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Economic outlook: A retrospective look on 2023 and forward glimpses into 2024

Highlights: A retrospective look on 2023 – The 10 biggest surprises in the year that was

Surprise #1: China's disappointing reopening	A substandard performance in key growth indicators dashed expectations for a strong resurgence from the pandemic-related lockdown. Markets were additionally disappointed in Chinese authorities' early muted fiscal and monetary responses in their efforts to prioritise sustainable and higher-quality economic growth.
Surprise #2: The projected 2023 recession never materialised	Recession was a buzzword among investors leading up to 2023, with views differing on the potential depth and duration of the anticipated slump. Optimism has nevertheless grown as resilience in global economic activity has coincided with diminishing inflationary pressures and strong labour markets.
Surprise #3: Energy shortages in Europe overplayed	Confronted by the prospect of much less Russian gas in the wake of the war in Ukraine, there were fears that Europe's energy infrastructure would struggle in winter. Yet the combination of a milder winter, lower energy consumption and a diversification of energy sources contributed to the region weathering the challenge.
Surprise #4: High(er) for longer	Markets steadily repriced for the prospect of high(er)-for-longer interest rates in response to better-than-expected economic data. Going forward we are likely to see this influencing the broader economy as individuals and companies may curtail spending in response to high borrowing costs.
Surprise #5: Failure of overextended regional banks	In March 2023, the financial landscape witnessed the collapse of a number of midsized banks that were susceptible to a rapid rate hiking cycle by the United States (US) Federal Reserve (Fed) after an extended period of near-zero rates. Nonetheless, the crisis is unlikely to extend to larger banks that hold more capital.
Surprise #6: Trump a solid front-runner in the Republican primary race	Civil litigation and legal actions have, to the contrary, bolstered former US President Donald Trump's position in the primaries. Recent polling data indicates a substantial lead for him over the incumbent president, Joe Biden, particularly in pivotal swing states.
Surprise #7: Israel-Hamas war exposes inherent Middle East	Hamas' unexpected attack against Israel on 7 October 2023 triggered a retaliation from Israel, resulting in a humanitarian crisis in Gaza and heightening the potential for a broader regional conflict.
Surprise #8: Buoyant stock markets	The US stock market experienced an unexpectedly firm upswing in the first half of 2023, propelled by the technology sector. Nevertheless, corporate pricing power could still yet erode as delayed repercussions of tighter policies may eventually exert pressure on consumers and businesses.

Surprise #9: Historic gold purchases by central banks	Central banks have accelerated their net purchases of gold to record levels in the current uncertain geopolitical landscape. Aside from safe-haven and inflation-hedging characteristics, gold affords central banks an opportunity to diversify their foreign exchange reserves, particularly in light of sanctions.
Surprise #10: Loadshedding tamed over winter in South Africa	Despite the worst-ever electricity shortages in 2023, winter electricity shortfalls were less severe than anticipated, attributable to the expedited installation of solar power, a reduction in breakdowns at power stations, a less restricted supply of diesel and the return to operation of some of Eskom's units.

Highlights: Forward glimpses into 2024 – Tracking 10 trends on our macro radar

Trend #1: Economic gravity to play catch-up	The underpinnings of more resilient-than-expected economic growth in 2023 seem precarious. Interest rates are likely to start biting and economic hardship could follow should interest rates remain high for longer. In the US and Europe, corporate bankruptcies have already started to rise, albeit from low levels.
Trend #2: Divergent growth prospects	The pandemic, war in Ukraine and climate crises have all played a role in reversing trends in poverty reduction, particularly in lower-income economies, where reduced fiscal space and increased debt vulnerabilities will add to a slower convergence toward the living standards of higher-income nations.
Trend #3: Inflation descent to slow	The next leg down in inflation could take longer given that food and energy base effects are no longer working in favour of reducing inflation sharply, a recovery in real wages may drive an uptick in demand and political pressure is rising to ease policy in response to rate hikes starting to have an effect on the economy.
Trend #4: Monetary and fiscal interaction	Fiscal responsibility through a more credible and better-targeted fiscal framework can play a role in lowering inflation, while reducing debt, by tempering aggregate demand. This prevents central banks from having to raise interest rates by as much and creates a fiscal buffer that can be used in the event of the next shock.
Trend #5: Darker geopolitical climate	Geopolitical tensions present additional downside risks to the global economy, which is already under strain. Political tensions are expected to remain heightened globally, with a report from *The Economist* indicating that more than half of the world's population will experience an election in 2024.
Trend #6: South Africa's (SA) coalition future	Decreasing voter turnout and substantial advances for fringe parties at both ends of the political spectrum can be interpreted as indications of SA's evolving democracy, yet they may also signal a more divided society. The ruling party has persevered with a diminished majority, but it faces declining popularity.
Trend #7: SA's logistical challenges to outlive loadshedding's shadow	Eskom's generation turnaround plan and the private sector's appetite for renewables points to 2023 as the worst year of the energy crisis. Nevertheless, SA's logistics crisis is worsening. National Treasury estimates that rail inefficiencies have cost SA around 6.5% of GDP in 2022 and an expected 5.5% of GDP for 2023.
Trend #8: SA's debt challenges endure	The key context for understanding SA's precarious public finances position lies in the significant rise of SA's government debt in relation to the economy since 2008, over which period real per capita growth has stagnated. Consequently, SA's interest burden has soared, crowding out more useful forms of expenditure.
Trend #9: A respite from inflationary pressures	Although we see renewed inflation risks stemming from geopolitically-driven food and energy prices, passthrough from currency weakness and administered prices, demand-pull price pressures and wage inflation are expected to remain contained, limiting second-round or persistent inflation pressures.
Trend #10: Rate pause, rhetoric roars	Even with no more interest rate hikes forecasted in the current cycle, the SA Reserve Bank (SARB) is likely to maintain its hawkish rhetoric to keep inflation expectations at bay. Guiding inflation back towards the midpoint of the target on a more sustainable basis can help to reduce the economic costs of high inflation.

A retrospective look on 2023: The 10 biggest macro surprises in the year that was

2023: The year that was

As the dust continued to settle in the aftermath of the Covid-19 pandemic, a seismic shift in interest rates together with a further easing of conditions in global supply chains have done well to improve global inflation pressures, which have more than halved since their peak. While the slowdown in world growth in 2023 is likely to be less severe than initially anticipated, the war in Ukraine grinds on in its second year and heightened geopolitical uncertainties have created obstacles for higher and more sustainable growth outcomes.

The confluence of pandemic-induced economic turbulence combined with soaring food and fuel prices, stemming from the war in Ukraine, have precipitated a spate of debt crises in more vulnerable economies. A rapid escalation in interest rates has compounded those crises, accentuating the socioeconomic divide between affluent and impoverished segments of society, worldwide. The looming spectre of a cataclysmic climate crisis, simmering societal discontent and the expanding chasm of inequality have upended assumptions about a world economic framework dominated by traditional great power politics. Supply chain chokeholds stemming from the pandemic have starkly underscored the vulnerability of an economy reliant on global sourcing, emphasising the politics of economic dependencies and challenging economic foreign policy orthodoxies.

A necessary policy adjustment continued over the course of 2023 to keep inflation under control, but the global economy surprised investors with its resilience. Casting an eye back over the year that was, we highlight the ten main surprises that financial markets were not fully anticipating for 2023:

The biggest macro surprises of 2023:

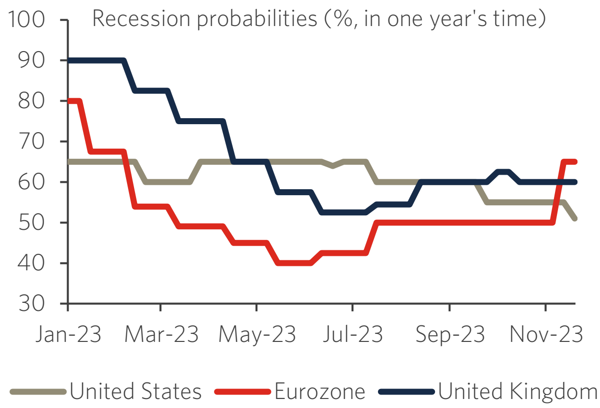
Surprise #1: China's disappointing reopening

A substandard performance in industrial production, exports and retail sales, coupled with anaemic readings on inflation saw expectations on Chinese growth sliding relative to the resurgence expected by markets. Investors were in addition disappointed by the earlier fiscal and monetary responses of China's authorities to a tenuous rebound as the economy emerged from strict zero-Covid lockdown measures. Authorities ramped up targeted policy efforts towards the end of the year given that they have recognised the limitations of relying solely on credit expansion to pump up the economy as it did fifteen years ago. Instead, they are now prioritising sustainable and higher-quality economic growth.

Surprise #2: The projected 2023 recession never materialised

Whether deep or shallow, long or short, the idea the economy was headed for a recession was pretty much a common view among investors as we headed into 2023. Optimism about the state of the global economy, the US in particular, nevertheless grew as resilience in economic activity coincided with diminishing inflationary pressures and buoyant labour markets, despite signs of softening in the latter (see chart 1). Although some extreme risks have moderated since the first quarter of the year, the balance of risks remains tilted to the downside, in our view, particularly in economies like the Eurozone, where fragilities remain.

Chart 1: Recession probabilities ending 2023 lower



Source: Bloomberg, Momentum Investments

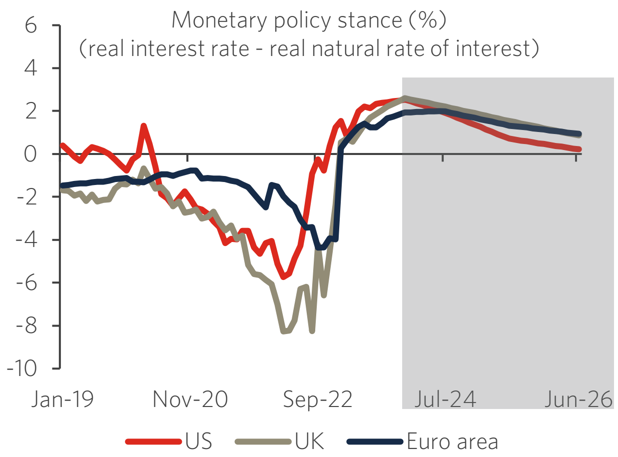
Surprise #3: Energy shortages in Europe overplayed

Confronted by the prospect of much less Russian gas in the wake of the Russian incursion into Ukraine, there were fears that Europe's energy infrastructure would struggle to endure the winter. Yet the combination of a milder winter and the European Union's phased implementation of a strategy to curtail energy consumption and diversify sources contributed to the region weathering the challenge. During the course of 2023, we saw Germany, Italy and other gas-reliant nations pivoting from Russian dependency without any major electricity shortages. Moreover, Europe's gas storage levels have promisingly climbed to 96%. Nonetheless, Europe's increasing dependence on liquified natural gas remains vulnerable to volatile global gas markets.

Surprise #4: High(er) for longer

During the year, markets steadily repriced for the prospect of high(er)-for-longer interest rates in response to stronger-than-forecasted economic data in the US given that the Fed needs a cooler economy to quell inflation pressures (see chart 2).

Chart 2: Monetary policy to remain tight despite slowing growth



Source: International Monetary Fund (IMF), Momentum Investments

Together with stronger-than-expected economic data, the US government's worsening fiscal position (noted by Fitch and Moody's rating agencies, which lowered the country's sovereign bond rating by one notch each in 2023) has led to a sharp sell-off in US government bonds.

Earlier in 2023, the yield on 10-year government bonds briefly reached 4.9%, a level not witnessed since 2007. The significance of bond yields lies in their pivotal role in shaping interest rates for credit cards, car loans and home mortgages, thereby influencing the broader economy. Elevated yields also have repercussions for businesses through amplifying their cost of debt. The resultant increase in borrowing costs poses a potential threat to the economy, as both individuals and companies may curtail spending in response to higher interest rates.

Furthermore, the exposure of many banks to government bonds renders them vulnerable to rising yields. However, despite these concerns, the likelihood of a financial sector disruption resembling the events of 2007/2008 is deemed relatively low, given their healthy capital positions.

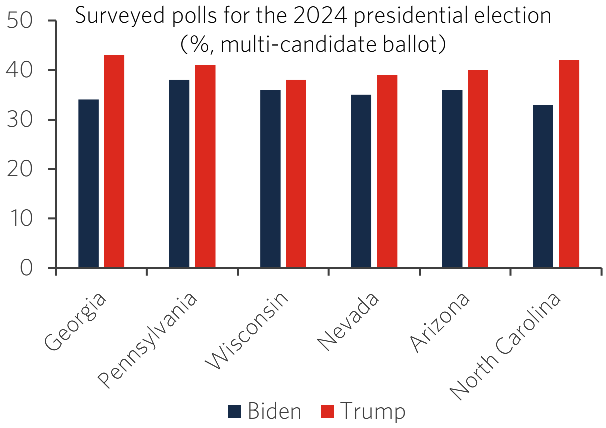
Surprise #5: Failure of overextended regional banks

In March, the financial landscape witnessed the downturn of Silvergate Capital, Silicon Valley Bank (SVB), Signature Bank of New York and later on, First Republic Bank. Silvergate and Signature bore the brunt of their ties to the volatile cryptocurrency market, which experienced both rapid growth and subsequent decline. Meanwhile, SVB and First Republic encountered setbacks due to investments that proved susceptible to a risk for which the banks had insufficiently prepared — rapid interest rate hikes implemented by the US Fed after an extended period of near-zero rates. While high interest rates needed to lower inflation may also produce stresses in the financial system that will require prompt policy responses to stabilise financial conditions, the crisis is unlikely to extend to larger, more capitalised banks given their enhanced ability to withstand a prolonged downturn this time around against a stricter regulatory backdrop following the fallout from the global financial crisis (GFC).

Surprise #6: Trump remains a solid front-runner in the Republican primary race

Civil litigation and legal actions, far from weakening former US President Donald Trump's standing, have seemingly bolstered his position in the primaries. Recent polling data indicates a substantial lead for him over the incumbent president, Joe Biden, particularly in pivotal swing states crucial for determining the election outcome (see chart 3). To secure victory, Biden is reliant on the active participation of young voters, progressives and Arab-Americans. However, a significant number within these demographics harbor discontent towards his administration's stance on Israel. If progressives abstain from voting or opt for fringe candidates, this could further shift election dynamics to favour Trump.

Chart 3: Trump leading Biden in swing states



Source: FiveThirtyEight – 21 November 2023, Momentum Investments

Surprise #7: Israel-Hamas war exposes inherent instability in the Middle East

Hamas' unexpected attack against Israel on 7 October 2023 triggered a military retaliation from Israel, resulting in a humanitarian crisis in Gaza and heightening the potential for a broader regional conflict. The influence of the US in the Middle East remains significant. However, its support for Israel's military actions has compromised its credibility in the region and eroded its global standing, particularly in the Global South.

The escalating mistrust of the US in the Middle East, coupled with its inability to guide the region toward stability, has compounded the absence of a shared vision. Consequently, individual states are instead prioritising short-term interests, perpetuating the regional crisis and escalating the risk of unintended conflict. Addressing this challenge necessitates a new US strategy for the Middle East, especially if the goal is to establish peace and strategically balance power against China by fostering a Middle Eastern economic corridor.

Surprise #8: Buoyant stock markets

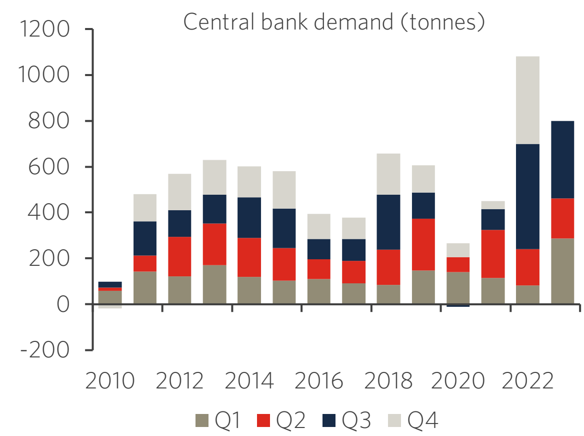
Despite earlier predictions, equity markets have shown resilience. The US stock market experienced an unexpectedly firm upswing in the first half of 2023, in particular, propelled by the technology sector. Despite facing substantial challenges stemming from increased interest rates and weakened earnings in 2023, technology companies initially defied expectations, staging a robust comeback.

The brief upheaval caused by the collapse of several banks earlier in the year proved transitory, with prompt interventions from policymakers and regulators averting broader contagion. Corporations showcased adeptness in passing on heightened costs to consumers, thereby shoring up their earnings. Nonetheless, pricing power could still yet erode as the delayed repercussions of tighter policies may eventually exert pressure on consumers and businesses, necessitating a potential reset in consumption, profit margins and corporate pricing dynamics.

Surprise #9: Historic gold purchases by central banks

Against the backdrop of the prevailing uncertain macroeconomic and geopolitical landscape, central banks, led by the People's Bank of China, have accelerated their net purchases of gold to record levels throughout the initial three quarters of 2023 (see chart 4).

Chart 4: Rising central bank enthusiasm for gold



Source: World Gold Council, Momentum Investments

A sharp increase in net gold purchases can be attributed not only to its traditional appeal as a safe-haven asset during risk-off phases and its role in hedging against inflation but also to a strategic effort by central banks to diversify their foreign exchange reserves, particularly in light of the US's decision to freeze Russian foreign exchange reserves in the aftermath of the conflict in Ukraine.

Prominent among the central banks engaging in this gold-buying spree are those from nations aspiring to challenge the dominance of the US dollar or manoeuvre around Western currency sanctions. Notably, China, Russia and India stand out as key players in this trend, underscoring a broader geopolitical and economic global realignment.

Surprise #10: Load shedding tamed over winter in SA

Throughout most of 2023, SA grappled with prolonged and detrimental electricity shortages, marking the most challenging year to date in this regard. Eskom's generating plant availability plummeted to unprecedented lows, driven by unparalleled levels of unplanned unavailability.

However, in recent months, the performance of SA's power generation sector has surpassed expectations. Contrary to initial concerns, winter electricity shortfalls for 2023 were less severe than anticipated, attributable to the expedited installation of solar power, reduced instances of breakdowns at power stations, a more unrestricted supply of diesel and the return to operation of some units within Eskom's fleet. While the ageing and strained coal plant fleet remains vulnerable to unplanned breakdowns, an impressive pipeline of private sector renewable energy projects indicates that the worst of load shedding should largely be behind us.

Forward glimpses into 2024: Tracking 10 trends on our macro radar

From a higher level of global economic resilience and buoyant stock markets to negative geopolitical shifts, the canvas of 2023 has been painted with strokes of unpredictability.

While investors generally agree the world will avoid falling into a deep and protracted recession in 2024, the global economy is set to slow substantially due to the lagged effects of previously sharp monetary policy tightening, limited fiscal space and still above-target inflation. Moreover, unexpected geopolitical events will remain wild cards that could shape the political, economic and financial landscape in 2024.

Here are ten trends we are closely monitoring on our macro radar for 2024:

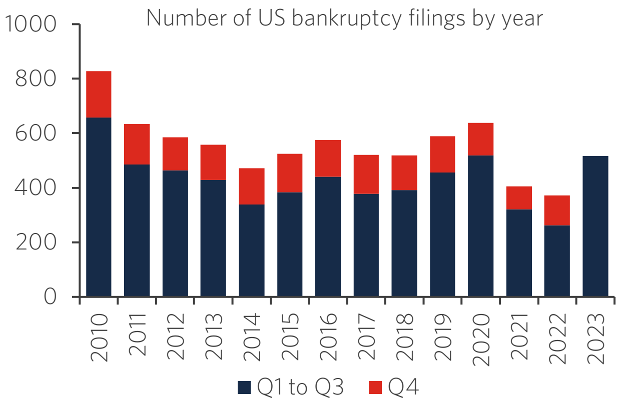
Trend #1: Economic gravity to play catch-up

Amid the Russia-Ukraine and Israel-Palestine wars, the global economy remains resilient. Just a year ago, the consensus viewed an inevitable recession would arise given the sharp increase in interest rates to arrest soaring inflation. Yet, even the most optimistic investors have been surprised to the upside. Across the globe, inflation is receding, unemployment rates have largely remained stable and major central banks may have paused their monetary tightening measures. Despite China grappling with a property crisis, indications point to potential benefits from backend-loaded stimulus.

Nevertheless, the underpinnings of the resilience in economic growth in 2023 seem precarious. Interest rates are likely to start biting and economic hardship could follow should interest rates remain high for longer. In the US and Europe, corporate bankruptcies have already started to rise, albeit from low levels. The risk of declining corporate earnings coupled with tighter funding conditions pose a further risk to corporate health.

According to Standard and Poor's (S&P) Global Market Intelligence, 516 US bankruptcies were filed for the first three quarters of 2023, which exceeded the 425 average bankruptcies experienced over the corresponding period for the past 13 years (see chart 5). Bankruptcy filings have been highest in the consumer discretionary, healthcare and industrials sectors. Bankruptcy declarations are similarly the highest on record since 2015, although risks are concentrated in transport, hospitality, education and health.

Chart 5: US corporate bankruptcies on the rise despite low starting point



Source: S&P Global Market Intelligence (October 2023), Momentum Investments
Data for Q4 2023 unavailable at the time of writing

Trend #2: Divergent growth prospects

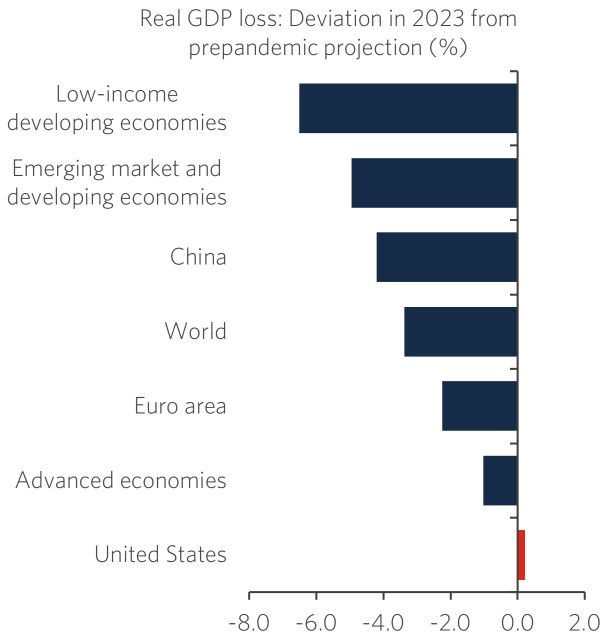
Although growth in the global economy has seemingly defied gravity in 2023 and the retreat in inflation has progressed well, according to the IMF, output in the global economy is estimated to be 3.4% (or US$3.6 trillion in 2023 prices) smaller than what was forecasted before the pandemic (see chart 6). These output losses vary by economy, ranging from a small gain in the US, given the extent of earlier fiscal and monetary policy stimulus, to larger losses in low income and developing economies, where higher interest rates and depreciated currencies have worsened their fiscal positions.

An earlier reopening in advanced economies, a higher availability of more effective vaccines, more robust stimulus measures and a quicker recovery in labour markets, due to remote work access, have all led to the disparate post-pandemic growth outcomes between advanced and emerging nations.

Robust consumer spending is expected to slow in the US in 2024 as pandemic-related savings diminish further while softer conditions in the labour market are likely to be less supportive. Moreover, investment could slow on prolonged high interest rates.

In Europe, a slowdown in major economies such as Germany, pressure on real wages and calls for fiscal austerity should limit the extent of the recovery in 2024.

Chart 6: Asymmetrical post-pandemic economic rebounds



Source: IMF, Momentum Investments

Although investors were critical of Chinese authorities' muted fiscal and monetary policy responses earlier in 2023, meaningful policy announcements were made later in the year and as such should positively spill over into growth outcomes for 2024 by stabilising the housing market and boosting consumer sentiment. Nevertheless, growth has likely structurally shifted into a lower growth channel as authorities aim to sustain more sustainable growth outcomes. Demographic factors and an end to high rates of urbanisation will further cap growth outcomes going forward.

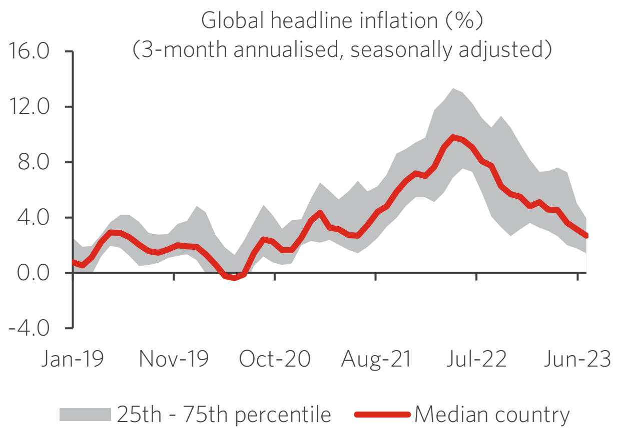
Furthermore, the pandemic, conflict in Ukraine and escalating climate crises have collectively played a role in reversing longstanding trends in poverty reduction, widening the gap between richer and poorer nations, particularly where reduced fiscal space and increased debt vulnerabilities will add to a slower convergence toward the living standards of higher-income economies.

Trend #3: Inflation descent to slow

The Bank for International Settlements has shown that it takes a longer time to wring the last bit of excess inflation out of the economy than it does to bring price pressures down in the initial phase following a high inflation episode.

The IMF notes that global inflation has more than halved from its peak of 11.6% (quarterly, annualised) in the second quarter of 2022 to 5.3% in the second quarter of 2023. The median country's inflation rate, from a sample of 35 countries accounting for 81% of the world's 2022 output, has dropped from 9.6% in June 2022 to 2.7% in July 2023 (see chart 7).

Chart 7: Global inflation in retreat



Source: IMF, Momentum Investments
35 Sample economies included, which account for 81% of 2022 world output

Furthermore, cross-country disparities in headline inflation have reduced as inflation has dropped overall. That said, the IMF warns that 93% of the 72 inflation-targeting countries covered will see inflation exceeding central bank targets in 2023. This is expected to only drop to 89% in 2024. Only by 2025, is headline inflation anticipated to be within 0.2 percentage points of the target in the majority of economies.

The next leg down in inflation could take longer for a number of reasons. Food and energy base effects are no longer working in favour of reducing inflation sharply, while there could be a demand pickup as real wages recover on the back of upwardly adjusted nominal wages and falling inflation. Moreover, as the initial repercussions of monetary policy tightening begin to impact consumer and business spending, political pressures often intensify, prompting calls for an easing in monetary policy.

Elevated demand for labour-intensive services has led to a tight labour market, which has driven a sustained rise in services inflation. However, a deceleration in manufacturing suggests services activity will weaken. A dip in services inflation should follow in 2024, alongside softer labour markets and weaker economic activity.

Trend #4: Monetary and fiscal interaction

As essential economic functions of the state, monetary and fiscal policy are intricately connected. For them to foster a stable financial and macroeconomic setting, they need to maintain a manageable level of interaction.

The abrupt and substantial recession caused by the pandemic has nevertheless placed increased demands on both fiscal and monetary policies, necessitating closer coordination of domestic policies. Government played a critical role in helping individuals and firms navigate pandemic-related lockdowns and facilitate an economic recovery. However, when inflation is high and persistent, across-the-board fiscal support could appear reckless, particularly in the context of resilient growth and low unemployment, which would argue for tighter fiscal policy. As a result, central banks have arguably had to slam the brakes harder to ensure price stability.

Enacting fiscal restraint can play a role in lowering inflation, while reducing debt, by tempering aggregate demand. This would prevent central banks from having to raise interest rates by as much. As such, the policy mix matters.

Fiscal responsibility through a more credible and better-targeted fiscal framework should also help to address looming pressures on debt sustainability, through rebuilding buffers that can be deployed in the event of the next economic shock.

Fiscal policy faces enormous challenges going forward. Ageing populations strain pension and health-care systems, while achieving net-zero carbon emissions demands public investment. There is an additional need to increase defence spending to counter the threats posed by autocracies, against the backdrop of higher geopolitical tensions globally.

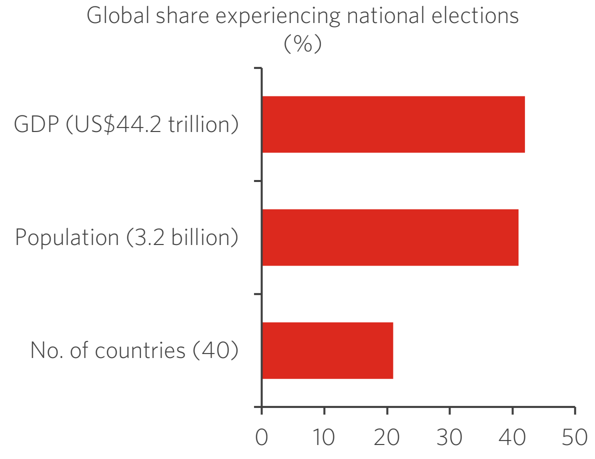
Trend #5: Darker geopolitical climate

Investors were already navigating a complex global landscape before the tragic events unfolded in the Middle East. However, the conflict between Hamas and Israel has introduced a new layer of uncertainty for the global economy, particularly if the war escalates into broader Middle Eastern conflict which could compromise the Strait of Hormuz, through which a fifth of the world's total oil consumption passes.

Geopolitical tensions present additional downside risks to the global economy, in which major growth engines are already under strain. Furthermore, political tensions are expected to remain heightened globally, with a report from *The Economist* indicating that more than half of the world's population (76 countries) will experience an election in 2024. The Economist Intelligence Unit forecasts that out of the 71 countries covered by its Democracy Index, only 43 will have fully free and fair votes.

According to *Bloomberg*, elections in 40 of the 76 countries are national. This represents 41% of the world's population and 42% of GDP (see chart 8).

Chart 8: Packed 2024 national election calendar



Source: Bloomberg, Momentum Investments

Among these elections, Taiwan's vote in January is likely to attract attention, as a victory by the pro-independence Democratic Progressive Party could prompt China to adopt a more aggressive stance toward Taiwan. This could result in a larger demonstration of China's military dominance, potentially leading to international sanctions on China and/or direct conflict between the US and China, depending on the severity of the strategy to unify Taiwan with China. Despite the need to focus on slower domestic growth, we still believe the risk of China pursuing the unification of Taiwan in a stronger manner is higher in the next five years than it has been in the last decade, given the increase in Chinese military movements around Taiwan.

Voters in the US will also have a chance at electing their president in 2024, in what is likely to be a tight race between the Democratic incumbent, Joe Biden, whose popularity according to an average of poll captured by FiveThirtyEight dropped to below 40% in early December, and Republican front-runner and former President Donald Trump. Trump has managed a sizeable lead over Biden in a number of swing states where polls have been conducted, raising the possibility of a second presidential term by Trump.

In this scenario, we assume economic nationalism is ramped up as trade barriers rise further. The US would most likely take a step back on the global political stage given that American support for maintaining an active role in world affairs has dropped to its lowest level since 2014. Moreover, under a second Trump term, regulation would likely be rolled back, while fiscal sustainability and central bank independence would come under increased scrutiny.

Ukraine and Russia are also set to elect a president in 2024. Although election outcomes are largely viewed as being predetermined in Russia, the Carnegie Endowment for International Peace notes that the start of a Russian presidential term is usually accompanied by reshuffles or major reforms. This time, however, we could see less movement given the potential distraction from Russia's military goals in Ukraine. While a war precludes elections during wartime in Ukraine, a presidential vote could still take place in 2024. While the incumbent president,, Volodymyr Zelensky still polls high, an October 2023 Gallup public opinion poll suggests that the share of polled Ukrainians supporting the war dropped from 70% in 2022 to 60% in 2023 as living costs have escalated, threatening a rise in socio-economic instability.

With Ukraine's two greatest military aid providers being the US and Germany, military assistance packages are likely to be received in smaller amounts and less frequently, going forward, given that the conflict in Gaza has diverted artillery away from Kyiv. With Russia damaging more than half of Ukraine's electricity grid last winter through missile and drone attacks, Ukrainians remain vulnerable with no end to the war in sight as yet.

Trend #6: SA's coalitions future

Decreasing voter turnout and substantial advances for fringe parties at both ends of the political spectrum can be interpreted as indications of SA's evolving democracy, yet they may also signal a more divided society. The ruling African National Congress (ANC) has persevered with a diminished majority, but it faces challenges in the foreseeable future.

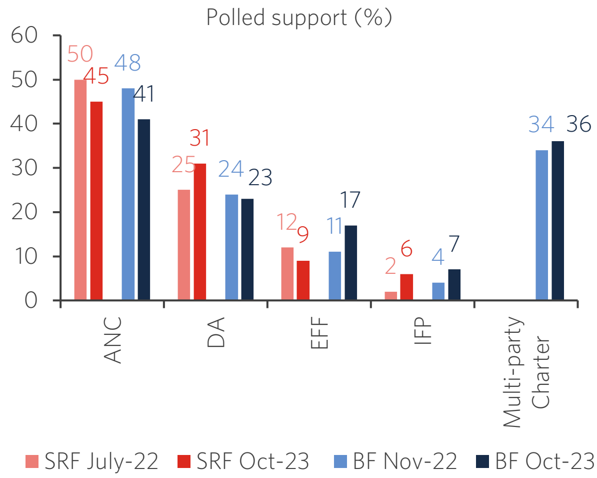
Support for the ANC has dropped given the energy crisis, logistics failures and insufficient progress on curbing corruption (see chart 9). This includes the National Prosecuting Authority's inability to prosecute key high-profile individuals linked to state capture, spoiling SA's chances of removing itself from the greylist by 2025."

The opposition to the ANC is maturing with increasing support for the opposition alliance, the Multiparty Charter, and new political movements sprouting up as we approach the national elections, slated for early May 2024. Polls conducted by the Social Research Foundation (SRF) and the Brenthurst Foundation (BF) in October point to ANC support levels which are polling meaningfully below 50% at a national level. On a provincial level, the potential for a coalition-led government looms even larger. Political analysts are currently guiding towards a coalition-led government in both Gauteng and KwaZulu-Natal, which collectively account for 44% of SA's population and 49% of GDP.

Scenarios for the national election outcomes range from an ANC-led coalition or a marginal ANC majority, which would likely augur a less stable political environment, to a retained ANC majority with a firmer mandate, under which a more stable policy environment could emerge if the ANC and the incumbent president can pursue their agenda more assertively.

Moreover, voter turnout against the backdrop of declining democratic participation globally could affect election outcomes. According to the *Daily Maverick*, increased voter turnouts are likely to benefit the ANC, Economic Freedom Fighters (EFF) and Inkatha Freedom Party (IFP), while a lower voter participation in the national election could favour the main opposition party, the Democratic Alliance (DA) and the Freedom Front Plus.

Chart 9: Support for the ruling party has dropped



Source: SRF, BF, Momentum Investments

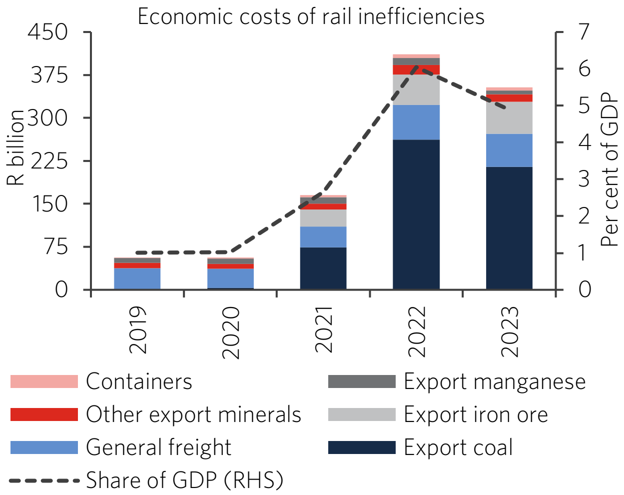
Trend #7: SA's logistical challenges to outlive loadshedding's shadow

The SARB estimates that loadshedding will detract up to two percent points from GDP growth for 2023 based on an expected 250 days of loadshedding, up from a calculated loss of 0.7 percentage points in 2022. Nevertheless, lower anticipated levels of loadshedding could translate into a smaller 0.8 percentage point detraction from GDP growth in 2024.

Eskom's generation turnaround plan and more investment appetite from the private sector for wind and solar suggests that the worst of the energy crisis is behind us. Furthermore, businesses have invested in backup and alternative energy sources, enabling them to withstand reduced levels of loadshedding and mitigating the impact on economic growth.

SA's logistics crisis is nevertheless worsening. National Treasury estimates that rail inefficiencies have cost SA around 6.5% of GDP in 2022 and could amount to close to 5.5% of GDP in 2023 as Transnet battles to meet its performance targets on general freight and coal, in particular. Although there was an attempt to test the appetite of the private sector to partner with the ailing state-owned entity, through an auction of railway slots in 2022, it only piqued the interest of two bidders. The inherent complexity of the contract negotiations, including pricing, investment timelines and the commercial reality of service offering, were some of the reasons why this largely failed.

Chart 10: Logistics inefficiencies remain a binding constraint on SA growth



Source: Treasury, Momentum Investments

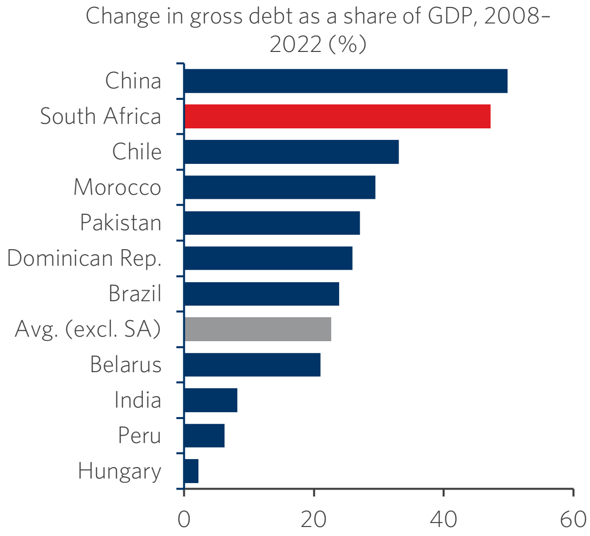
Outside of freight rail, SA's port terminals have been ranked as globally inefficient by the World Bank with the Ports of Durban and Ngqura ranked as 365th and 361st respectively out of 370 ports worldwide. An estimated 71 000 containers were stuck on ships outside the Durban port in late November 2023, which is likely to raise costs for businesses, lower SA's competitiveness in the global sphere and disrupt supply chains. This is likely to detract from growth outcomes for the fourth quarter of the year, leaving growth for the second half of the year considerably softer than the first.

While government has set up a National Logistics Crisis Committee and is working towards implementing a Freight Logistics Roadmap to reform the logistics sector, this is likely to weigh on government's fiscal and debt position in the medium term. Meanwhile, inefficiencies in our rail and port systems will likely cap growth outcomes to a projected 1% in 2024 and 1.7% in 2025.

Trend #8: SA's debt challenges endure

The November 2023 medium-term budget policy statement announced new budget forecasts that were worse than Treasury had announced in February 2023 as revenues came under strain from a drop in mining revenue. The key context for understanding SA's precarious fiscal situation lies in the significant rise of SA's government debt in relation to the economy since 2008. The country's debt ratio as a share of GDP has risen by 47%, only surpassed by China from a comparable emerging market grouping (see chart 11). If one were to take gross government debt for the current fiscal year and spread it across the entire SA population, each person in SA would have debt worth R84 483. The escalation of debt can be attributed primarily to the GFC and the repercussions of the Covid-19 pandemic. However, the worsening in fiscal outcomes has also been influenced by sluggish economic growth stemming from electricity and logistics inefficiencies.

Chart 11: SA's rate of debt accumulation stacks up unfavourably



Source: Treasury, Momentum Investments

Consequently, SA's interest burden has mushroomed. In September 2023, the IMF warned that SA's interest bill on its growing public debt burden could shoot higher from 19% to 27% by 2028, which would be more than twice the size of the health budget. Spreading out government's interest bill for the current fiscal year over the full year would equate to government spending R970 million on debt-service costs daily.

To arrest high debt levels, SA could reduce spending, but this could result in a bigger deterioration in service delivery and give rise to socio-economic stresses. Alternatively, government could raise taxes, but this can also be counterproductive when SA's tax burden is already comparatively high. As such, painful spending trade-offs likely lie ahead in order to commit to the envisaged fiscal consolidation path. Expenditure demands have risen in a relatively low growth environment, in which poverty and inequality have remained high. Moreover, financial and operational difficulties at state-owned entities could add to government's debt woes in the medium term. Although government proposed to plug the financing gap in the current fiscal year without raising government bond issuance by much, pressure on SA's local bond market will likely escalate in the coming quarters as SA's redemption profile ramps up.

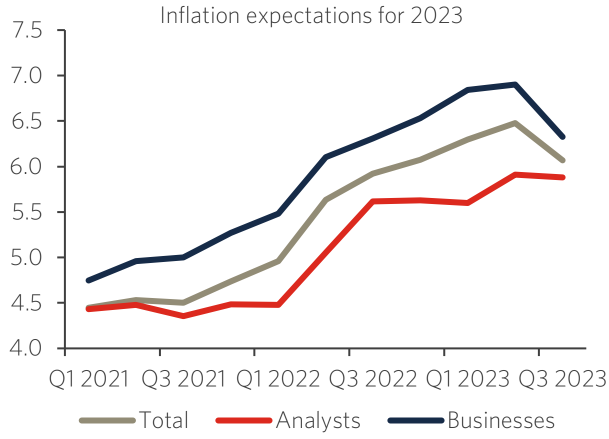
Trend #9: A respite from inflationary pressures

Headline inflation escaped the top end of SA's 3% to 6% inflation target range in May 2022 on the back of surging food and energy costs. Inflation remained outside the upper end of the target for 13 months, peaking at 7.9% in July 2022, but has since traded within the SARB's target range.

Effective monetary policy communication and early action by the SARB prevented a sustained de-anchoring of inflation expectations in SA. According to the Bureau of Economic Research (BER), total inflation expectations peaked at 6.5% in the second quarter of 2023. This was higher at 6.9% for surveyed businesses in SA, but lower for surveyed analysts at 5.9%, suggestive of market players maintaining their view of central bank credibility in spite of higher living costs.

Although we see renewed inflation risks stemming from geopolitically-driven food and energy prices, passthrough from currency weakness and administered prices, demand-pull and wage inflation is expected to remain contained, limiting second-round or persistent inflation pressures. We expect headline inflation to average 5.9% in 2023, dropping to an average of 4.9% in 2024.

Chart 12: Analysts have maintained their view of central bank credibility



Source: BER, Momentum Investments

Trend #10: Rate pause, rhetoric roars

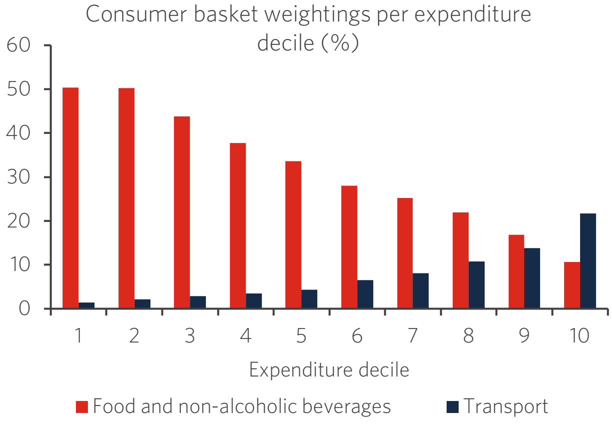
Major central banks hit pause towards the end of 2023, but warned they are ready to act should disinflation trends reverse, threatening a sustainable inflation return to target.

Before the last three Monetary Policy Committee decisions to keep SA interest rates steady at 8.25%, the SARB had hiked the repo rate 11 times since November 2021. The SARB has noted the encouraging shift in inflation drivers that have eased since the global inflation surge. However, it remains concerned that loadshedding and drier El Niño weather conditions could sustain upward pressure on food prices.

High food prices disproportionately affect lower income households given their share of wallet spend. Food prices account for an average of 48% of consumer baskets for the bottom 30% of spenders in SA relative to an average of 16.5% for the top 30% of spenders in SA (see chart 13).

As such, the SARB is likely to maintain its hawkish rhetoric to keep inflation expectations at bay. It has warned in the past that guiding inflation back towards the midpoint of the target on a more sustainable basis can help to reduce the economic costs of high inflation and can ultimately assist in achieving lower interest rates in the future as the central bank avoids having to hike more aggressively to contain inflation pressures which could have unhinged.

Chart 13: Lower-income households disproportionately exposed to food price pressures



Source: BER, Momentum Investments

Central banks remain nervous to declare a victory over inflation too soon given that many unresolved episodes of inflation in the past were proven by the IMF to have been accompanied by 'premature celebrations', as central banks relaxed policy too soon and second-round inflation shocks surprised markets. Moreover, looser fiscal policy in SA has placed a disproportionate burden on monetary policymakers to contain inflation expectations and keep inflation under control.

As such, we expect the SARB to remain on hold at 8.25%, with the first interest rate cut of 25 basis points projected for the second quarter of 2024, at the earliest. We have pencilled in three interest rate cuts of 25 basis points each for 2024, which is less than the 50 basis points easing suggested by SARB's Quarterly Projection model for the same period.