ECONOMIC AND MARKET OVERVIEW

analytics

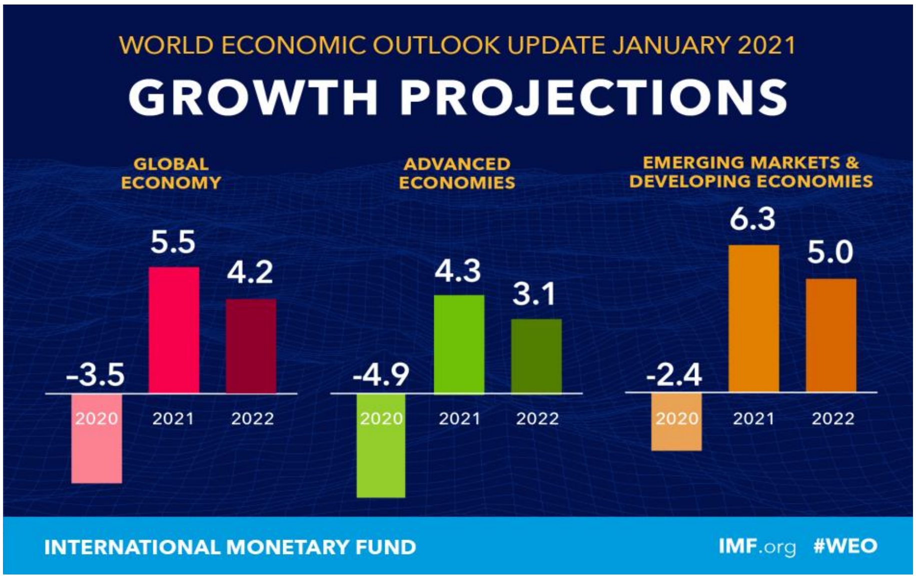
February 2021

Global

It's been just over a year since most of us learnt of the existence of a new coronavirus and its related disease, Covid-19. This pandemic has had a significant and lasting effect on the global economy.

In their latest World Economic Outlook Update the International Monetary Fund (IMF) expects fiscal and monetary support, as well as the distribution of vaccines, to broadly lift economic activity around the world. However, this view is not without risks. Although recent vaccine approvals have raised hopes of a turnaround in the pandemic later this year, renewed waves and new variants of the virus pose concerns for the outlook. Amid high levels of uncertainty, the global economy is projected to grow 5.5 percent in 2021 and 4.2 percent in 2022, against a long-term average of around 3.5% per annum. This follows a contraction of 3.5% last year, which was a smaller decline than expected in the midst of the synchronized economic lockdown.

The strength of the recovery is projected to vary significantly across countries, depending on access to medical interventions, effectiveness of policy support, exposure to cross-country spillovers, and structural characteristics entering the crisis. From the chart below it may seem as if emerging markets are leading the recovery. This is, however, heavily skewed by China (8.1%) and India (11.5%) whose growth rates are expected to be exceptionally high in the year ahead. South Africa (2.8%), Nigeria (1.5%) and Russia (3.0%) are emerging markets that are likely to lag the global GDP growth rates in 2021:



Policy actions should ensure effective support until the recovery is firmly underway, with an emphasis on advancing key imperatives of raising potential output, ensuring participatory growth that benefits all, and accelerating the transition to lower carbon dependence. As noted in the October 2020 World Economic Outlook (WEO), a green investment push coupled with initially moderate but steadily rising carbon prices would yield needed emission reductions while supporting the recovery from the pandemic recession. It's clear that the United states, under the Biden administration, will go to great lengths to support these views expressed by the IMF.

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…as long ago as 2006 they sounded the alarm on pandemics…

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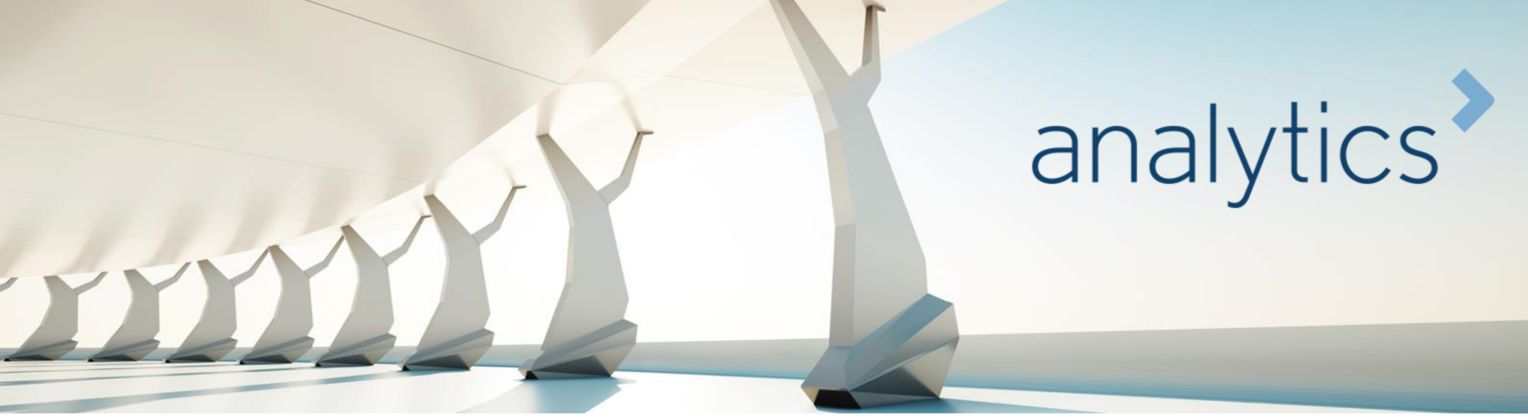


South Africa

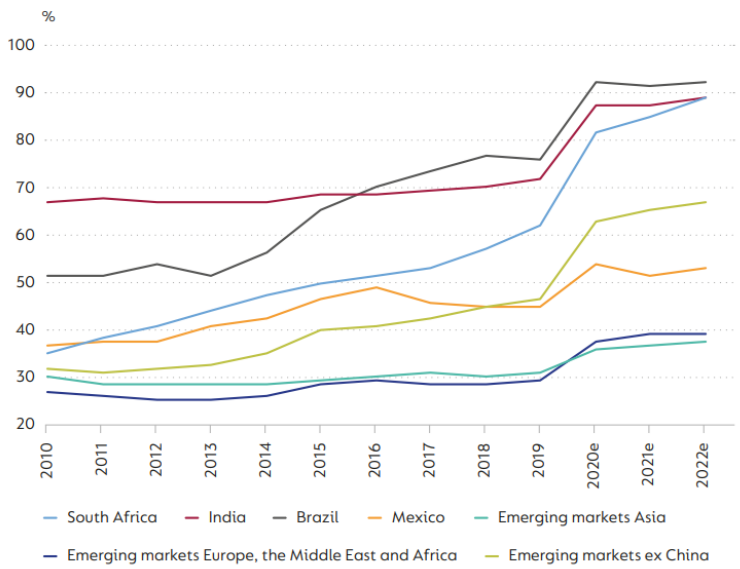
In their first meeting for the year, the South African Reserve Bank's Monetary Policy Committee (MPC) decided to leave the repurchase rate unchanged, maintaining it at 3.5% and moving the prime lending rate to 7%.

As was the case during the previous two meetings, 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, although the virus will continue in new waves, the rollout of vaccines is expected to boost global growth prospects generally. The Reserve Bank has therefore revised global growth estimates for 2021 higher. However, global distribution of vaccines is likely to be slow, creating an uneven pace of global economic recovery in 2021 – a view that is shared by the IMF.

Despite very robust terms of trade and stronger exports, getting back to pre-pandemic output levels will take time. Sharply lower public and private investment last year and continued weakness in 2021 will weigh on growth prospects. GDP is now expected to grow by 3.6% in 2021 and by 2.4% in 2022. In both instances it's a more optimistic view than what the IMF has of South African economic improvement (2.8% in 2021 and 1.4% in 2022). Let's hope that our local experts are eventually proven to be correct.

With the global recovery well under way (even if it's not smooth sailing), talk of inflation risk has started again. The overall risks to the local inflation outlook appear to be balanced in the near and medium term. Local food price inflation is higher but expected to remain broadly contained. The MPC additionally notes the significant but likely temporary reduction in medical insurance price inflation this year. Given low pass-through, risks to inflation from currency depreciation are expected to stay muted. However, additional exchange rate pressures could result from fiscal risks – funding the government's budget deficits over the next few years could put severe pressure on the rand. The graph below depicts how South Africa's debt to GDP levels (in light blue) have increased when compared to other emerging markets. All eyes will be on the Minister of Finance and National Treasury on 24 February when the budget speech will reveal how they intend to deal with this matter:

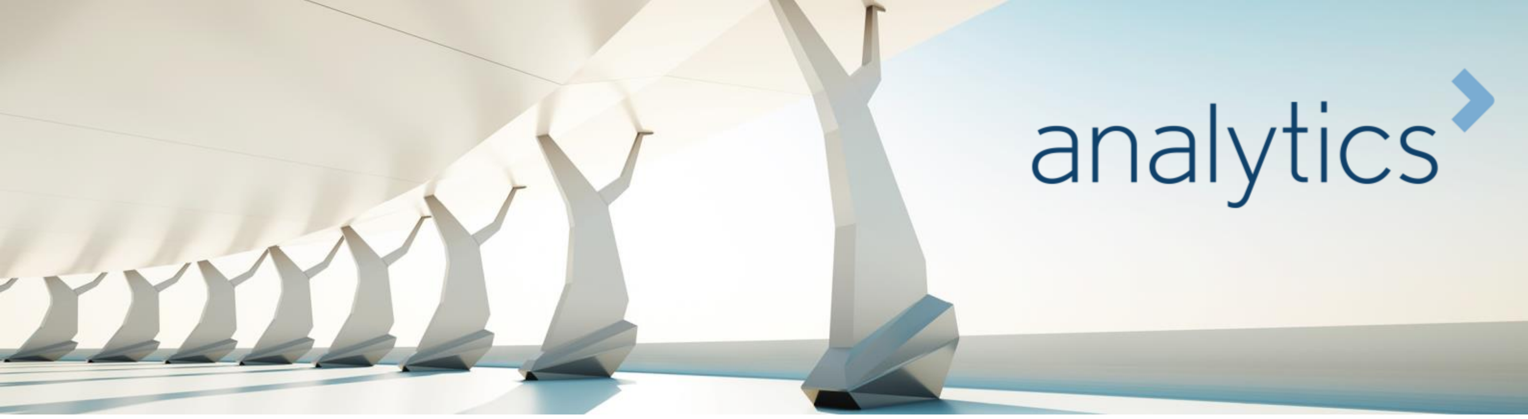
Debt to GDP Ratio



Source: Coronation Fund Managers, UBS

Market Performance

The US leadership transition from Republican to Democrat eventually proceeded through gritted teeth and amid high security. The Georgia runoff election placed both the Senate and the House of Representatives in the hands of the Democrats. In their latest market commentary, Laurium Capital notes that, while the "Blue Wave" majority across the US legislature was significant, it could not overcome renewed fears of Covid mutations, slow vaccine rollouts, and lingering fiscal concerns in many major economies. As a result, the strong global equity rally of the last quarter of 2020 gave way to a less convincing and messy January return.



In developed markets, early enthusiasm and new index highs were followed late in the month by a strong sell-off. In the US, an epic short squeeze in GameStop highlighted social discord, and simmering unhappiness with the narrow financial market gains post the Global Financial Crisis (and especially post Covid).

In South Africa, the Covid caseload thankfully responded to the level 3 lockdown measures and declined. Nonetheless, a bungled vaccine procurement process and rollout plan kept domestic stocks in check. The SA equity market, however, rallied quite strongly, rather rhyming with emerging markets which in general had a better month than developed markets.

This turbulence in global risk appetite unsettled the rand, as well as domestic bond yields, but both retraced from their weaker levels towards the end of the month as US yields stabilised. A slightly weaker ZAR added a return tailwind as the US dollar looked to make back some of its recent losses.

The FTSE/JSE Capped Swix Index was up 5.2%, with strong returns from the resources sector, which returned 4.9% as metal prices and even soft commodity markets held firm. The Industrials index (led by a resurgent Naspers/Prosus on the back of a rally in Tencent) was also up 8.5%. In contrast, the local-only Financial index was down 3.1%, reflecting the local concerns more keenly.

MARKET INDICES [1] (All returns in Rand)	31-Jan-21		
	3 months	12 months	5 years
SA equities (JSE All Share Index)	21.2%	14.5%	8.1%
SA property (S&P SA Reit Index)	25.7%	-39.1%	-9.1%
SA bonds (SA All Bond Index)	6.6%	8.1%	9.6%
SA cash (STeFI)	1.0%	5.2%	6.9%
Global developed equities (MSCI World Index)	7.9%	16.4%	12.7%
Emerging market equities (MSCI Emerging Market Index)	12.1%	28.8%	14.2%
Global bonds (Barclays Global Aggregate)	-5.3%	7.2%	3.3%
Rand/dollar [2]	-7.4%	0.4%	-1.1%
Rand/sterling	-1.6%	4.5%	-1.7%
Rand/euro	-3.4%	10.0%	1.2%
Gold Price (USD)	-1.6%	16.7%	10.6%
Oil Price (Brent Crude, USD)	49.2%	-3.9%	10.0%

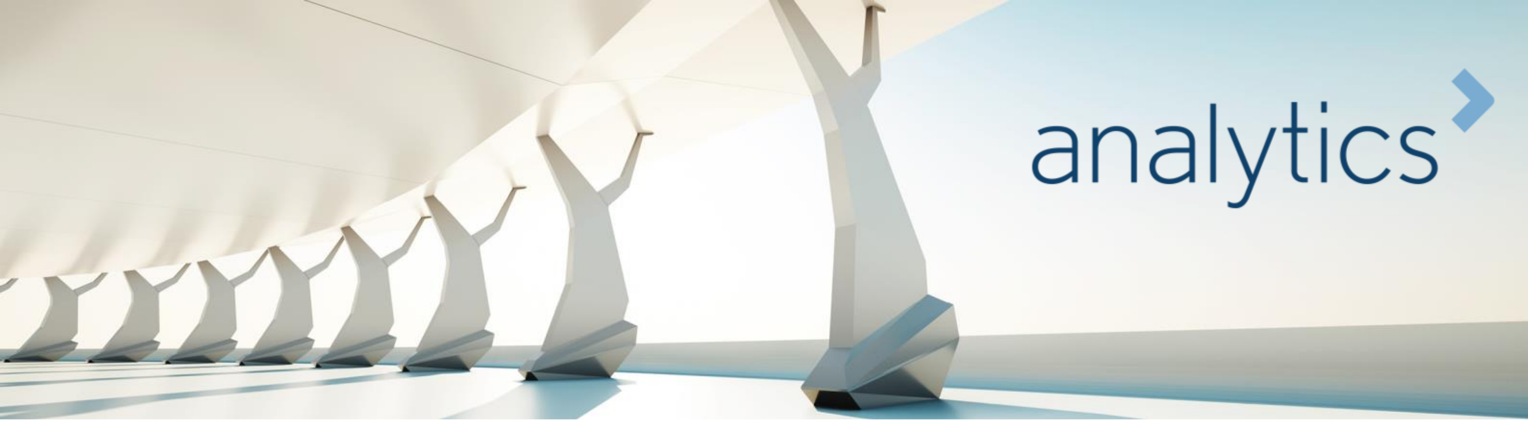
1. Source: Factset
2. A negative number implies fewer rands are being paid per US dollar, so it implies a strengthening of the rand.

Commentary – what (else) could go wrong?

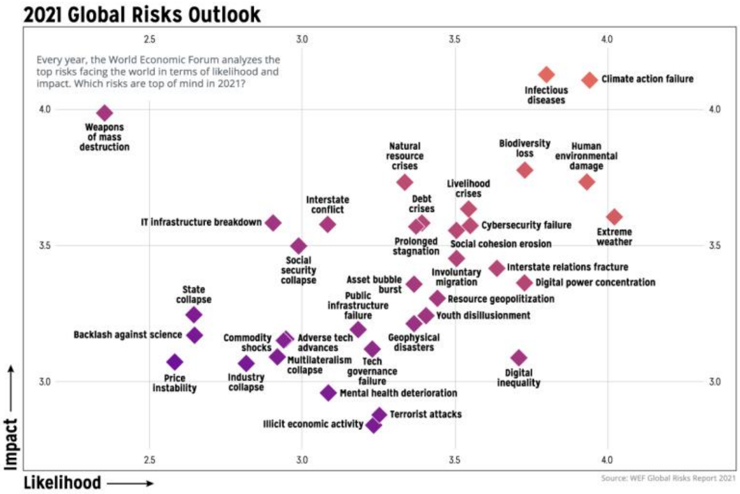
In the preface to the World Economic Forum's 16th Global Risk report, the authors recall that as long ago as 2006 they sounded the alarm on pandemics and other health related risks. That year, the report warned that a "lethal flu, its spread facilitated by global travel patterns and uncontained by insufficient warning mechanisms, would present an acute threat." Impacts would include "severe impairment of travel, tourism and other service industries, as well as manufacturing and retail supply chains" while "global trade, investor risk appetites and consumption demand" could see longer-term harms. Subsequent editions have stressed the need for global collaboration in the face of this and related risks.

In 2020, the risk of a global pandemic became a reality. As governments, businesses and societies survey the damage inflicted over the last year, strengthening strategic foresight is now more important than ever. With the world more attuned to the apparent risk, there is an opportunity to leverage attention and find more effective ways to identify and communicate risk to decision-makers.

Behavioural psychology predicts that most recent events dominate our views when we think about risks that may lie ahead. This causes biases to creep into our forecasts and assessments of what may lie in store for us. It's similar to the fears that arise in the immediate aftermath of an earthquake (and related aftershocks) when the probability of the next earthquake is at its lowest. As time goes by this probability increases while the fear subsides. Against this backdrop it may be useful to look at the global risks that leaders think about, setting the Covid-19 pandemic aside for a moment.



The scatter plot below shows a combination of the likelihood (horizontal axis) and the impact (vertical axis) rated on a scale from 1 to 5. The survey respondents consisted of a global network of business, government, civil society and thought leaders.

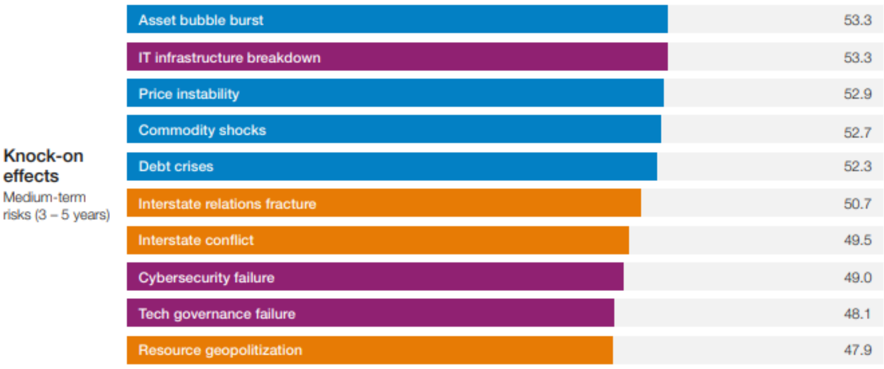


Sources: Visual Capitalist, The Global Risks Report 2021 – 16th Edition (World Economic Forum)

One of the themes that emerges from this year's report is the risks and consequences for widening inequalities and social division. Much of this is a direct result of the dynamics the pandemic created. It's however true that societal fragmentation existed before the pandemic and has only been exacerbated by weak safety nets and fragile economic structures. The gap between the "haves" and "have-nots" is likely to widen further if technology access and ability remains unequal.

The respondents also had to forecast when risks will become a critical threat to the world. The clear and present dangers (with a shorter than two-year time horizon) include (but are not limited to) infectious diseases, extreme weather events, cybersecurity failure and terrorist attacks.

It's the knock-on effects that the report predicts that are of particular interest for investors. The chart below shows the percentage of respondents that expect the horizon of these risks to be within 3 to 5 years. Those highlighted in blue are classified as economic risks:



These economic (and other) risks should enjoy much consideration in the long-term thinking of investors. Elevated asset price levels, a significant increase in global debt and the subsequent foundation for inflation are all present features of our investment landscape. It's not the end of the world, but turning a blind eye is also not the solution. Like Sonny Kapoor said in the 2012 film "The Best Exotic Marigold Hotel": "Everything will be all right in the end and if it's not all right, then it's not yet the end."