MENTENOVA

ECONOMIC OVERVIEW

QUARTER 3, 2024

Contents

EXECUTIVE SUMMARY

South Africa's economic landscape underwent a significant transformation in 2024, beginning the year under pressure from loadshedding, political uncertainty, and pre-election anxiety. However, by the third quarter, the formation of a Government of National Unity (GNU) brought stability, and structural reforms in energy and fiscal policy that revitalised investor confidence, especially among foreign investors.

The introduction of the two-pot retirement system in September, alongside rate cuts, further stimulated the market, fostering a more risk-on environment. Listed property emerged as a top performer, achieving an 18.7% return for the quarter, while equities grew by 9.6% in local currency terms. Small-cap stocks outperformed within the equity class, returning 15.6%. Meanwhile, the Rand strengthened against major currencies, most notably the US dollar, appreciating from R18.36 to R17.27 year-to-date, supported by US election volatility and a 50 basis point rate cut by the Federal Reserve, compared to a 25 basis point cut by the South African Reserve Bank (SARB).

In the fixed income and credit markets, volatility was a feature of the year, but by the third quarter, South African bonds delivered a 10.5% return, aided by political stabilisation and policy reforms. Debt reduction efforts, such as through the Gold and Foreign Exchange Reserves Contingency Account (GFECRA), also contributed, bringing external debt down by 17%, from $84 billion in 2021 to $70 billion in Q1 2024. Despite this progress, South Africa still faces challenges, particularly in its budget deficit, which narrowed to $12.8 billion in August 2024 from $21.4 billion a year earlier. Economic growth remains below the target needed to manage debt, with projections of 1.8% for 2024 and 2.2% for 2025 (Goldman Sachs), below the 3% required for long-term stability.

Globally, emerging markets such as Brazil, India, and China are expected to grow faster than South Africa, with growth rates of 2.8%, 6.1%, and 4.6% respectively in 2024. China, in particular, is benefiting from expansionary policies aimed at boosting economic activity, with the Shanghai Shenzhen CSI 300 Index gaining 17.9%. This outperformance compared to Brazilian and Indian equities, which returned 7.8% and 6.4% respectively, signals a broader shift in market sentiment, with value stocks gaining favour over growth stocks.

In the US, volatility marked much of the third quarter. The S&P 500 fell 6.1% in August but quickly recovered, closing the month with a 2.4% gain. By the end of the quarter, "old economy" sectors had regained prominence, pushing the S&P 500 up 5.9%. The technology-heavy Magnificent 7 Index, which had led the market earlier in the year, began to consolidate, with a more modest 5.7% return.

In foreign fixed income, US bonds performed well, with the FTSE World Government Bond Index delivering a 7% return, boosted by rate cuts. Commodity markets told a different story, with oil prices falling by 17%, while gold reached new highs, increasing by 13.2%. The US labour market softened slightly, with unemployment rising to 4.3%, though this was driven more by an increase in the labour force than by job cuts. The US economy grew by 3.1% year-on-year, supported by consumer spending, and inflation which cooled to 2.6%, and fading fears of a hard landing.

The Bank of Japan’s unexpected rate hike disrupted global carry trades, which rely on borrowing in low-interest currencies to invest in higher-yielding assets. As the yen strengthened, carry trade positions unwound, leading to increased market volatility. While the BoJ’s policy shift marks a step towards normalising monetary conditions, it also highlights risks to global market stability.

In summary, 2024 has seen South Africa making strides in stabilising its economy and attracting investment, though challenges remain in the form of slower-than-needed growth. Globally, emerging markets are performing well, and a shift towards value stocks is gaining traction, with developed markets still navigating volatility in the face of monetary policy shifts.

Q3 MARKET OVERVIEW: V-SHAPED JOURNEY TO BROADLY POSITIVE PERFORMANCE

Most asset classes delivered positive returns in Q3. However, the journey was marked by several bouts of market volatility. In early August, the combination of the unwinding of yen carry trades, driven by the Bank of Japan's interest rate hike, the softening US economic data, and the thin liquidity, hurt equities. Then in early September, concerns about the health of the US economy resurfaced, and US equities, particularly the tech sector, fell sharply. For the remaining quarter, the start of the Federal Reserve's rate-cutting cycle (with the Fed cutting the rate by 50bps), new stimulus packages announced in China, and a less hawkish tone from the Bank of Japan supported the rally of stocks.

Figure 1: Performance of Major Asset Classes and Indices in Local Currency Terms

30 September 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)
FTSE/JSE ALSI Total Return	4.0%	9.6%	15.9%	23.9%	14.7%	13.7%	9.4%
FTSE/JSE Capped SWIX Total Return	4.0%	9.6%	15.9%	25.4%	12.4%	11.9%	7.6%
S&P 500 Total Return	2.1%	5.9%	22.1%	36.4%	11.9%	16.0%	13.4%
STOXX 600 Total Return	-0.3%	2.6%	11.7%	19.2%	7.5%	8.5%	7.1%
Nikkei 225 Total Return	-1.2%	-3.5%	15.2%	21.2%	11.0%	13.9%	11.0%
MSCI World Total Return	1.9%	6.5%	19.3%	33.0%	9.6%	13.6%	10.7%
MSCI ACWI Total Return	2.4%	6.7%	19.1%	32.3%	8.6%	12.7%	9.9%
MSCI EM Total Return	6.7%	8.9%	17.2%	26.5%	0.8%	6.1%	4.4%
MSCI World Value Index	1.8%	9.7%	17.0%	28.1%	10.0%	10.3%	7.9%
MSCI World Growth Index	2.0%	3.5%	21.5%	37.8%	8.6%	16.2%	13.0%
MSCI World Small Cap Index	1.9%	9.5%	11.4%	25.4%	2.7%	9.5%	8.5%
FTSE UK Series FTSE All Share TR	-1.3%	2.3%	9.9%	13.4%	7.4%	5.7%	6.3%
MSCI AC Asia Ex. Japan Index	8.4%	10.5%	21.5%	29.3%	0.9%	6.9%	5.7%
MSCI Europe Excluding United Kingdom Index	-0.4%	2.1%	11.7%	20.3%	7.9%	9.6%	8.3%
Shanghai Shenzhen CSI 300 Index	21.1%	17.9%	20.3%	12.1%	-3.8%	3.4%	7.4%
Korea Stock Exchange KOSPI Index	-3.0%	-7.3%	-1.3%	7.2%	-3.5%	6.9%	4.6%
Taiwan Stock Exchange Weighted Index	0.0%	-2.0%	26.9%	39.3%	13.4%	19.3%	13.5%
NSE Nifty 50 Index	2.3%	7.8%	20.1%	33.2%	15.2%	19.2%	14.0%
Ibovespa Brasil Sao Paulo Stock Exchange Index	-3.1%	6.4%	-1.8%	13.1%	5.9%	4.7%	9.3%
Nasdaq-100 Index	2.6%	2.1%	20.0%	37.5%	11.9%	22.0%	18.5%
Bloomberg Magnificent 7 Total Return Index	6.5%	5.4%	44.4%	62.5%	25.2%	47.2%	
S&P ex Magnificent 7	1.4%	8.0%	17.0%	29.2%	8.1%	11.0%	
Dow Jones Industrial Average TR	2.0%	8.7%	13.9%	28.8%	10.0%	11.8%	12.0%
STEFI	0.7%	2.1%	6.4%	8.6%	6.9%	6.1%	6.6%
ALBI	3.9%	10.5%	16.7%	26.1%	11.1%	9.8%	9.1%
IGOV	0.7%	4.8%	6.9%	13.5%	7.8%	7.2%	5.4%
WGBI	1.6%	7.0%	2.7%	11.0%	-4.4%	-2.1%	-0.1%
Bloomberg Global Inflation-Linked Total Return Index	1.7%	6.0%	3.2%	12.0%	-4.8%	-0.5%	0.8%
Bloomberg US Agg Total Return	1.3%	5.2%	4.4%	11.6%	-1.4%	0.3%	1.8%
Bloomberg EuroAgg Total Return Index	1.2%	3.7%	2.5%	9.2%	-3.3%	-2.1%	0.5%
Bloomberg Global Agg Corporate Total Return Index	1.8%	6.3%	5.3%	14.6%	-1.5%	1.0%	2.0%
Bloomberg US Corporate High Yield Total Return Index	1.6%	5.3%	8.0%	15.7%	3.1%	4.7%	5.0%
Bloomberg Pan-European High Yield Total Return Index	1.0%	3.7%	7.0%	13.0%	2.4%	3.1%	3.8%
J.P. Morgan EMBI Global Core Hedged EUR	1.7%	5.9%	7.3%	17.0%	-2.9%	-1.2%	1.2%
SAPY Total Return	5.0%	18.7%	30.0%	51.3%	16.0%	5.4%	4.3%
MSCI US REIT Total Return	2.7%	16.1%	15.8%	34.4%	5.0%	5.5%	7.8%
S&P Global Property Total Return	3.9%	16.4%	13.6%	30.1%	1.4%	2.5%	5.0%
STOXX 600 Real Estate Total Return	4.6%	13.1%	9.4%	33.4%	-4.8%	-1.7%	2.2%
FTSE EPRA Nareit Global REITs TR Index	3.3%	16.2%	12.9%	30.4%	2.4%	2.8%	5.5%
Crude Oil	-8.9%	-16.9%	-6.8%	-24.7%	-3.0%	3.4%	-2.7%
Aluminium	6.7%	3.4%	9.5%	11.3%	-3.0%	8.7%	2.9%
Copper	6.4%	2.4%	14.8%	18.8%	3.2%	11.4%	4.0%
Gold	5.2%	13.2%	27.7%	42.5%	14.5%	12.3%	8.1%
Platinum	5.6%	-1.4%	-1.0%	8.1%	0.5%	2.1%	-2.8%
Nickel	4.4%	1.3%	5.4%	-6.4%	-1.2%	0.1%	0.6%
Palladium	3.5%	2.7%	-8.8%	-19.6%	-19.4%	-9.8%	2.6%
Iron Ore	5.2%	-2.1%	-24.3%	-14.6%	-6.1%	1.4%	2.1%
Bloomberg Commodity Index Total Return	4.9%	0.7%	5.9%	1.0%	3.7%	7.8%	0.0%
USDZAR	-3.1%	-5.1%	-6.0%	-8.7%	4.6%	2.7%	4.3%
GBPZAR	-1.3%	0.4%	-0.8%	0.1%	4.4%	4.4%	2.4%
EURZAR	-2.4%	-1.3%	-4.6%	-3.8%	3.3%	3.1%	3.0%
JPYZAR	-1.3%	6.4%	-7.3%	-5.1%	-3.9%	-3.0%	1.6%
Dollar Index Spot	-0.9%	-4.8%	-0.5%	-5.1%	2.3%	0.3%	1.6%

Source: Bloomberg

Developed market equities, the MSCI World Index, delivered 6.5% over the quarter, outperformed by the MSCI Emerging Markets Index, which gained 8.9%. The S&P 500 gained 5.9% over the period, outperforming the STOXX 600 which delivered a more muted return of 2.6% on the back of the sluggish nature of the Eurozone recovery. Despite a more reassuring tone from BOJ officials after its July rate hike helped Japanese stocks to pare some losses, the market still ended Q3 in the red. Rate-sensitive sectors such as global REITs and small caps rallied hard. The MSCI Value Index delivered an impressive return of 9.7%, while the MSCI Growth Index gained 3.5% for the quarter. In the US, it seems that the market began to broaden out and shifted attention towards ‘old economy’ sectors in Q3, after several years of outperformance in technology and ‘new economy’ stocks. Among emerging markets indices, Chinese equities rallied on the back of Beijing's coordinated stimulus, while South African equities were up nearly 10% for the quarter, driven by China-exposed Naspers and the optimism that a combination of falling interest rates and the coalition government will boost growth. Indian equities gained 7.8% over the period, slightly behind the MSCI Emerging Market Index.

Fixed-income markets also benefited from rate cuts and the shift in investors' expectations for interest rates. The FTSE World Government Bond Index delivered 7.0% for Q3, while other investment-grade and high-yield indices also gained within the range of 4.0% to 6.0% over the period. The SA nominal bonds benchmark, the ALBI Index, delivered a remarkable 10.5% over the quarter, significantly outperforming the inflation-linked bonds, the IGOV Index, on the back of cooling inflation prints.

Commodity performance was lacklustre. The most prominent was the oil price, which fell by nearly 17% over the quarter, on the back of growing concerns over the global economic growth outlook. Meanwhile, the gold price reached its new all-time high and rose by 13.2% over the period, driven by a combination of monetary policy easing, geopolitical tensions, and market uncertainty.

Turning to the FX, the ZAR appreciated by 5.1% against the USD, mainly driven by dollar weakness as the dollar index fell by 4.8% over the quarter. The ZAR traded relatively flat against the GBP and made a modest gain of 1.3% against the EUR.

The FRA market has priced in the US interest rate to reach 3.5% by mid-2025, which is much lower than its outlook of 4.3% at the beginning of the quarter. Should there be evidence of a further slowdown in the US economy, the Fed is ready to take action to cut rates more aggressively and more quickly. As it stands, muted activity and cooling inflation have prompted a synchronised rate-cutting cycle among most major central banks. From what we have seen over the past quarter, investor sentiment can be easily and significantly swayed in either direction. With inflation edging closer to target levels, central banks are again shifting their focus on growth. There will likely be more volatility ahead with the approaching US election, interesting tailwind dynamics from declining interest rates, and headwinds of slowing economic growth amid ongoing Middle East and Russia–Ukraine geopolitical tensions.

RESILIENCE TO RISK: US ECONOMY FACING PIVOTAL MOVEMENTS

US Economic Uncertainty: Labour Market Volatility and Recession Rumours

Over the quarter, market participants experienced much uncertainty about the US economy as recession rumours re-surfaced, with concerns largely driven by labour market volatility. Looking back to 2022, post-COVID, labour costs rose. Logic suggests that, to maintain equilibrium in the labour market, businesses would have to reduce their labour forces. This would trigger a rise in the unemployment rate and a decrease in disposable household income, culminating in a recession. Currently, the US labour cost for Q2 2024 saw a downward adjustment to 0.4%; however, the uptick in unemployment levels raised concerns.

The US unemployment rate was up, reaching 4.3% in August 2024. This triggered Sahm's rule of recession, which states that the economy is in a recession if the three-month average unemployment rate is at least 0.5 percentage points above its minimum from the previous 12 months. This, however, was not a cause for concern this time around as the rise in the unemployment rate was largely driven by an increased labour supply that was growing at a faster rate than that at which jobs were being added to the economy. The expanded labour supply was due to immigration and a general increase in the number of labour force participants.

Figure 2: US Unemployment Rate

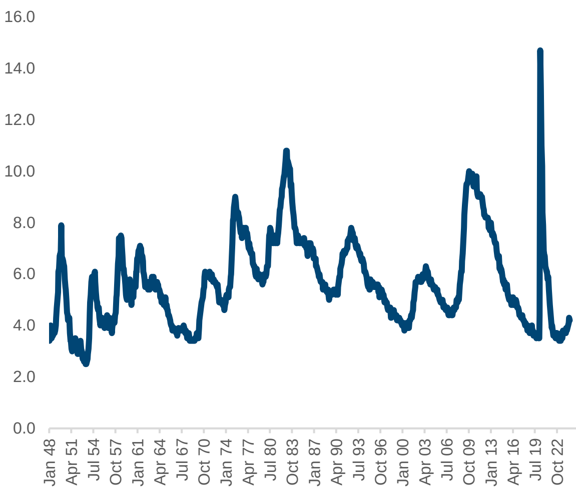
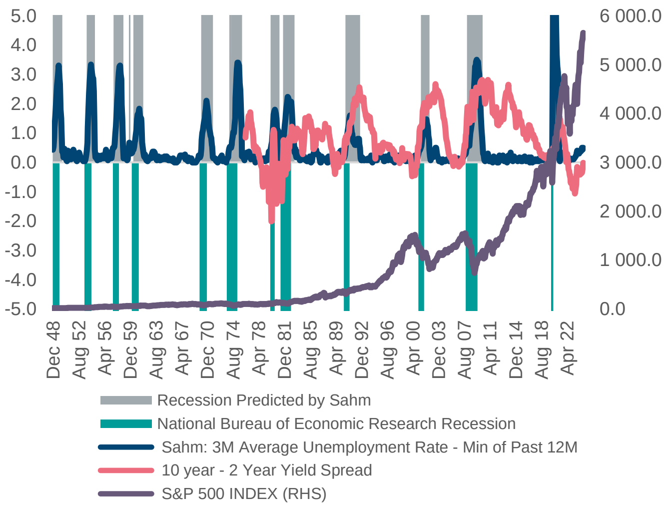


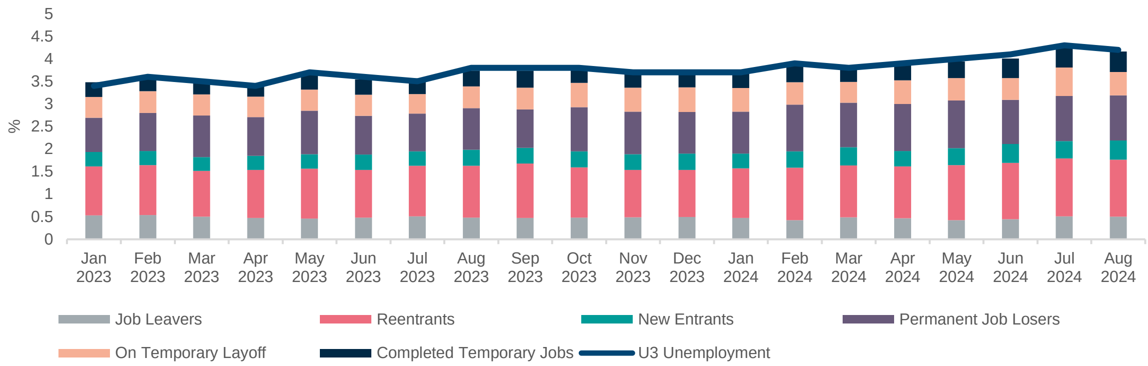
Figure 3: Sahm's Indicator



Source: Bloomberg

Other labour market indicators, such as the number of job openings relative to unemployment numbers, the job opening rate, the quit rate, and layoffs, point to a cooling labour market that is returning to pre-COVID levels and is hence normalising. The initial jobless claims and continual jobless claims have also seen a slight decline over the quarter. The downward revision here is a consequence of declining job openings rather than layoffs. Evidently, labour markets have indeed cooled off. However, as things stand, there is nothing of fundamental concern that could cause a plunge.

Figure 4: Unemployment Rate Contributors



Source: Bloomberg

US economic growth over the previous quarter experienced healthy gains of up 3.1% YoY in real GDP. This was largely influenced by stronger consumer spending, which rose by 2.7%, and an improvement in business investment spending, which remained resilient even in the face of high interest rates. Into Q3 2024, consumer spending continued to show some gains, with retail sales less autos and gas stations up by 2.7% YoY in July. However, over the quarter, manufacturing output growth remained flat, supported by a rebound in autos in August.

Figure 5: Retail Sales Less Auto and Gas Stations MoM

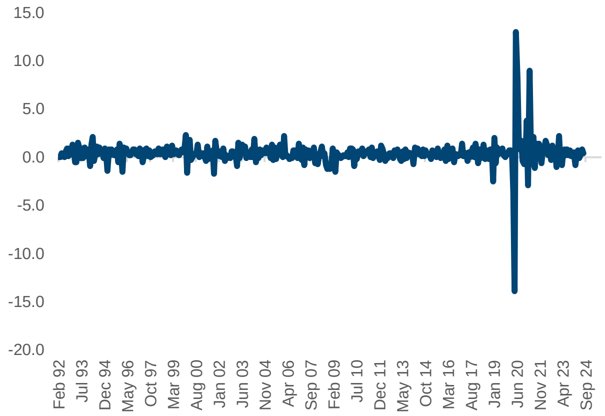
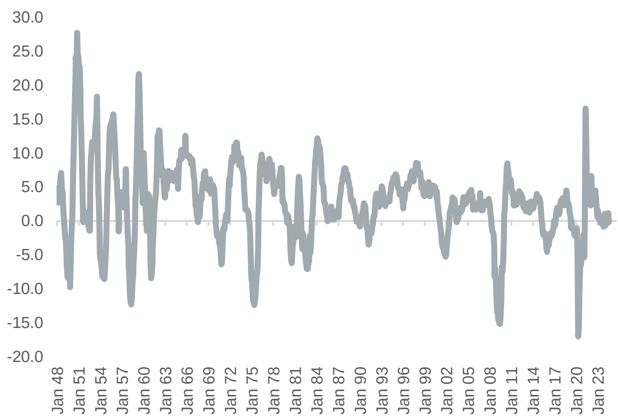


Figure 6: US Industrial Production YoY



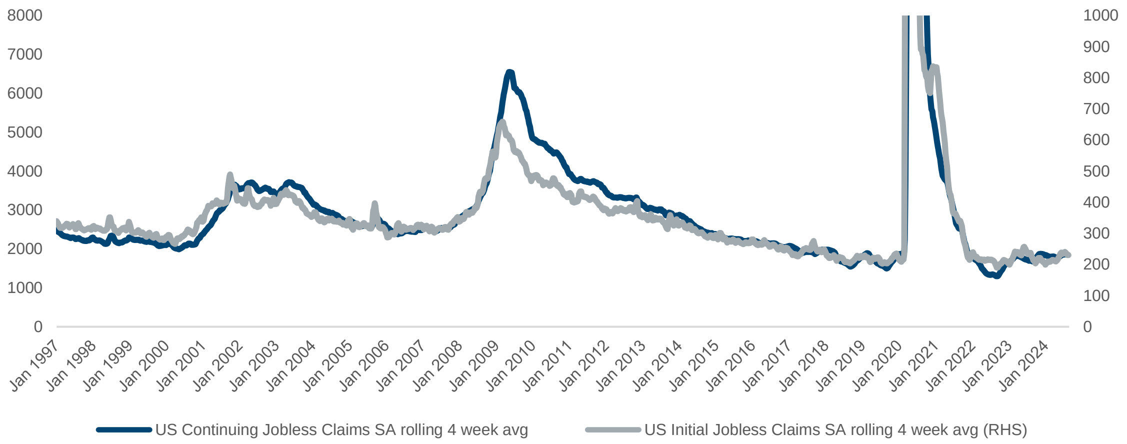
Source: Bloomberg

Contrary to last year's unanimous prediction of a recession, which never materialised, market participants are seeing a full swing of the pendulum towards a soft landing in the books for 2024. The gradual upward movement of inflation numbers, post-COVID, to its peak in 2022, was a source of concern. To tame the high inflation prints, the US Federal Reserve initiated its interest rate-hiking cycle in an effort to slow spending and thus remove price pressure, which will see inflation move to the Fed's target of 2.0% YoY. The Fed commenced its cycle of interest rate hikes, as seen in early 2022. Although prints were still relatively high into 2023 (which fuelled the prediction of a 2023 recession), the US inflation PCE moved from 3.7% YoY in August 2023 and dropped at a gradual pace to 2.6% in August 2024. As inflation (as well as the economy) began to stabilise, the Fed was able to commence a cycle of rate cutting, which proceeded from the September 2024 FOMC Meeting, by announcing the cutting of interest rates to 50bps. This surpassed the market expectations of a 25bps cut. Committee members commented that this was a calculated move to ensure a soft landing at the end of the year.

Following the September 2024 FOMC outcome, committee members agreed to ease monetary policy for the first time in four years by a steep 50bps cut (supported by 10 out of 11 members, with one member favouring a 25bps cut). The Fed's dual mandate is to achieve price stability and full employment, which requires a balance between inflation and employment. In recent years, the Fed's goal has been to tame the high inflation prints. Notably, it has achieved this goal, with core inflation gradually moving down from its peak in 2022 to 2.5% in July 2024, with a slight uptick in August to 2.6% (which is near the Fed's inflation target of 2%). Thus, the Fed is pivoting from inflation-focused to employment-focused.

Given the slight price stability, labour markets, in contrast, have seen slight turbulence which has become a focal point for the Fed. As mentioned in previous paragraphs, labour markets have experienced slight softness, with the job openings-to-unemployment ratio moving from 2:1 to 1:1. The July jobs report indicated the smallest payroll increase for the past three years and growing concerns about a recession. August data was evidence of a possible recession *not* occurring, as there was no indication of massive layoffs, which would have been a concern. Even though the labour market is cooling, it is not (yet) cracking. The initial jobless claims provide real-time insights into the state of the job market. Early September data showed that initial jobless claims had dropped, which is indicative of a steady labour market.

Figure 7: US Initial and Continual Jobless Claims



Source: Bloomberg

Recessionary risks continue to be on many people's minds, with the extent to which the yield curve has moved in 2024. Usually, the tilt curve would un-invert just before a recession commences. However, this time around it is tricky to predict, as the expansionary phase experienced by the US is the result of the country coming out of an 'induced recession' due to the pandemic, and not market performance. The fiscal response was also different this time around, being looser for longer.

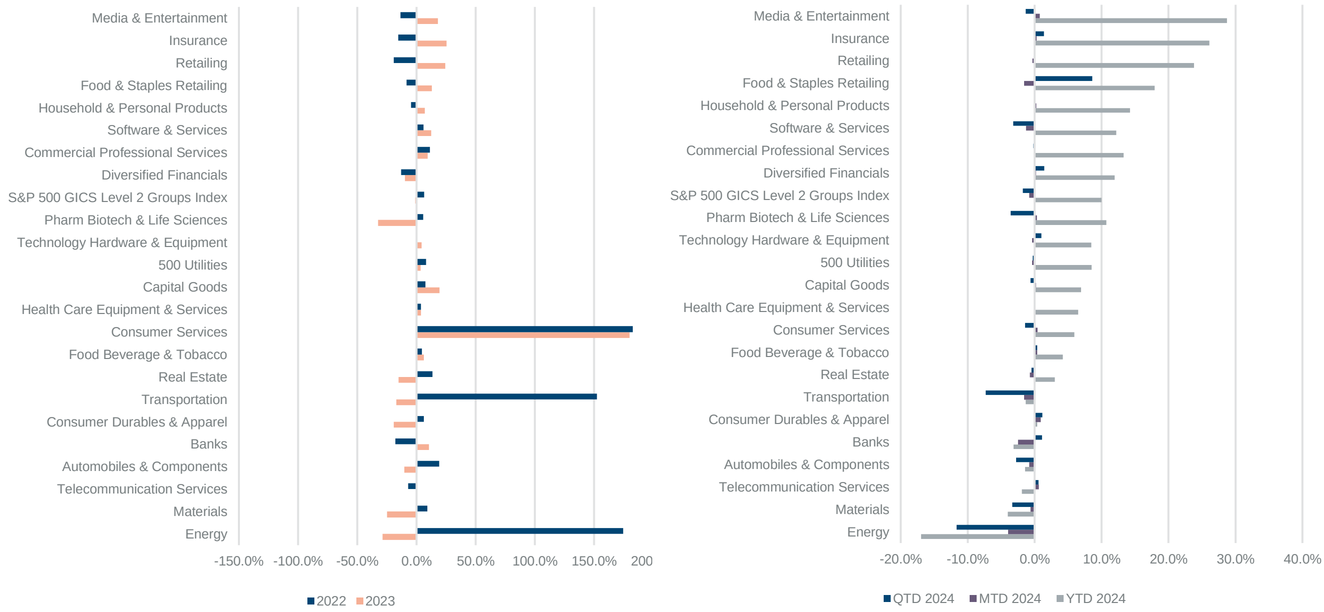
Earnings Resilience Amid Economic Slowdown

Apart from concerns about a potential recession being put on the table again because of increased volatility in the labour market, there is also considerable concern that the slowdown could potentially impact earnings growth. Looking at the S&P 500 earnings as a proxy for US earnings, earnings data for the past two years and halfway through 2024 show that there were only a handful of stocks in the S&P 500 that drove earnings over the past year – which were mainly the Magnificent 7. This was concurrent with the surge in global technological advances and AI, with the rest of the index seeing a contraction in earnings.

Surprisingly, even with a drop in earnings, growth put in a respectable 5.7% in nominal terms YoY. The contradictory data on corporate earnings and economic growth seems to support the ideology that an improvement in profits is possible even though the economy is slowing down.

How is this possible? Earnings forecasts on a sectorial basis make this possible due to diversification within the index. The earnings forecast data shows that earnings are largely driven by underlying industry tailwinds. For instance, S&P 500 earnings for 2022 were largely driven by the energy, transportation, and consumer services industries, as a result of high commodity prices. As a result, 2023 earnings were normalised within these sectors (except consumer services), piggybacking on the previous year's strengths. Currently, what might broaden forecasted earnings is if S&P 500 earnings were led by media & entertainment, insurance and retailing, with a downward shift in consumer staples.

Figure 8: S&P 500 GICS Level 2 Indices 2024 Earnings Estimate Revision



Source: Bloomberg, as of 29 September 2024

STRONG RECOVERY IN SOUTH AFRICAN EQUITIES

The third quarter of 2024 demonstrated resilience in the South African equity markets, which delivered strong overall returns, despite varying performance across sectors. Investor sentiment remained positive, driven by improved economic stability, a more favourable political landscape following a market-friendly election outcome, and ongoing improvements in electricity supply reliability.

For the quarter, the FTSE/JSE Capped SWIX and FTSE/JSE Shareholder Weighted All Share Index (SWIX) returned approximately 9.6%, reflecting broad-based optimism in the market. Small and mid-cap stocks outperformed, delivering returns of 15.6% and 10.95%, respectively, as investors favoured growth-oriented sectors. The property sector was a standout performer, with the FTSE/JSE SA Listed Property Index surging by 18.7%, driven by expectations of lower interest rates and stronger economic fundamentals.

Despite these gains, the resource sector lagged, declining by 2.5% over the quarter due to weaker global demand and falling commodity prices, particularly in metals and mining stocks. However, the industrial and financial sectors showed significant resilience, with the FTSE/JSE Industrials Index gaining 11.6% and the Financials Index rising by 10.2%.

The quarter's strong overall performance was underpinned by the South African Reserve Bank's (SARB) 25-basis-point interest rate cut in September, which fuelled positive sentiment alongside a stabilising electricity supply. As South Africa continues its economic recovery, the outlook for domestic equities remains cautiously optimistic, supported by structural reforms and an improving macroeconomic environment.

Figure 9: SA Repo Rate follows CPI YoY %

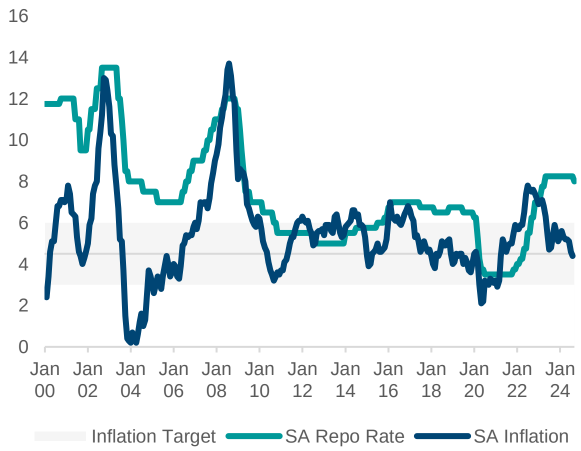
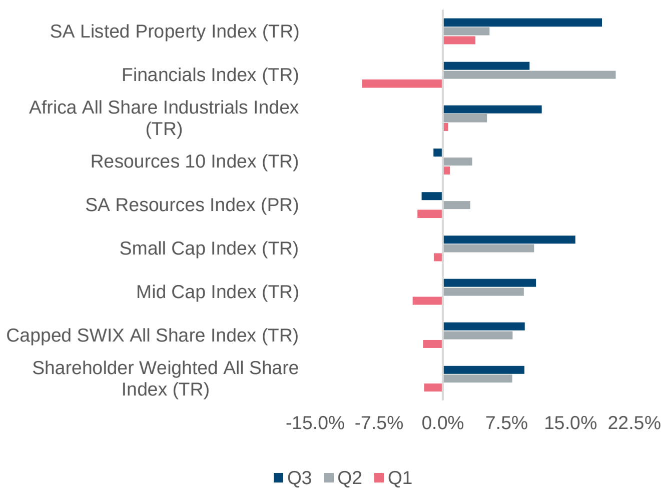


Figure 10: Quarterly FTSE/JSE Performance 2024



Source: Bloomberg

South Africa's Government of National Unity: A Turning Point

The establishment of South Africa's Government of National Unity (GNU) on 14 June 2024, following the national elections in May, marks a crucial shift in both the political and economic landscape. The GNU emerged as the logical option as no single party had secured a majority, resulting in the need for a coalition government. This new political arrangement has generated cautious optimism among both local and international investors, as hopes for improved political stability and governance have risen. However, this sense of optimism is moderated by South Africa's deep-seated structural economic challenges.

The announcement of the new National Executive towards the end of June 2024 had an immediate positive impact on markets. Key indicators reflected this improved sentiment, with the South African Rand remaining steady and local equities demonstrating resilience. Investors reacted positively to the appointments of key ministers, particularly the retention of experienced individuals such as Finance Minister Enoch Godongwana, whose role is seen as pivotal in maintaining fiscal discipline and policy continuity.

Figure 11: ZAR Appreciates as Sentiment Returns

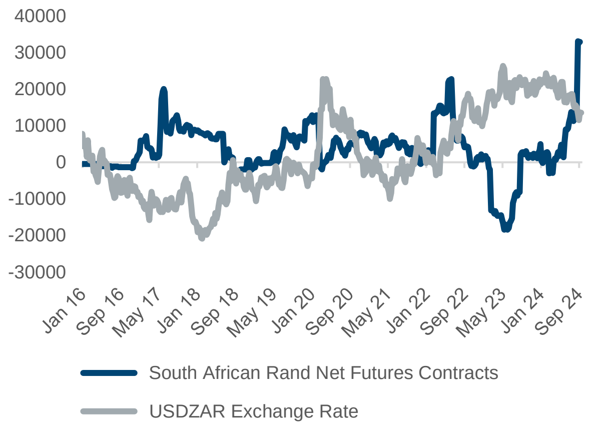
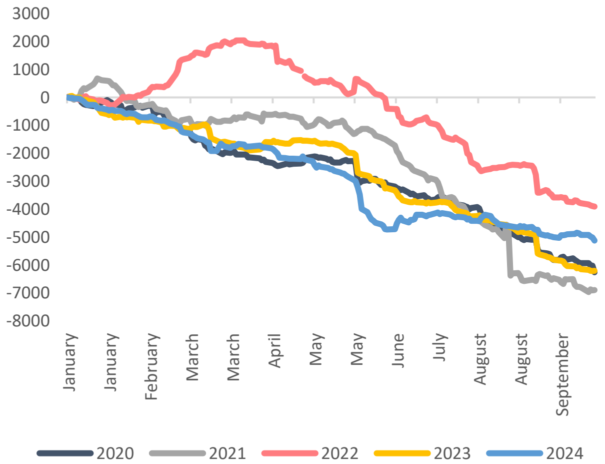


Figure 12: Net Equity Sales to Foreigners Recover



Source: Bloomberg

The GNU's formation coincided with an improvement in business confidence. The RMB/BER Business Confidence Index (BCI) climbed by three points in Q3 2024 to 38 – the highest level since late 2022. This reflects a growing sense of optimism among businesses, with a small majority across different sectors expecting conditions to improve over the coming months. Retail and new vehicle sales have shown a notable recovery, further boosting domestic market confidence.

President Cyril Ramaphosa's inaugural address underscored the GNU's commitment to fostering inclusive economic growth, addressing inequality, and achieving national unity. Key structural reforms have been initiated, such as the merging of the Ministries of Electricity and Energy and the creation of a separate Ministry of Mineral and Petroleum Resources, all of which are aimed at improving governance in critical sectors. The formation of the GNU has injected a degree of optimism into South Africa's outlook, but numerous hurdles remain. Despite the uncertainties ahead, the early market response to the GNU offers a glimmer of hope for a more stable and prosperous future.

Figure 13: ABSA Manufacturing PMI

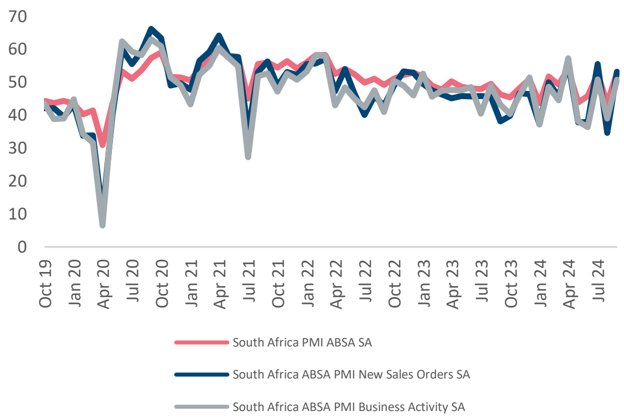
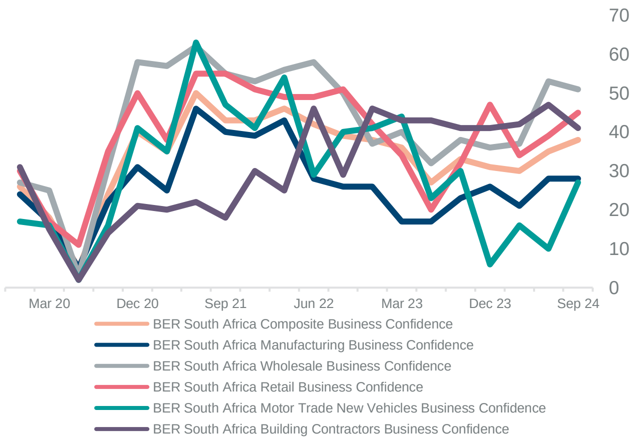


Figure 14: Business Confidence Improves



Source: Bloomberg

Reforming South Africa's Energy Sector: A Path to Stability and Growth

In 2024, the South African government, in partnership with Eskom, launched transformative reforms aimed at enhancing power stability, curbing loadshedding, and fostering sustainable economic growth. These comprehensive reforms are centred on boosting operational efficiency within Eskom, expanding generation capacity, and encouraging private-sector participation in the energy landscape. As a result, significant strides have been made in improving the electricity supply, with loadshedding considerably reduced throughout the year.

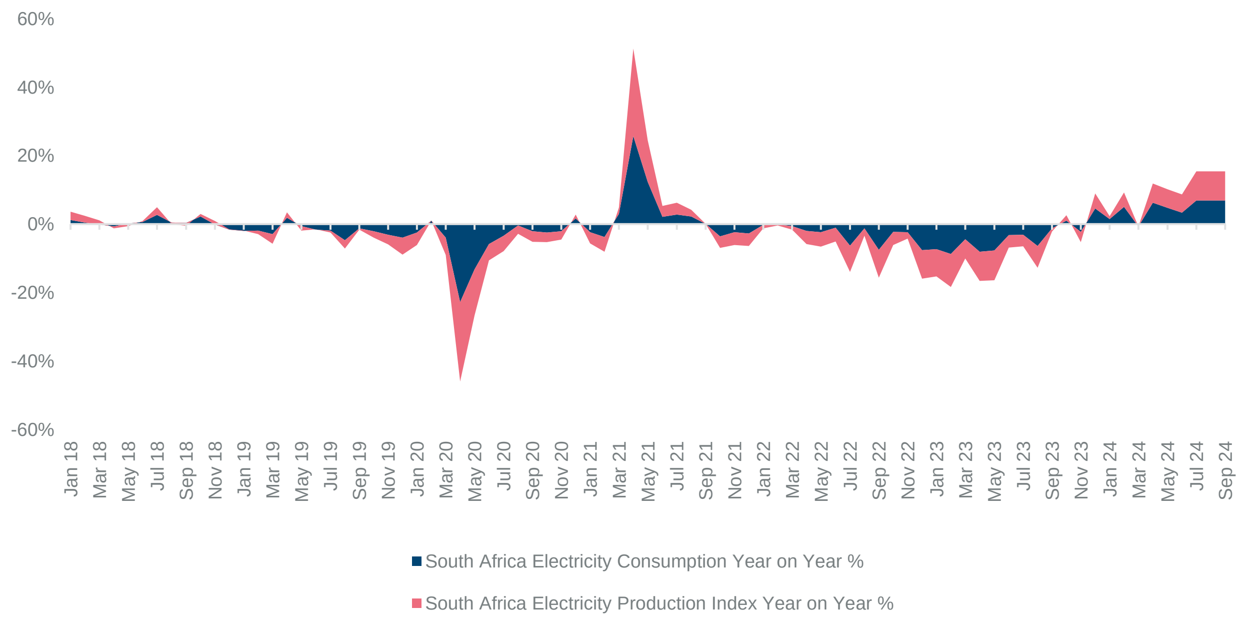
Central to these reforms is Eskom's emphasis on operational enhancements and proactive maintenance of its power plants. By August 2024, the utility had successfully minimised the occurrence of unplanned outages, achieving an average breakdown rate of between 9,800 MW and 12,400 MW. This increase in the reliability of power plants has directly contributed to greater overall generation capacity and enhanced grid stability. A notable achievement was the commissioning of Kusile Unit 5, which added 800 MW to the grid, with further contributions anticipated from Medupi Unit 4 and Koeberg Unit 2, collectively expected to add 1,740 MW by September 2024. These advancements represent significant progress towards bolstering Eskom's total installed capacity and upgrading South Africa's power generation infrastructure.

Eskom entered into partnerships with Independent Power Producers (IPPs), enabling them to sell surplus electricity back to the grid. The government also increased the licensing threshold for private generation projects from 1 MW to 100 MW, unlocking substantial investment opportunities which facilitated the addition of over 5,000 MW of new generation capacity. Furthermore, a strong emphasis was placed on renewable energy, with Eskom accelerating the procurement of over 14,000 MW from wind and solar sources under the Integrated Resource Plan (IRP).

These reforms have yielded tangible improvements in power stability. By July 2024, Eskom had achieved available capacity of 35,000 MW during peak demand periods, while the Energy Availability Factor (EAF) had improved to around 70%. As a result, South Africa had enjoyed over 100 consecutive days without loadshedding by mid-2024. This unprecedented level of stability has positively influenced various sectors of the economy, instilling greater confidence among businesses and investors.

The enhanced electricity supply has significantly benefited several key economic sectors. Notably, the manufacturing and retail sectors have experienced marked improvements, as the absence of loadshedding has facilitated uninterrupted operations. This stability has led to enhanced production efficiency, contributing to increased output and profitability across these vital areas of the economy..

Figure 15: Electricity YoY Production Exceeds YoY Consumption



Source: Bloomberg

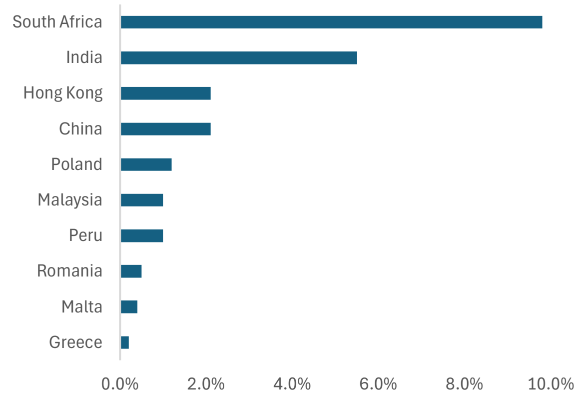
FIXED INCOME AND CREDIT

Political Stability Fuels Optimism for South African Enterprises

In 2024, South Africa's economic environment experienced two distinct phases. The first half of the year was marked by uncertainty, primarily due to concerns about escalating loadshedding and political instability, and anxiety surrounding the upcoming elections. Pre-election polls hinted at the likelihood of a coalition government, further heightening market participants' unease. However, the situation shifted dramatically in the third quarter, following the formation of a Government of National Unity (GNU), which helped restore investor confidence.

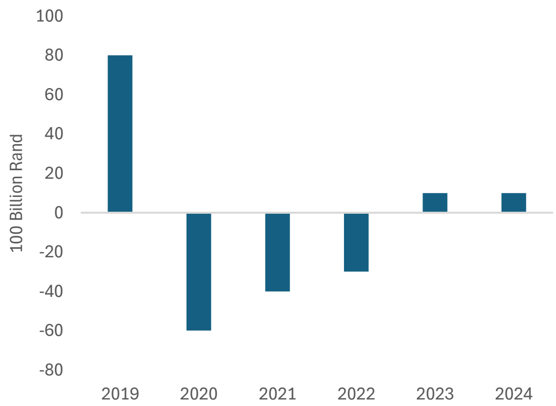
This political stabilisation had a significant positive impact on the local fixed-income market. By July, South African bonds had emerged as top performers amid emerging-market government debt, delivering a robust return of 8.5% in dollar terms. The establishment of the GNU, coupled with the implementation of the Gold and Foreign Exchange Reserves Contingency Account (GFECRA), played a crucial role in influencing bond yields. Longer-dated bonds, in particular, benefited from the improved sentiment in the market. By mid-2024, foreign purchases of local debt surpassed the total volume from the previous year, underscoring the renewed interest from international investors. Yield curves shifted lower, reflecting strengthened investor confidence and stabilising the National Treasury’s borrowing costs, which had previously hovered above 10%.

Figure 16: World Local Currency Government Bond Returns YTD US



Source: Bloomberg

Figure 17: South Arican Bonds Find Favour with Foreigners (Non-Resident Flows)



Source: Bloomberg, JSE Ltd
Note: 2024 figure is year-to-date to July 8

While investor confidence began to recover and concerns about loadshedding eased, South Africa continued to face significant long-term fiscal challenges. The debt-to-GDP ratio remained elevated, exceeding comfortable levels. To achieve debt sustainability, the economy needs to grow by approximately 3%, while a growth rate of 5% is essential for making meaningful progress in reducing poverty and fostering inclusive growth. Considering that the real growth rate for 2023 was 0.6%, structural reforms, such as the liberalisation of electricity production and initiatives like Operation Vulindlela aimed at enhancing logistics infrastructure, are critical for driving sustained economic growth.

Operation Vulindlela, a joint initiative between the Presidency and the National Treasury, is playing a pivotal role in accelerating these much-needed structural reforms. Led by Deputy Finance Minister David Masondo and directly overseen by President Cyril Ramaphosa, the programme focuses on transforming key sectors, such as electricity, water, transport, and digital communications, in a bid to modernise the economy. It also seeks to reform the visa regime to attract skilled talent and boost tourism – both crucial components in driving economic recovery and long-term growth.

At the heart of Operation Vulindlela are 19 priority reforms designed to significantly alter South Africa’s economic trajectory. The initiative takes a government-wide approach, with a dedicated Vulindlela Unit responsible for monitoring progress, facilitating technical support, and providing policy recommendations. By addressing bottlenecks and fostering accountability, it aims to improve economic efficiency, reduce operational costs, and create a more competitive environment to promote sustained growth across key industries.

In terms of inflation, trends were more favourable than anticipated, prompting the South African Reserve Bank (SARB) to implement rate cuts. A 25-basis-point reduction, while less aggressive than some had expected, helped to maintain the attractiveness of South Africa's yields for global investors. Following Jerome Powell's remarks at the Jackson Hole Symposium, which indicated a shift in US monetary policy, the subsequent 50-basis-point rate cut in the US made emerging-market assets, including South African fixed-income instruments, more attractive on a real return basis. This reinforces the positive outlook for South African bonds, further boosting investor sentiment in the third quarter.

Corporate Credit Spreads Tighten Despite Economic Headwinds

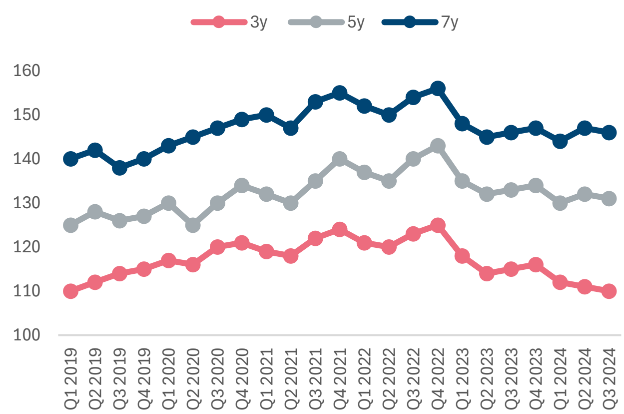
Corporate credit spreads are currently at their tightest in a decade, even as the macroeconomic environment remains challenging. In response, investors are increasingly turning to alternatives, such as government floating rate bonds, credit-linked notes, and offshore bonds. This shift is evident in lower bid-to-cover ratios, fewer participants in auctions, and clearing spreads that no longer push the lower limits of price guidance.

While the market sees an average of 23 unique corporate issuers per year, true diversification is limited. Ten issuers have entered the market only once, and 14 others have not issued bonds in more than five years. Only 13 companies have consistently issued bonds in at least nine of the past 12 years, highlighting a narrow pool of regular issuers.

Despite the relatively small group of frequent issuers, the overall credit quality has improved significantly. In 2013, AAA- and AA-rated issuers made up 31.1% of the market, but by 2023, this figure had risen to 85%. However, this rise in credit quality has not attracted more bidders, with recent auctions seeing a notable decline in participation. Investors appear to be seeking higher returns elsewhere or simply abstaining from auctions due to the tight spreads.

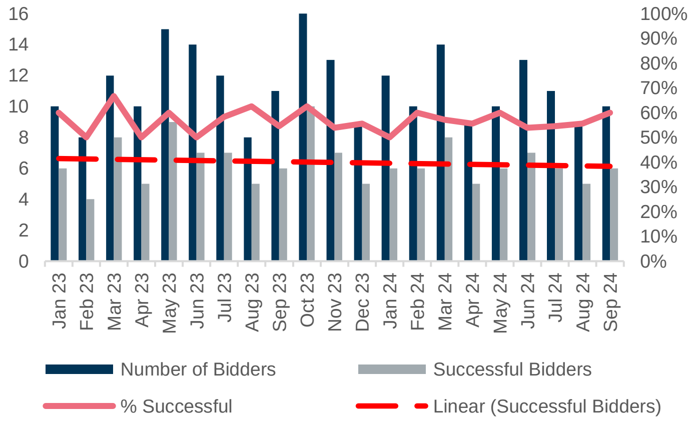
Though credit ratings have strengthened, spreads are not fully reflecting the broader economic conditions. South Africa's economic growth has been sluggish, at times close to recession, yet spreads have continued to tighten across various tenors and rating bands. A review of auction data over the past 18 months shows a decline in the number of bidders and a drop in the percentage of successful bids, reinforcing the notion that investors are seeking alternative options for yield enhancement.

Figure 18: Credit Spreads Tightening



Source: JSE, Absa Research
Note: Movement in spreads across the 3-, 5- and 7-year senior notes issued by banks during public auctions over this period.

Figure 19: Auction Bids Analysis



Source: RMB Global Markets

BOJ CAUSES THE GLOBAL MARKET TO TREMBLE

Bank of Japan increased rates, causing a shock to global markets

In March 2024, the Bank of Japan (BoJ) raised its short-term interest rates from -0.1% to a range of 0–0.1%, marking the end of its negative interest rate policy that had been in place since 2016. This was the first increase in 17 years and was prompted by improving economic conditions, particularly rising wages and inflation. Following this, on 31 July 2024, the BoJ raised the key interest rate again to approximately 0.25%, responding to ongoing price increases and aiming to stabilise the yen against the US dollar.

Figure 20: Japanese improving economic conditions

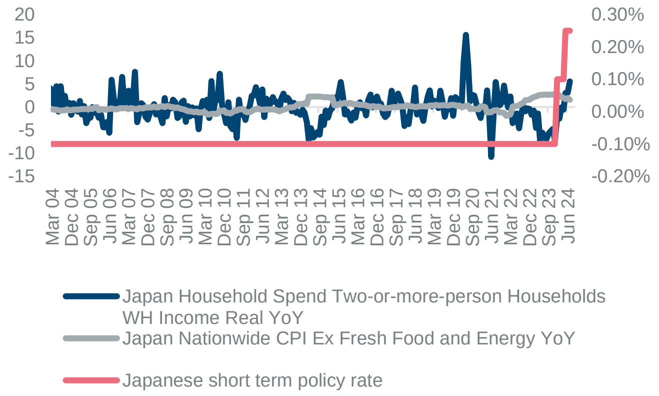
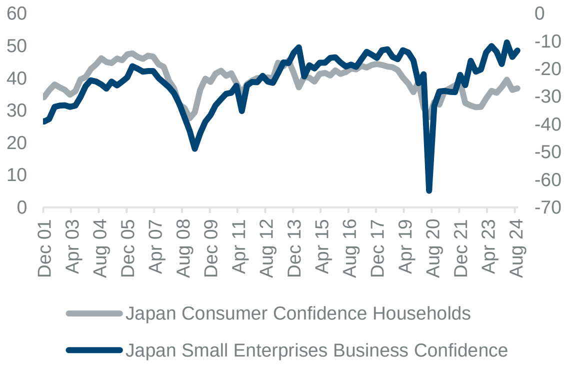


Figure 21: Japanese confidence return



Source: Bloomberg

The recent interest rate hikes by the BoJ have had a significant impact on the carry trade, a popular investment strategy where investors borrow in a low-interest currency to invest in higher-yielding assets. Traditionally, the Japanese yen has been a favoured funding currency due to its extremely low interest rates. This has allowed investors to borrow yen cheaply and invest in currencies or assets with higher returns, such as the US dollar and/or other riskier assets. This disrupted many existing carry trades that relied on borrowing yen at low rates to invest elsewhere.

As the yen strengthened, investors who had engaged in yen-funded carry trades faced increased costs when repaying their loans, prompting many to unwind their positions. This unwinding caused significant volatility across global markets, leading to sharp declines in stock prices and increased sell-off of riskier assets as investors sought safer holdings. These rate hikes led to increased volatility in financial markets, which later experienced fluctuations due to market reactions. However, the global equity market did rally after the sharp decline, giving investors the opportunity to purchase shares at attractive valuations.

Figure 22: Global Equity Indices

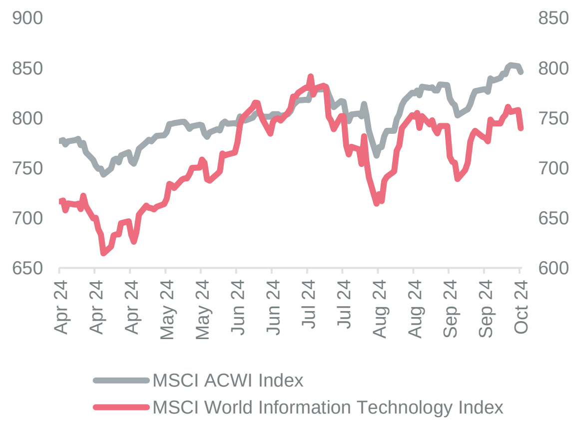
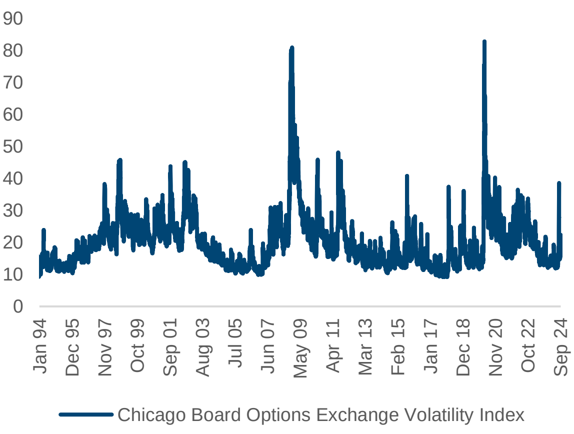


Figure 23: Volatility Index



Source: Bloomberg

Central banks' role in carry trade strategies

Central bank policies play a crucial role in shaping carry trade strategies, primarily through their influence on interest rates and market volatility. For these trades to be profitable, several conditions must be met, including stable interest rates and low market volatility. When a central bank adopts an expansive monetary policy, such as lowering interest rates or implementing quantitative easing, it typically leads to increased risk appetite among investors. This environment encourages carry trades as investors seek higher returns from riskier assets.

Conversely, if a central bank raises interest rates or signals a tightening of monetary policy, the profitability of carry trades can diminish. For instance, if the central bank of the funding currency raises its rates or the target currency's central bank lowers its rates, the profit margin for carry traders can shrink or even disappear entirely. Moreover, central bank interventions can lead to significant exchange rate fluctuations, which pose risks for carry traders. If unexpected monetary policy changes occur, they can trigger rapid currency appreciation or depreciation, impacting the value of investments made through carry trades.

A shift in the Bank of Japan’s monetary policy

The BoJ's decision to move away from negative rates is seen as a significant shift in its monetary policy, which could impact global markets, especially US Treasuries. Japanese investors, who traditionally hold a substantial amount of US debt, might withdraw their investments in favour of domestic bonds offering higher yields, potentially resulting in rising yields on US Treasuries.

Overall, while the BoJ aims to normalise its monetary policy after years of aggressive easing measures, real interest rates in Japan remain negative when adjusted for inflation, indicating that monetary conditions are still relatively accommodative. The central bank's actions reflect a cautious approach to balancing economic recovery with the need for stability in both domestic and global markets. Therefore, while rate hikes may help to control inflation, they also pose risks to economic stability and growth, particularly for industries that benefit from a weaker currency.

Figure 24: Monthly Yen-to-Dollar Exchange Rate

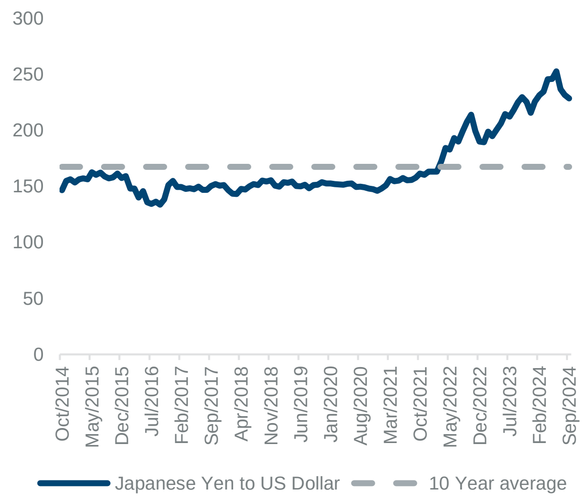
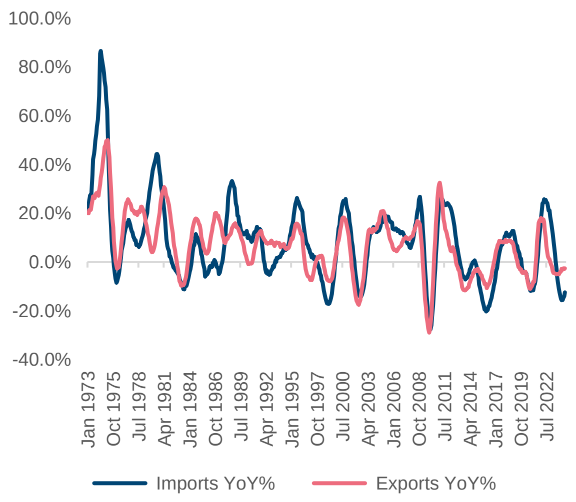


Figure 25: Japanese Year-on-Year Trade



Source: Bloomberg

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