South Africa Watch

BofA Macro Day takeaways: what we learned

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Macro Day takeaways: Three key messages emerge

On 4 March, we hosted our 'BofA Macro Day' in Johannesburg ahead of the 25th Sun City Equities conference on 5-6 March. We present our takeaways from policymakers and local specialists, including those from the National Treasury, the SARB, Minerals Council, Transnet, and political and independent experts. What were the key messages? (1) Rate cuts appear delayed but are not yet denied and will probably be shallow (100bp) and done by 1Q25. (2) Near-term fiscal fears have reduced, while addressing the sources of fiscal risks is still a work in progress. (3) The election will be pivotal but with no policy shift. The run-up to elections on 29 May will likely be noisy, with polls indicating a weak ANC performance. Coalition options probably mean the status quo on policy outlook will be maintained.

Start of rate cutting cycle still from July

The SARB is likely to remain in a holding pattern for the March and May meetings, in our view. We keep our July baseline as the start of the interest rate cutting cycle. However, we trim 25bp from our cumulative cut estimate. We now see them adding up to only 100bp compared to 125bp previously. They will likely take place between 3Q24 and 1Q25 – and should be quick and shallow. Inflation back at 4.5% by year-end 2024 would see the terminal rate at 7.25%.

Fiscal fears reduce going into election on 29 May

Heading into the 29 May general election, the fiscal outlook has not been as bad as we had previously feared. The Treasury has largely kept unchanged its fiscal framework from October 2023. See South Africa Watch: Spending grip + SARB profits transfer champion short-term boost for Budget 26 February 2024. Addressing the underlying fiscal issues is still a work in progress – spending risks in wages, social grants, debt service and SOE (state-owned enterprises) bailouts. For now, elimination of bailouts for too-big-to-fail state companies (Eskom +Transnet) could help support fiscal consolidation over the medium term. 2026 could be a turning point with no further Eskom support – leading to a large-enough primary surplus to ensure debt stabilisation (a year later than the Treasury baseline).

Pivotal election but no policy shift

The governing African National Congress (ANC) could lose a majority for the first time since 1994. However, as it is still the largest party, it is likely to remain in power through a coalition. Opposition parties are fragmented, reducing the likelihood of a combined and stable opposition-led government. Other options that could keep the ANC in power include the notion of a government of national unity. In the event of the ANC performing badly, circa 40%, and it having to find a partner, political analysts think that ANC/DA (Democratic Alliance) is a more probable option than ANC/EFF (Economic Freedom Fighters). There was conference participant pushback about an ANC/DA union, while ANC/EFF could only happen if President Ramaphosa were to step down. Both scenarios look unlikely. We see no policy shift post elections.

Macro Day takeaways

SARB rate cuts delayed but not yet denied

The SARB is still in a holding pattern while it considers the next likely steps toward cutting. The central bank's inflation projections point to 4.5% by year-end. Core CPI is already well-anchored around 4.5%. Inflation volatility has largely emanated from supply-side sources – large swings in food, international oil prices and exchange rate weakness. The glide path to 4.5% could be quicker if international oil prices remain benign, the Federal Reserve starts cutting at mid-year, the USD weakens, and the ZAR strengthens materially on no domestic setbacks. In other words, global developments that support Fed cutting and a weaker dollar would be necessary for the SARB to start cutting.

Can the SARB cut before the Fed?

This looks less likely based on our conference. Brazil and Chile cut because they had room with large positive real rates compared to South Africa. The SARB will likely wait as it sees Fed actions as an important variable in forecasting global rates. In theory, the SARB could cut if inflation returns to 4.5%, even if the Fed doesn't cut first. However, continued dollar strength would mean foreign flows would remain net outflows, keeping the ZAR on the backfoot and this may be a detriment to actual inflation prints relative to baseline forecasts.

SARB cuts likely to be shallow

We still assume SARB cuts will start from July. We see the March MPC as unlikely to offer many insights into the cutting cycle so far. May's MPC could start providing signals but could be clouded by election-related risk on the ZAR. Nevertheless, the SARB's quarterly QPM model forecasts the policy rate returning to a neutral level around mid-2025. The latest nominal neutral level is 7.25%, which would imply a shallow cutting cycle of up to 100bp from the current 8.25% policy rate. While the QPM is considered a loose guide, we believe it can be more useful in a cutting than hiking cycle. In the near term, monetary policy remains tight.

Can the policy rate go back to pre-COVID levels?

That would be 6.5%-6.75%. This is less likely given that higher global rates and fiscal risks have pushed up the risk premium. On SARB estimates, the real neutral rate has increased from 2.5% to around 2.7% this year, resulting in the nominal neutral rate settling at 7.25%.

Lower inflation target gaining momentum post GFECRA

The lower inflation target is now an active subject of discussion. It is argued that GFECRA (Gold and Foreign Exchange Contingency Reserve) drawdowns could weaken the SARB. Financing the Treasury without fixing underlying fiscal issues may be a moral hazard. Nevertheless, mechanisms and rules are being implemented that define the drawdowns without negatively impacting liquidity or the bank's capital position. A lower inflation target is being considered – discussions are ongoing about a point target with a tolerance band. SARB has a de-jure 3-6% target while the de-facto rate is 4.5%. To make sense, a new target would have to be lower than 4.5%. Another consideration is comparisons with other emerging market peers that target around 3%.

Tapping GFECRA without selling FX reserves

Drawdowns of the GFECRA fund assume no selling of FX reserves to pay the Treasury. GFECRA is an unrealised profit account from trading FX reserves kept at the SARB on behalf of the government. The drawdowns are likely to be the new normal, although moderate, to keep the buffer reserve at ZAR250 billion at minimum. We learned that the GFECRA buffer of at least ZAR250 billion is strong enough to absorb any large potential ZAR strengthening – for instance, ZAR16 or ZAR15 per USD. Problems would arise if the ZAR were to strengthen to as much as ZAR11 per USD, though strengthening is highly unlikely given domestic macro weaknesses.

Containing spending growth reducing fiscal fears

The National Treasury has managed to calm market fears about substantive fiscal deterioration. It has kept fiscal forecasts largely linked to the October 2023 medium-term budget policy statement (MTBPS). The January 2024 fiscal performance showed a year-on-year spending squeeze of almost 12%, bringing year-on-year spending to just above 5% fiscal year to date relative to more than 7% in December data. As the 2023 fiscal year ends on 31 March, the National Treasury could see the deficit coming close to its target. However, fiscal risks remain over the medium term, as addressing underlying fiscal issues continues.

No spending program cuts risks pending bills later

The Treasury is holding the expenditure line by squeezing nominal growth of core spending (excluding interest costs). In other words, it is avoiding real spending growth and keeping it largely linked with average inflation. Independent fiscal experts are of the view that programs to consolidate spending cuts would be better than just limiting cash spending. The risk of just limiting cash spending is the delayed payment of bills that could show up in the next fiscal year. Rather, consolidation should be on reduced policy programs not cash spending limits.

Growth in wage bill linked to inflation

Expenditure adjustments in the 2024 budget were moderate. They included additional spending in compensation budgets to support labour-intensive ministries, such as health, and education that had been squeezed by announced cuts. To make medium-term fiscal forecasts more credible, the Treasury made provisional allocations for the social relief and distress grant (SRD) until 2027. The wage bill now has an assumption of 4.5% annual growth. Some wage bill measures being reviewed include occupational specific dispensations benefits. They are largely in health, justice and correctional services. Early retirement options are being considered to generate permanent savings.

Debt service growth slowing on central bank transfer

Debt service costs could reduce with declining fiscal deficits and therefore lower borrowings. The pace of increase has been largely unsustainable, 15-20% per annum. The 2024 baseline assumes less than a 10% increase per annum, largely helped by a ZAR100 billion GFECRA drawdown, reducing the overall amount borrowed. Other measures being considered by the Treasury include diversifying the funding mix in both the domestic and external markets, while staying away from the Eurobond market at least until 2025.

Spending contained near term for too-big-to-fail SOEs

The Treasury has no expectation of equity support to Transnet over the medium term. The ZAR47 billion guarantee is valid until March 2025 – using ZAR21 billion in the 23/24 fiscal year and ZAR25.5 billion in 2024/25. Transnet has total outstanding debt of ZAR123 billion. The mandate is to meet government conditions on guarantees. Guarantees have helped Transnet to access financing from lenders. Since issuing guarantees at end-2023, financing for 2023/24 is now fully covered.

If anything, Eskom lost money – ZAR4 billion over two fiscal years – due to not meeting guarantees (selling Eskom finance company). Instead, the focus is on implementing Transnet's turnaround plan. After electricity generation, transmission is next to require funding. Funding for Eskom transmission is constrained by the weak balance sheet. A public private partnership (PPP) is a likely route for financing. For example, IFC (International Finance Corporation) is working with the government on designing PPPs that could help fund transmission of generated electricity.

Tax revenue growth has GDP growth limitations

To close the near-term tax revenue gap on weak economic performance, the Treasury has used bracket creep as its main tool – it has skipped any inflation adjustment of personal income tax brackets.

Over the years, personal income taxes (PIT) have performed better than expected, while corporate income taxes (CIT) have largely disappointed. However, they are now largely in line with expectations (now that commodity-related gains are taken out of forecasts). VAT collections have surprised negatively due to higher-than-anticipated VAT refunds – in particular, VAT refunds on solar imports that have been higher than expected (with increase in power cuts) plus VAT refunds claims from corporates that switched to road from rail transport for moving goods (transport logistics issues with rail and ports).

Future tax policy options are limited

It appears to us that there is no intention to increase any of the above main tax instruments over the medium term. The fiscal authorities see a VAT increase as a possibility should politicians propose unfunded new policy initiatives, for instance, introducing a basic income social grant or national health insurance. The Treasury believes the small grant already in the fiscal framework supports strengthening of health systems. However, the bigger stories are not clear in terms of how and when.

Election risk –ANC likely to stay in power with some help

The 2024 election is pivotal. The ANC could lose its majority for the first time in 30 years. But no clear winners are likely due to opposition fragmentation. Former President Jacob Zuma's new party, MK party, has pushed down the polling results of the ANC and other major parties. The weaker the ANC, the more complicated the coalition scenarios could turn out to be. Coalition deals look likely post-election.

Our baseline scenario is that the ANC wins around 45% of the vote and forms a coalition with small parties. Many small parties such as the Patriotic Alliance and Good party could easily provide support to the ANC, while ActionSA and Rise Mzansi could bring better checks and balances. ANC polling around 40% could suggest need for coalitions with one of the main opposition parties – DA or EFF. Political analyst Frans Cronje assigned a higher probability to an ANC/DA coalition than one with ANC/EFF. Conference participants pushed back on ANC/DA coalition ideas.

Government of National Unity proposal?

Political analysts also suggested the possibility of the ANC proposing a government of national unity, should it poll closer to 40%. That would involve bringing most opposition parties under one umbrella. This would be more of a centrist majority coalition without the EFF – which is less likely, in our view. We think it would be easier to have bilateral agreements than a big umbrella. Perhaps it would be an idea for 2029 should the ANC's popularity decline further.

GDP growth uplifts remain on too-big-to-fail SOEs

2023 GDP growth at 0.6% year on year, compared to 1.9% in 2022, was weighed down by persistent power shortages. The 2024 outlook on power supply is better than in 2023, which supports our 1.3% growth outlook. Some Eskom plants that were out during much of 2023 have returned online, while solar imports have boosted power supply and reduce reliance on Eskom. Energy generation from renewables is likely to slow with the focus shifting to creating transmission lines. Experts put the electricity transmission network required at around 14,000 km to connect all the new generation.

The focus in 2024 is on reducing logistics hurdles – in rail and ports, largely operated by Transnet. Transnet's recovery plan focuses on stabilising volumes moved on its lines, particularly for iron ore and coal moved to the Saldanha Bay and Richards Bay terminals. Anecdotal evidence shows some improvements in tonnes moved since October 2023. Third-party access to ports has been granted, while third-party use of rail is still a work in progress. Some initiatives include bulk terminal expansion at Richards Bay and new equity partners at ports.

Overall investment and consumption should continue to underpin economic growth over the medium term. Investment spending, helped by the private sector, in the public sector will likely focus on energy supply and transport networks. A SARB cutting cycle could help boost consumption spending in 2H24 as it starts its interest-cutting cycle.

Exhibit 1: South Africa Key Economic Forecasts
Economic growth to improve to 1.3% from 0.6% in 2023

	2019	2020	2021	2022	2023e	2024f	2025f
Real GDP growth (%yoy)	0.3	-6.0	4.7	1.9	0.6	1.3	1.5
CPI average (%yoy)	4.1	3.3	4.6	6.9	5.9	4.9	4.5
Policy rate (%,end of period)	6.5	3.5	3.8	7.0	8.3	7.5	7.3
Fiscal Bal (% of GDP)	-6.1	-9.8	-5.1	-4.6	-5.8	-5.4	-5.6
Primary Bal (% of GDP)	-2.5	-5.7	-0.9	0.0	-0.8	-0.3	-0.3
Debt (% of GDP)	57.2	70.1	67.8	70.9	73.9	76.2	77.9
Current Account Deficit % of GDP	-2.6	1.9	3.7	-0.5	-1.5	-2.6	-2.5
Exchange rate (USD/ZAR end period)	14.0	14.7	15.9	17.0	19.0	18.0	18.4
Exchange rate (USD/ZAR avg)	14.5	16.5	15.0	16.5	18.6	18.7	18.1

Source: BofA Global Research

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