ECONOMIC COMMENTARY

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YOUR MONTHLY ECONOMIC UPDATE

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RUSSIA, THE UKRAINE, AND SOUTH AFRICA'S BUDGET

During February, market uncertainty peaked, and this caused volatility to erupt. After a lot of negotiations, media staging, propaganda, and hard sanctions, Russia invaded the Ukraine. The reasons for this invasion range from believable to fanatical, and even includes a conspiracy or two. Officially, Russian President Vladimir Putin wants to ensure that the Ukraine, with a population of more than 40 million people, does not join the North Atlantic Treaty Organization (NATO). This intergovernmental military alliance between 28 European countries, the United States (US), and Canada is a collective security agency, wherein each member state agrees to defend the others if attacked by any external party. If the Ukraine were to join NATO, its allies would then have to join them in fighting Russia. Add to this mix concerns about China annexing Taiwan, and fears about a Third World War start to infiltrate market sentiment.

Another concern that Putin has is that if the Ukraine joins NATO, it will allow the US (read NATO) to open an army base too close for Russia's comfort. Having a US (NATO) military base so close does not fit well with the narrative around Russian pride and sovereignty in the area, and does not bode well for the love-hate relationship that still exists between Russia and the US. From here, the reasons for Russia's invasion get a bit blurrier. Russia's proud alter ego, embodied by its President, might want to rebuild Russia into the Soviet Union powerhouse that it once was. Then there are rumours about Ukrainian separatists that want to re-join Mother Russia. And then, if you want to go full-out conspiracy, there might be a story about inflating energy prices that is worth considering.

We all know that oil has counted its last days, and that oil prices should, in fact, already be falling, until reaching the capitulation cliff around 2030/35. During this period, most experts believe that the use of sustainable energy sources should take over from dirtier sources like crude oil. So, if you (Russia) and your allies, the Organization of the Petroleum Exporting Countries (OPEC), own most of the oil production in the world, and want to keep prices as high as possible to make money for as long as possible, what do you do? You cannot reduce supply any further because then no one makes money. Maybe a skirmish is all you need to send oil prices beyond $100 a barrel for the first time since 2014, which is exactly what happened.

Whatever the case may be, we maintain that the impact of the Russian-Ukrainian crisis will be limited to a temporary sentiment-driven shock to markets. This crisis acted more as a catalyst for markets that have been running too hot for too long, to blow off some steam, before interest rates start to increase around the world. Through this lens, the recent volatility that resulted from Russia's invasion makes more sense. Of course, the crisis will impact energy and commodity prices, which can keep global inflation elevated but, most likely, only in the short to medium term. We do not believe that this crisis will have a lasting impact on global economic growth, which will, therefore, not suppress earnings growth or valuations. The main risk to markets remains the possibility of a monetary policy error from key central banks around the world.

In terms of South Africa's (SA's) National Budget, our main impression is that it was a tough Budget that was well delivered and should bear much fruit in the long term. It was especially tough on civil servants who will receive below-inflation wage increases over the next three years. It was also tough on state-owned enterprises (SOEs), who will receive very little, if any, support, from government over the next couple of years. It was also tough on taxpayers who could finally see the real cost of an inefficient government. The debt service cost that government must pay, mostly owing to its inefficiencies, has now ballooned to R302 billion, roughly R4 300 per person living in SA. Imagine if we had less debt and more of that money could be spent on supporting economic activities. The shock to taxpayers is even greater if you consider the number of grants that must be paid to keep average South Africans out of abject poverty. Including the special COVID-19 grant, almost 30 million South Africans are now dependent on government. Compare that to the 15 million individuals with jobs in SA, or the 8 million individuals who are paying most of the taxes to keep the entire country going. Nevertheless, government has been firm and consistent since President Ramaphosa's appointment in 2018. Implementing tough choices around wage bills and privatisation now will bear much fruit later.