MARCH 2024

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DAWN OF THE S&P 5,000

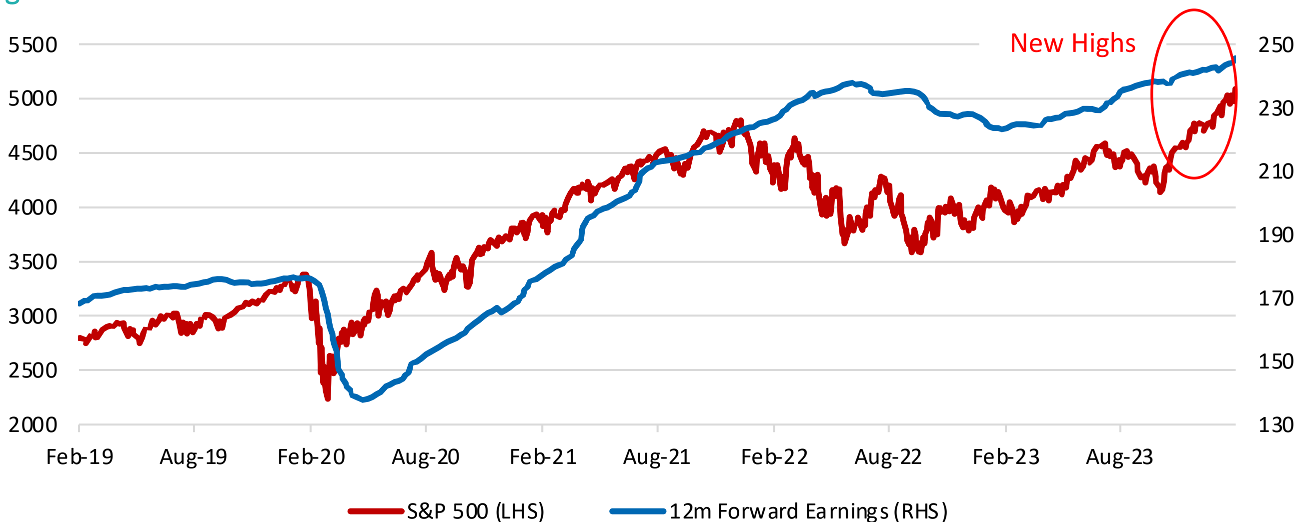
On the 8th of February the S&P 500, the benchmark equity index in the US, closed above 5,000 points for the first time in history. As of the end of February, the S&P 500 is already up over 6.0% in 2024, well above the 1.9% average gain that Wall Street Strategists had predicted for the entire calendar year.

The recent market gains can be primarily attributed to the rally in tech stocks on the back of blockbuster earnings numbers, particularly those coming out of chipmaker Nvidia.

Interestingly, on a broad index level it took the S&P 500 index 757 days to climb from 4,800 points to 4,900 points, and only 15 days to go from 4,900 to 5,000.

With a strong underlying Economy (led by a very healthy and eager-to-spend American consumer), resilient corporate earnings, and optimism surrounding the prospect of declining interest rates, US stock prices are poised to remain supportive in the near term, barring an exogenous shock to the market.

Fig 1. S&P 500 Index



Source: Analytics, Bloomberg

Consistently strong earnings numbers from the underlying companies in the US economy remain supportive of the broad equity index. While the trajectory of the US stock market can be expected to be highly sensitive to policy rate expectations in the short term, these composite earnings and valuations will ultimately drive the underlying trend in the market over the long run.

We remain less optimistic than the market consensus surrounding the projected path of inflation, and expect US headline inflation to bottom out well above the 2% target later this year. Sticky rents and wages inflation, supported by extremely low levels of unemployment will continue to put upward pressure on US inflation. As a result, interest rate cut expectations have been pushed further and further back into 2024. At the start of the year market participants were pricing in a very optimistic 6 interest rate cuts (a full 1.50% reduction in the repo rate) over the course of 2024. As at the end of February, the expectation has already been markedly revised downwards to 3-4 rate cuts on the back of sticky inflation numbers and strong economic growth.

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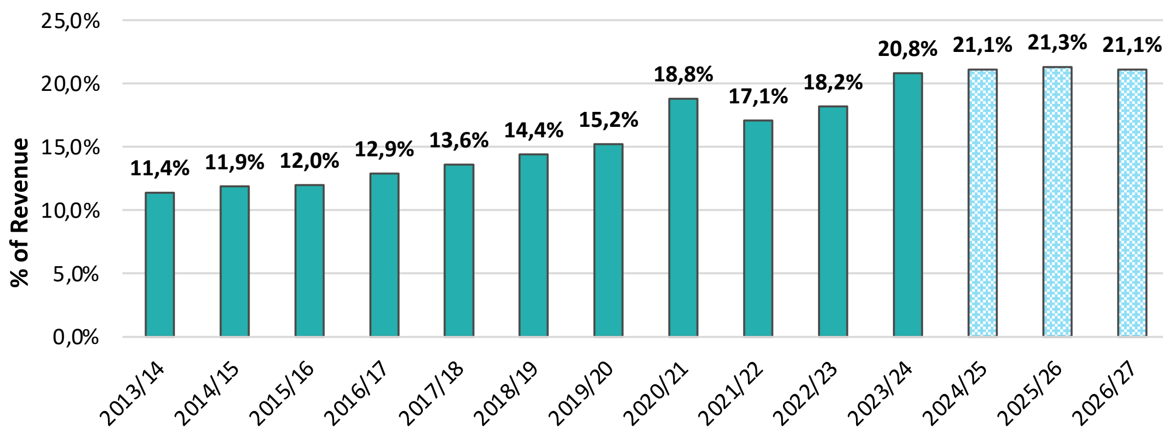
DEBT DILEMMA: THE SA BUDGET SPEECH

Locally, February saw the annual budget speech by minister of Finance Enoch Godongwana. Debt remains a primary area of concern within the South African Economy, with local debt to GDP expected to increase to 73.9% over the 2023/24 fiscal year. As a consequence of the ballooning debt burden, the debt-service cost has grown dramatically over the last decade. At current levels, the cost to service the growing debt burden absorbs a larger portion of the annual budget than healthcare, basic education, or social protection. Currently, National Treasury spends an estimated R356 billion rand annually on debt-service costs. Put another way, the cost to service our debt costs the South African economy nearly R1 billion every day – this being before Treasury have reduced the level of outstanding debt by any degree.

Fig. 1 Debt-Service Cost



Source: Analytics, National Treasury

In response to the fiscal risks associated with rising borrowing costs, the South African Reserve Bank (SARB) and government have made adjustments to the regulations governing the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) in the recent budget speech.

The GFECRA account accumulates valuation gains from South Africa's foreign exchange and gold reserves, and is reflected as an asset on Treasury's financial statements. The balance of the GFECRA has grown substantially, reaching R507.3 billion in January 2024, largely due to the depreciation of the Rand over time. Due to the large balance, a proposed settlement agreement between the National Treasury and SARB will allow the government to access R150 billion of the GFECRA balance between 2024/25 and 2026/27. This access aims to reduce borrowing and subsequently curb the growth in debt-service costs. Initially, R100 billion will be allocated for debt repayment, with an additional R100 billion provided to the Reserve Bank to stabilize money market conditions. Over the following two years, two more tranches of R25 billion each will be made available to the government.

While making use of the GFECRA account to reduce the local debt burden is a useful short-term panacea, it does little to address the longer-term structural issues present in the country. Furthermore, the use of these reserves provides government with the flexibility to continue spending at levels that will ultimately prove unsustainable.

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