momentum investments

in the moment

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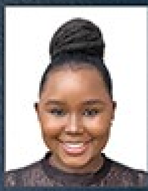


Business pulse: Narrow retreat in confidence to 31 points driven by new vehicle dealers

Highlights

- Business sentiment, measured by the First National Bank (FNB)/Bureau for Economic Research (BER) business confidence index (BCI) dropped by two points from 33 to 31 points in the fourth quarter of 2023.
- New vehicle dealers expressed the most pessimism as evidenced by the 24-point drop in the index to six points. This decline outweighed the optimism expressed by retailers (15-point increase) and manufacturers (three-point increase). Retailers and manufacturers are likely encouraged by the upcoming festive season and fewer power cuts.
- Despite improvement in manufacturers' confidence levels, the index remains depressed at 26 points. Statistics South Africa (Stats SA) reported a contraction of 1.2% quarter on quarter (q/q) in seasonally adjusted (sa) manufacturing output, which means the sector likely detracted from economic growth in the third quarter.
- Mining production (negative 1.6% q/q, sa), wholesale trade sales (negative 0.6% q/q, sa) and the contraction in building plans completed are all expected to weigh on economic growth in the third quarter.
- Seasonally-adjusted retail trade sales grew by 0.8% q/q in the third quarter of 2023 and will provide some support to third quarter economic growth, but we do not expect this to make a meaningful impact.
- Retail trade sales in the fourth quarter are typically boosted by the festive season rush but the inefficiencies of the logistics network which has resulted in congestion at the Durban port threaten retail activity. Nevertheless, we anticipate retail trade sales in the coming quarters to be supported by the extension of the social relief of distress grant (SRD), higher employment, an improvement in real wages, a pause in interest rates with interest rate cuts possibly commencing in the second quarter of 2024, and the introduction of the two-pot system.
- Stats SA conducted the annual reweighting exercise on manufacturing production and mining production with results implemented in the September 2023 publications. Platinum Group Metals (PGM) overtook coal as the largest item in the mining basket and the weight of gold in the mining basket continued to decline.
- Logistics is also a major impediment in the mining industry. Government is in the process of legislating the Freight Logistics Roadmap which aims to stabilise and ultimately reform Transnet. We believe funding, appointing capable management and private sector participation will be key for the success of the roadmap.
- Persistently low business confidence, weighed down by loadshedding (albeit less intense lately); difficulties in the logistics space; financially strained consumers; elevated interest rates and uncertainty around the upcoming 2024 elections should cap the extent of the recovery in economic growth next year. The dip in the fourth quarter BCI

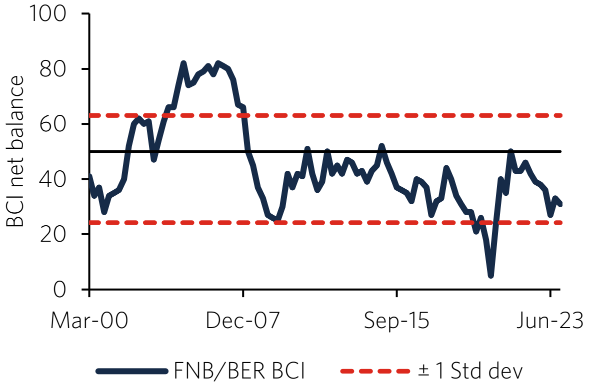
supports our view of weak economic growth in the remaining two quarters of 2023 and an annual average growth rate of 0.7% for 2023.

- Investment in the energy sector has boosted fixed investment growth which we forecast at 6.4% in 2023 before tapering off to 6% in 2024 and 5.5% in 2025. An accelerated intervention in the logistics network by the private sector would boost business sentiment and provide a potential upside surprise to our growth forecasts.

New vehicle dealers drive down business confidence in the fourth quarter of 2023

Following the six-point improvement to 33 points in the third quarter of 2023, the FNB/BER BCI unexpectedly dropped slightly to 31 points in the fourth quarter of 2023 (further below the 50-point neutral mark as seen in chart 1). An improvement was expected based on less intense loadshedding, a pause in the repo rate and the upcoming festive season but lower sentiment emphasises the multitude of hurdles faced by the business community. According to the BER, respondents cited logistic challenges, crime, corruption and delayed payments (which impact the production process) as reasons for the lower confidence levels in the fourth quarter.

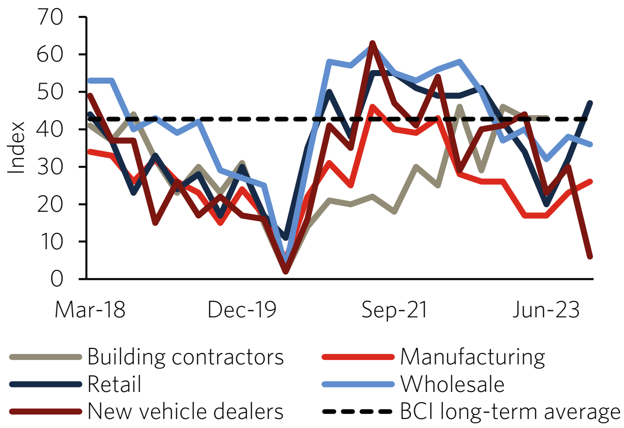
Chart 1: BCI disappointingly drops to 31 points



Source: BER, Momentum Investments
Data until the fourth quarter of 2023

The main driver of lower business confidence was the new vehicle dealers subindex, where confidence fell by 24 points to six points (the lowest level since the second quarter of 2020 when economic activity came to a virtual standstill) as seen in chart 2. The BER attributed this to weak local demand due to lower consumer disposable incomes and a higher interest rate environment.

Chart 2: New vehicle dealer confidence plunges



Source: BER, Momentum Investments
Data until the fourth quarter of 2023

The drop in business confidence among new vehicle dealers outpaced the improvement in sentiment expressed by retailers (up 15 points to 47) and manufacturers (up three points to 26). The BER cautions that underlying retail trade results show a decline in sales volumes especially from non-durable goods retailers and notes that volume growth may be depressed due to price increases of some non-durable goods (likely referring to fuel and egg prices).

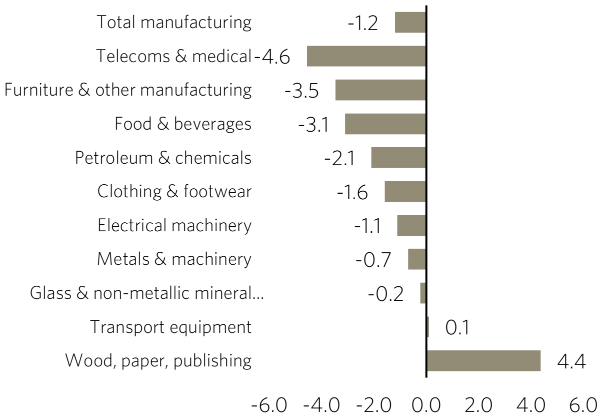
The BCI of building contractors remained unchanged at 41 points in the fourth quarter and declined by two points to 36 for wholesalers due to lower sales volumes.

Slight optimism expressed by manufacturers, but the operating environment remains challenging

According to Stats SA, seasonally-adjusted manufacturing output contracted by 1.2% q/q in the third quarter of 2023. The largest negative contributions were from food and beverages (negative

3.1%, contributing negative 0.7 percentage points) followed by petroleum and chemicals (negative 2.1%, contributing negative 0.4 percentage points) but the contraction was broad-based with eight of the 10 manufacturing divisions recording a decline in output as seen in chart 3. Lower manufacturing output points to the sector possibly detracting from economic growth in the third quarter.

Chart 3: Broad-based decline in manufacturing output in 2023 Q3 (% q/q)

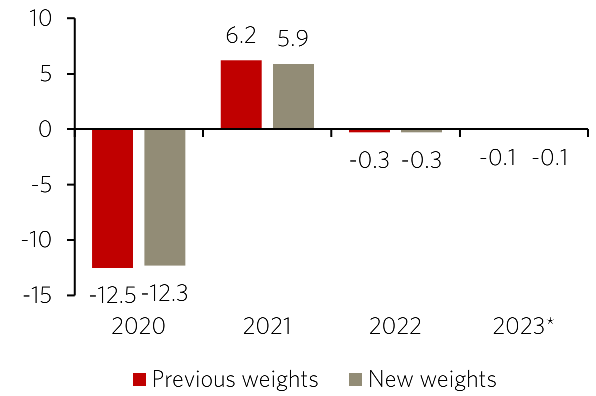


Source: Global Insight, Stats SA, Momentum Investments

On a year-on-year (y/y) basis, total manufacturing output recorded 0% growth in the third quarter of 2023 relative to the third quarter of 2022 and contracted by 0.1% year-to-date (January to September).

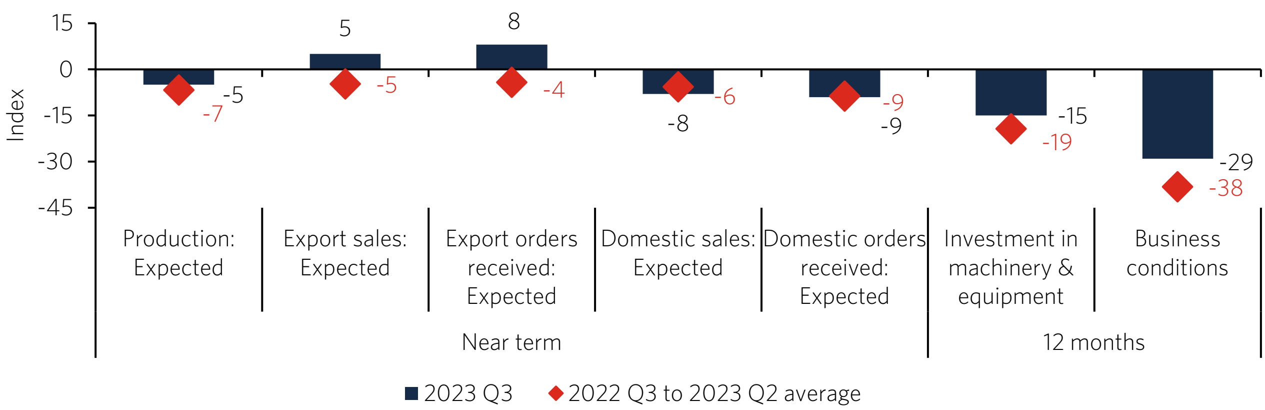
In the September manufacturing production and sales publication, Stats SA brings attention to the reweighting of manufacturing production (an annual exercise) and notes that the new weights were adopted in the September release. These new weights have been calculated based on the average of national accounts value added data for 2018 to 2020 (previously 2017 to 2019) and affects data from 2020 onwards. This exercise did not result in big changes to the weights which, according to Stats SA, is the historical norm partly because the use of a moving average provides stability in the weights. Only two divisions have a higher weight namely, food and beverages (21.44% from 20.75%) as well as metals and machinery (19.96% from 19.73%). The remaining eight divisions have a smaller weighting than before. On a net balance, the growth in total manufacturing output (year-to-date) was unchanged at negative 0.1% y/y as seen in chart 4.

Chart 4: Annual growth rates (%) for manufacturing production based on previous and new weights



Source: Stats SA, Momentum Investments
** Year-to-date (January to September)*

Chart 5: Manufacturers less optimistic in the third quarter of 2023 compared to the previous four quarter average



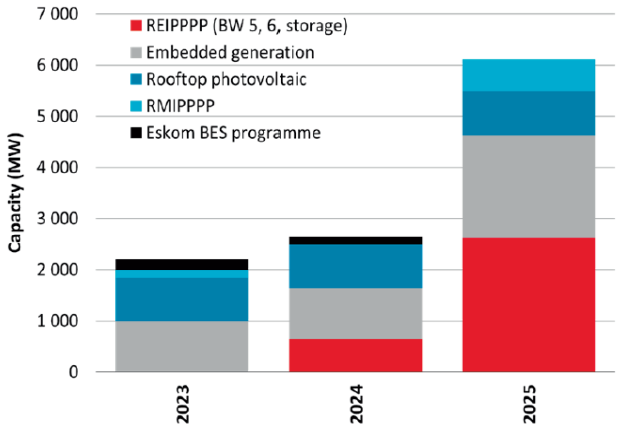
Source: BER, Momentum Investments

The third quarter contraction in manufacturing activity was in line with the depressed, albeit improved, sentiment expressed by manufacturers in the third quarter (23 points from 17). Further insights drawn from the third quarter manufacturing survey indicate a higher expectation of production as well as export sales and export orders received in the near term as seen in chart 5. This may be partly driven by the upcoming festive season and less intense loadshedding. However, expected domestic demand (sales and orders) was lower than the previous four-quarter average reflecting constrained consumers.

On a 12-month view, manufacturers appeared more optimistic with a better score for investments and business conditions but both indices are still negative which means the operating environment is still expected to be challenging. ABSA highlights that investment intentions improved more for replacements than additions implying that manufacturers are focusing more on remaining operations and less on expanding capacity given uncertainty in the operating environment.

Interpreting the third quarter detailed manufacturing survey results in conjunction with the 12.2-point drop in the ABSA PMI subindex measuring expected business conditions in the next six months suggests potentially better activity in the manufacturing sector as the festive season approaches followed by weaker activity as uncertainty builds toward the 2024 elections. Thereafter, the operating environment may improve by the end of 2024 on the back of potentially more stable electricity supply as more renewable energy comes online (see chart 6) and as repairs to Eskom's fleet are completed.

Chart 6: Strong renewable energy pipeline

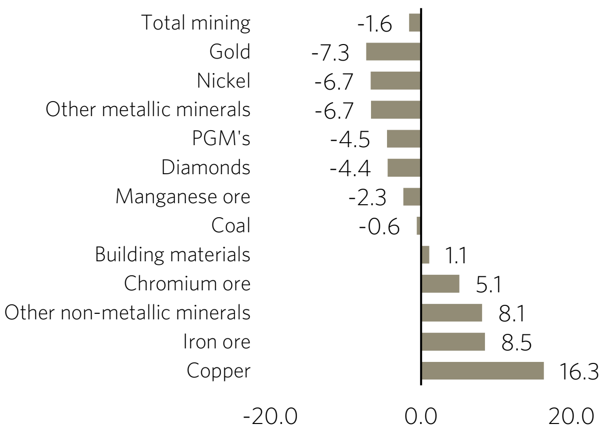


Source: National Treasury
REIPPP: Renewable Energy Independent Power Producer Procurement Programme, RMIPPPP: Risk Mitigation Independent Power Producer Procurement Programme, BES: battery energy storage

PGMs overtake coal as the biggest mineral group in the mining basket

Similar to manufacturing, seasonally-adjusted mining output contracted in the third quarter of 2023 and likely detracted from third quarter economic growth.

Chart 7: Mining output in 2023 Q3 (% q/q)

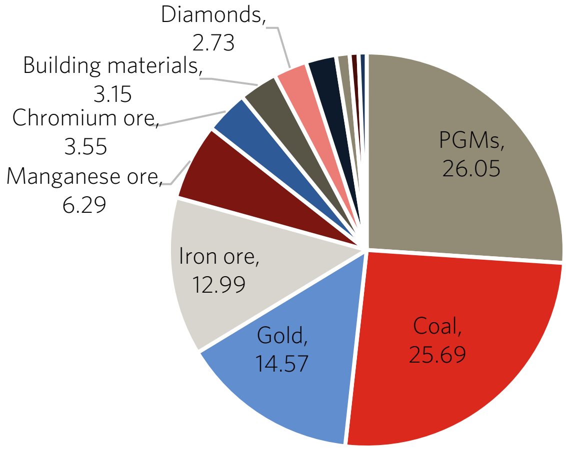


Source: Global Insights, Stats SA, Momentum Investments

Mining output fell by 1.6% q/q and the largest negative contributions stemmed from PGMs (negative 4.5%, contributing negative 1.2 percentage points) and gold (negative 7.3%, contributing negative 1.1 percentage points).

The reweighting exercise conducted for manufacturing production was conducted for mining production. The weight of PGMs in the mining basket lifted to 26.05% from 22.96% in 2019 which made PGMs the biggest item in the mining basket (see chart 8), overtaking coal. Iron ore, manganese ore, and other metallic minerals also resulted in a higher weight and gold continued to decline from 20.1% in 2017 to 14.57%.

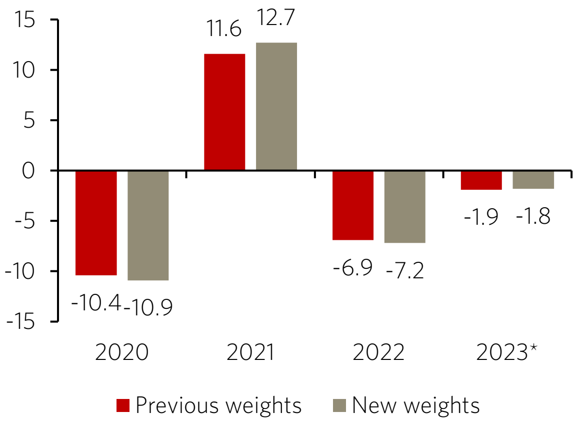
Chart 8: New weights in the mining basket (%)



Source, Stats SA, Momentum Investments
Last four positions are other metallic minerals (2.48%), nickel (1.11%), other non-metallic minerals (0.73%) and copper (0.66%)

When incorporating the new weights, growth in total mining output (year-to-date) was slightly better at negative 1.8% y/y from negative 1.9% y/y as seen in chart 9.

Chart 9: Annual growth rates (%) for mining production based on previous and new weights

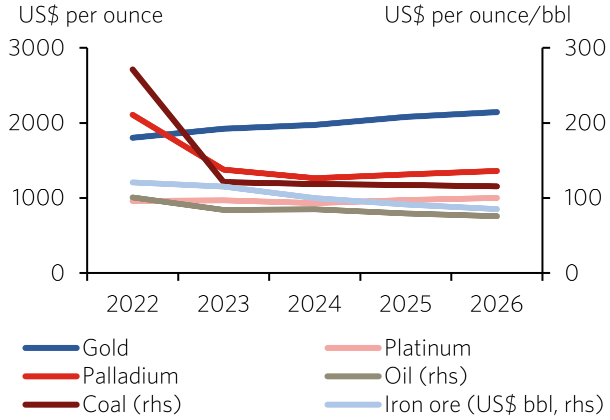


Source: Stats SA, Momentum Investments
** Year-to-date September*

In the October 2023 Medium-Term Budget Policy Statement, National Treasury indicated that lower mining production relative to last year is due to severe power outages and poor rail operations, which reduced the country's export capacity. Government plans to address logistics constraints through the legislation of the Freight Logistics Roadmap which aims to stabilise Transnet in the short term (six to 12 months) and reform the logistics system in the long term. The passing and successful implementation of the roadmap has the potential to improve performance in the mining sector and other industries affected by the underperformance of Transnet. The success of the roadmap depends on a variety of factors including funding, the appointment of capable persons in the vacant key management positions, and the maintenance and willingness for more private sector participation. Treasury raised concerns over additional potential risks in the mining sector as weaker demand from China, community unrest, illegal mining and violent crime.

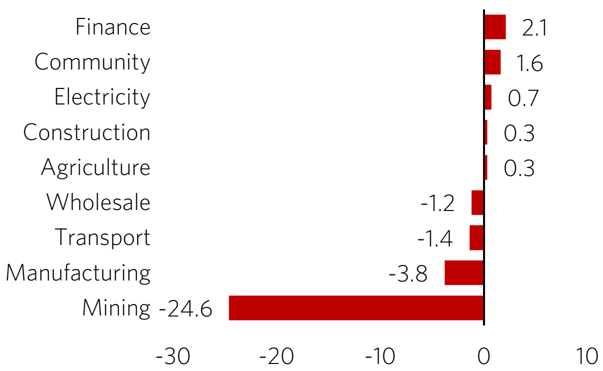
Commodity prices (see chart 10) are projected to remain relatively muted over the medium-term and will consequently weigh on the mining sector and government revenue collection (see chart 11)

Chart 10: Unexciting commodity price trajectory



Source: National Treasury, Momentum Investments

Chart 11: Mining provisional tax down R26 billion*

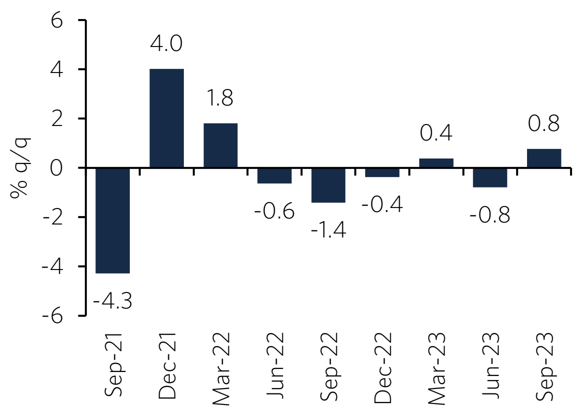


Source: National Treasury, Momentum Investments
** Provisional corporate income tax in the first six months of 2023/24 relative to the same period in 2022/23*

Logistics inefficiencies threaten retail activity

On a more positive note, seasonally-adjusted retail trade sales increased by 0.8% q/q in the third quarter of 2023., essentially reversing the contraction of 0.8% q/q recorded in the second quarter as seen in chart 12. This means that the volume of retail trade sales in the third quarter of 2023 was around the same level recorded in the third quarter of 2022. Nevertheless, retail trade activity will contribute positively toward the trade, catering and accommodation component of gross domestic product (GDP) in the third quarter of 2023.

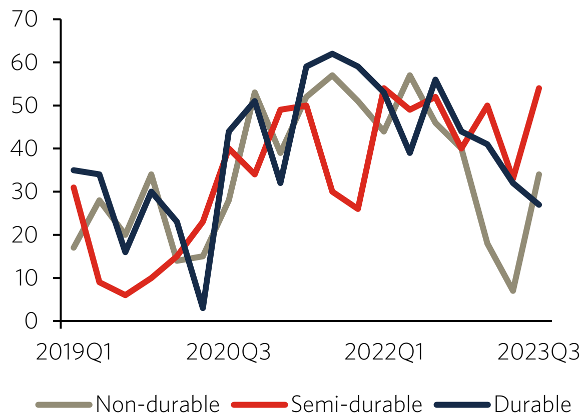
Chart 12: Retail trade sales gains in 2023 Q3 offset Q2 contraction



Source: Global Insights, Stats SA, Momentum Investments

The main driver of retail trade sales in the third quarter was textiles, clothing, footwear and leather goods (5.2%, contributing 1 percentage point). This coincides with improved confidence among semi-durable goods retailers from 33 points in the second quarter BER retail survey results to 54 in the third quarter (see chart 13). Sentiment expressed by non-durable goods retailers also improved from a historical low of 7 to 34 over the same period (thanks to moderating food and fuel inflation in the period under review). According to the BER, we are likely to see a further improvement in sentiment from semi-durable goods retailers in the fourth quarter on the back of demand for 2023 Rugby World Cup-associated apparel.

Chart 13: Durable goods retailers more pessimistic



Source: Global Insights, BER, Momentum Investments

Wholesale trade sales contracted by 0.6% q/q in the third quarter, the second consecutive quarter-on-quarter contraction. Dealers in machinery, equipment and supplies recorded the highest growth of 22.5% q/q (contributing 2.7 percentage points) but this was outweighed by a decrease in sales from dealers in solid, liquid and gaseous fuels and related products (negative 8.1%, contributing negative 2.4 percentage point) in conjunction with lower sales from other types of deals.

We anticipate retail trade sales in the coming quarters to be supported by the approaching festive season, the Black Friday sales, the extension of the SRD grant by an additional year, higher employment, a gradual recovery in real wages, and a pause in interest rates with the possibility of rate cuts from the second quarter of 2024. According to the BER, the introduction of the two-pot system (a system that allows contributors to withdraw up to a third of their retirement fund) is expected to boost retail trade sales, particularly non-durable goods when it comes into effect.

The inefficiencies of the logistics network threaten retail activity, especially in the upcoming holiday season (which is traditionally the busiest time in the retail sector). According to *Moneyweb*, importers are concerned that the backlog at the Durban port could result in them not having their products in time for the holiday rush. The average length of offloading cargo has reportedly increased by three to four times and

Transnet estimates that it will take seven to 15 weeks to clear the 63 vessels at the port. Due to these delays, some importers and exporters are opting for more costly forms of transport (air and road) which may either result in lower profit margins or higher retail prices.

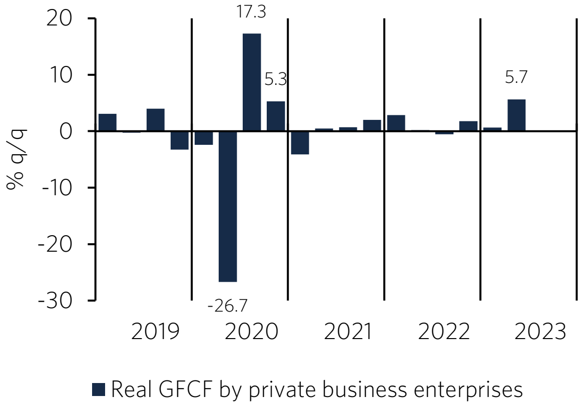
Weak sentiment in the construction industry despite the improvement in the third quarter

As reported by Stats SA, the real value of building plans passed contracted by 28.5% q/q, sa in the third quarter of 2023. The decrease was recorded across all three building types namely, non-residential buildings (negative 60.4% q/q), additions and alterations (negative 19.9% q/q) and residential buildings (negative 13.3% q/q).

The value of buildings completed contracted by 5.7% q/q, sa. Additions and alterations declined by 12.3% q/q, residential buildings declined by 9.1% q/q and non-residential buildings completed increased by 12.3% q/q. The lower number of building plans passed and completed followed positive growth of 18.4% q/q and 9.6% q/q, respectively, in the second quarter.

According to the SA Reserve Bank (SARB), seasonally-adjusted real gross fixed capital formation (GFCF) by private business enterprises grew by 5.7% in the second quarter of 2023 from 0.7% in the first quarter. As seen in chart 14, growth in private sector GFCF has been weak over the past quarters. Solid growth was previously recorded in the second half of 2020. The acceleration in GFCF could be ascribed to an increase in capital outlays on construction works, non-residential buildings, as well as machinery and equipment.

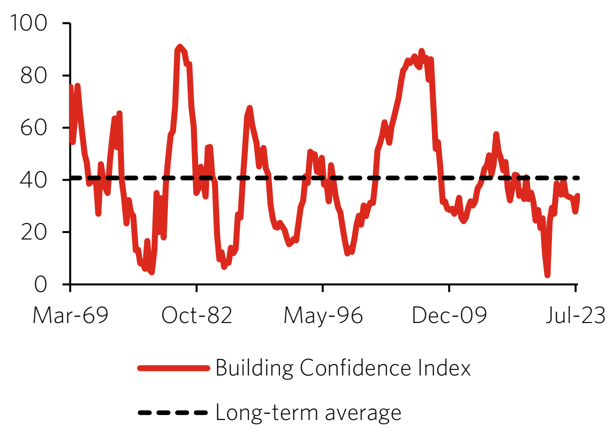
Chart 14: Turnaround in private sector GFCF growth



Source: SARB, Momentum Investments

In terms of industry sentiment, participants in the construction sector were less pessimistic in the third quarter as indicated by the FNB/BER building confidence index increasing to 34 from 28 in the second quarter of 2023 (see chart 15). The pause in the repo rate in July likely contributed positively to improved sentiment (the third quarter survey was conducted between 16 and 31 August 2023). Nevertheless, the majority of the respondents (66% in the third quarter) viewed prevailing operating conditions as unfavourable.

Chart 15: Building confidence index below long-term average



Source: Global Insights, BER, Momentum Investments

Respondents that pushed up the building confidence index in the third quarter were quantity surveyors (up 13 points to 39), building materials manufacturers (up 13 points to 26), architects (up 7 points to 30) and sub-contractors (up 7 points to 47). Contractors and hardware retailers expressed a two-point confidence decline to 41 and 20, respectively. Hardware retailers exhibit the lowest confidence level among the respondents. This is reflective of lower renovations from the pandemic period and financially strained consumers.

The construction sector continues to be hampered by the work-from-home environment which is keeping office rates elevated and the high interest rate environment is also suppressing demand.

Upcoming expected interest rate cuts from the second quarter of 2024 and the continued moderation in inflation will likely boost sentiment, affordability and demand.

Ailing state-owned entities are stifling confidence and economic activity

The BCI of 31 points in the fourth quarter of 2023 indicates that more than two-thirds of respondents view the general business environment as unsatisfactory. This is due to a number of factors including loadshedding (albeit less intense lately), difficulties in the logistics space, financially strained consumers and elevated interest rates. Furthermore, the upcoming 2024 elections increase uncertainty. Depressed business sentiment does not bode well for economic growth. We expect weak economic growth in the remaining two quarters of 2023 and an annual average growth of 0.7% for 2023.

Further improvement in the intensity and duration of power outages (i.e. less loadshedding), the likelihood of lower inflation and interest rates in 2024 and a continuation of the urgency in driving the reform agenda are necessary to lift business confidence and economic growth in 2024. We maintain our view of growth improving to 1% in 2024 and 1.7% in 2025.

We forecast fixed investment growth of 6.4% in 2023 due to energy-related investments but this is expected to taper off to 6% in 2024 and 5.5% in 2025. An accelerated intervention in the logistics network by the private sector would boost business sentiment and provide a potential upside surprise to our growth forecasts.

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