analytics
CONSULTING

Economic and market overview

3 May 2019

Global

According to the latest[1] International Monetary Fund (IMF) bi-annual World Economic Outlook, the strong global economic expansion of 2017 and 2018 slowed notably in the second half of last year. It reflects a confluence of factors affecting the major economies around the world. China's growth declined following a combination of needed regulatory tightening to rein in shadow banking and an increase in trade tensions with the United States. The euro area economy lost more momentum than expected as consumer and business confidence weakened and car production in Germany was disrupted by the introduction of new emission standards, investment dropped in Italy as sovereign spreads widened and external demand, especially from emerging Asia, softened. Elsewhere, natural disasters hurt activity in Japan. Trade tensions increasingly took a toll on business confidence and, so, financial market sentiment worsened, with financial conditions tightening for vulnerable emerging markets in the second quarter of 2018 and then in advanced economies later in the year, weighing on global demand. Conditions have eased in 2019 as the US Federal Reserve signalled a more accommodative monetary policy stance and markets became more optimistic about a US/China trade deal.

As a result of these developments, global growth is now projected to slow from 3.6 percent in 2018 to 3.3 percent in 2019, before returning to 3.6 percent in 2020. Much of the rebound in global growth rates in 2020 is focused on growth in China and India, and rightly so, given their increasing weights in global income.

After continued turmoil about Brexit, it has now been postponed to 31 October 2019, but it's not any clearer what the deal will look like when the United Kingdom eventually leaves the European Union.

The IMF report concludes that risks to their economic outlook are tilted to the downside. A further escalation of trade tensions and the associated increases in policy uncertainty could further weaken growth. The potential remains for sharp deterioration in market sentiment, which would imply portfolio reallocations away from risk assets, wider spreads over safe haven securities, and generally tighter financial conditions, especially for vulnerable economies. Possible triggers for such an episode include a no-deal Brexit withdrawal of the United Kingdom from the European Union, persistently weak economic data pointing to a protracted global growth slowdown, and prolonged fiscal uncertainty and elevated yields in Italy – particularly if coupled with a deeper recession – with possible adverse spillovers for other euro area economies. A rapid reassessment by markets of the monetary policy stance in the United States could also tighten global financial conditions. Over the medium term, climate change and political discord in the context of rising inequality are key risks that could lower global potential output, with particularly severe implications for some vulnerable countries.

South Africa

The increase in economic activity in South Africa remains tepid by any stretch of the imagination as most forecasts point to a GDP growth rate of not much more than 1% for 2019, and only slightly more in 2020. These factors, alongside a slowdown in household consumption, increased taxes and fuel prices, paint a bleak picture for local investors. Unstable power supply and slowing global growth

[1] A bi-annual report of which the latest version was published in April 2019.

continue to pose further significant downside risk to this growth outlook. On the brighter side, policy and political uncertainty has somewhat decreased, but investors are likely to wait until after the elections to make investment decisions.

The Governor of the South African Reserve Bank (SARB), Lesetja Kganyago, defended the independence of the Bank (and central banks around the globe) during a speech he gave at the World Bank Reserves Advisory and Management Program in April. With specific reference to South Africa, he added that the introduction of inflation targeting in 2000 has steadily improved the anchoring of inflation expectations and has reduced the level of inflation. In recent years, the SARB has been attempting to steer inflation expectations closer to the midpoint of the 3-6% inflation target range. The bank believes that this will improve policy flexibility and increase the scope for countercyclicality.

He highlighted two positive developments in South African banking. The SARB, alongside other regulators, is currently introducing deposit insurance and a resolution framework for banks and other systemically important financial institutions. Deposit insurance is expected to reduce the risk of retail bank runs, while the resolution framework will formally introduce the possibility of private creditor bail-in. Both regulations will limit the public cost of bank failures.

South African investors are no doubt following the results of the national elections that took place on 8 May. If nothing else, it will give investors some indication of the pace at which the overhaul of the ruling party will continue and may just prove to be a much needed boost for consumer and business confidence.

Market performance

Financial markets recorded a respectable performance in April as economic data was broadly in line with expectations and central banks kept to their dovish tone.

Local equities had a strong month with the FTSE/JSE ALSI index recording its fifth consecutive month of positive returns. This was in line with major global markets, some of which have reached record highs. The strong performance could be attributed to the valuation gap between the domestic market and its emerging market counterparts

South African bonds underperformed other domestic asset classes (except for cash) but considering the poor performance of global bond markets, it has held up well. The strong performance followed despite further fiscal pressures on state owned enterprises and a lack of local economic growth. Inflation-linked bonds had a much improved month as investors looked to benefit from the attractive inflation carry.

The listed property sector had a strong recovery, but the elevated volatility of the sector continues. On face value valuations are more compelling but risks to the sector remain high.

South African Multi-Asset High Equity Funds delivered an average of 4.8% to investors during the last 12 months with their low equity counterparts returning 6.12%.

Market indices[2] (All returns in rand)	30 April 2019 3 months	12 months	5 years
SA equities (FTSE/JSE All Share Index)	9.5%	3.9%	6.8%
SA property (S&P SA Reit Index)	-5.8%	-11.8%	7.7%
SA bonds (SA All Bond Index)	1.6%	5.0%	8.4%
SA cash (STeFI)	1.7%	7.2%	7.0%
Global developed equities (MSCI World Index)	16.9%	23.0%	14.8%
Emerging market equities (MSCI Emerging Market Index)	11.5%	9.5%	11.1%
Global bonds (Barclays Global Aggregate)	8.4%	15.9%	7.2%
Rand/dollar[3]	8.0%	14.8%	6.4%
Rand/sterling	7.1%	8.7%	1.0%
Rand/euro	5.5%	6.5%	1.9%
Average South African Multi-Asset High Equity Fund	6.8%	4.8%	5.8%
Average South African Multi-Asset Low Equity Fund	4.5%	6.1%	6.4%

Commentary – South Africans make their mark

South Africa's national elections on 8 May was a big focal point for many investors. As Carol Paton of Business Day explains in this sobering article of 30 April it's not the size of the ANC victory that matters, but rather how much courage President Ramaphosa can afford to show.

Ramaphosa's vision and courage at the crux of SA's future development[4]

All of us — even those who will vote for the most sectarian party on the ballot, the Freedom Front Plus — need Cyril Ramaphosa to succeed. It is a fact that of all the actors on the political stage, Ramaphosa is uniquely placed right now to divert SA from its present trajectory.

If the next five years in SA are going to be viable at all — insofar as the state and economy are sustainable and function reasonably well — we need Ramaphosa to steer us through it.

The question, though, is whether he can. To change the trajectory, he will need to be a much stronger leader than he is now. It is not just a matter of some personnel changes and assembling an improved but still flawed cabinet. It means taking a hand in redirecting the ANC and the emerging elite away from its instincts, which are to feed off the state as the quickest route to personal wealth, without regard for the long-term consequences.

It means reorienting the state and government — and therefore the governing party — towards a rights-based society that is genuinely open for business, and away from one that is fixated on re-engineering the economy and society.

If SA trudges on for another five years with 1% to 2% growth and a state that increasingly fails to provide basic services, we will see growing unemployment and escalating social conflict and violent crime. Capital will continue to leave SA and so will the skilled and those who pay taxes, no matter Ramaphosa's exhortations to white citizens not to let their children leave. From a sustainability point of view, SA's time is running out.

[2] Source: Factset
[3] A negative number implies fewer rands are being paid per US dollar, so this implies a strengthening of the rand.
[4] Published in Business Day of 30 April 2019

In his latest book SA’s biggest doomsayer, RW Johnson, asks the question: how did it get to this? How did it happen that the ANC, which had vowed not to follow the path of other liberation movements and fall into corruption, cronyism and elite enrichment, has repeated exactly those mistakes?

The answer, says Johnson (and not in a nice way; his argument is laden with afro-pessimistic generalisations) is that as in other postcolonial African states, in SA it was a “bureaucratic elite” that took power and it is the pursuit of their interests that has exposed the state to systemic corruption. The bureaucratic elite is a term used by Marxist theorists to describe a political class whose fortunes are tied to proximity to the state, which it uses to leverage economic opportunities.

It is an interesting aside that Johnson, who is a former Oxford historian and a liberal, finds Marxist terminology the most effective analytical tool at hand. His analysis is not much different from that of left-wing academics such as Tom Lodge, who have theorised the South African state as one built on relations of neo-patrimonialism. In this arrangement the political class is held together through the exchange of reciprocal favours based on patronage rather than being united by political ideas or ideology.

The consequence is the absence of national interest and the inability of leaders to assert and pursue a common vision, as the political agenda must constantly be balanced among competing vested interests. This is where we are trapped, caught between sectional interests of groups that constrain the political choices.

Asking Ramaphosa to break this mould is a tall order. It would require him taking the risk of causing a deep ruction in the ANC, and if he loses being removed from his post in five years’ time.

So far, he has shown no appetite for such a gamble and has backed down at every turn before the fight has even got started. Public service retrenchments, an Eskom pay freeze and job cuts and privatisation have already all been ruled out. Whether he can or will attempt to break the mould of history has little to do with what percentage the ANC scores in these elections. It is about vision, strategy and extraordinary courage, a kind of courage that does not come along often in a country’s history.

We saw it in the Mandela generation of the 1950s, where a cohort of extraordinary leaders — Nelson Mandela, Ahmed Kathrada, Walter and Albertina Sisulu and Oliver Tambo — saw fit to break with the logic of pure African nationalism and campaign for a non-racial SA.

That decision was not about “Mandela magic”, it was a about a peer group of courageous and visionary leaders who imagined an almost unimaginable future for SA.

Ramaphosa might like to be such a leader. But it will not be that surprising if he can’t be.