DIE STRANDLOPER

This is the second report for 2020.

POLITICS.

- Imagine — a little invisible virus upsets the outlook for the whole world economy and upsets all stock exchanges, all currency, bond and commodity markets and to a much larger extent than the threats of war in the Middle East, or the US/China trade war, or even the tweets of president Donald Trump or the missiles that North Korea fires into the air from time to time.

- In the meantime our minister of finance delivers, under the circumstances, a fairly sensible budget, but the test will be to what extent he will find support from the rest of his comrades in the ruling alliance and to what extent the execution of the budget is realised.

- At the same time the Covid-19 virus spreads around the world in no time and indications are that the governments of the rest of the world do not have the same authority over their populations like the Chinese authorities illustrated to us. Indications are that more and more people will be affected by the virus in coming weeks and months with negative implications for the world economy, financial and commodity markets in many months to come.

- Given the current situation within the US Democratic Party indications are that president Donald Trump is likely to stay in the White House after the November elections.

- At the same time German politics are in disarray, but the Christian Democratic Union of chancellor Angela Merkel will perhaps sort out their problems by April 2020.

- Indications are that the Brexit separation of Great Britain from the European Union (EU) is unlikely to be finished by December 2020 and that negotiations between the two entities will be tough, to say the least.

- The Middle East remains in turmoil with renewed fighting in Syria involving Syrian government, Russian and Turkish forces, Will there be a new wave of Syrian refugees into Europe or will they remain a Turkish problem?

- The tension within Iran and between Iran and the US remains high while the problems in Yemen continue.

- Many conflicts continue within Africa but we can rest assured that the current Chairman of the African Union will soon appoint a commission to investigate all these problems. These conflicts however limit investments and growth within the continent.

- The Venezuelan problem continues.

- No solution is in sight for Zimbabwe.

- After seeing some Cuban doctors, ex-president Jacob Zuma needs some dark glasses and according to some of his spokespersons, he is a very sick man after returning from Cuba. So be warned and be very careful which doctors you consult if you do not see or feel very well!

INTERNATIONAL

- Currently the corona virus is affecting the world's currency, bond, stock and commodity markets. It reflects the uncertainty caused by the virus and its impact on the world economy. China reacted by closing public transport and other facilities, extending the Lunar New year holidays for schools and factories, while confining people to their dwellings. This resulted to a sharp weakening of the economy as demand and supply were adversely affected in February and the Purchasing Managers' Index for the private sector fell to a record low level.

- With the virus spreading to the rest of the world, uncertainty gripped international financial markets. Certain sectors of the world economy are more severely hit — like the tourist and airline industries — but given the continued closure of some Chinese factories, it also affects supply lines in many sectors and in many countries dependent on Chinese imports.

- However, the world population remains mobile and the virus even more so. Therefore, it is unlikely that the Covid-19 virus will stop affecting the whole world. To what extent this will adversely affect world economic growth is still unclear, but it is assumed that the negative impact will be felt in at least the first half of the year.

- Whereas growth of between 2.5% and 3% was forecast previously for 2020, it is now assumed that world economic growth is unlikely to top 2.5%. There is even some speculation that the US economy could experience a recession in 2020.

- The worst part about the virus, is the uncertainty as to the extent it will affect economic activity and for how long this will continue.

- Given this uncertainty, speculators and investors fled out of stock exchanges causing some of the worst declines in share prices since the 2008 financial crisis. Money also flowed out of commodity markets and found comfort in the bond markets as well as in gold — until gold fell sharply at the end of February.

- Currently it is assumed that central banks in many countries are likely to ease their monetary policies by cutting interest rates as well as reserve requirements while they could buy more bonds to inject liquidity into world financial markets. It is also assumed that the current crisis could motivate some countries to embark on some fiscal stimulus as well. Whether these measures will bring consumers back to spend money, is still to be seen. International short-term interest rates are set to decline in coming days and months.

- While stock exchanges showed severe losses, bond markets benefited from the inflow of capital. On 2/3/2020 ten-year US bonds traded at 1.07% (1.53% on 31/1/'20) UK government bonds at 0.42% (0.52% on 31/1/'20), German bonds at —0.67% (—0.44% on 31/1/'20), Japanese bonds at —0.10% (— 0.06% on 31/1/'20) and Chinese bonds at 2.79% (3.07% on 31/1/'20).

- At the time of writing employment levels have not been adversely affected by the world health crisis and inflation remains under control in most major industrialised countries. Latest inflation rates are: US 2.5%, UK 1.8%, Euro Area 1.4%, Germany 1.73%, Japan 0.7% and China 5.2%.

- With many Chinese factories still closed due to the impact of the virus, general commodity prices also came under downward pressure in the past month. Indications that central banks are likely to embark on a concerted effort to stabilise world economic growth as well as financial and commodity markets and general commodity prices showed some recovery at the beginning of March. It is however assumed that commodity prices could show some further softness reflecting a weaker performance of the Chinese economy in the rest of the year.

- Initially gold benefited from the uncertainty gripping world financial and commodity markets and showed some strength until the end of February when it fell sharply. On 2 March gold at $1594/fine ounce, showed a rise of more than 23% over the past year. It is likely that gold will still find some support in coming weeks given the persistent uncertainty regarding the impact of the virus on world economic and financial trends as well as further monetary stimulus from central banks. Overbought situations could however result in profit taking from time to time. Platinum is currently adversely affected due to indications that the industrial demand, especially form the car industry, could remain weak for a considerable period of time.

- International oil prices have fallen sharply since the onset of the corona virus outbreak. Brent crude has dropped by 20% over the past year and by more than 4.0% over the past month to levels of approximately $52 per barrel. The oil price found some support from indications that OPEC countries and Russia could decide to cut production by even more than one million barrels per day and that monetary stimulus could be forthcoming from central banks. It is assumed that the oil price remains soft in at least the first half of the year.

DOMESTIC

- According to Statistics SA, the RSA showed real growth of 0.2% in 2019. Before the severe impact of the corona virus on world economic growth became evident, forecasts indicated that RSA growth could improve to approximately 0.5%in 2020.

- Given the impact of the corona virus, many forecasts indicate a lower growth rate than 0.5% for 2020. However, according to an article written by professor Johan Willemse in Beeld newspaper, growth could benefit substantially from a bumper summer grain harvest and its multiplier impact on the rest of the economy that could push growth to levels of close to 2% in 2020.

- At the same time, consumers remain under severe pressure while it is anticipated that unemployment will continue to rise in 2020 and subsequent years. Given the uncertainty of government policies and its impact on the business environment, it remains unlikely that private sector investment will show a noticeable improvement in 2020. At the same time the budget indicated that if government wants to improve its financial situation, public sector consumption expenditure must be cut substantially in coming fiscal years as no room exists for tax increases.

- In 2019, a trade surplus of R24.7 billion was recorded compared with the R15.2 billion of 2018. In January a much smaller than expected deficit of R1.87 billion was recorded with imports declining 16.1% and exports declining by 1.4% from December levels. Given the outlook for the world economy and especially the anticipated weakening of the Chinese economy, exports are unlikely to perform well in 2020. A bumper summer grain harvest could boost maize exports in 2020 as well as in 2021, but is anticipated to boost overall economic growth only modestly. The forecast poor performance of the domestic economy indicates that imports are also likely to show at the most only a modest increase in 2020. Another trade surplus can be expected, but the current account of the balance of payments is likely to show a deficit of approximately R150 billion in 2020. This deficit will have to be financed by the inflow of international short-term funds.

- The budget announced by the minister of finance on 26 February, was sensible in the sense that it did not rely on large tax increases to finance the budget deficit, but more on cuts in government expenditure and especially the envisaged cut of R160 billion in the salary and wage bill in the next three years. Unfortunately the budget deficit as a percentage of the gross domestic product (GDP) rises to an alarming 6.8% while the target should be no more than 3% of GDP. The real test will be to what extent the minister finds support from his comrades in the ruling alliance to really cut salaries and wages with municipal elections looming in 2021. Unfortunately government cannot rely on tax increases to boost its revenue as it would most likely undermine economic growth and therefore also tax income. It is also disappointing that no mention was made about any privatisation or closure of any state owned enterprises. It also seems as if pension funds will be expected to fund some of these enterprises in coming years, without a guarantee that there will be any meaningful return on this funding for the foreseeable future. If this happens, it is assumed that pensioners will receive their guaranteed pensions in the next, say twenty years, but that tax payers will eventually be called in to bail out the pension funds by way of higher taxes.

- Unfortunately the budget is unlikely to boost growth in the 2020/21 fiscal year. There are also no signs that the dire situation of most municipalities will be rectified in the foreseeable future and indicates that local taxes and tariffs are likely to continue rising at above inflation rate levels in coming years.

- As mentioned, unemployment is likely to rise further from current unacceptable levels in coming months and years. This poses the risk of social unrest.

- Poor economic growth, unacceptably high and rising unemployment, inflation expected to remain fairly well under control in the next two years, declining international interest rates, all indicate that local short-term interest rates could be cut. I assumed that the Reserve Bank would wait until the second half of the year to see to what extent government shows discipline in handling their finances and how financial markets will react to further credit downgrades to junk status by all rating agencies. Currently it seems as if the Reserve Bank will have the opportunity to cut interest rates earlier, even in March, given local and international circumstances.

- Local long-term interest rates did not follow international long-term interest rate trends since end of January. On 2 March ten-year government bonds traded at 9.17% (8.98% on 31/1/20). This upward movement reflects the large public sector long-term financing demand, indications that the credit rating of the country will be cut and the risk of capital outflows following such a development, Poor growth of the domestic economy, inflation remaining under control and lower international interest rates will limit any upward movement of these rates.

- The rand remains volatile. It is adversely affected by any factor (like the corona virus) that causes a flight out of emerging markets into safe-havens, a strong dollar, weakness of international commodity markets, speculation about a credit downgrade, uncertainties caused by political statements about land expropriation without compensation or implementation of the impossible and unaffordable National Health Insurance scheme, negative growth rates of the domestic economy, electricity supply disruptions affecting the economy, fear about the unsustainable growth of public sector debt and especially of state owned enterprises like Eskom. The rand finds some support from the differential between local and international interest rates and the still well-functioning financial system.

INVESTMENT ENVIRONMENT

- Recently the dollar weakened against other currencies as it was anticipated that US short-short-term interest rates would be cut. This happened on 3 March — before the scheduled Federal Reserve Board meeting of 18 March — when the federal funds rate was cut by 50 basis points to a level of between 1% and 1.25%. US interest rate levels are still higher than in other major industrialised countries and growth of the US economy is still stronger than in these other countries.
- Given the real and feared impact of the corona virus in at least the first half of 2020, it is anticipated that short-term interest rates are likely to be cut even further in all major industrialised countries and to be supported by other monetary easing policies in coming weeks and months.
- International long-term interest rates are currently in many cases once again at record low levels as investor and speculative funds pour into safe-haven government bond markets. These rates are currently regarded to be too low and once the uncertainty of the impact of the corona virus disappears, these rates are likely to show strong upward movements, which could result in capital losses.
- RSA investors cannot currently afford to invest in international money and capital markets where interest rates are very low or even negative.
- Notwithstanding ample liquidity and low and declining interest rates, international stock exchanges showed massive losses in recent weeks. This reflected the fear that economic growth and therefore company profits and dividends will be adversely affected by the impact of the corona virus in coming weeks and months. Current levels of some shares indicate some buying opportunities in months to come when the virus has run its course.
- General commodity markets are also adversely affected by the impact of the Covid-19 virus as well as indications of a slowdown of the Chinese economy. If and when the virus dissipates, it is likely that general commodity prices will rise again, depending on the specific demand and supply situation of every commodity.
- The gold price benefits from the uncertainty caused by the spreading corona virus as well as the ample liquidity and low and declining international interest rates. This is likely to be the case in coming weeks and even months as well.
- International oil prices are expected to remain soft in at least the first half of the year due to the impact of the corona virus on the world and especially Chinese economic growth forecasts as well as the rising oil production of the US. Oil prices find support from indications that OPEC and Russia are likely to cut oil production by even more than a million barrels per day
- Local short-term interest rates are likely to be cut in the near future.
- Local long-term interest rates are likely to come under upward pressure due to the

expected credit downgrade, the expected outflow of capital from local financial markets, the large and rising demand for long-term financing by the public sector.

- The local stock exchange is influenced by international trends, as well as the poor performance of the domestic economy and its impact on company profits and dividends. It is also affected by any outflows of capital to international financial markets.
- The rand remains volatile with a long-term weaker trend as policy mistakes of the past twenty-five years are not rectified.

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