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ECONOMIC AND MARKET OVERVIEW

Global

The global economy remains in a very healthy position as it continues to grow at an annualised real growth rate of roughly 3.5%. Unemployment rates continue to fall across the developed world, with consistent job gains in the United States and Eurozone.

Despite most developed markets being near full employment, wage increases are expected to be modest over the next 18 months. Because of the implementation of trade tariffs (and the talk of much more), this is not quite the growth sweet spot we had in 2017. It however remains a very favourable environment for global economic expansion as inflation remains under control. Outside of the United States, the core inflation change across the developed world has been marginal. Except for Turkey and Argentina, emerging market inflation also remains at historically low levels.

Against this backdrop, the general direction of interest rates in developed markets will remain upwards if not left unchanged. As anticipated, the Bank of England (BoE) and the European Central Bank (ECB) left rates on hold at the last round of policy meetings. The BoE appears to be treading cautiously until Brexit uncertainty has been resolved (and this may take some time yet), while the ECB is keeping a close eye on risks to the economic outlook. The US Federal Reserve will continue a path of further increases after the Federal Reserve raised the target range for the federal funds rate by 25 basis points (from 2 percent to 2.25 percent) during its September 2018 meeting, in line with market expectations.

Much of this strong growth may already be reflected in markets. The astute investor would look out for possible surprises to this positive outlook and accumulate growth assets on weakness as short-term noise causes markets to deviate from long-term fundamental valuations.

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South Africa

The economic outlook in South Africa is not quite as rosy as in the rest of the world.

Following the early September announcement from Stats SA that South Africa is in a technical recession, the unemployment rate increased to 27.2%. It indicates that aggregate household incomes remained under pressure. Headline inflation – projected at 4.7% this year (and down from 5.3% in 2017) – is expected to provide a much-needed boost to real incomes, but in the absence of significant employment gains, household consumption is likely to remain constrained. It's against this background that initiatives such as the South African Government's recent Jobs Summit and the economic stimulus and recovery plan which President Ramaphosa announced in September are key to a sustainable improvement in local economic development.

Government's finances have come under significant pressure due to competing expenditure priorities, while tax revenue collections have been undermined by low growth outcomes. It is therefore not surprising to see government's investment spending contract, as National Treasury tries to maintain fiscal prudence. Investment by the government and state-owned enterprises (SOEs) is likely to remain lacklustre due to fiscal consolidation and weak SOE balance sheets.

South Africa

In addition to the initiatives mentioned above, President Ramaphosa's direct foreign investment drive remains crucial for growth: he has made significant progress in his US$100bn investment target, receiving commitments totalling R464bn. These, once realised, will provide a much needed boost to the local economy. The market also seems to have generally accepted Tito Mboweni's appointment as minister of finance after Nhlanhla Nene's second (and this time self-inflicted) departure from this role.

The deputy governor of the South African Reserve Bank (SARB), Daniel Mminele, addressed the Central Banking Seminar of the Federal Reserve Bank of New York on 2 October and made it clear that the next likely interest rate move in South Africa is upwards. He said that the SARB's Quarterly Projection Model (QPM) projects that in order to bring inflation back towards the target midpoint (4.5%) in the long run, five interest rate increases of 25 basis points each will be needed by the end of 2020. He added that the QPM projection is not a pre-commitment to a future rate path, but rather a broad policy guideline that can and will evolve as economic conditions change. At its most recent meeting, the Monetary Policy Committee opted to leave the repurchase rate unchanged at 6.5%, cognisant that downside risks to the growth outlook had partly offset the upside risks to the future.

Compared to the rest of the world, South Africa's outlook is not particularly bright. The important question is how much of this is priced into market. And remember that it's always darkest before dawn.

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Market Performance

September was a particularly tough month in markets for investors. Local equities (-4.2%) recorded their second worst month in five years as healthcare, consumer and rand hedge stocks came under severe pressure despite stability across global markets. Resources was the only sector to deliver positive returns. The listed property sector recorded its seventh negative monthly return this year and, together with inflation-linked bonds, is now underperforming money market returns over five years.

Domestic bonds traded in a 40-basis point range in September and yields ended slightly higher from August's close. This meant that the All Bond Index returned only 0.3% in September. Money market was the best performing asset class among local and global asset classes during the month.

Alongside most emerging market currencies, the rand strengthened against its developed market counterparts and gained nearly 4% against the US dollar. This weighed on the returns on global assets for local investors as small movements in global equities, property, bonds and cash were overshadowed by dollar weakness. The divergence between US and emerging market stocks increased as negative sentiment towards the latter continued to put pressure on equities and bonds in developing markets.

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Market indices[1]	30 September 2018		
(All returns in rand)	3 months	12 months	5 years
SA equities (JSE All Share Index)	-2.2%	3.3%	8.0%
SA property (SAPY)	-1.0%	-15.7%	6.8%
SA bonds (SA All Bond Index)	0.8%	7.1%	7.1%
SA cash (STeFI)	1.7%	7.3%	6.8%
Global developed equities (MSCI World Index)	8.5%	17.2%	17.6%
Emerging market equities (MSCI Emerging Market Index)	2.3%	4.3%	11.3%
Global bonds (Barclays Global Aggregate)	2.3%	3.4%	7.9%
Rand/dollar[2]	3.2%	4.8%	7.1%
Rand/sterling	2.0%	1.9%	2.5%
Rand/euro	2.7%	3.0%	3.8%
Average South African Multi-Asset High Equity Fund	1.1%	3.1%	6.7%

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

Commentary – It's darkest before dawn

One does not need to go far to find a pessimistic South African now. Whether it's the economy, political turmoil or even sport, it's easy to see the dark clouds that are gathering over the southern tip of Africa. It's against this backdrop that Cyril Ramaphosa's actions to stimulate the economy and plan for a better future come as a welcome relief.

In recent years, the South African economy has not grown at the pace needed to create jobs

On 25 September, the President announced measures agreed by Cabinet to reignite growth, stimulate economic recovery and secure confidence in sectors affected by regulatory uncertainty and inconsistency. In recent years, the South African economy has not grown at the pace needed to create jobs, while at the same time public finances have been constrained, limiting the ability of government to expand its investment in economic and social development.

The central element of the economic stimulus and recovery plan is the reprioritisation of spending towards activities that have the greatest impact on economic growth, domestic demand and job creation. This will be supported by the formation of an Infrastructure Development Fund.

In total, the plan will result in reprioritised expenditure and new project level funding of around R50 billion. This reprioritisation of spending needs to take place within the current fiscal framework and in line with the normal budgetary process.

The President highlighted that for the economy to grow at a rate that will lead to job creation on a meaningful scale, there needs to be a significant increase in levels of investment.

The stimulus and recovery plan has five key areas of focus, namely:

- Implementation of growth enhancing economic reforms
- Reprioritisation of public spending to support job creation
- The establishment of an Infrastructure Fund
- Addressing urgent and pressing matters in education and health
- Investing in municipal social infrastructure improvement

One of the initiatives implies changes to South Africa's visa regime to boost the tourism sector. These include changing regulations on the travel of minors, changes to the list of countries requiring visas to enter South Africa as well as changes to visa requirements for highly skilled foreigners. This should boost the formal and informal tourism sector. Another important reform is to restore investment and exploration levels in the mining sector to boost exports and job creation. This includes a revised Mining Charter. Apart from these two, there are six other specific initiatives that should create a much more business friendly environment in time.

In a recent article, Kevin Lings, Chief Economist of STANLIB, notes that the stimulus and recovery plan also prioritises infrastructure spending as a key driver of economic activity. More specifically, the government has made the decision to set up a South Africa Infrastructure Fund, inviting the private sector to enter into meaningful partnerships with government. Infrastructure expansion and maintenance has the potential to create jobs on a large scale, attract investment and lay a foundation for sustainable economic expansion. The contribution from the fiscus towards the Infrastructure Fund over the medium-term expenditure framework period (three years) would be more than R400 billion, which will be used to leverage additional resources from developmental finance institutions, multilateral development banks, and private lenders and investors.

To ensure these funds are used effectively and that projects are completed on time and on budget, the government is establishing a dedicated Infrastructure Execution Team in the Presidency that has extensive project management and engineering expertise to assist with project design and oversee implementation.

Commentary – **It’s darkest before dawn**

Lings further states that the stimulus measures are to be applauded since there is an urgent need to lift the country’s rate of economic growth as well as boost business confidence. Many of the growth initiatives identified are critical to the growth of specific industries or sectors. Unfortunately, from a macro-economic perspective, most of the measures announced were relatively modest and unlikely to provide an immediate and very significant boost to economic growth and employment. This is the nature of stimulus packages that are based primarily on re-prioritising government expenditure. This does not suggest that the initiatives are unimportant, but rather that the focus will be on changing the priority of government spending to focus more directly on lifting economic growth and employment.

The key exception to the above view is the Infrastructure Fund, since it has the potential to provide a catalyst for additional private sector investment. In that regard, government needs to urgently identify key infrastructure development projects, complete a feasibility and environmental impact assessment and then look to implement the projects as quickly as possible. In the past, whenever government has announced an ambitious infrastructural development program, they have largely failed to focus on implementing the projects in a timeous and efficient manner that adheres to budgets and completion deadlines. This lack of implementation has, over-time, undermined the credibility of SA government stimulus packages, thereby weakening business confidence.

These stimulus measures come amid several other developments on the economic terrain, including the recent Jobs Summit on 4 and 5 October and the forthcoming International Investment Conference which will bring together South African and international investors on 26 and 27 October. Hopefully, all these initiatives will combine to boost the South African economy into 2019. And it may just be the dawn that we’re looking for while in the darkness of the night.

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