SAKELIGA

SELFSTANDIGE SAKEGEMEENSKAP

Economic update for business decision-makers

June 2020

Executive Summary

- Lockdown has hit South Africa and the global economy extremely hard. There are signs of stabilisation offshore as lockdowns are gradually lifted, but recovery is likely to be quite slow and many sectors remain in difficulty.
- The early indications are that price deflation has held sway as demand for products and commodities has collapsed. But central banks are printing money ferociously and there is a risk that inflation accelerates sharply when demand returns.
- The rand has stabilised somewhat after the market turmoil of March and April, and Reserve Bank rate cuts and policy interventions have created some calm in the financial system. However, we caution that the underlying economy is still extremely weak.

Considerations for Corporate Strategy

SA lockdown:
Lockdown regulations remain critical to recovery. Regulations remain irrational. Sakeliga will continue to monitor these.

Financial system:
Ailing state finances and banking risks leave scope for considerable financial system volatility and tight credit.

Covid Socialism:
Covid-19 has opened a door for the ANC government to implement even more socialistic policy. Be alert.

Currency:
The rand sell-off in March/April made the rand somewhat undervalued, but we remain cautious to become bullish just yet.

Interest rates:
The SARB has cut rates aggressively and expects to keep cutting through the course of 2020. Expect lower rates.

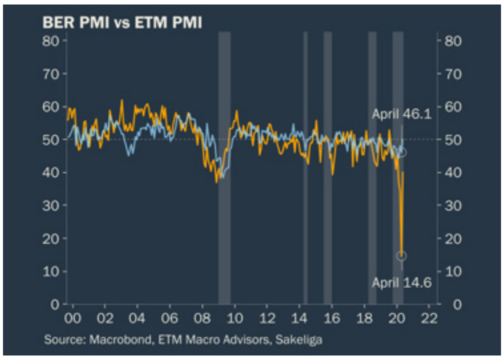
Global:
The global recovery will depend on swift exists from lockdowns and subsiding virus fears. This must be monitored closely.

South Africa Business and Economic Dashboard (May/June, 2020)

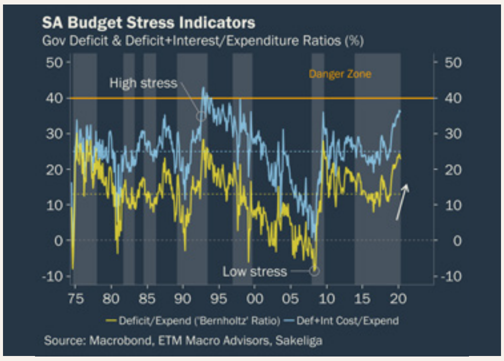
Source: Macrobond, ETM Macro Advisors, Sakeliga

South Africa Economic Summary

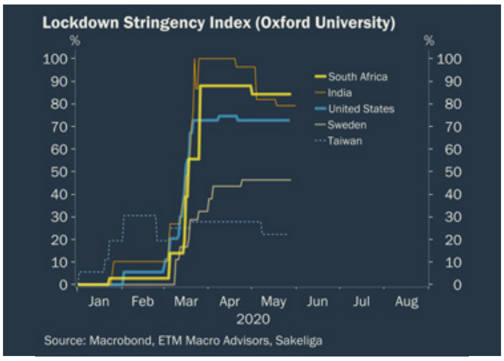
Bottom Line:
South Africa has had a harsh lockdown, which has had brutal economic effects on the country. Fiscal deterioration is rapid. More interest rate cuts are expected. Evidence of recovery will emerge in June.



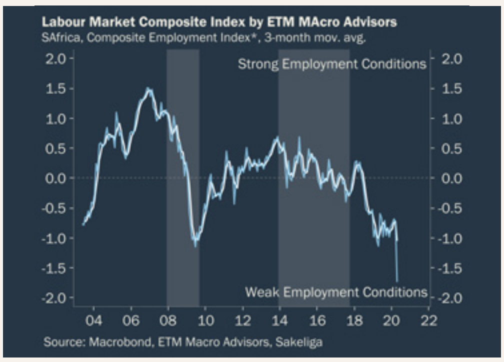
South Africa's **manufacturing purchasing managers** index (PMI) is an index of economic activity in the South African manufacturing sector. In April, the official PMI was 46.1 (white line), only marginally below the 50.0 level which separates sector expansion and contraction. This implied that lockdown was not having such a bad impact on industry. ***But once adjusting for an error in the PMI methodology discovered by ETM Macro Advisors, an adjusted PMI had actually fallen to just 14.6 (orange line) – a collapse far worse than the 2008/09 recession.***



Our **budget stress indicators** continue to move sharply higher during the Corona-crisis and lockdowns. Government new borrowing and ongoing interest expenses will soon account for 40% of total government spending, and we expect this number could easily surpass 50% in due course. Government estimates see expenditure rising considerably to supposedly cushion the blow of lockdowns, while tax revenues are expected to fall by nearly R300bn. ***When the ratios in the adjacent chart climb above 40%, it is regarded as risking a major fiscal crisis.***



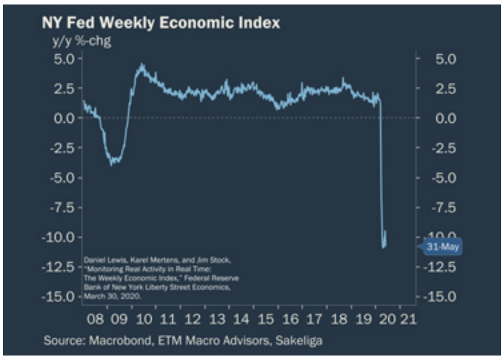
Data and analysis from Oxford University on the **stringency of lockdowns** show that South Africa has had, and maintained through May, one of the most draconian lockdowns in the world. From the chart, we can see that Swedish and Taiwanese measures have been very mild, whereas South Africa and India instituted very hard lockdowns, possibly fearing susceptibility of impoverished populations. US lockdowns have been harsh in some states and mild in others. ***The SA lockdown becomes less stringent from June 1, meaning economic activity will now begin to repair.***



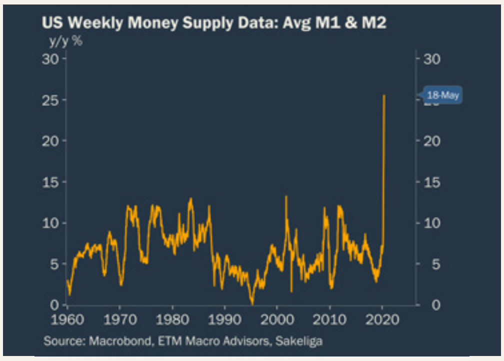
The ETM **Labour Market Composite Index** slumped sharply in April and probably fell further in May as national economic activity ground to a halt. Falling revenues have forced companies to lay off staff. Job security is low and many of those who have managed to retain their jobs are facing substantial pay cuts. Cutting staff costs is part of how businesses try to stay afloat amid plummeting sales. ***Our estimates show that job losses have probably amounted to somewhere between 2-3 million people. Employment conditions will slowly begin to repair in June.***

Global Economic Summary

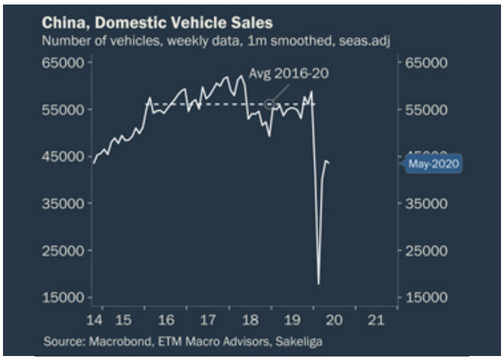
Bottom Line:
April appears to have been the worst month for economic decline in the global economy. Signs of some stabilisation are emerging, but China shows recovery is still quite slow. Beware future inflation risks.



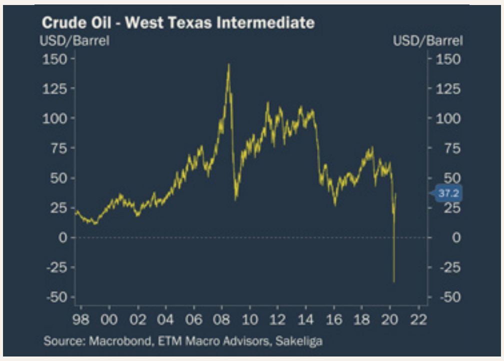
The New York Federal Reserve Bank produces the **US weekly economic index (WEI)** to monitor economic activity on a weekly basis with very up-to-date information. The WEI plunged lower in March and April, but began to stabilise in May as some US states began easing lockdown restrictions. The index implies that lockdowns may have created an economic depression 2-3 times worse than the recession in 2008/09. ***The key factor which we will now monitor for Sakeliga members is how rapidly this index recovers in the weeks and months ahead as lockdowns lift across more of the country.***



One of the factors about the Covid-19 crisis that we are monitoring closely is the surge in **dollar money supply growth** as the Federal Reserve prints money in an attempt to bail out banks and companies during the lockdown. At around 25% y/y, this is by far the highest rate of money growth since WWII. Early inflation signals show prices falling because of forced declines in spending. ***But as the economy opens up, we may see more and more money finding its way to buying goods and services and inflation risks may escalate. New money injections do now seem to be slowing in May.***



Because China was first to experience Covid-19 lockdowns and also emerge from them, it can tell us about the likely recovery from lockdowns. Chinese vehicle sales data has recovered since Feb/March but has settled in April/May around 20% below its average levels from 2016-19. Industrial output data in particular is still looking weak, and business activity is not recovering quickly. ***Chinese data is generally improved from its worst levels, but it continues to struggle to recover amid a global lockdown-recession and moves by Beijing to take the country back into lockdown.***



West Texas Intermediate crude oil crashed to a staggering -$38/barrel on April 20th. That's right, a negative price. This resulted from an acute shortage of storage space where producers were incentivised to pay buyers to take the oil off their hands or they would incur high costs trying to store it or face environmental fines if they tried to dump the oil. However, this situation has been alleviated. Oil prices have bounced back above $30/barrel. ***The low price has caused the supply of drilling rigs to fall (less supply), while demand is recovering as global lockdowns ease in May and June.***

South Africa: Presidential Policy Scorecard

Current score: *30/100*

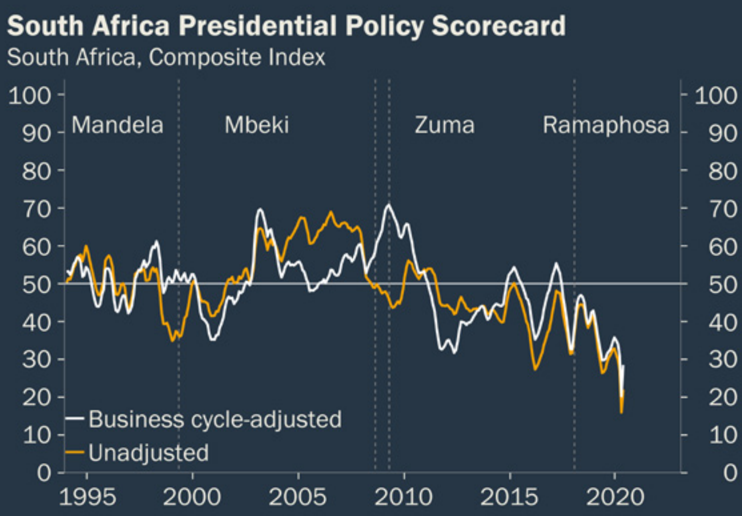
The South African government exhibits conflicting policy positions that leave business people wondering whether or not the administration will reduce the burden of state control and regulation on the economy. Promised reform appears to be slow in coming, whether due to inability or unwillingness to reform, 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 (MSCI)
- Energy production (Stats SA)
- Net private investment/consumption ratio (SARB, Stats SA)
- Net international investment position/GDP ratio (SARB, Stats SA)



Source: Macrobond, ETM Macro Advisors, Sakeliga

REPORT COMPILED BY:

Russell Lamberti (Head - ETM Macro Advisors) & Gerhard van Onselen (Senior Analyst - Sakeliga)