Pots of gold

Last month we wrote that over the next five to 10 years, as South Africa's fiscal burden becomes increasingly unmanageable, we expect that new, more creative sources of revenue and funding will be sourced.

SA's annual borrowing requirement includes not only the country's deficit (revenue minus expenditure), which averages around R300bn, but also a wall of sovereign redemptions, averaging R200bn per year, and Eskom's redemptions, which average R85bn per year over the next three years. In recent months, a series of discussions and announcements indicate which pools of reserves and public and private sector savings may be targeted, including NHI, GFECRA (Gold and Foreign Exchange Contingency Reserve Account) and the two-pot retirement system.

Fiscal watchdog bodies have generally viewed these options with caution, primarily because they set a precedent of tapping into once-off, short-term solutions which buy time and delay structural change, possibly greasing a slippery fiscal slope.

Could GFECRA be a funding option?

During the November MPC meeting's Q&A, SA Reserve Bank (SARB) Governor Lesetja Kganyago referenced National Treasury drawing down on the GFECRA, estimated at just under R500bn. Essentially, the GFECRA is unrealised profits from SA's foreign currency and gold reserves, which Treasury could be allowed to borrow at the policy rate. While it was clear that no decision has been taken, the governor did state that the SARB was in consultation with bodies such as the International Monetary Fund (IMF) to assist with potential Reserve Bank balance sheet implications. He also made it clear that the SARB would not be one of the many entities "standing in line" to be reimbursed by Treasury for costs related to monetising the GFECRA.

Opportunity for South Africans to access a once-off cash payment of up to R30,000 in an election year

Introduction of the two-pot retirement system was initially set for 1 March 2025 but was brought forward by Parliament's Standing Committee on Finance to a more-election-friendly 1 March 2024. The latest compromise is for implementation on 1 September 2024. The "two-pot-system" refers to retirement fund contributions being divided into two streams post 1 September: the first is a savings pot into which one third of all future contributions will be paid, and the second is a retirement pot into which two thirds will be paid. Members will have the option to make one withdrawal per year from the savings pot, taxed at the member's marginal tax rate, provided the savings balance is greater than or equal to R2,000. With respect to money already accumulated i.e., the existing retirement savings accumulated prior to 1 September 2024, this will remain in a "vested pot".

As at 1 September 2024, members can withdraw 10% of their vested pot (up to a maximum of R30,000), or transfer 10% to their savings pot. This will provide cash-strapped South Africans the opportunity to access a once-off cash payment of up to R30,000 in an election year. To protect pension funds, the law has changed upon member resignation. If members resign they will be entitled to withdraw the vested pot and the savings pot balances, but the retirement pot will only be accessible upon retirement or in the event of death. The treatment of the retirement pot on retrenchment is still under consideration.

Estimates of the amount of cash that could be withdrawn from the vested pot differ. Assuming that the average pension fund member's balance is R150,000, they could withdraw R15,000. SARS estimates that there were 3.56mn taxpayers contributing to pension funds in FY21. This implies that, at a maximum, R53.4bn could be drawn down from the pension fund pool, where the pool is estimated at R4.8 trillion. This once-off transfer would be positive for GDP and for tax revenue in 2024/25.

NHI to provide a new route for government to access a portion of household savings

The ANC has promised voters that the NHI will become a reality. In a show of commitment, the NHI Bill was passed by the National Council of Provinces in November and is currently before the country's president, awaiting either his signature or a referral back to parliament. The NHI can be viewed as a way to access a portion of household savings held by private medical aid schemes. It has implications for both bond and equity markets and will remain a source of uncertainty for markets.

In addition, new funding instruments have been introduced. Treasury raised R20bn in its first domestic Sukuk auction, at around 10bps above the equivalent SA government bonds. And the latest floating rate note (FRN) auction was also relatively successful and raised almost R8.5bn (RN2027 cleared at 3m-Jibar+110bp and RN2030 cleared at 3m-Jibar+145bp).

Weaker US data drives strength in SA bonds

Since August, our core view has held that the global monetary policy cycle is bullish for SA bonds. This view continued to find support in November as US Treasuries strengthened across the curve. The 10-yr US Treasury (UST) strengthened from 5.0% in mid-October to 4.1% currently (-90bp) and the 2-yr from 5.2% to 4.6% (-60bp), indicating an intensification of curve inversion. This is consistent with increased expectations of a recession and we note that Bloomberg's 1-yr recession indicator is sitting at 50%.

In response to moves in the global risk-free rate, SA's generic 10-yr nominal bond rate strengthened from 11.95% in October to 11.30% currently (-65bp). According to our analysis this is in line with its fair value which we estimate at 11.35%, given US TIPS (inflation linked bonds) at 1.95%. We note that lower global rates provide support for emerging market risk premia such that SA's sovereign risk has compressed from 355bp in October to 315bp currently.

The move in global rates was driven by several key US economic data releases which were weaker than anticipated. With respect to the labour market, US JOLTS (Job Openings and Labor Turnover Survey), showed fewer job openings than expected in October, at 8.73 million, from a downwardly revised 9.35 million in September. Job openings are now at their lowest level since early 2021. The decline in job

openings was broad based across sectors and the gap between job openings and unemployed people fell from 3 million people in September to 2.2 million people in October.

This less-tight labour market should feed into lower wage inflation, which is still elevated at 5.2%. Non-farm payrolls ADP Employment Report for November were also softer than expected and are seen as a precursor to the more reliable November non-farm payrolls report which, although slightly above expectations, still signaled the market weakness. US 3Q23 national accounts data also indicates pressure on the consumer as real household consumption slowed from 4.0% quarter-on-quarter (QoQ) to 3.6% QoQ.

US Supercore PCE inflation, the cleanest measure of underlying inflation – which is what keeps central bankers up at night – fell further in November to 3.5% year-on-year (YoY) from 3.9% in October and a peak of 5.1% in February this year. Weaker data has reinforced expectations that the Federal Open Market Committee (FOMC) would be able to begin the cutting cycle sooner rather than later. The effective fed funds rate is suggesting that the benchmark rate will be closer to 4.00% at the end of 2024, down from its current level of 5.33%.

Strong emerging market performance in November

Most emerging market (EM) assets were positively affected by the fall in US nominal and real rates. The World Government Bond Index (WGBI) gained 4.9% and EM equities rose 7.9%. Comparatively, SA's All Bond Index returned 4.7% and domestic equities were up 8.3%. Gold rose from $1983/oz to $2036/oz, while oil has fallen from $87/barrel at the end of October to $74/bbl currently. Traditionally gold is inversely correlated with US real rates and oil prices, as investors look for relative safety when the outlook is for growth and inflation to slow.

Domestically, inflation-linked bonds (+4.8%) marginally outperformed fixed rate bonds (+4.7%) and were well ahead of cash (0.7%). Offshore cash provided a 0.5% return in USD.

After a phenomenal performance in October, the rand depreciated -1.0% to 18.85 against the USD at the end of November and is currently trading close to 19.00. This came despite the dollar depreciating -3.0% against a weighted index of its major trading partners. Commodity price performance was mixed, but on average -2.2% lower on the month. The rand depreciated -4% to the euro and -5% to the British pound. Emerging market currencies on average appreciated +2.8%.

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