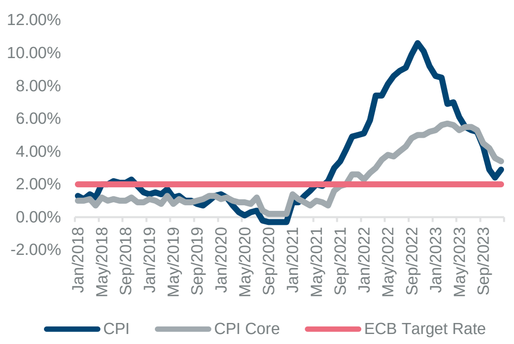
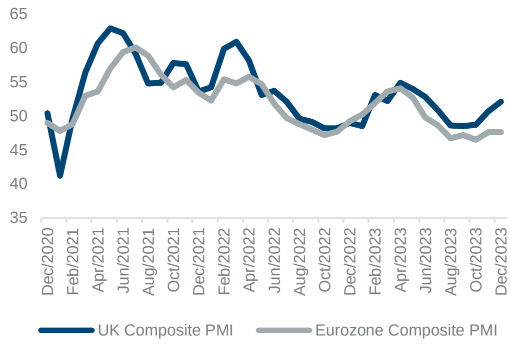


Figure 10: PMI Comparison



Source: Bloomberg

Signs of Recovery Despite Lingering Contraction

The UK's services sector exhibited growth, reflected in the FTSE 100, and expectations for future activity rose, indicating a potential avoidance of recession in 2024. The composite PMI, combining the services and manufacturing sectors, recovered from 48.5 in October to 48.7 in November, which is the highest movement since declining in May 2023. December's PMI rose to 52.1, which is above 50 and indicative of an expansionary phase. The Eurozone witnessed a mild sell-off in bond markets in response to inflation figures, while equities surged in Q4, driven by expectations of no further interest rate hikes. Cyclical sectors such as real estate and information technology excelled, while defensive sectors such as healthcare and energy lagged in performance.

The UK economy seemed to end 2023 on a stronger note, with positive signs in the services sector and expectations of gradual growth in 2024. The government's focus on growth measures, including decreases in income tax and the energy bill, is contributing to forecasts of a potential economic rebound in the second half of 2024. In the Eurozone, there are still concerns that affect goods inflation, such as disruptions in shipping and changes in government subsidies.

Figure 11: UK Business Investment

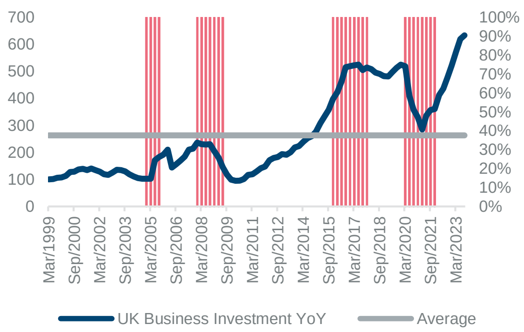
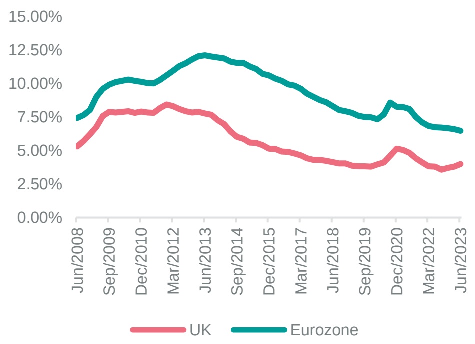


Figure 12: Unemployment rate over time



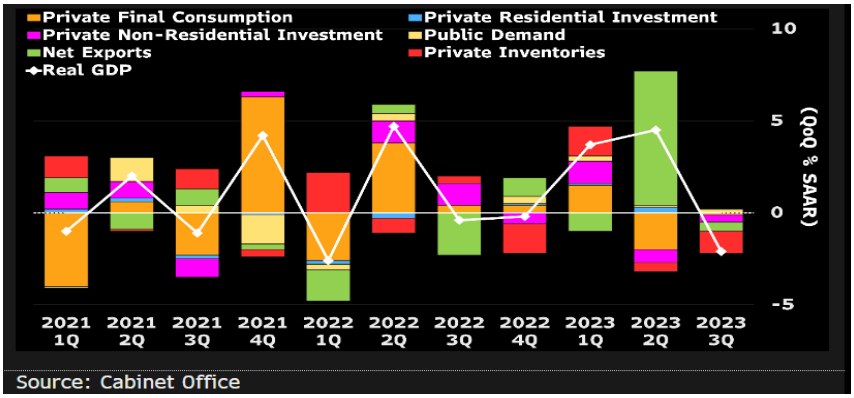
Source: Bloomberg

The pink sections pertain to the global demand for UK goods and services, the GFC, the Brexit referendum and the pandemic, respectively.

The UK's labour market remained resilient over the quarter, with unemployment expected to stay below 5% in the first quarter of 2024. Measures such as increases in the minimum wage, state pension and working-age benefits aim to support households and boost disposable incomes.

	The Eurozone's employment outlook remains uncertain, with the ECB being cautious about committing to rate cuts until wage pressures show signs of cooling. Both the UK and the Eurozone have grappled with economic challenges, but the UK is showing signs of economic resilience, positive sentiment and growth, while the Eurozone is facing inflationary concerns and a cautious central bank policy. Monitoring key indicators, including inflation, sectoral performance and employment outlook, provides valuable insights into the economic trajectories of these two regions.
Japan	**Inflation Moderates in H2 2023, Yen Depreciation Hits Q3 GDP** Q4 2023 saw Japan continuing its navigation in economic recovery in a post-pandemic landscape. With the global economy facing inflation and geopolitical tensions, Japan's domestic policies and external trade strategies are pivotal to maintaining its economic growth momentum. Inflation rates rose in the first half of 2023 but moderated into Q3 and Q4. Similar to other developed countries, Japan's unemployment rate remained at one of the lowest levels in the country's history, last seen in the early 1990s. However, with the Fed near the peak of its rate-hiking cycle, tweaks to the yield-curve controls have not managed to rein in yen weakness amid the Bank of Japan's aggressive monetary stimulus policy. The yen's 7.7% depreciation against the US dollar for the year (which recovered from a 15.8% depreciation at the end of October) hurt consumer spending and domestic demand (despite a healthy labour market), which sent GDP growth for Q3 to -2.1%, quarter on quarter annualised. Business investments and exports also shrank over the same period, potentially due to the global economic slowdown and the struggling Chinese economy. **Japan's Current Account Surges on Foreign Investments** The outlook for investment is mostly positive, as Japan aims to regain its status as a major semiconductor powerhouse. The Japanese economy minister announced a sizeable investment of ¥2 trillion ($13 billion) in subsidies for the chip-making industry in November 2023. The current account balance as a percentage of GDP increased from 1.46% in Q1 to 2.87% in Q3, mainly driven by increased foreign direct investment and portfolio investment and, to a lesser extent, an improvement in trade dynamics. The global manufacturing sector has been in a downswing since Q4 2022, and Japan is no different. Its manufacturing sector remains in contraction, with the Jibun Bank Japan Manufacturing PMI declining from 50.6 in May to 47.9 in December 2023. The services sector saw its weakest quarterly growth of the year, with the Jibun Bank Japan Services PMI index slowing to 51.5 from 53.6 at the end of Q3 2023. There was, however, an increase in overall tourism numbers during the quarter. The economic outlook for Japan remains cautiously optimistic. Growth is expected to be supported by continued expansionary fiscal and monetary policies as well as potential productivity gains from investments in digitalisation. However, inflation and labour-market dynamics require careful monitoring.

Figure 13: Contributions to Japan's GDP



Source: Bloomberg

Emerging markets

Emerging Markets Gain Momentum in Strong Q4 2023 Performance

Emerging markets put in sluggish performances early in the quarter, with the Middle East crisis increasing risk appetite in October. The rally seen in emerging markets in November was attributed both to a perception that interest rates had peaked as well as to gains in the technology, communications and services sectors. China, however, did not feature in the November rally since it was still struggling with the negative impacts of the severe pandemic regulations and the real estate industry. The quarter saw the International Monetary Fund (IMF) upgrading its assessment of China's growth to 5.3% in 2023 but with the expectation that it would still slow in 2024 to 4.6%. 2023 ended in positive territory for emerging markets after an eventful year.

Stagnant PMI Signals Stability

The Manufacturing PMI for emerging markets remained stagnant over the quarter, with both September and December registering 50.9. However, the inter-month change in November to 50.1 continued to signal an expansionary phase in the economy. India remained the fastest-growing economy, even though its manufacturing output growth rate had weakened from the previous quarter. The sustained expansion was primarily fuelled by higher growth in the services sector, growth in new orders and moderate foreign sales. The improvement in Taiwan's PMI, even though it remained the lowest of the emerging markets, was due to an upturn in semiconductor exports. Taiwan's exports increased by 3.8% YoY, following a period of contraction in the first half of the year and a modest recovery in the second half. Overall, emerging markets put in a moderate PMI performance due to new export orders, while also performing relatively better than developed markets which are facing challenging trade conditions.

Figure 14: Emerging markets PMI overtime

	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23
Global Manufacturing PMI	48.6	49	49.1	49.2	48.8	49.3
Developed Markets	47.1	46.8	47.4	47.4	47.5	47.7
Emerging Markets	50.2	51.4	50.9	50.9	50.1	50.9
China	49.2	51	50.6	50.6	49.5	50.7
Indonesia	53.3	53.9	52.3	52.3	51.5	51.7
South Korea	49.4	48.9	49.9	49.9	49.8	50
Taiwan	44.1	44.3	46.4	46.4	47.6	48.3
India	57.7	58.6	57.5	57.5	55.5	56
Brazil	47.8	50.1	49	49	48.6	49.4
Mexico	53.2	51.2	49.8	49.8	52.1	52.5
Russia	52.1	52.7	54.5	54.5	53.8	53.8
South Africa	47.3	49.7	45.4	46.2	45.4	48.2

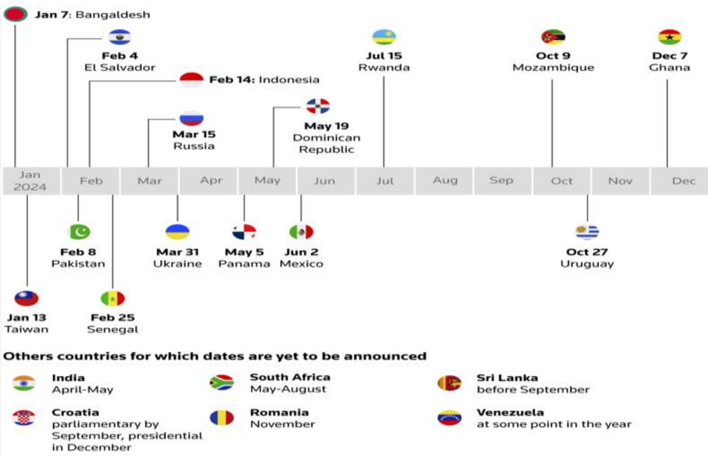
Source: Bloomberg

Election Year Concerns

As emerging markets prepare for the most important election year in decades, investors are paying close attention to fiscal discipline and populist movements from political figures which could potentially cause market volatility and cloud the forecast for some important economies. In 2024, elections will be held in countries that together house more than half the world's population and produce more than 60% of its economic output. After experiencing some external shocks, such as Covid-19, Russia's invasion of Ukraine and a rise in global yields, fiscal discipline will be a focal point during this wave of elections.

The elections in Argentina and Poland, held in the last quarter of 2023, served as a reminder that governments typically loosen their government spending during their campaign season, which may have dire implications for those that will install new administrations. Furthermore, these two countries' elections highlighted how elections can produce surprises. Argentina's far right-wing president-elect, Javier Milei, proposed a radical reform programme for the country. In the Polish election, investors applauded the unexpected victory of liberal, pro-EU Donald Tusk who defeated the populist coalition government.

Figure 15: Timeline of the 2024 elections in emerging markets



Source: Reuters

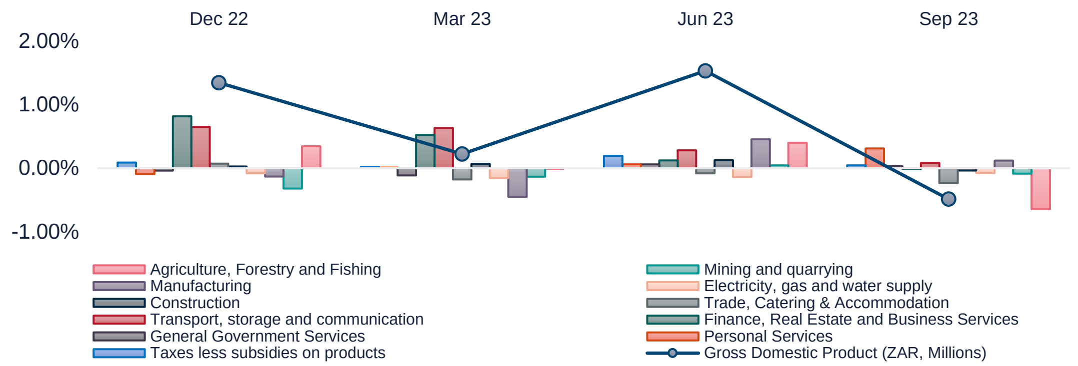
South Africa

Growth, PMI, and Inflation in Harmony

In the third quarter of 2023, South Africa witnessed a rebound in economic activity, marking a shift from the contraction experienced in the previous quarter. The preliminary data for Q4 2023 reveals quarter-on-quarter growth of 1.3% (ABSA Bank), with the PMI closing at 50.9. The recovery was underpinned by improved production across various sectors, notably in supplier performance, business activity and new orders. This positive trajectory was facilitated by a more favourable environment, characterised by softer oil prices and enhanced energy stability.

The Precious Metals and Mining Index displayed resilience, closing the quarter at 19.37%, thus providing a tailwind for South Africa's 2023 GDP outlook. As we close the chapter on 2023, GDP growth for the year is projected to be around 0.7% (ABSA Bank), reflecting the persistent challenges posed by geopolitical tensions, credit and inflation dynamics, and ongoing energy and logistics constraints.

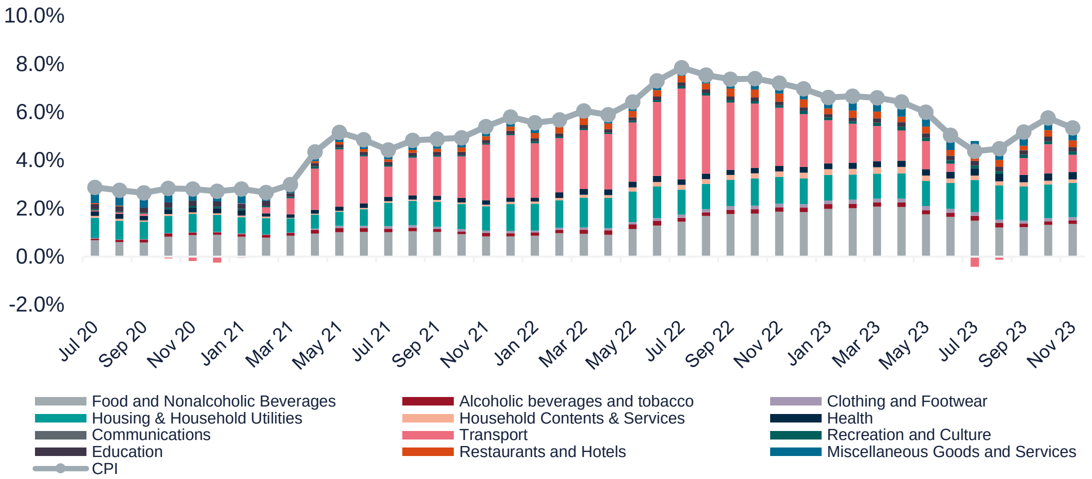
Figure 16: Contribution to SA GDP YoY



Source: Bloomberg

Inflation exhibited a modest easing in the short term, reaching 5.5% in November, from 5.4% in September. This marked the sixth consecutive month of headline inflation moderating within the SARB's 3–6% target range. Notable contributors to this consolidation were lower inflation in transportation (4.3% vs 13.9%) and food and non-alcoholic beverages (9% vs 12.4%) compared to December 2022. As we continue to navigate the economic landscape, this period also signified the apex of the interest rate hiking cycle, as short-term factors like supply chain disruptions and the weak rand gradually recede.

Figure 17: Contribution to SA CPI YoY



Source: Bloomberg

Easing Inflation Strikes a Chord for Property and Equities

Local markets responded positively to sustained periods of inflation easing, hinting at potential rate cuts. Notably, property and equities emerged as top performers, closing the year at 16.4% and 8.2% respectively. Property proved to be the star asset class in 2023, concluding the year with an impressive 10.1% growth rate, followed by bonds at 9.7%, cash at 8% and equities at 7.9%.

Debt-Servicing Weighs on Fiscus

On the employment front, growth has outpaced labour supply over the past two years, resulting in a decline in the unemployment rate from 35.3% in Q4 2021 to 31.9% in Q3 2023. However, despite this positive trend, the persistently high unemployment rate remains a concern and poses a challenge to sustainable GDP growth. Between 2008/09 and 2022/23, annual government spending grew from R713 billion to R2.1 trillion. This means that public spending per citizen increased from R27 629 to R33 390. However, this has had little impact on the creation of sustainable jobs and GDP growth. The bulk of government spending is shifting towards debt servicing, now standing at more than 14% of total expenditure, which consumes a larger share of the budget than education, social protection and health.

Figure 18: Growth in investment

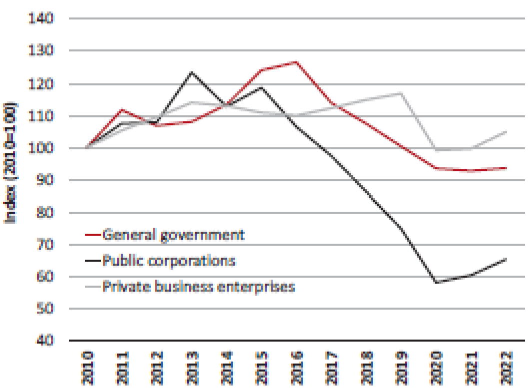
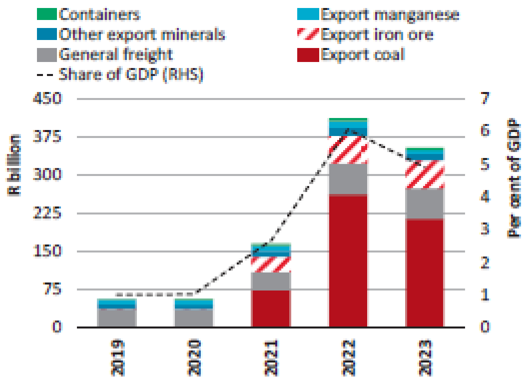


Figure 19: Economic cost of rail inefficiencies



Source: National Treasury

Turbulent 2023, Hopeful 2024 Rebound

The economic landscape in 2023 was marred by the challenges faced by state-owned enterprises, notably in the energy and logistics sectors. Energy saw its greatest decline in 2023, with record numbers of 335 days and 6 947 hours of loadshedding. Shipments and deliveries also experienced record lows, with transportation continuing to bear the brunt of failed ports and railways. Crime dealt another blow to the economy through the misallocation and inefficient use of resources, costing the economy roughly 10% of GDP in 2023 (World Bank). The combination of these factors significantly impacted South Africa's mining industry – the biggest exporter of platinum and a major exporter of gold, diamonds, coal and other raw materials – and negatively affected GDP.

As we turn the page to 2024, the government faces the imperative of addressing structural challenges and implementing reforms. Key initiatives, such as the reconfiguration of state-owned enterprises for greater efficiency and major projects like the National Health Insurance and Trans-Kalahari rail initiative, are anticipated to play a pivotal role in shaping the economic landscape in the coming year. The successful execution of these initiatives is crucial for fostering sustainable economic growth and overcoming the hurdles posed by the tumultuous year that 2023 was.

APPENDIX

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

JSE Code		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								
J203T	FTSE/JSE All-Share Index (ALSI)	2.0%	6.9%	9.3%	9.3%	13.5%	11.9%	9.9%	8.8%
J210T	FTSE/JSE Resources 20 Index	-1.3%	0.0%	-15.4%	-15.4%	6.0%	12.5%	13.9%	5.6%
J257T	FTSE/JSE Industrials Index	0.7%	5.9%	16.6%	16.6%	12.4%	11.6%	8.3%	8.2%
J580T	FTSE/JSE Financials Index	5.8%	12.3%	20.0%	20.0%	18.5%	6.1%	5.8%	7.5%
J403T	FTSE/JSE Shareholder Weighted Index (SWIX)	2.5%	8.0%	7.8%	7.8%	10.6%	8.7%	7.2%	7.3%
J433T	FTSE/JSE Capped Swix Index (Capped SWIX)	2.9%	8.2%	7.9%	7.9%	12.7%	9.0%	6.9%	7.1%
J200T	FTSE/JSE All-Share Top 40 Index	1.4%	6.6%	9.0%	9.0%	13.4%	12.5%	10.7%	8.9%
J400T	FTSE/JSE SWIX Top 40 Index	2.0%	7.8%	7.3%	7.3%	9.6%	8.6%	7.4%	7.1%
J201T	FTSE/JSE Mid Cap Index	7.9%	10.0%	9.7%	9.7%	12.8%	7.3%	4.7%	6.8%
J202T	FTSE/JSE Small Cap Index	6.0%	8.6%	11.2%	11.2%	23.9%	12.7%	6.9%	8.4%
J253T	FTSE/JSE Listed Property Index (SAPY)	9.9%	16.4%	10.1%	10.1%	14.9%	0.2%	-1.7%	2.9%
J254T	FTSE/JSE Capped Listed Property Index	9.9%	15.9%	10.7%	10.7%	14.1%	-1.9%	-3.8%	0.7%
	Local Interest-Bearing Indices								
ALBI	FTSE/JSE All-Bond Index (ALBI)	1.5%	8.1%	9.7%	9.7%	7.4%	8.2%	8.4%	8.0%
ALBI01	FTSE/JSE All-Bond Index 1 - 3 years	1.1%	4.1%	9.2%	9.2%	6.3%	7.6%	8.1%	7.7%
ALBI02	FTSE/JSE All-Bond Index 3 - 7 years	1.2%	5.7%	10.3%	10.3%	6.0%	9.1%	9.1%	8.6%
ALBI03	FTSE/JSE All-Bond Index 7 - 12 years	2.2%	9.4%	11.9%	11.9%	7.8%	9.2%	9.2%	8.4%
ALBI04	FTSE/JSE All-Bond Index +12 years	1.1%	9.2%	7.5%	7.5%	7.8%	7.5%	7.8%	7.6%
IGOV	Inflation Linked Government Bonds (IGOV)	2.2%	6.2%	7.0%	7.0%	8.9%	6.5%	5.0%	5.6%
STFIND	Short-Term Fixed Interest Composite Index (SteFi)	0.7%	2.1%	8.0%	8.0%	5.7%	5.9%	6.4%	6.4%
	Inflation Index								
ECPI	Consumer Price Index (1 month lagged)	-0.1%	1.4%	5.1%	5.5%	6.1%	5.0%	5.0%	5.2%
	International Indices								
MSCI.WRLD$	MSCI World Index	1.6%	7.8%	33.4%	33.4%	15.9%	18.9%	15.9%	15.4%
MSCI.EM$	MSCI Emerging Market Index	0.6%	4.3%	18.2%	18.2%	2.5%	9.2%	9.8%	8.9%
WGBI	FTSE World Government Bond Index (WGBI)	0.8%	4.5%	12.7%	12.7%	-0.1%	3.4%	4.1%	5.3%
SPBMGPTU Index	S&P Global Property	5.5%	10.7%	18.4%	18.4%	8.9%	8.5%	7.9%	10.2%
FSPI	USA S&P 500	1.2%	8.0%	35.4%	35.4%	18.3%	21.3%	18.1%	18.4%
FT100	UK FTSE 100	1.6%	3.4%	22.0%	22.0%	15.9%	12.0%	10.0%	8.4%
DJSX50	Euro STOXX 50	1.5%	9.7%	35.3%	35.3%	15.4%	15.7%	12.4%	10.0%
FJNK	Japan Nikkei 225	1.9%	7.9%	30.6%	30.6%	5.8%	13.0%	12.0%	12.5%
	Currency Movement								
USDZAR	Rand/Dollar (R18.36= 1 Dollar)	-2.6%	-3.0%	7.8%	7.8%	7.7%	5.1%	4.2%	5.8%
EURZAR	Rand/Euro (R20.18= 1 Euro)	-1.7%	0.9%	10.6%	10.6%	4.0%	4.2%	4.9%	3.4%
ZARJPY	JPY/Rand (7.71 Japanese Yen= 1 SA Rand)	-2.0%	-2.4%	0.0%	0.0%	3.1%	0.2%	-1.4%	-2.6%
GBPZAR	Rand/Pound (R23.3= 1 Pound)	-2.1%	0.9%	13.1%	13.1%	5.1%	4.9%	4.7%	3.0%

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