EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

31 March 2020

THE MARCH MONSTROSITY

In the past month, it's all been about the coronavirus. COVID-19 swept in and markets cracked, even in the United States where until recently, things couldn't have been going better. In most equity markets, locally and abroad, indexes fell by as much as 30%. Updating our forecasts with the latest research suggests that the global economy might only grow at a rate close to 1%, down from close to 3.5% in 2019. Should lockdowns be extended, and factories, mines, and shops remain closed, we could easily see a full year contraction, like the one we saw in 2009 when the global economy contracted by -1.7%.

South Africa's economy, like most small, open, and developing economies, will come under a lot of pressure. Not only directly by not having enough, effective healthcare systems, but indirectly because of the economic hole we were in before the pandemic. In a worst-case scenario our economy can contract as much as -6%. However, the lockdown and awareness should help to stabilize the rate at which COVID-19 spreads, allowing us to bulk-up on healthcare. One good initiative was the R30 billion government re-allocated from the UIF fund to a new "National Disaster Benefit Fund". This new fund is aimed at supporting households who will, amongst others, lose their incomes due to COVID-19. Research has shown that these types of cash injections can boost short-term spending, although food stamps or the like might have been better. Our base case is therefore, only to see a contraction around -1.8%. We are also confident that government, organised labour, and the private sector will be able to come to agreeable terms that will support businesses.

So, Moody's finally ripped off the bandage and downgraded our foreign and local-currency debt to sub-investment grade, i.e. junk. Good riddance! Markets were already pricing in a downgrade since Nene-gate in December 2016. All that the delay was doing was fuelling uncertainty over when it would eventually happen, placing unnecessary pressure on our financial markets. The indecision from Moody's will cause a lot of volatility in the short-term as the timing of their decision couldn't have come at a worst time. The bad news caused by government's internal mismanagement, fuelled by the worse news associated with the coronavirus, and now some more bad news of a downgrade. It's like throwing both fat, and gasoline over an open flame. For this reason, I was hoping that Moody's would at least wait until the crisis dissipated to see exactly how our economy fairs after some measure of certainty and normality had at least returned. Especially because the reasons they gave for the downgrade (poor labour policies, weak governance, SOEs, and failing state finances, to name but a few) are the same reasons they could have used to downgrade us a year ago.

After the short-term volatility we still believe that the rand should appreciate, mostly because of a reduction in uncertainty and some possible short-term capital inflows. Another reason why we won't see a sustained depreciation is because most of the bond outflows that would have occurred because of a downgrade, occurred because of the coronavirus. Something to look forward to is the possible inflows into our newly minted junk bonds. Just like some investors are, by mandate, only allowed to invest in investment grade bonds, others are only allowed to invest in sub-investment grade bonds. However, this will only occur once fearful institutional investors see past their short-term emotions and start reducing liquidity and investing again. But, don't hold your breath. What investors should rather be doing, after consulting with investment specialists of course, is to use the current volatility to re-structure and if possible, even increase their holdings. Like Winston Churchill said: "Never let a good crisis go to waste".

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