ECONOMIC COMMENTARY

- Francois Stofberg

Newsletter

3 December 2019

EMERGING MARKETS

Local markets were down roughly -2.1% in November, but the rand slowly started to appreciate, finally breaking through the R14.80 levels in early December, racing towards R14.50. Another month of negative growth puts year-to-date performance on the JSE at a dismal 3.3%. If you strip out some of the riskier resource stocks, the JSE is once again busy producing a year of negative performance; that's even before you add the cost of inflation. Luckily though, inflation has been slowly decreasing over the last year, reaching an 8-year low of 3.7% in October. Average inflation in 2019 will probably be around 4.2%, a testament to successful monetary policy in South Africa.

Usually, as inflation comes down, a country's central bank, in this case the South African Reserve Bank (SARB), reduce interest rates to boost demand and in turn inflation. However, demand has been under severe strain in South Africa. Consumers are reluctant to spend as their confidence levels continue to hover in the record-low regions. But even as inflation comes down the SARB decided not to reduce interest rates which currently yield an after-inflation rate of 2.3%; one of the highest in the world. There are three reasons for their reluctance:

+ Confidence-driven demand is simply too low. Even if the SARB cut rates, it wouldn't have a substantial impact on consumption and economic growth.
+ Lesetja Kganyago, governor of the SARB, made it clear that they are now targeting levels around 4.5%, despite the ongoing debate about which level of inflation is optimal.
+ Higher real rates help keep South Africa attractive for investors. This is important in an environment of shifting momentum. Unlike policies that favor short-term consumption, greater levels of investments favor long-term sustainable growth and employment generation.

On the other end of the investment spectrum, the S&P500 had another exceptional month in November, up by 3.4%. Year-to-date the United States market is up 24% emphasizing the importance of having enough exposure to global markets. Strong profit growth and healthy sentiment have kept United States markets running at full capacity. Although wage inflation is strong, a fall in average payroll and employment levels over the last two years point towards an economy that's slowing down. As a result, the Federal reserve decided to shift towards a looser monetary policy. Another indicator that the economy is slowing down is the ongoing fall of investment-spending by United States corporates, which point towards their belief that the record-long United States expansion is finally coming to an end. Most analysts agree that the United States should enter a period of slowdown during the latter parts of 2020 which is good news for emerging economies. A slowdown in the United States should shift momentum back to emerging economies and their markets. This is where we believe South Africa, as an emerging market, can benefit.

Although local markets are down, the rand's strength supports our view that there is a shift in sentiment in South Africa. As the phase one trade deal and Brexit becomes a reality, the United States blows off some steam but fears of a global slow-down remains. As the Middle East remains dormant, momentum continues to favor emerging economies. Among emerging economies, a couple of things draw the right attention to South Africa:

+ Our president's hard-selling investment drive;
+ The attack on corruption;
+ Extremely low valuations; and
+ Positive earnings growth.

Unfortunately, it's always darkest before the dawn. But at current projections we still believe the JSE will produce substantial growth within the next 24 months.

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