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Economic update for business decision-makers

February 2020

Executive Summary

- South African business conditions remain weak, though didn't seem to worsen much compared to our last update 3 months ago.
- One of the biggest business risks is government fiscal stress. This holds the threat of businesses losing state contracts, higher corporate and household taxation, more government borrowing putting strain on debt capital markets, and the lingering risk of central bank capture and higher inflation.
- Companies are finding some relief in lower inflation, which, while reflective of poor pricing power, also keeps interest rates contained and fosters general macroeconomic and currency stability. The weakness in the labour market also makes it easier to afford staff, though emigration and skills shortages remain a problem.

Considerations for Corporate Strategy

Moody's credit rating:
This issue has been overhyped. SA has already been downgraded in the market.

National Budget:
Keep an eye on taxes and closing loopholes, SOE policy, and general state willingness to reform broken state finances.

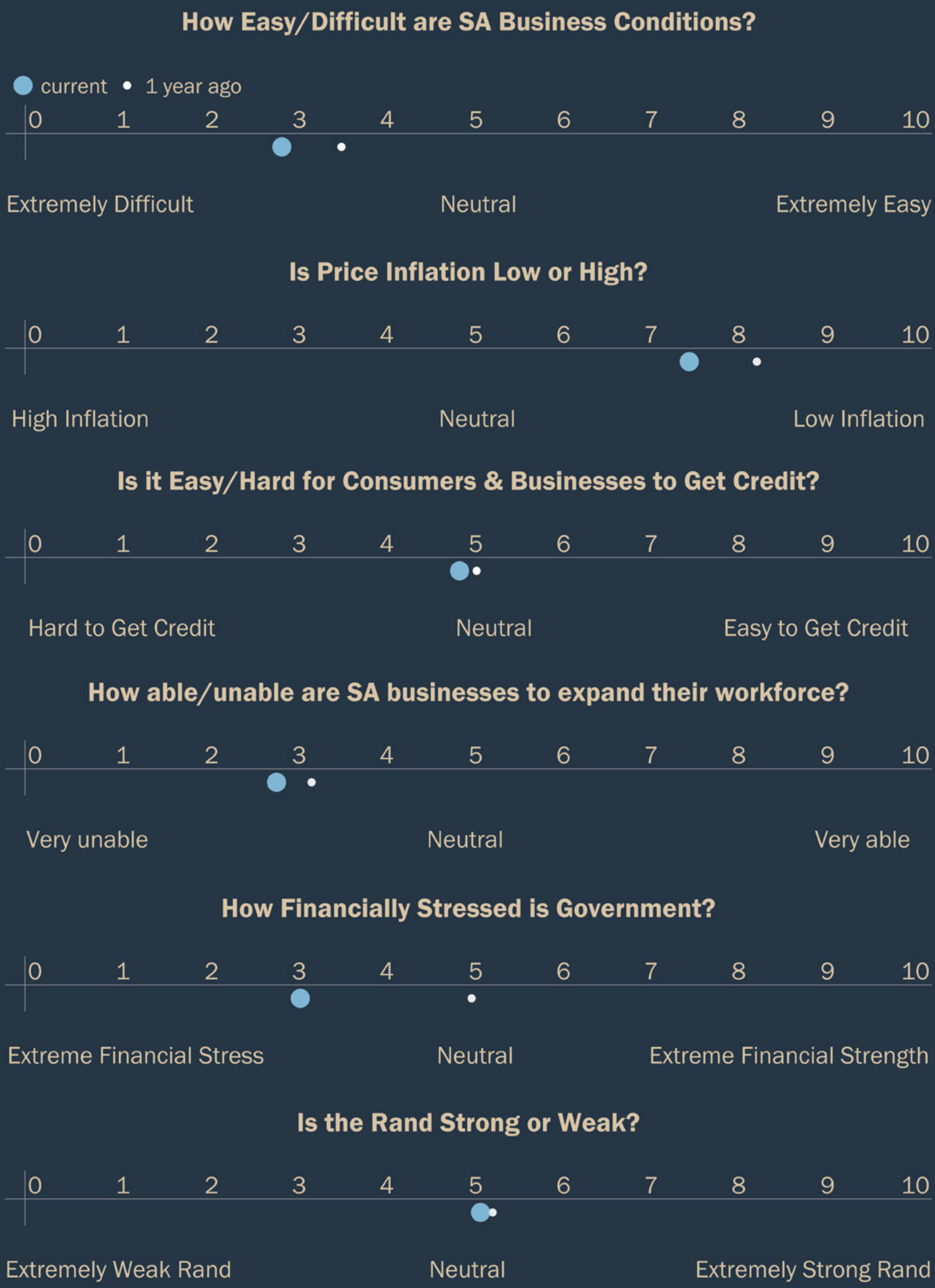
Emigration:
Middle and upper-middle class emigration is a large and important trend for analysing your market and supply of skills.

Currency:
The rand is currently neither very strong nor very weak, presenting no obvious strategic opportunity yet.

Turnover:
Turnover conditions in SA are expected to remain tough in H1 2020 and Eskom power shortages continue to hurt activity.

Global:
Offshore economic conditions remain broadly weak, putting ongoing strain on export growth.

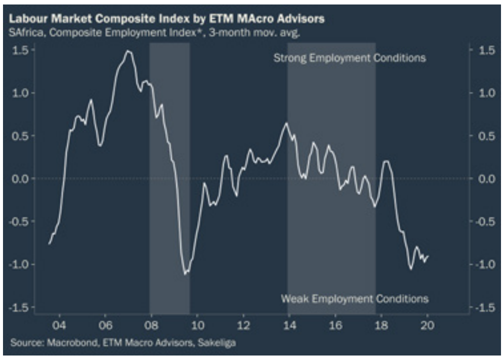
South Africa Business and Economic Dashboard (February, 2020)



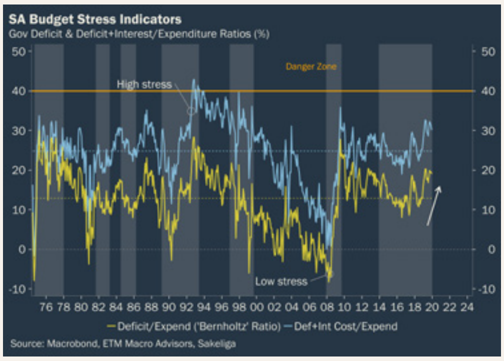
Source: Macrobond, ETM Macro Advisors, Sakeliga

South Africa Economic Summary

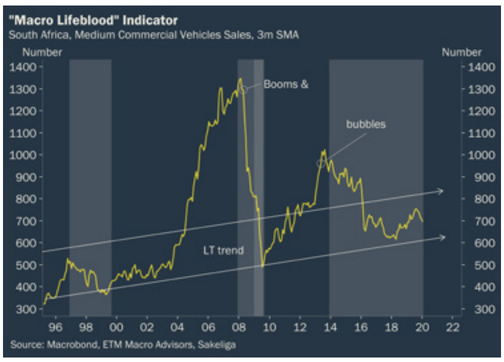
Bottom Line:
Signs of economic and job market weakness abound. The country's fiscal situation continues to deteriorate – all eyes on the Feb 26 national budget. Energy production falling. Further rate-cut risk rising.



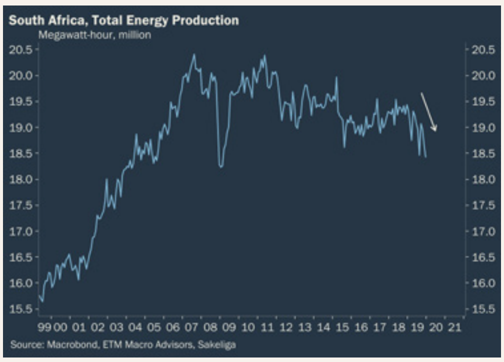
South Africa's **employment conditions** have remained extremely weak. This was borne out in the Q4 2019 Labour Force Survey which showed another decline in total employment after adjusting for typical seasonal factors. According the Stats SA, over 100 000 jobs were lost (net) in 2019. Minimal new investment and business formation continues to curtail hiring until meaningful investment confidence returns and more capital is committed to productive projects. ***The early employment data for 2020 (January) looks very poor, according to the BER manufacturing employment survey.***



All eyes will be on the finance minister in late February at the tabling of the national government budget. Much reform is needed but to date the government has been unable and/or unwilling to reduce the size of the state and its payroll. Our **budget stress indicators** have moved sharply higher since mid-2018. Government new borrowing and ongoing interest expenses now account for one third of total government spending and rising. ***20 cents of every rand government spends is borrowed. When these ratios climb above 40% it is regarded as risking a major fiscal crisis.***



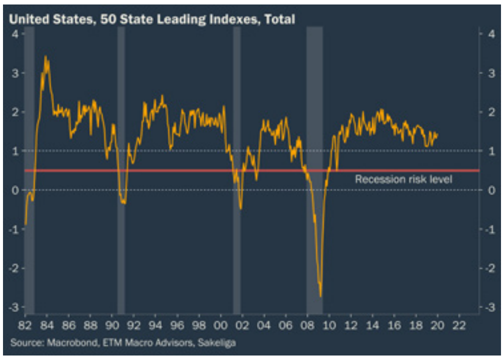
Medium and light commercial vehicles sales have fallen by over 10% since August 2019. We call this an indicator of the "lifeblood" of the economy because it gives an indication of urban small and medium logistics and retail and wholesale activity. ***The index implies recession-like conditions continued in Q4 2019 and into January 2020***. Not only does it suggest that urban retail and wholesale activity is depressed, but likely also suburban building activity, an industry that uses small and medium trucks for materials transport. This trend signifies lingering economic difficulty.



Energy production in South Africa has now slumped to lows not seen since the depth of the deep recession in 2009. Current production levels are 10% lower than the peaks in 2007 and 2011. A combination of declining production capacity and resulting weaker economy and demand have pushed production levels sharply lower since December 2018. ***The supply capacity constraint is a mega headwind for the economic system but also the social and political system, affecting basic confidence in the country and putting government finances at even greater risk.***

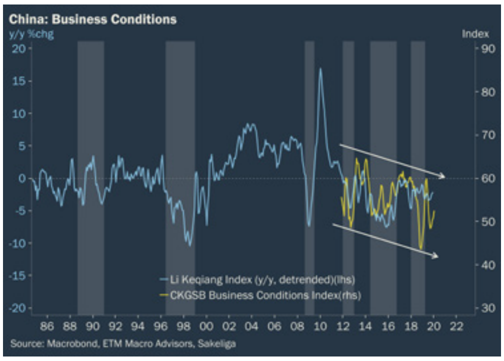
Global Economic Summary

Bottom Line:
US economic activity remains reasonably robust, but keep note of rising budget deficits and a possible stock market bubble. Meaningful Chinese recovery remains elusive. Lingering post-Brexit caution.



The **composite leading indicator of 50 US states** continues to show no obvious sign of recession risk in the world's biggest economy. Although some US industrial activity remains weak and overall logistics activity appears to be slowing somewhat, the broad array of economic activity indicators remains fairly buoyant and signals ongoing expansion. In another election year, with the US stock market at record levels and ongoing declines in the unemployment rate, President Trump looks like the favourite to retain the White House. ***However, a lurking risk is very large fiscal deficits and a possible stock market bubble.***

Britain's currency, reflected here as the **GBPUSD (Dollars per Pound)**, has to date made only a small recovery, despite much more clarity on the Brexit situation, a large majority for a fairly moderate Tory party, and signs indicating that the pound is undervalued. In the adjacent chart, a 'wedge' pattern is shown, which would point to much larger appreciation potential for the pound if it can break above $1.35. ***Perhaps the lingering weakness in sterling is the remaining uncertainty around trade and financial sector regulations, as well as renewed talk of Scottish secession.***



The Li Keqiang index and CKGSB (business school) Business Conditions index are highly regarded indicators of Chinese economic activity. The data of investment, turnover and earnings activity suggest that China has not perceptibly escaped its productivity slump of 2018/19. It is also yet to break out of the decade long decline in industrial productivity. ***Some surveys (by Credit Suisse and CFA institute), show economic expectations (confidence) surged stronger in Dec and Jan. But this doesn't seem to have translated into better hard data yet.***

The **gold price** climbed impressively in 2019 and finds itself just shy of $1 600/oz. The market is eyeing out the record highs of 2011 and 2012 above $1 800. The price has risen around 50% since the 2016 lows and around 500% since the early 2000s. Rising gold prices tend to signal a degree of global financial concern and slowing economic growth, which was very much the case in 2019. ***Such gold price appreciation also tends to benefit South Africa, a large gold producer. This seems to be one reason why the rand has remained relatively stable in recent times.***

South Africa: Presidential Policy Scorecard

Current score: *30/100*

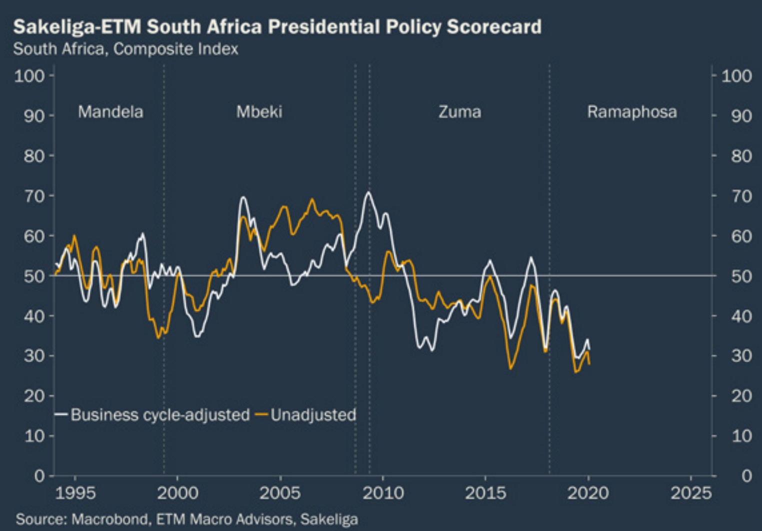
The South African government exhibits conflicting policy positions that leave business people wondering whether or not the administration will reduce the burden of state control and regulation on the economy. Promised reform appears to be slow in coming, whether due to inability or unwillingness to reform, or both.

Against this confusing and conflicting policy backdrop, it is especially important to determine how de facto existing policy is affecting measurable macroeconomic indicators. In this way, we hope to track a scorecard of the administration's policy progress in terms of real-world effects rather than merely conjectured and promised effects.

Our scorecard comprises 10 factors, each scored out of 10 to make a score out of 100. We show an unadjusted and business cycle-adjusted index (using the ETM business cycle indicator). The adjusted index diminishes the effect of business cycle booms and recessions.

The 10 factors:

- The ETM labour market composite index (Stats SA, BER, SACCI)
- The rand vs emerging market currency basket exchange rate (Macrobond)
- South African bond yields relative to offshore bond yields (Macrobond)
- Political constraints on business survey (BER)
- ETM SA Fiscal Stress Index (Stats SA, National Treasury)
- Manufacturing fixed investment confidence (BER)
- SA vs emerging markets small & mid-cap equity performance (Macrobond)
- Energy production (Stats SA)
- Net private investment/consumption ratio (SARB, Stats SA)
- Net international investment position/GDP ratio (SARB, Stats SA)



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