A LITTLE LESS CAUTION AND A BIT MORE OPTIMISM

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Since the formation of the Government of National Unity (GNU) in late June, South African asset prices have rallied strongly, signalling a potential shift in South Africa's economic landscape.

It may be too early to definitively state that the growth trajectory will improve durably towards the 2.5% - 3.0% "breakeven" growth rate that will lower the debt-to-GDP ratio and the unemployment rate, but there is room for cyclical optimism and a partial re-rating in valuations.

The GNU – a fancy name for a multi-party coalition – only recently "celebrated" its first 100 days in office. The major challenge to the durability of the GNU is that the ANC and DA are not "ideological bedfellows", as Barney Mthombothi (former editor of the Financial Mail) recently put it in a recent Sunday Times Op-Ed. The contentious policy areas are education and the National Health Insurance.

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MORE ALIGNED THAN IT APPEARS

Outside of these populist policy areas, the ANC and the DA are arguably more aligned than the headlines would have us believe. The constraint on the ANC is that it is not allowed to shift its narrative on revolutionary development, opting to use public private partnerships (PPP) rather than outright privatisation to expand much-needed infrastructure. Even so, done effectively, PPPs will be able to move the needle on capex and potential growth in the medium to longer term. A positive of the GNU is that it is fully aligned – moving from foes to friends - with the objectives of Operation Vulindlela (for detail see here), which is now entering phase 2.

We think it is unlikely the South African Reserve Bank will lose its independence, and we expect an ongoing focus on fiscal consolidation, even if gradual.

A CAUTIOUSLY OPTIMISTIC VIEW

Following politically-induced uncertainty ahead of the 2024 elections, business and consumer confidence has risen gradually. This reflects not only the better political outcome, but also the lack of load shedding. Perversely, the improvement in energy provision has dampened fixed investment as the need for embedded generation has declined. That said, ongoing large electricity tariff increases will create renewed demand in a bid to manage energy costs. An expansion in grid capacity, at an estimated cost of almost R400bn, is needed to further improve economic growth from the electricity side.

The woes in the rail and port sector have had a less direct impact on confidence, given that it is not as obviously felt as the lack of electricity. Even so, it has had a meaningful effect on export growth and competitiveness. Transnet has partnered with a private company to upgrade and manage the Durban Container Terminal Pier 2 (a 25-year contract), it is aiming to implement a PPP for the Ngqura container terminal (Eastern Cape) and Richards Bay port (Kwa-Zulu Natal). The National Logistics Crisis Committee is working with Transnet and the private sector to improve key rail corridors.

Combined, the resolution to logistical constraints should probably lift growth by around 1%. Multi-year infrastructure expansion is set to lift fixed investment growth to 4% - 6% over the medium term, and GDP growth to 2% - 3%.

POSITIVE MARKET MOVEMENTS AND THE RAND

The expected improvement in GDP growth and investment rates have positive spillovers to how the market sees the credit rating and foreign capital inflows evolve. This contributed to the sharp decline in SA's bond yields and the appreciation in the rand. A fundamental fair-value model for the rand exchange rate shows that the valuation range for the USD/ZAR exchange rate has fallen, from 18.00 – 18.50 to 17.00 – 17.50. We would not be surprised by an overshoot towards 16.00 – 16.50 should the dollar continue to weaken as the Fed cuts rates. A sustained improvement at 16.00 would require a meaningful decline budget deficit and the debt ratio.

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THE IMPACT OF A STRONGER RAND

A sustained stronger rand would enable the Reserve Bank to maintain the inflation rate at or below the 4.5% effective target, which would feed back into lower interest rate and inflation volatility. Lower macroeconomic volatility enables a more stable business environment. A key requirement would be the addition of political and socio-economic stability, where the latter would benefit from low and stable inflation.

From a cyclical perspective, sharp disinflationary pressures in the short-term should give way to rising inflation (albeit still aligned with the 3% - 6% inflation target) in the medium term. This will be driven by improving domestic demand, a potential recovery in the housing market, and higher global commodity prices. The pick-up in inflation will not be enough to completely derail expectations for the South African Reserve Bank to lower interest rates.

An environment of a stronger rand and lower inflation bodes well for consumption and credit extension, which could be the kicker need to ignite a more durable expansion. Stricter financial sector regulations make credit imbalances less likely. Moreover, consumer balance sheets are not as stretched as they were in the late-2000s or the mid-2010s. The flip side to a stronger rand is less competitive exports, but improvements on the network side would over time lower input costs to alleviate some of the loss of competitiveness.

On a net basis, these dynamics will be positive for GDP growth and living standards.

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