ECONOMIC AND MARKET OVERVIEW

analytics

December 2020

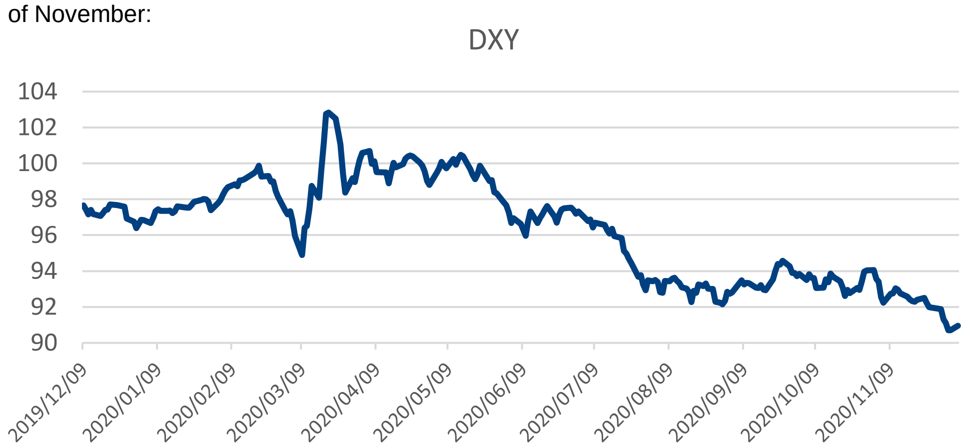
Global

After all the hype around the 3 November US election, interest in US politics has died away surprisingly quickly as it became apparent that Joe Biden will most likely be inaugurated on 20 January 2021.

This change in news focus was perhaps not all that surprising as more relevant matters, such as a second Covid-19 wave in the northern hemisphere and accompanying lockdowns, are threatening to derail the global economic recovery. Various vaccines seem to be in the final stage of approval, but distribution of these and the willingness of communities to be vaccinated also play a role in creating the conditions for a sustained return to previous levels of economic activity.

This is clear from a recent report published by TS Lombard, an independent economic and investment strategy research house. They concluded that the world economy will benefit from an effective vaccine (or vaccines) but that it also faces two major downside developments: the second wave of infections which is more virulent than previously expected (especially in Europe), and delays in the implementation of a second fiscal stimulus package in the United States which was originally scheduled for the end of the third quarter this year. They believe that the vaccine upside and these short-term downsides should combine to sustain stock markets at their current very high ratings: the downsides and resulting disappointing Q4 and Q1 growth will keep central bank policies ultra-easy, while the prospective consumption benefits from the vaccine will sustain investor confidence.

The “risk-on” sentiment among investors put further pressure on the US Dollar with emerging markets currencies being the major beneficiaries of capital flows. The chart below shows how the US dollar index started the year strong but from the point where markets turned in March have weakened by nearly 12% to the end of November:



The mere change in year from 2020 to 2021 will not be enough to make downside risks to the global economy and investment markets disappear. Large discrepancies exist in the valuations of investment opportunities: growth versus value, developed markets versus emerging markets, new versus old technology to name a few. As a result, careful consideration in terms of asset allocation and stock selection is likely to be the main factors contributing to successful investment outcomes in 2021.

South Africa

In their last meeting for the year the South African Reserve Bank’s Monetary Policy Committee (MPC) decided to leave the repurchase rate unchanged, keeping it at 3.5% and the prime lending rate to 7%.

As was the case during the previous meeting, three of the MPC members voted to keep the rate unchanged with two members favouring a reduction of 0.25%. In his statement, the governor of the Reserve Bank, Lesetja Kganyago, noted that it has become clear that Covid-19 infections will occur in waves of higher and lower intensity, caused in the large part by pandemic fatigue and lapses in safety protocols.

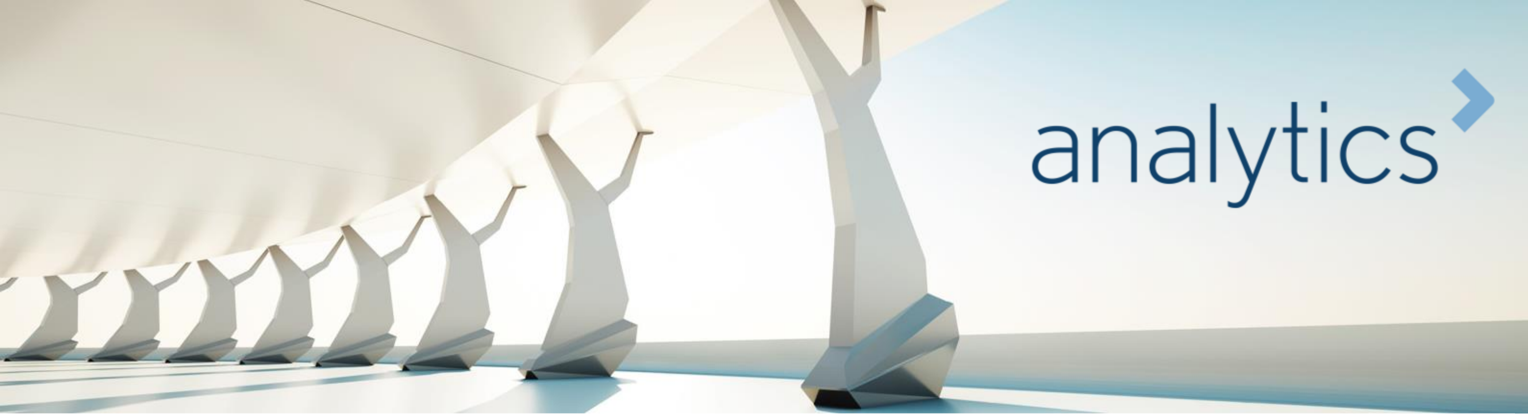
The “risk-on” sentiment among investors put further pressure on the US Dollar

South Africa’s economic output is now expected to grow by 3.5% in 2021…

Investors with portfolios tilted towards South Africa had reason to smile…

By the 1840s Santa himself was a frequent commercial icon in advertisements

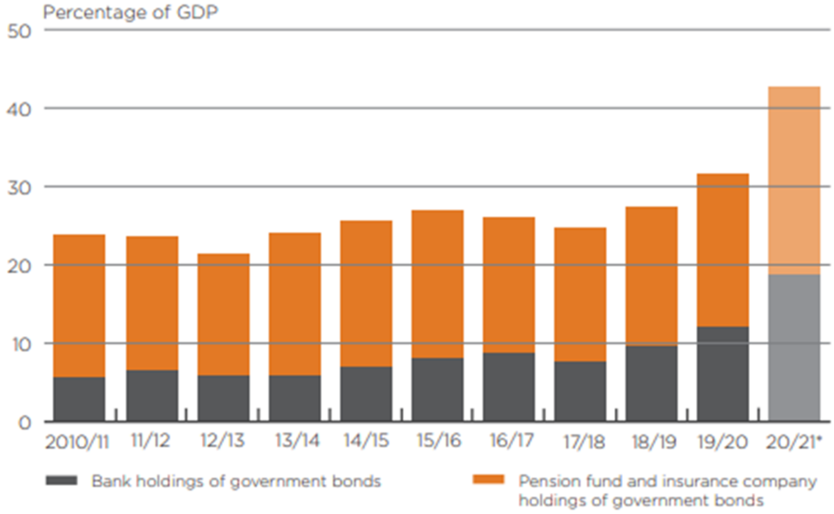
…shopping, contrary to popular belief, does not come naturally to everyone.



The virus is spreading rapidly in parts of North America and Europe, and hotspots have emerged in some parts of South Africa. Despite the welcome development in November of successful vaccine trials, the global distribution of vaccines is likely to be slow, resulting in a modest pace of global economic growth into 2021. South Africa's economic output is now expected to grow by 3.5% in 2021 and by 2.4% in 2022.

The Governor further stated that the accommodative policies in many advanced economies and the improved economic outlook have supported a partial recovery in global financial markets. But this has so far resulted in only a trickle of fresh capital flows to emerging markets, and financing conditions remain uncertain. South Africa's high public financing needs have been met instead by local private sector savings and borrowing from international financial institutions. The graph below (from the SARB's latest Financial Stability Review) shows how local banks and pension funds have stepped in as lenders while foreigners were selling local government bonds:

Figure 12: The domestic financial sector's exposure to government debt



* The 2020/21 data is based on NT's government debt forecast and the assumption that the share of government bonds held by domestic banks, pension funds and insurance companies remains stable at the September 2020 level and is representative of their total government debt holdings.

Sources: NT and SARB

The Bank's headline consumer price inflation forecast averages 3.2% in 2020 and is slightly lower than previously forecast at 3.9% in 2021 and remains at 4.4% in 2022. It implies that official interest rates are likely to remain stable for the foreseeable future, lending further support to the performance of equity markets.

Market Performance

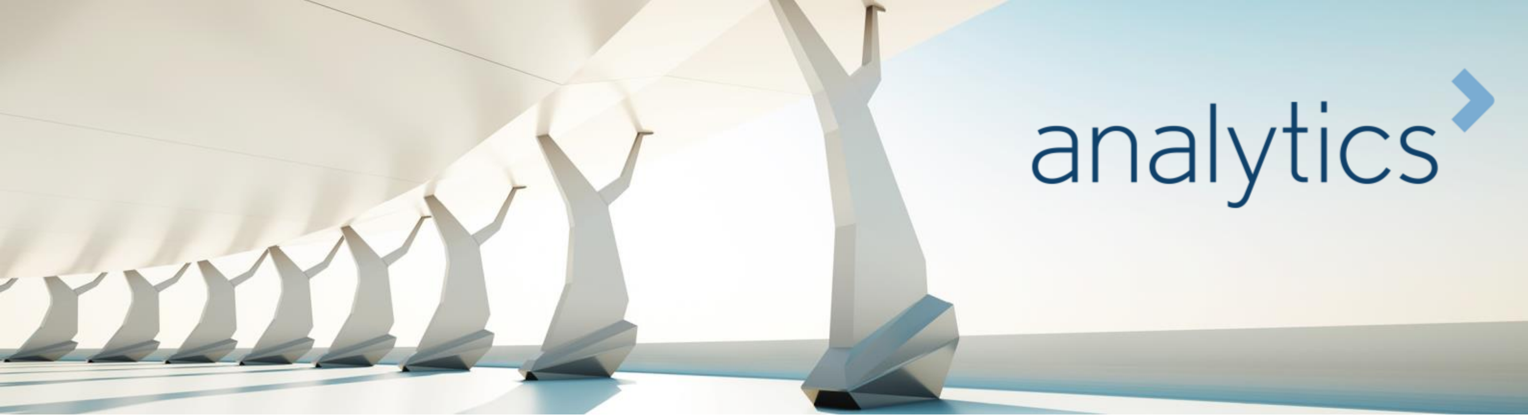
The prospect of various Covid-19 vaccines, the increased likelihood of a Biden presidency and better than expected news-flow from company earnings announcements all contributed to very strong equity market performance in November. Tantalum Capital reports that most major indices were up more than 10% (in local currency). Not even the second wave of Covid-19 infections in the UK, US and Europe could dampen investors' appetite for risk. The expectation is that lockdowns would be short in duration and economically much less damaging than in March this year.

Against this backdrop emerging market equities flourished, and even though South Africa makes up less than 4% of the MSCI World Emerging Markets index, the local market still benefited from this positive sentiment. The US dollar weakened against most currencies, industrial commodity prices rose and longer dated South African bonds rallied. Investors with portfolios tilted towards South Africa had reason to smile at the end of the month.

Property securities recorded its best monthly performance in over 12 years as it gained over 17% in November. This strong recovery, however, was accompanied with increased volatility of the sector pointing to investors' concern about the sustainability of the rally.

Local bonds ended the month 3.3% stronger as foreign investors returned as net buyers of South African government bonds, despite further debt rating downgrades by Fitch and Moody's.

Bitcoin (and other crypto-currencies) continued its strong run of late, but investors would do well to remember the volatility these currencies exhibit – on the way up and on the way down.



MARKET INDICES[1] (All returns in Rand)	30 November 2020		
	3 months	12 months	5 years
SA equities (JSE All Share Index)	3.6%	6.0%	5.1%
SA property (S&P SA Reit Index)	5.7%	-48.1%	-12.3%
SA bonds (SA All Bond Index)	4.1%	8.1%	8.4%
SA cash (STeFI)	1.0%	5.8%	7.0%
Global developed equities (MSCI World Index)	-3.5%	21.6%	13.1%
Emerging market equities (MSCI Emerging Market Index)	0.3%	25.5%	12.7%
Global bonds (Barclays Global Aggregate)	-7.2%	14.5%	6.1%
Rand/dollar[2]	-8.6%	5.6%	1.4%
Rand/sterling	-8.9%	9.0%	-1.0%
Rand/euro	-8.6%	14.6%	4.0%
Gold Price (USD)	-9.8%	21.2%	10.7%
Oil Price (Brent Crude, USD)	5.1%	-23.8%	1.3%

1. Source: Factset
2. A negative number implies fewer rands are being paid per US dollar, so it implies a strengthening of the rand.

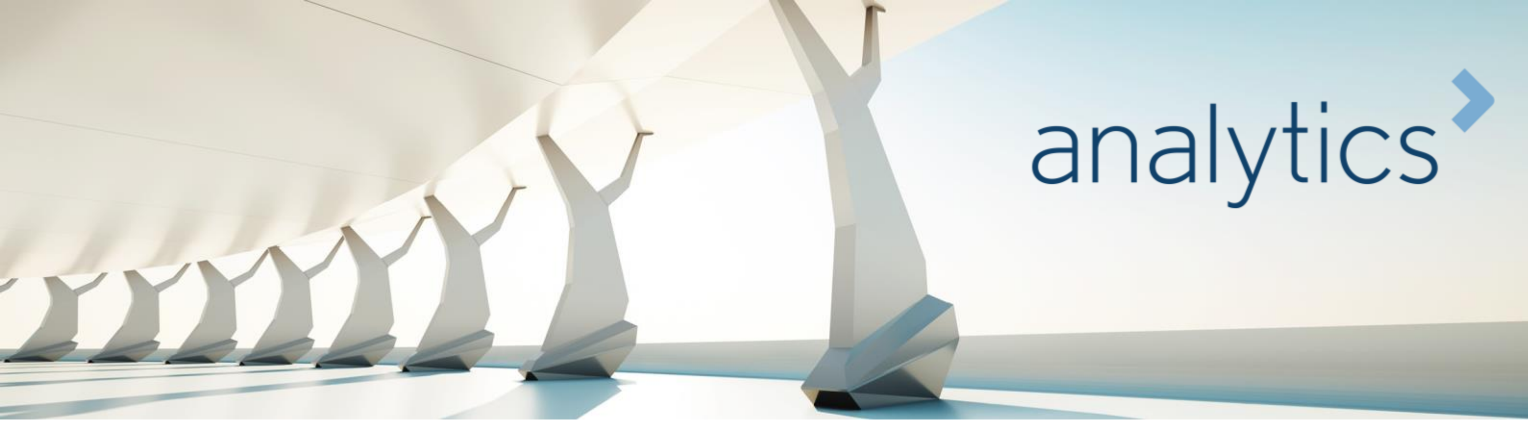
Commentary – the economics of Christmas[3]

A curious ritual takes place each year in Japan – it's called Kurisumasu ni wa Kentakkii, or Kentucky for Christmas. This is the habit of eating KFC on the 24th of December. It began as an inspired bit of marketing when KFC noticed in the 1970s that expatriates who craved turkey substituted it with a bucket of Colonel Sanders' best. It has since become a popular Japanese tradition with queues forming around the block and pre-orders being placed as early as October.

Christmas, as you may know, is not a religious holiday in Japan, where only a tiny minority of the population is Christian. Kurisumasu ni wa Kentakkii however demonstrates how easily commercial interests can hijack religious festivals. From Diwali in India to Passover and Rosh Hashannah in Israel, but most notoriously Christmas in America. Why, for instance, does Santa Claus wear read and white? Many people will tell you that it's to match a can of Coca-Cola and was popularised by their advertising in the 1930s. It's a good story, but the red and white Santa was not created to advertise Coca-Cola but rather a rival beverage called White Rock back in 1823. Rudolph the Red Nose Reindeer was the one who was invented as a marketing gimmick. The modern Santa Claus is a century older – adapted from Dutch traditions in the once Dutch city of New York (New Amsterdam) by prosperous inhabitants of Manhattan such as Washington Irving and Clement Clark Moore. They also wanted to turn Christmas Eve into a hushed family affair rather than the raucous partying of street gangs – everyone tucked up in bed and not a creature stirring. Not even a mouse. Moore, who penned the line "'Twas the night before Christmas" in 1823 did as much as anyone to create the idea of Santa Claus – the patron saint of giving presents to everyone. Whether they want them, or not. It was at the same time that advertisements for Christmas presents became common in the United States. By the 1840s Santa himself was a frequent commercial icon in advertisements. The tradition of giving gifts took a firm hold. Christmas shopping is therefore not a new phenomenon – it has been around for almost two hundred years.

Joel Waldvogel (an economist and author of "Scroogenomics"[4)] has been able to track the impact of Santa on the United States economy over the decades. By comparing retail sales in December with those in November and January Professor Waldvogel has been able to calculate the Christmas spending bump all the way back to 1935. You may find it interesting that, relative to the size of the overall economy, Christmas spending then was three times bigger than what it is today. Waldvogel has also compared the Christmas boom in the United States to other countries around the world. It may be surprising to learn that consumers in the United States are not the biggest relative spenders. They lag countries such as Portugal, Italy, South Africa, Mexico and the United Kingdom which have the largest retail boom compared to the size of their economies.

3. References to Christmas should be understood to equally apply to other religious holidays with gift giving rituals
4. Scroogenomics (Why you shouldn't buy presents for the holidays) by Joel Waldfogel. Princeton University Press 2009



In the grand scheme of things Christmas is a modest affair – financially speaking. In the United States, for every $1000 spent across the year, just three dollars are specifically attributable to Christmas spending. After all, you were going to buy groceries in any event, pay your rent and watch Netflix for the month. For certain retail sectors such as jewellery, technology (and useless bric-a-brac) Christmas is still a big deal. A small portion of a very large number is, after all, still a large number. Waldvogel reckons that at least $70 billion is spent on Christmas alone in the United States, and worldwide about $200 billion. I know that the economist in you wonders whether all that money is well spent?

“There are worlds of money wasted at this time of year, in getting things that nobody wants, and nobody cares for after they are got.” Author Harriet Beecher Stowe expressed this complaint in 1850 as an early example of a recurring Christmas dilemma. Economists and religious moralisers don’t often find themselves on common ground, but on the subject of Christmas they do. Both groups think that a lot of Christmas spending is wasteful. Santa’s gifts rarely miss the mark. He is, after all, the world’s number one toy expert. The same cannot be said of the rest of us.

Professor Waldvogel’s most famous academic paper (The deadweight loss of Christmas[5]) simply measures the gap between the cost of a Christmas gift and how much it is valued by the recipient (without accounting for the warm glow of “it’s the thought that counts”). He concluded that the typical $100 gift was valued at only $82 on average.

This wastage figure seems to be fairly robust across countries and different religious festivals with gift giving rituals. Two Indian economists calculated this dead weight loss during Diwali. It suggests that around $35 billion is being thrown away around the world in the form of poorly chosen gifts. This is roughly equal to the annual loans granted by the World Bank to developing countries. This is real money, and it is really being wasted. That’s before pondering the strain on the economy by concentrating so much spending in one month rather than spreading it across the whole year, or the time and aggravation devoted to the task of shopping which, contrary to popular belief, does not come naturally to everyone.

In analyzing this dilemma, other economists have tried to come up with alternatives to clumsy gift giving. Gift cards and vouchers seem like more optimal gifts but do not help as much as these economists would hope. They’re often unredeemed or resold online at a discount to their original cost. If you’re set on buying a gift card, note that vouchers for lingerie sell well below face value on eBay, while vouchers for office supplies and coffee hold their value quite well. Wish lists fair much better. Research, not surprisingly, suggests that recipients are generally delighted to receive a gift that they’ve already specified. Givers are deceiving themselves thinking that a left field choice would be more welcome. Even Santa Claus prefers to receive a friendly wish list from children. Who are the rest of us to think we can do better?

We could also choose to learn from the reformed Ebenezer Scrooge[6], who, Charles Dickens declares, knew how to keep Christmas well, if any man alive possessed the knowledge. On Christmas morning the only physical gift he gave was a prize turkey. The Christmas spirits had shown him that the turkey was sorely needed (much like KFC in Japan!). Other than that, he gave people his company and his money.

Money.

That’s the true spirit of Christmas!

5. The Deadweight Loss of Christmas. Waldfogel, Joel. The American Economic Review, Dec 1993
6. A Christmas Carol. Charles Dickens, 1843
This article is based on a BBC podcast (50 things that made the modern economy) and an article in the Financial Times, both by Tim Harford.