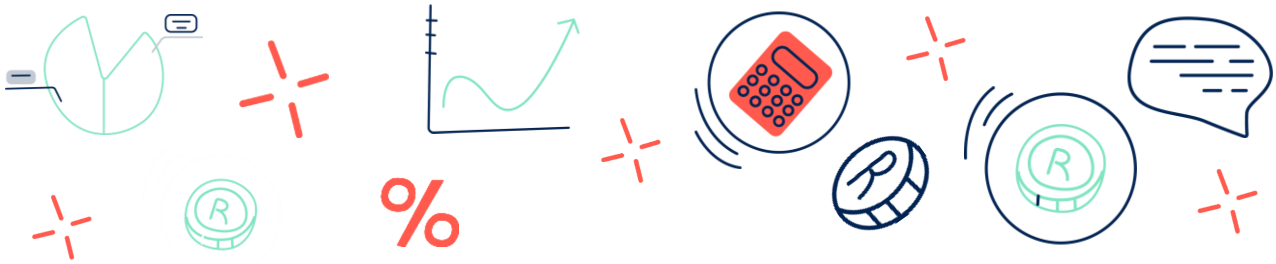
Economic Commentary
August 2024



Ready for rate cuts?
The US economy, although slowing, remains buoyant. This coupled with increased certainty around interest rate cuts in the last quarter of 2024 supported equity and bond market performance in August. Risks to continued economic resilience are building and the pace of slowdown remains uncertain.

South African politics are settling with the spotlight shifting to economic reform to lift the growth outlook. Stronger performance from the local equity market continued into August, but mining stocks proved a drag due to weaker metal prices and reduced earnings outlook. Goldfields, specifically, lost value as the miner announced further production cuts and operational challenges.

US remains resilient for now
US bond yields have been declining, reflecting an improved inflation outlook and dovish statements from Fed Chair Jerome Powell, who has indicated that rate cuts are imminent. This has led to a weaker dollar, which has, in turn, benefited emerging markets, including a recent strengthening of the Rand.

Despite a slowing economy, the US remains resilient, with GDP growth exceeding 2%. However, there are medium-term concerns that could weigh on the US economy: consumer savings rates are historically low and below pre-COVID levels, government deficits are significantly higher than historic levels, and the debt-to-GDP ratio has surpassed the post-WW2 peak. Against the backdrop of a high fiscal deficit, the next governing party will have their hands tied with respect to tax cuts and spending. While it's uncertain if the current slowdown will precipitate a recession, the lack of structural systemic issues suggests that any potential recession would likely be shallow. This, along with significant rate cuts and expected double digit earnings growth, at least in the short term, is maintaining the high S&P 500 valuation on a PE ratio in excess 20x.

Chinese consumers struggling to gain confidence
In China, the economic situation remains poor as is evidenced by lacklustre credit and monetary aggregate growth. Weak internal demand, low consumer confidence and depressed consumer spending are being offset by double-digit export growth. Risks continue to build as we see further tariffs being placed on Chinese exports and continued weakness in the property market weighing on consumer sentiment.

Given the weak Chinese economy, coupled with a sluggish global manufacturing cycle, the risk to bulk commodity prices remains to the downside.

Spotlight on South Africa's economic reform

The South African bond market has benefited from declining US bond yields and tighter sovereign credit spreads. With US real yields already relatively low at 1.7%, meaningful further declines would require obvious signs of a US recession. Positive domestic news could further narrow SA credit spreads, which are currently around 3%, aligning with the 10-year average.

A lower cost of capital has led to higher valuations of domestically exposed shares, which have meaningfully outperformed since the elections. Domestic equities, including banks and retailers, are now trading in line with their 10-year averages. Absent a significant commodity cycle, further increases in valuations will depend on the necessary economic reform to drive economic activity and growth. In particular, we are closely monitoring progress at Transnet, which could substantially boost South Africa's GDP growth going forward. Nonetheless, even at current valuations, the combination of dividends and double-digit earnings growth should deliver strong returns from the domestic equity market.

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