ECONOMIC COMMENTARY

- Dr. Francois Stofberg

YOUR WEEKLY ECONOMIC UPDATE

8 March 2022

AND SO, IT CONTINUES...

The whole world continues to look on in disbelief as Russia's invasion of the Ukraine drags on, despite heavy sanctions and the seizing of assets from anything or anyone related to Russia. Russian flights have been restricted and travel bans have been imposed. The United Kingdom (UK) has cut Russian companies out of their insurance market, the world's largest commercial and speciality insurance centre. Germany has abandoned the Nord Stream 2 Baltic Sea gas pipeline project. The United States (US), UK, and European Union (EU) removed several Russian banks from the SWIFT banking system, the messaging infrastructure that links the world's banks together. And so, the list goes on. Fitch and Moody's have also downgraded Russia's sovereign debt to junk status. Their reasoning is that the economic pain that Russia is inflicting on itself, as well as the effects of these sanctions, will make it difficult for Russia to honour their debt repayments. Another result of the conflict has been soaring commodity prices that have increased on the back of supply chain fears. In fact, raw material prices have seen their most striking weekly increase since 1973, which was during the great oil crisis.

As Russia continues to distance itself from the rest of the world, and as heavy sanctions from governments and institutions from around the world continue, a major source of energy and commodities is being choked off from global supply chains, which will undoubtedly accelerate global inflation. The oil price alone has increased to $140 per barrel. JPMorgan Chase & Co., a bank, has warned that the crude oil price could reach $185 a barrel if Russian supply continues to be disrupted. Wheat prices also reached their highest level since 2008, when fears hit markets that the Ukraine might have to reduce their output. Wheat is an essential ingredient for many foodstuffs, from bread to cookies and even noodles, and the Ukraine supplies almost a quarter of global exports.

On the one hand, higher commodity prices are good news for local producers. But on the other hand, elevated prices and persistent shortages can have a severe negative impact on global economic growth, which, in turn, is not good news for local commodity producers. What also reduces the potential for global growth is a decline in confidence that, in turn, reduces investment and increases the potential for credit stress that can ripple through markets. Lower global economic growth is also not good news for company earnings. Tied to higher inflation, it creates a dilemma for central banks around the world who are heading into a cycle of tighter monetary policy. Nevertheless, we have not changed our long-term strategy. We will still be investing in quality companies. That being said, we have increased our cash position a while back to make the most of the volatility that we are currently experiencing.

The US has been isolated from many of the recent shocks that have rocked the European block of countries, which has caused the Euro to fall back to its two-year low against the US dollar, to below $1.10. However, in the US, strong employment numbers point toward a continuation of their healthy recovery. Employers in the world's largest economy added 678 000 new jobs, far more than what analysts were expecting. Unemployment has now fallen back to 3.8% in the US, as employees are dragged back to the office by improved healthcare conditions and higher wages. Whilst fears about COVID-19 are finally dying down, hourly earnings have increased by more than 5.1% over the last year, much higher than the historic average. Amidst all the chaos, it seems as if the Chairman of the Federal Reserve (Fed), Jerome Powell, still feels comfortable with raising interest rates at least 0.25% in the US. In his view, this would be a good first step in a series of adjustments that he expects will be necessary in 2022 to rein in inflation in the US.

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