EFFICIENT GROUP

ECONOMIC COMMENTARY

- Francois Stofberg

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THE WORLD GONE MAD

In the first week of August I want to reflect on the past month of July. It was a quiet month; global and local markets were going strong and the rand was starting to appreciate back to normal levels. Even after the South African Reserve Bank (SARB) decreased interest rates by 0.25%, adding roughly R5 billion back to household consumption, the rand remained strong. But then the United States Federal Reserve (Fed) also decreased interest rates by 0.25%, Trump tweeted about more trade war retaliation, and the Chinese currency (the yuan) depreciated to historic levels. All this led to confusion and market turmoil.

If I'm honest, I think the world is going a bit mad. In times like these I think it's more important than ever to find sound financial advice and keep to long-term investment strategies. It's true that the United States has now been in one of its longest recoveries since it was founded on the 4th of July 1776. But this does not mean that a severe crash is around every corner. It also doesn't mean that the United States will continue along this divergent path. Sooner or later the process of creative destruction will be triggered, but it won't be anything like the 2008 global financial crisis. Unlike then, there is no single overblown instrument that has crept into every investment portfolio to eventually wreak havoc once it bursts. So, we're expecting the United States to go into a slowdown, in fact, the flash-statistics like jobs and payrolls are already showing it. We might even have a correction or a technical recession, however these will be limited to the confounds of the United States. Usually, when the US sneezes the rest of us catches a cold, but this time round it will be limited to a runny nose and not the 2008 bubonic plague.

Last week I discussed the trade war. Although it's bad, it's also not as bad as the media makes it out to be. Even in a worst-case scenario where global tariffs reach 60%, most models show a meagre 2%-3% reduction in global GDP. However, none of these models capture the pre-emptive and ongoing countermeasures that various governments use to keep their economies afloat. The United States reduced corporate taxes and reduced their interest rates. The Chinese lowered the reserve ratios banks must hold, and now even devalued their currency. Also, these models have been unable to capture how easy commodity markets and supply chains have adopted to changes in demand and supply. The Chinese changed their soybean supplier from the United States to Brazil, almost overnight. Even United States companies found it easy to shift their demand towards Mexico when import restrictions were imposed on Chinese goods. A better estimate is that a full-blown trade war will only reduce global growth by 1%-1.5%, which is bad, but doesn't warrant the type of sell-off we're seeing in equity markets.

Then, our local economic madness. Like the rest of the world, South Africans seem to read every bit of pessimistic news they can lay their hands on and then they don't even know that Google and Facebook algorithms pick-up on your searches, conversations, posts on various websites, and the videos you watch. This turns into an eternal pessimistic cycle. SA is not the next Zimbabwe, or Venezuela, because the following five fundamental structures are still in place:

+ **One:** we have a (relatively) healthy and working democracy, which amongst others means that we can get rid of corrupt leaders without shedding blood. It also means that power-corrupt crooks can't stay in power for too long.
+ **Two:** our press is free, and this leads to crooks being caught. Even though they are seldom sent to jail, their misdeeds are uncovered, and they're removed from power.
+ **Three:** our judges are unbought, and the rule of law is enforced.
+ **Four:** our monetary policy is immaculate. Not only does this help to reduce the rate at which buying power is eroded, but stable prices create a healthy environment for an economy to thrive in. Also, at current and projected levels of inflation long term interest rates are reduced. This in turn reduces the total long-term debt burden.
+ **Five:** our financial markets are well-regulated, very liquid, and our assets are in high demand (even the government debt used to bail-out Eskom). This means that the same voters who put the ANC in power, feel the impact of this poor decision on their pockets. That's why the ANC's national votes have fallen from 67% to 55%, and why they lost Nelson Mandela Bay Metropolitan and Johannesburg Metropolitan.

The ANC, not the President, know they must start getting their act together, just like they did in 1994. But like then, it will take at least 15 years to bring us back to a place of progression.

81 Dely Road, Hazelwood, Pretoria, 0081 +27 (0)87 944 7999 info@efgroup.co.za www.efgroup.co.za