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ECONOMIC COMMENTARY - By Francois Stofberg

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A LESS SENTIMENTAL ANALYSIS OF REALITY

In a Bloomberg survey on South Africa's fiscus, analysts recently forecasted a 6.5% budget deficit (expressed as a percentage of GDP). At this rate the shortfall will be substantially larger than originally forecasted by Finance Minister, Tito Mboweni, during his February 2019 budget speech. During this occasion government was expecting an already large 4.5% deficit. However, the economy has been growing at a much slower rate than initially anticipated. Whereas the Finance minister believed the economy would grow at 1.5%, it will most likely only grow at 0.5%. As we reported last week, a slower growing economy means less work, less sales, less profits, less travel and less imports. This translates into less personal income tax, less VAT, less dividend and company taxes, less fuel levies, and obviously we can add and add to that list. Trouble at SARS and smart tax-avoidance by tax payers have meant that revenue is most likely to come in R50 billion below budget. Bailouts to Eskom, SAA, and the SABC have inflated spending, the result being a substantially higher budget deficit and overall government debt levels; probably in the range of 60% to GDP.

Where does this leave us? Luckily, most of the bad news is already priced into markets who have already seen this coming and kept the rand at unnaturally high levels around R14.80. Following the medium-term budget policy statement (MTBPS) and the announcement made by Moody's shortly thereafter, local equity and currency markets should start improving. The reason for this is simple: uncertainty always overshoots. Currently, investors are bombarded with the unknown and flee to what they perceive are safer alternatives;

+ local cash (not advisable for the long-term investor), or,
+ greater levels of offshore exposure (careful now).

As they start fleeing others notice and follow. This of course plays off in an international landscape where investors cling to unnaturally-high-yielding developed markets, despite the looming slowdown. Pessimism fuels pessimism and local markets are kept depressed. But sentiment has an immediacy to it. Should markets finally start realising that the rich developed markets will not be able to produce stellar double-digit returns forever, investors will once again start looking towards riskier, higher-yielding emerging market assets. When they do start looking, they'll also realise that South Africa's equity prices are severely depressed, so too is the currency, which make buying South African equity a no-brainer. Something similar happened in Brazil, when, after a downgrade to junk by all the credit agencies, their local equity market, the Bovespa, rallied roughly 148% from January 2016 to date. For this reason, we caution local investors against changing their long-term asset allocation without proper financial advice. Sentiment (emotions) should not influence long-term decisions. The key takeaway from the past 5 years of absurdity in both local and international markets, is that actively managing geographical exposure in your portfolio is important. It's not that (local) cash, fixed income or whatever other asset class is a better alternative to long-term investing, it's that alternatives do play an important role as they stabilise volatility.

In Canada, Justin Trudeau of the Liberal Party (LP), was re-elected for his second term as president, although this time not with a majority vote. Trudeau lost some votes after damning photos of his past were released. In these photos, he wore inappropriate make-up. Although the photos were from his youth and the make-up was worn as part of a costume, conservative voters turned against him. As a result, the LP has been forced into a coalition with the National Democratic Party (NDP). However, both the LP and NDP lost favour among voters as the conservative party led the polls in this year's election. In general, it seems as though Canada is divided, and the LP will have to do a lot to convince voters to keep them in power during the next elections.

In some other interesting news. Tesla once again caught pessimists off guard when they announced a 3rd quarter cash increase of $5.3 billion. Analysts were expecting a 42-cent loss per share, but profits bolstered a $.186 profit per share. Tesla managed record levels of car deliveries and cut costs by 16% year-on-year. Markets liked the news and the share price rallied by 21%. Tesla announced that they plan on delivering between 360,000 and 400,000 cars this year and are on route to release their Model Y, some electric trucks, and batteries from their first up-and-running Gigafactory.

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