EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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UNFORGETTABLE OCTOBER

Local markets were nervously awaiting the medium-term budget and the credit rating announcement by Moody's. Uncertainty caused the JSE to slump, and the rand to fall well below R15.00, measured against the US dollar. Unlike in most countries, sentiment-driven uncertainty has a funny way of having a direct impact on our local equity and currency markets. Despite mixed interpretations, offered by anyone who believes him or herself an expert, we believe the news was positive and points towards a hopeful tomorrow. Hope (positive sentiment), even unfounded (like not being downgraded) or unrelated (like winning the rugby world cup), has a funny way of causing momentum to shift, which in turn causes mindsets (ideologies) to shift, which ultimately brings us to a better tomorrow.

So, the medium-term budget policy statement (MTBPS) or mini-budget as we know it, showcased all the heartache we were expecting. Revenue was roughly R50 billion less than initially forecasted by the Treasury in February of this year, most notably because the economy is not growing: everyone seems confident that growth will only reach 0.5% in 2019. As a result, the budget deficit will fall just short of 6%, measured as a percentage of GDP. And, of course, that wasn't the end of it: debt to GDP is expected to reach 70% before too long, fuelling the speed at which interest repayments is growing. At face-value the rapid erosion of fiscal sustainability is a cause for concern, because it's one of the main reasons why our economy isn't growing. It's also why S&P and Fitch have already downgraded us to junk.

However, it's clear from the minister's blunt presentation of these facts that the government has finally come to grips with reality. This is good news because "You can always count on Governments (Americans) to do the right thing, after they've tried everything else" (paraphrasing Winston Churchill). In his mini-budget address the Minister of Finance, Tito Mboweni, once again cut to the real issue of government finances, once again paraphrasing "we have too many civil servants and we pay them too much". This builds on the Minister's decision in February not to increase wages of members of parliament and executives at SOEs, and to push civil servants who are close to retirement to take packages without incurring penalties. He cleverly informed South Africans how many civil servants earn more than R1 million a year. These announcements speak to the masses, hopefully turning them against the notion of spending too much on wages. In effect, he's busy convincing the ANC's supporters that government shouldn't be employing more people. If this shift is possible, it would be an important ideological shift that will hold profound positive benefits for economic growth. As government continues to shift their focus away from social upliftment (increasing the size of their wage bill) towards economic upliftment (spending on investments and the ease of doing business) the potential for long-term sustainable growth increases. Another key issue which was not addressed (even though the mini-budget was not the forum for it) is the ineffective spending on scarce resources, most notably wasting money on poorly run SOEs like Eskom, SAA, and the SABC, to name but a scant few.

From this backdrop Moody's decided not to downgrade South Africa's government debt to junk, but only to revise their current grading down to negative. From this positive news the rand seems to be gathering momentum towards R14.50, should it break through this critical level it might even recover back to levels around R14.00. However, global sentiment has not shifted back to riskier emerging markets and as a result the JSE is struggling to find similar momentum. However, we are confident that negotiations between the US and China, which have led to a Phase 1 deal, will be globally growth positive and shift momentum back to emerging markets. Also, as the developed world starts to slow down, South Africa's relative position will improve which will further aid sentiment towards our markets. For this reason, we remain confident that the JSE will enter a period of substantial growth within the next 24 months.

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