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SHANE WATKINS: Get ready to buy wedding presents

After enduring 15 years of a vicious cycle, SA is about to enter a virtuous one

12 JULY 2024 - 05:00

by SHANE WATKINS

Picture: 123RF/PERFECTPIXELSHUNTER

A battle-scarred old fund manager that I worked with used to say that SA went to all the funerals and none of the weddings. And after enduring almost 15 years of appalling economic mismanagement and low or zero economic growth, you could be forgiven for having the same jaundiced view.

A behavioural phenomenon called "recency bias" causes us to formulate our expectations of the future based on our recent experience. Humans are reluctant and slow to recognise changes and the inflection points associated with those changes. During the Zuma years, the economy grew only 1.5% a year. In the three-year Covid-19 period, there was no growth whatever. We forget that during the

Mandela-Mbeki era of nearly a decade and a half the economy grew on average 3.6% a year, and in some years nearly 6%.

South Africans have become so used to low or no growth that we struggle to conceive of SA as a high-growth, desirable investment destination. We believe that the country is now at a turning point, and that while not much has improved visibly yet, the future is more positive than is generally appreciated. Growth is likely to return to our moribund economy.

There are so many good reasons to be positive, but perhaps none more so than our recent election. The ANC lost power in the general election, and instead of disputing the outcome (as has been the case in many instances in Africa and globally), they accepted the democratic outcome. Whatever the ANC's shortcomings, this respect for democratic principles should be admired and applauded.

Performance can be measured absolutely and relatively. Our country is beginning to improve in an absolute sense, off a low base. And as political and economic conditions in the rest of the world deteriorate, we improve in a relative sense.

Cut rates

George Soros famously coined the term reflexivity to describe self-reinforcing cycles. Good outcomes lead to better outcomes, and vice versa. Having endured 15 years of a vicious cycle, we are about to enter a virtuous cycle. Higher growth and greater confidence will strengthen the rand. A stronger rand will lead to lower inflation. Lower inflation will allow lower interest rates, which will raise asset prices and stimulate economic growth.

The US Federal Reserve is likely to cut rates later in 2024. The consensus is for four or five rate cuts over the next 12 months. Lower US rates allow lower interest rates globally (including in SA), and tend to suggest higher commodity prices (good for SA). Real interest rates in SA are among the world's highest. Our 10-year bonds have a real yield of 6%. Because real rates are so high, it removes the incentive for cash-rich corporates to invest as they can do very well by just remaining in cash. Lower interest rates will stimulate investment.

Past missteps have created a low base from which our economy can grow. Our ports rank near the lowest globally. Last year, Transnet transported 33% less tonnage than it did in 2017. It is estimated that more than R50bn was lost last year in coal exports alone, just because of logistical inefficiency.

Eskom load-shedding reached record high last year, our mining investment attractiveness ranking plummeted and almost all SOEs became unprofitable. Fixing the problems at Eskom, Transnet and Portnet will go far to getting us back on a growth path. Operation Vulindlela is driving a credible improvement off a low base.

Poorly conceived

Other “easy wins” are available. Analysis of the fiscal accounts shows that there has been much wastage within government expenditure. Work done by the auditor-general shows that R751bn of government spending over the past 10 years was classified as unauthorised, irregular or fruitless and wasteful.

A further R331bn of government spending was shelled out in SOE support in the face of corruption and state capture at those institutions. Putting this in context, we estimate that this unnecessary expenditure added 15% of GDP to the stock of public sector debt over the past 10 years. While the government of national unity has risks, it introduces an element of scrutiny and accountability that has been lacking for many years. It is reasonable to think that most of the previous wasteful expenditure will not continue.

In 2024, a poorly conceived change to Regulation 28, which governs pension funds, allowed funds to take 45% of their assets offshore. Many SA fund managers sold their SA shares at their lowest point and moved the money offshore while the rand was at its weakest.

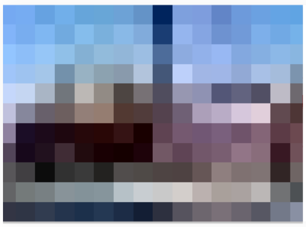
Because these fund managers are now at their max offshore exposure, they do not have SA shares that they can meaningfully sell. Foreign investors have also sold down SA assets and are underweight in the SA equity market. It’s hard to believe that 20 years ago SA was 11% of the MSCI emerging markets index. However its weight is less than 3%. The supply of SA equities is thus drying up while the fundamental outlook is improving. Prices of SA shares are likely to rise, driven by less supply, higher earnings and a lower discount rate.

We are positive on the outlook for our country and economy. JSE share prices are cheap and the outlook for earnings is improving. We like SA government bonds with a yield of 11%. Likewise SA banks, some of which trade at or below book value and a dividend yield of about 10%. We also positively identified value unlock opportunities such as Remgro, and some SA retailers with a self-help story such as Pick n Pay and Spar.

In this improving environment, I encourage all South Africans to approach the future not from a mindset of fear because we perceive there to be scarcity, but rather from a mindset of abundance, in which if we are willing to share then enough is available for all of us to live our best lives in the world's best country.

Funerals lie behind us and weddings ahead. Get ready to buy your wedding presents.

Watkins is the founder and chief investment officer of All Weather Capital.



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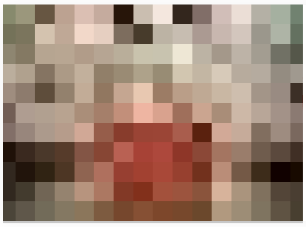

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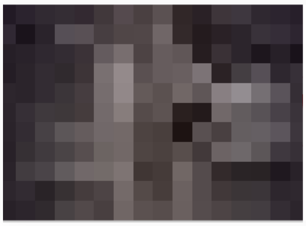

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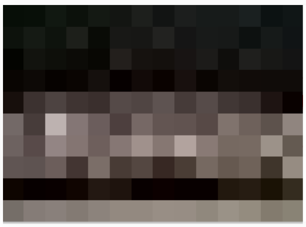

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