EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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MARCH MAYHEM

March has been quite a month! The rand took a beating, equity markets (both locally and abroad) were flat, and the United States (US) bond market inverted! Brexit also fits in there somewhere. The Brits introduced a new voting process to the democratic system, an indicative vote that would help them find an acceptable alternative to Prime Minister May's current deal.

Over in the US we heard that the Fed will no longer be hiking interest rates this year – a bold and direct statement unlike the tone we've gotten used to from the Fed. In fact, Chair Powel said the Fed would only reconsider interest rate decisions in early 2020. He went on to explain that the Fed would then consider the data and might even decide to decrease interest rates. Usually, such a dovish tone would lead to a depreciation of the US Dollar. However, measured relatively against the European Union (EU), US fundamentals are still considerably stronger. In fact, whilst the US maintains "full" employment, produces strong industrial figures, keeps inflation on target, and fights for free trade, the EU only manages to muddle along. A similar comparison can be drawn between the US and most developed countries. So, where else would a risk-averse investor take their money than to US bonds? Consequently, the US yield-curve inverted, fuelling speculation about an impeding recession.

Understanding the relative strength of the US economy helps to explain why we've seen this inversion – higher demand for US bonds increases the price of bonds but decreases the yield. It also helps to explain why we are not yet worried about the inverted yield curve and its ability to predict recessions. Unlike the environment preceding previous recessions, the US economy seems to be stable and healthy (going like a Boeing). Even last year's fears about an overvalued market that "must" lead to a crash, dissipated after the earning's recession on the S&P 500. It therefore seems more likely that investors are simply too emotional; their fixation on historic trends and inability to contextualise a broader understanding of events leads to an inability to objectively interpret current data. These emotions further explain the inverted yield curve. That is, investors believe the future is more stable than the short term because a recession "must" occur. However, considering the current economic environment in the US, we believe that even if a recession does occur it would look a lot more like last year's earning's recession than the 2008 crash.

In South Africa (SA), March was the month in which load shedding ended (for now) and we've finally been able to estimate the likely cost shedding has on our economy. In our estimation we consider the average number of load shedding hours. However, we also consider the ability of different industries, both small and large, to recover their production by either relocating, using generators, running more shifts, or delaying production. In this estimate we therefore also assume consumers simply delay their spending to eventually continue their consumption at a latter, more comfortable time when the aircons are back on. Adjusted for inflation, the cost of each day of load shedding is therefore roughly R1.1 billion. Or put differently, it costs our economy almost R120 million for each hour of load shedding. It is important to remember that this is only an estimate for the direct cost of load shedding, it does not consider the possible impact on our economy due to a fall in investor and business sentiment towards SA. Using this estimate, we were able to determine that if load shedding persists for 10 days in each of the upcoming quarters, our growth estimate for 2019 would fall from 1% to 0.65%. Should we, however, experience 20 days of load shedding during quarter 2, our economy will plunge into a recession.