DIE STRANDLOPER

This is the sixth report for 2020.

POLITICS.

- The Covid-19 pandemic is still causing major disruptions in the world economy. Many governments decided on the cautious re-opening of economies in an effort to prevent a total economic collapse. Unfortunately some of these efforts had to be reversed as the number of infections have risen dramatically since these partial re-openings took place.
- Governments, especially in some developing economies, had to take the decision to either open the economies notwithstanding rising infections, or to face a total collapse of the economy and in the longer term an unbearable debt situation. It is also a situation where it must be decided whether people die as the result of the virus, or of poverty and hunger. This situation is also applicable to South Africa.
- At the time of writing, the US infection rate is about 40,000 new cases per day and could rise to 100,000 per day if the behaviour of people does not change. It also indicates that the re-opening of the economy could easily be reversed with a negative impact on growth.
- World-wide the fear exists that following the first round of infections, this can be followed by new waves of infections if the virus mutates with resultant negative growth implications. Clearly, the uncertainty caused by the pandemic, is still far from over.
- Notwithstanding the improvement in US employment figures, the employment situation is far from satisfactory and could undermine the chances of president Donald Trump to be re-elected as president of the US on 3 November 2020.
- On 1 July Germany took over the rotating presidency of the European Union (EU) for six months. This provides the German chancellor an opportunity to show some strong leadership before she steps down as leader of her party in 2021. The challenges are however immense in the sense that during the next six months an agreement should be reached on the implementation of Brexit while the severe impact of the Covid-19 pandemic on the EU economy must be handled.
- While the World Health Organisation (WHO) tells us that the worst of the pandemic is still to come, the fear exists that the populations and economies of Latin America and Africa can be severely affected in the rest of the year.
- Commentators are worried that many poor African countries with poor health facilities could be under immense pressure to handle large outbreaks of the virus amongst their people.
- According to the Zimbabwean government they closed the stock exchange in an effort to stabilise the currency. They say that the

stock exchange was used to transfer money out of the country and undermined the value of the re-introduced Zimbabwean dollar. Inflation is currently about 800%.

- North Korea blew up a liaison office between the two Koreas where discussions could be held on various subjects like the security situation and sanctions affecting the relationship between the two countries. Perhaps it was cheaper and more spectacular to destroy the building, financed by South Korea, than to fire some missiles into the air?
- Russia does not need to have any elections until 2036 because president Vladimir Putin is allowed to be president until then, following the outcome of a referendum — very democratic!
- Keep in mind: the safest way to evade the coronavirus is to wash your hands, wear a mask, stay away from family and friends while visiting only your enemies and thereby practising social distancing! (So all my children, grand children and friends have been declared enemies.)

INTERNATIONAL

- Different forecasts differ widely about the growth trends for 2020 and 2021 and are changed on an almost monthly basis. Some forecasts that last month indicated the world economy would show negative growth of just less than 5% in 2020, have now been changed to show negative growth of less than 4%. The assumption remains that growth will be about 5% in 2021.
- Recently the IMF forecast negative growth of 4.9% for the global economy in 2020 and a recovery of 5.4% in 2021.
- I am still of the opinion that it remains very difficult to make any reliable forecasts about the economic trends in the next two years while the uncertainty about the development of the Covid-19 pandemic persists. We however can be certain that the global economy will show negative growth in 2020 and hope that positive growth will return in 2021.
- The improved outlook for the global economy from some institutions is based on a stronger recovery than what was expected by some of the developed economies once the lockdown periods eased.
- Whereas negative growth of 6.5% was forecast for the US, it is anticipated that negative growth of less than 5% can be expected in 2020. Negative growth of more than 9% is currently forecast for the UK; the Euro Area is forecast to show negative growth of about 6.5%, instead of almost 7%, Germany is forecast to show negative growth of just more than 4%, instead of previous forecasts of almost 6%; Japan is forecast to show negative growth of less than 6%, instead of negative growth of about 6.5%. The Chinese economy is forecast to show positive growth of 2% instead of the previous just more than 1%.
- It is very normal that forecasts become too pessimistic once a problem, and in this case an unknown problem, arises and once things start to return to normal to become too

optimistic about the recovery. Therefore I assume that before the end of the quarter and the end of the year, we will have more adjustments to the forecasts for 2020 and 2021.

- US unemployment declined from the record 14.7% in April to 13.3% in May and 11.1% in June. Latest unemployment figures for the other countries is: UK 3.9%, Euro Area 7.3%, Germany 3.9%, Japan 2.9% and China 5.9%. It is still anticipated that unemployment will remain at elevated levels in most countries in the rest of the year.

- Inflation remains well under control and is expected to remain under control and mostly at levels below the central banks' target rates in 2020 and 2021. Latest inflation rates are: US 0.1%, UK 0.5%, Euro Area 0.3%, Germany 0.9%, Japan 0.1% and China 2.4%

- Given the outlook for negative growth in 2020, elevated unemployment levels as well as inflation that remains well-behaved, it is anticipated that short-term interest rates will remain at current low levels for an extended period of time. These rates are unlikely to rise before 2022 at the earliest.

- The current low long-term interest rates, respond very quickly to any sign of an economic recovery. On 1 July US ten-year government bonds were trading at 0.68% (0.64% on 29/5/20); UK bonds were trading at 0.21% (0.18% on 29/5/20), German bonds were trading at —0.39% (—0.45% on 29/5/20), Japanese bonds were trading at 0.05% (—0.1% on 29/5/20), Chinese bonds were trading at 2.89% (2.7% on 29/5/20). These long-term rates remain at very low levels. It is anticipated that they will continue to react to any change in the containment or renewed outbreak of the coronavirus in the rest of the year and well into 2021. Any sign of an economic recovery will push them higher and any sign of an increase in Covid-19 infections and a resultant poorer economic performance, will push them lower.

- General commodity prices are also influenced by indications that economies, and especially the Chinese economy, is performing better. The London Metal Exchange index which includes six commodities namely aluminium, copper, zinc, lead, nickel and tin rose by 6.6% in the past month. In the past month copper rose by 9.8%, aluminium by 5.3%, tin by 9.2%. The copper price rose on better than expected factory data from top consumer China, while supply disruptions took place in Chile, the world's largest miner of the metal. Unfortunately for South Africa, the coal price weakened by 4.8% while the iron ore price moved sideways during the past month. Manganese prices have weakened by 15.6% in the past month.

- Gold still finds support from the ample liquidity in world financial markets as well as political tensions and uncertainties in many parts of the world. In the past month the gold price rose by 4.6% and for the year the rise is 25.2%. Platinum prices declined by 2.2% for the past month and by 3.4% in the past year. Both palladium and rhodium weakened in the past month.

- The international oil price benefits from the reduction in supply from OPEC and Russia while demand is seen as rising due to the reduction in the lockdown of many economies as well as a drop in US inventory levels. At the same time any upward trend of the oil price is inhibited by the overall poor performance of the global economy as well as technological changes like electric cars and cheaper renewable energy. In the past month Brent crude oil prices rose by 7.4%.

DOMESTIC

- Negative growth of 2% quarter-on-quarter (q-o-q) was recorded in the first quarter of 2020. The negative trends were softened by the strong 27.8% q-o-q positive growth of the agricultural sector which partly offset the negative trends of the mining and manufacturing sectors which showed negative growth rates of 21.5% and 8.5% respectively. The financial sector showed positive growth of 3.7%.

- Although the agricultural sector is likely to show positive figures in the second and third quarters of the year, it is anticipated that especially the second quarter will show a dismal negative figure. According to the Reserve Bank negative growth of more than 32% can be expected in the second quarter.
- The uncertainty regarding the development of the Covid-19 pandemic and the possibility of some future tighter lockdowns and the impact thereof on the economy in the rest of the year, make it impossible to make reliable forecasts for the economic performance of the year. Currently forecasts still range between 6% and 16% negative growth for the year and positive growth of between 3% and 5% in 2021.
- The May trade account showed a surplus of R15.9 billion compared with the R36 billion April deficit. Exports rose by 96.1% while imports fell by 2.2%. The sharp rise in exports was a reflection of some international trading markets re-opening as well as local harbours re-opening again allowing exports to resume. Currently it is assumed that the current account of the balance of payments could show a deficit of about R100 billion which is likely to be financed by an inflow of short-term international capital.
- The supplementary budget was delivered on 24 June. It indicated that due to the extra expenditure and smaller tax revenue caused by the Covid-19 pandemic, the consolidated budget deficit would be 15.7% of gross domestic product (GDP) compared to the 6.8% which was announced in the February budget. The lockdown and the forecast negative growth of 7.2% for the year, indicates that the shortfall on tax income will be R304.1 billion. This will leave government debt at 81% of GDP at the end of the current fiscal year which will rise to 81.7% of GDP. If total savings of R410 billion is carried out in the next two fiscal years government debt will rise to 87.4% of GDP by the end of the 2023/4 fiscal year. The savings will be R250 billion plus a cut of R160 billion in the salary and wage bill in the next two years. Although the minister indicated that these savings were agreed upon by cabinet, it is still unclear whether the other members of cabinet realise what the implications of these savings entail. The international rating agencies have indicated that they doubt whether these saving targets will be achieved and indicate that further debt downgrades could follow even before year-end. The financing requirements of government become so large that it is negotiating to borrow $7 billion in international markets. If government would borrow all the money it needs in the domestic market, no savings would be left for investment by the private sector.
- According to the Auditor General's latest report very little progress has been made by municipalities in terms of their financial management in the past three years. Irregular spending increased in the past year which runs from 1July to 30 June, from R25 billion in the previous year to R32 billion in the year ended 30 June 2020. Allocations received from central government were often spent on salaries and wages instead of much needed maintenance or development of infrastructure. Unfortunately municipalities often increase taxes and tariffs, thereby undermining the possibility of doing profitable business and employing people in any South African town or city.
- Although no tax increases were announced, the minister indicated that additional taxes to the tune of R40 billion could be levied in the next three years. It is clear that the fiscal

policy is not supportive of growth in the next three years. Growth enhancing policies will have to be announced by other government departments, otherwise the current unemployment rate of 30.1% is likely to rise not only in the rest of 2020, but also in subsequent years. This could easily lead to social unrest and increased crime in coming months and years.

- Inflation remains well under control and declined to only 3% in April. It is assumed that prices could rise as the economy opens up, but with a good agricultural crop expected, food price increases could remain subdued, while oil prices are likely to remain below last year's levels. The average inflation rate is likely to remain below the target level of the Reserve Bank in 2020.
- Given the expected well-behaved inflation rate, poor economic growth and unacceptably high and rising unemployment, short-term interest rates are likely to move sideways until well into 2021 and even 2022. The risk is that these rates could even decline further in the rest of the year.
- Long-term interest rates rose to 9.21% on 1 July from 8.95 on 29/5/20. This reflects the large borrowing requirement of the public sector as well as the possibility of further credit downgrades, even before the end of the year. Long-term interest rates could come under more upward pressure if it becomes clear that government is unsuccessful in controlling expenditure in the next two to three years.
- The rand remains volatile. The same factors influence the performance of the rand as mentioned last month, namely: fear for the exposure to developing economies in general, any strength of the dollar, the uncertainty caused by the lockdown, political uncertainties regarding land expropriation without compensation as well as the implementation of the unaffordable National Health Insurance System, the rising budget deficit and the resultant rise in public debt and its risk of causing further credit downgrades, the resultant risk of further capital outflows. At the same time the rand finds limited support from the interest rate differential between local and international interest rates as well as the still well-functioning local financial system.

INVESTMENT ENVIRONMENT

- Global stock exchanges and commodity markets, benefit from the partial easing of lockdown situations in many countries. They also benefit from the ample supply of liquidity in world financial markets as well as the current very low interest rates that are likely to remain at these levels for an extended period of time. Any increase in Covid-19 infections, however adversely affects financial and commodity markets.
- Although stock exchanges benefit from low interest rates and the ample liquidity in financial markets share prices are adversely affected by the poor economic environment which indicates that profits and dividends will be under pressure in at least the rest of the year. The hope of capital appreciation and dividends performing better while interest remains low and in negative terrain, supports stock prices.
- Generally foreign exchange markets remain volatile and are influenced by increases or declines of coronavirus infections per country. The dollar benefits from recent upbeat US economic data, but weakens on recent sharp increases in coronavirus infections.
- International short-term interest rates are likely to move sideways in all major industrialised countries until at least 2022.
- International long-term interest rates are volatile, but move mostly sideways. They are however, at such low levels that they rise on any indication of an economic recovery.

Persistent low inflation rates are likely to prevent any sharp increase in these rates in the rest of the year.

- While general commodity prices benefit from signs of economic recovery in countries and especially China, every commodity is influenced by its specific demand and supply situation.
- Gold continues to benefit from low international interest rates, ample liquidity, volatility in financial markets and political tensions. These factors are likely to remain present in the rest of 2020 and well into 2021.
- The international oil market benefits from signs of economic recovery and supply restrictions of oil.
- Local short-term interest rates are likely to move mostly sideways in the next eighteen months.
- Local long-term interest rates could come under upward pressure due to the very large financing requirements of the public sector in the next two years as well as any further credit downgrades. Low inflation and poor economic growth is likely to limit upward trends.
- The local stock exchange suffers from the poor performance of the economy and its impact on company profits and dividends, as well as the outflow of capital. It is also affected by international stock exchange trends.
- The rand remains volatile, but has a softer long-term trend against all major currencies.

Ulrich Joubert

3 June 2020.

Contact Information: ulrich.joubert@gmail.com or cell: 083 458 1370