DIE STRANDLOPER

This is the fifth report for 2020.

POLITICS.

- The confusion caused by the Covid-19 pandemic continues. It confuses both the medical as well as economist fraternity in the sense that doctors don't understand the virus fully and therefore are uncertain how to treat patients when they land in hospital while economists, especially one that I know personally, have not a feel for what will happen to the economy in the rest of the year.
- We will rather not venture into the political environment where some politicians think that they can control everything — from disallowing anyone to smoke legal cigarettes to the shoes you may wear to the food you want to hand out to the hungry!
- Is the minister of Public Enterprises and the trade unions really determined to resurrect SAA from the ashes while so many other more financially healthy airlines are in deep trouble?
- The pandemic will have an impact on the US November 3 presidential election given the poor performance of the economy and the high unemployment rate, but to what extent no one can determine at the moment.
- The pandemic is also having an impact on Brexit negotiations, but Boris Johnson is of the opinion that the UK will leave the European Union (EU) notwithstanding severe differences between UK and EU negotiators by the end of the year — even without any agreement.
- According to the chairman of the Africa Union, Africa is handling the Covid-19 epidemic very well, but are some of the other background problems like malaria, HIV/Aids, tuberculosis, diabetes, poverty and hunger not perhaps being neglected?
- In the meantime quite a number of African countries are battling an insurgence of Moslem extremists. Although many of these conflicts are in Mali, Niger, Nigeria, Burkina Faso, one wonders whether we do know what the real situation is in the northern parts of Mozambique?
- Following the new Chinese laws and rules for Hong Kong, the tension between China and the US has escalated and could spill over into heightened trade tensions in weeks and months to come.
- The Great Leader of North Korea is still scarce and one wonders what he is up to — perhaps just afraid of the invisible virus or some other disease?
- The safest way to handle the corona virus is to wash your hands, wear a mask, stay away from family and friends while visiting only your enemies and thereby keeping social distance! (I suppose our government wants us to do so?)

INTERNATIONAL

- Currently world economic growth is supported by way of large spending programs, loan guarantees, deferred tax payments by many governments. This of course increases budget deficits by way of additional expenditure or deferred income. Many of these programs are to run for a specific limited period of time and are likely to be reversed next year. These fiscal measures find support from monetary policies pursued by central banks who have cut interest rates and embarked on programs of adding liquidity to financial systems. While monetary supporting efforts will continue for some time, cutting of interest rates has come to an endin many countries.

- The programs pursued by governments as well as central banks, are supportive of growth in 2020, but are likely to limit growth in 2021 when these programs are reversed. This softens the forecast negative growth for 2020, but at the same time limits the growth recovery in 2021.

- Currently negative growth of just less than 5% is forecast for the world economy in 2020, while positive growth of just more than 5% is forecast for 2021.

- Currently US negative growth of about 6.5%, UK negative growth of more than 9% , Euro Area negative growth of almost 7%, German negative growth of almost 6%, Japanese negative growth of about 6.5% while positive growth of just more than 1% is forecast for China in 2020. Current forecasts indicate positive growth rates for all of these above mentioned countries in 2021. It must be kept in mind that the expected positive figures for 2021 come off a very low base.

- It is anticipated that unemployment will rise sharply in most countries, but especially in the US where unemployment is 14,4%, while the May figure could rise to approximately 20%. In the UK unemployment is at 3.9% in the Euro Area at 7,4% in Germany at 3.5%, in Japan at 2,6% and in China at 6%. The US unemployment figures plus the negative economic growth rate, are not good news for the incumbent president of the US if he wants to be re-elected in November.

- It is anticipated that inflation will remain under control in the developed countries in 2020 as well as in 2021— notwithstanding the strong liquidity boost the world economy receives at the moment. Currently inflation in the US is 0.3%, in the UK 0.8% in the Euro Area 0.1% in Germany 0.6%, in Japan 0.1% and in China 3.3%.

- Short-term interest rates are at very low levels in most developed countries and even at negative levels in some. It is assumed that there exists only limited scope for even lower interest rates in most of these countries, while it is anticipated that further interest cuts are unlikely to boost economic growth in any meaningful way. Therefore it is expected that central banks will rather continue to boost liquidity by for example buying government and even company bonds in coming months.

- Long-term interest rates showed mixed movements in the past month. On 29 May

US ten-year government bonds were trading at 0.64% (0.61% on 1/5/20), UK government bonds were trading at 0.18% (0.25% on 1/5/20), German bonds at —0.45% (—0.58% on 1/5/20), Japanese bonds at —0.1% (—0.02% on 1/5/20), Chinese bonds at 2.7% (2.51% on 1/5/20). Whereas a month earlier the view was that long-term interest rates could soften further in coming months, it is now not a foregone conclusion that this will happen as it is anticipated that following a very poor performing second quarter in most developed economies, signs of a recovery may come to the fore in the third quarter. This could put a floor under further long-term interest rate declines in the second half of 2020.

- Given indications that the Chinese economy showed some signs of recovery in March and April, many general commodity prices showed a modest recovery in the past month. Iron ore 62% fe rose by 9.8%, rhodium by 8.4%, coal by 1.6%, but palladium declined by 0.8% in the last month. It is anticipated that general commodity prices will remain weak in the rest of the year as the world economy slows down and recovers only modestly in the second half of the year.

- Gold strengthened by 2.7% and platinum by 7.9% in the past month. Gold still benefits from the low international interest rates, ample liquidity in financial markets as well as the increased tension between the US and China in recent weeks. It is assumed that these underlying factors will persist in coming weeks and months. Gold could therefore find further support in this period. Any improvement in the world car market is likely to support the platinum, palladium and rhodium prices. These commodities could also find support from any disruption in the South African mining sector.

- International oil prices made a sharp comeback in the last month. Brent crude rose by 39.7% while West Texas Intermediate rose by 88.4% in the past month. This is a reflection of too sharp declines in previous periods, further cuts in production due to the low oil price as well as indications that demand could recover in a large consumer country like China. At the same time it is anticipated that above ground stock levels are still at fairly high levels and will take time to fall to acceptable levels. It is therefore expected that the oil price will show a modest recovery towards the end of the year.

DOMESTIC

- Current forecasts still indicate a deep recession for the South African economy in 2020. It is still almost impossible to determine the damage that was done to the economy during the two months of lockdown and the still existing closed sectors of the economy — some of which could perhaps open up only in the third quarter of the year. A lot of uncertainty is also caused by conflicting statements of ministers and the confusion created by these statements.

- It is however certain that many consumers are in a much poorer situation than before the lockdown as many have lost their jobs or part of their income. It is also assumed that consumers will be very cautious to venture into shopping malls in coming weeks and months, because although the lockdown has been eased, the virus is still around and invisible. If infections rise sharply in coming weeks — as forecast — it is assumed that consumers will remain very cautious.

- Given the good summer rainfall season we had, the agricultural sector is forecast to show a positive contribution to overall growth for the year. First indications are that we could even have a good winter rainfall period. Some parts of the country are however, still battling with a severe drought.

- In April the trade account showed a record deficit of R35 billion with exports falling by

55.1% from March, while imports declined by only 6.5%. This left the trade account for the first four months of the year with a small deficit of R0.3 billion. It is assumed that the current account deficit for the year could be about R100 billion. This amount should be financed by an inflow of short-term foreign capital.

- Unfortunately the central government budget deficit is likely to be very large and some indications are that it could be in the region of 15% of gross domestic product (GDP) compared to the acceptable international norm of 3%. This dire situation is the result of the expected shortfall in revenue due to the poor performance of the economy as well as the announced increased expenditure to support the economy — and Cuba. Eventually government will have to cut expenditure drastically to control the budget deficit and rising public debt — this must apply to all levels of government namely, central, provincial, local as well as state owned enterprises and surely to SAA as well! It also indicates that fancy schemes like the National Health Insurance Scheme cannot be afforded.
- Unemployment is rising and the official figure is likely to be above 30% in the rest of the year as well as in 2021. This indicates that social unrest and crime are likely to escalate in coming months.
- Inflation remains well under control with the latest figure of 4.1% for March compared with 4.6% in February. It is assumed that the April figure will have to be adjusted quite a few times as information was difficult to find during the lockdown period. It is however forecast that the average inflation rate for the year could be at the lower end of the target band, or even below the 3% level.
- Given the poor outlook for the domestic economy, the high and rising unemployment rate as well as inflation remaining below the target rate of 4.5%, the Reserve Bank cut interest rates by a further 50 basis points to bring the prime lending rate to 7.25%. Whereas the Reserve Bank indicated in April that short-term interest rates could be cut by another 125 basis points in coming months, it now indicated that interest rates are unlikely to be cut further. The Bank is rather likely to ease financial conditions by injecting liquidity into financial markets. At the same time it is unlikely that short-term interest rates are to rise in even the next two years.
- Long-term interest rates softened quite sharply in the past month. On 29 May ten-year government bonds were trading at 8.9% — 1.38% lower than a month ago. The poor performance of the economy as well as the persistent low inflation rate, indicates that long-term interest rates could soften even further in coming months. At the same time the fact that South African bonds fell out of the World Government Bond Index, that we are downgraded to junk status and that the public sector demand for long-term financing is rising sharply, indicate that these rates could come under upward pressure in coming months.
- The rand remains volatile. It softens on 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

- The world economy is slowly moving out of the severe lockdown period. This helps to improve sentiments in all parts of the world. Unfortunately there is still a lingering fear that a second round of severe Covid-19 infections could disturb sentiments and therefore disrupt financial markets in coming months.
- In periods of uncertainty, the dollar and US financial markets remain the major safe haven of the world. In the meantime it appears as if the dollar moves in fairly narrow bands against the major currencies.
- The Swiss franc and yen are also regarded as safe havens in times of uncertainty.
- International short-term interest rates are likely to move mostly sideways in coming weeks. No increase in these rates is forecast until at least the end of 2021.
- International long-term interest rates are also likely to move sideways in coming weeks due to the still poor performance of the world economy, rising unemployment as well as persistent low inflation rates. It is unlikely that these rates will show any major upward trend until end of 2021.
- Stock exchanges have performed quite well in the last month. Notwithstanding the poor outlook for growth and therefore for company profits and dividends, investors and speculators are willing to pour money into stock exchanges in the hope of capital appreciation and dividends performing better than interest rates — especially negative interest rates.
- General commodity prices show slow and modest recovery, reflecting the easing of lockdowns as well as some better performance of China.
- Gold finds support from persistent low interest rates, ample liquidity and more political tension.
- Oil recovers, but is assumed to show a moderate recovery until the end of the year.
- Local short-term interest rates are expected to move sideways and are unlikely to rise before the end of 2021.
- Local long-term interest rates have softened during the past month. It reflects some easing of the fear for the credit downgrades and the resultant large capital outflows the country suffered. The large demand for public sector long-term financing puts upward pressure on these rates.
- The local stock exchange suffers from the poor performance of the domestic economy. It is however influenced by international stock exchange trends.
- The rand remains volatile, but has in the longer term a softer trend against all major currencies.

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