EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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A NOTE ON THE CURRENT CHAOS IN SA

What a week it's been in South Africa. Statistics South Africa (Stats SA) reported better than expected, but still dismally bad, economic growth figures. We were expecting the economy to grow by 0.7% during 2018, but actual figures showed that the economy grew by 0.8%. Which is dismal for a couple of reasons: most notably because it implies that, overall, the real income of South Africans only grew by 0.8%, which I for one wouldn't be happy with. What's worse is that 0.8% isn't even close to being enough to cover the population growth of about 2%, which means on a per capita (person) level, many South Africans are getting poorer. This picture worsens if one accounts for the fact that economic (income) growth comes predominantly from the already "wealthy" individuals in the tertiary sector, and not from the traditionally less wealthy workers in the primary and secondary sectors. Also, an economy that only grows at 0.8% with a high population growth rate, implies that not nearly enough jobs are being created to adjust for the growing workforce. So, our already high unemployment figures (second highest in the world) will most likely worsen over the medium to long term. *Eish!*

Luckily, most of the bad-growth-news should have already been priced into markets. Being one of the worst places to invest in, weighed our markets down over the last couple of years but was not the main reason we've seen the recent sell-off in local equities or the depreciation of the rand.

The recent sell-off in local equities was caused, to a greater extent, by passive investors at large global financial institutions. These institutions most likely decided to take profit after a very good US Dollar-denominated run on the JSE – not because of load shedding or the "nationalisation" of the South African Reserve Bank (SARB). After January the JSE was the top performer in dollar terms among all global equity markets, up by close to 10%; a better return than most US portfolios achieve in a year. So, why remain invested in a very volatile economy if you can lock in strong returns and move capital to more structurally-safe economies that have the potential to deliver additional returns at reduced risk? As active investors we, however, remain optimistic about the JSE's prospects, especially at these very low earnings-multiples and believe there is even more room for price-growth.

Unfortunately, South Africa's economy is very dependent on short-term capital flows that finance our current account deficit. As dollars become scarcer (after a sell-off), and therefore more expensive, pressure is placed on the rand. As if that wasn't enough, the dollar also gained momentum because of the relative strength of the US economy. Until recently, markets believed that the European Union (EU) would stop quantitative easing this year and possibly even hike the interest rate once this year. However, after the president of the European Central Bank (ECB), Mario Draghi, gave a very dovish message, it seems there's very little that can stop the dollar from gaining on other major currencies. The ECB lowered their growth expectations for the Euro-area, explained that inflation isn't where it should be, and tried to explain why the next round of bond repurchases is a good idea. All of this means that the US economy still looks relatively stronger than the rest and that interest rates in the US will remain relatively higher, a perfect setup to attract short-term, foreign capital and support a stronger dollar. The net effect is a weaker rand.

On a side note: President Ramaphosa's remark on nationalising the SARB is political talk, to say that they are going to buy-back (or even take) the SARB's privately issued shares. In so doing, the SARB will be "nationalised" to a certain extent and the ANC would have won over some of the radical votes the EFF have taken from them in recent elections. However, all the nationalised shares will do is give the ANC another vote on the board of directors of the SARB, who have no say over the constitutionalised mandate of the SARB. So, basically nothing changed and the mandate of the SARB remains independent.