SIMEKA

member of Sanlam group

Economic Commentary

April 2022

The news of Russia's invasion of Ukraine has dominated global media and financial markets since February 2022. In the post-Cold War era, serious conflict and naked aggression were considered less likely to occur and the above invasion shocked the financial environment. NATO-aligned countries responded by implementing sanctions and a trade embargo against Russia. It is uncertain how effective these steps will be in the short term, as no countries from Africa, South America or Asia (except for Japan, Singapore, South Korea and Taiwan) joined in the sanctions and trade embargo against Russia.

The immediate economic impact of the Russia-Ukraine war was a spike in the prices of commodities of which Russia is a large producer, for example oil, liquid natural gas, nickel and platinum group metals (PGMs). The price of wheat spiked in the agricultural futures market and fertiliser prices rose as Russia and Ukraine are both large exporters of potash and ammonia, which are used to produce fertiliser. The expectation is that global inflation is likely to linger for longer at elevated levels. Higher energy and food prices will drive global inflation upwards and hurt consumers across the world.

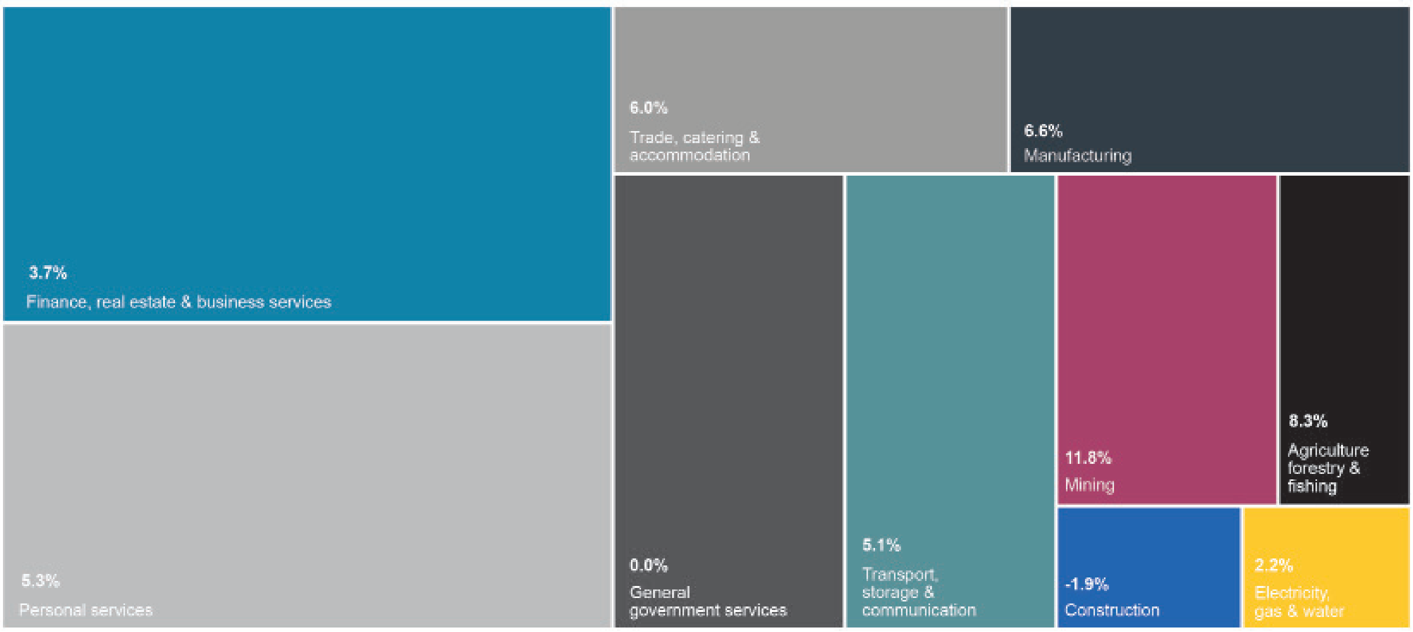
The oil price spiked on news of the invasion and whiplashed up and down on rumours of peace talks. (Graph 1: Oil price (Brent spot) US$ a barrel).

Similarly, the price of PGMs palladium and rhodium increased sharply in March 2022. (Graph 2: Palladium and Rhodium US$ an ounce).

In South Africa, the Reserve Bank's Monetary Policy Committee increased the repurchase (repo) rate by 0.25% each time at its meetings in January and March 2022 (in addition to the 0.25% increase in November 2021). The hawkish approach follows the higher inflation rate in South Africa and the robust economic recovery in 2021. Further reasons contributing to the Reserve Bank's hawkish approach may include the fact that some sectors of the economy may be experiencing constraints, and the necessity to maintain a synchronised approach with the global interest rate cycle in order to protect the rand exchange rate. It is not ideal for interest rates to be increased while final household consumption expenditure is still under pressure. Further hikes in the repo rate are anticipated in 2022, perhaps two increases of 0.25% each (bringing the repo rate to 4.75%). (Graph 3: South African Reserve Bank repurchase rate).

South Africa's gross domestic product (GDP) expanded by 4.9% for the full year in 2021, compared to a contraction of 6.4% in 2020. The recovery occurred largely in the primary sector of the economy where agriculture, forestry & fishing experienced lively growth and mining & quarrying continued its solid performance. (Figure 1: Growth in gross domestic product per sector).

Figure 1: Growth in gross domestic product per sector



To appreciate South Africa's actual economic position, the GDP for 2021 should be compared with the pre-Covid levels achieved in 2019. Overall, the GDP for 2021 was still 1.5% lower than in 2019. In the primary sector of the economy (7.7% of total), the agriculture, forestry & fishing sector was 22.9% higher in 2021 than in 2019 while the mining sector was 1.5% lower than in 2019. In the secondary sector of the economy (16.4% of total), the manufacturing sector (-6.5%), electricity, gas & water sector (-3.9%) and construction sector (-21.4%) were all still lower in 2021 than in 2019. With the exception of the trade, catering & accommodation sector and the transport, storage & communication sector, most components of the tertiary sector of the economy (66.4% of total) achieved a higher output in 2021 than in 2019.

Final household consumption expenditure in 2021 was still 1.1% below 2019 and gross capital formation was 18.9% lower in 2021 than in 2019 (gross capital formation shows the potential of the economy for expenditure on land improvements, plant, machinery, equipment and the construction of roads and railways).

The conclusion is that overall economic output must grow by at least 1.5% in 2022 to reach the pre-Covid 2019 levels; and even then, there will still be some sectors of the economy that are behind the levels last achieved in 2019.

By December 2021, there were 7 921 000 unemployed people and a further 3 806 000 discouraged job seekers in South Africa despite the economic bounceback (compared to 6 726 000 unemployed people and 2 855 000 discouraged job seekers in 2019). South Africa's labour force participation rate (number of people employed ÷ number of [employed people + unemployed people + discouraged job seekers]) fell from 63.2% in 2019 to 55.4% in 2021. Regardless of how the situation is assessed, approximately 2 million fewer people were employed in 2021 than in 2019, despite the economic recovery to date. (Graph 4: Unemployment).

Financial markets

The volatile performance of financial markets reflected the uncertain conditions that have prevailed since Russia's invasion of Ukraine. Ever since the 1980s, exogenous shocks such as regional wars have often provided investors with good buying opportunities. It is too early to say if the Russia-Ukraine war will have the same effect.

The higher commodity prices since the start of the war have been positive for South African producers, but volatility has increased as many global investors withdrew from risky positions in emerging markets. For example, the FTSE/JSE All Share Index reached an all-time high of 78 297 on 3 March 2022, only to fall to 69 557 on 15 March (by 11.2%). It subsequently recovered to 75 497. From the invasion on 24 February to 7 March 2022, the FTSE/JSE Resources 10 Index initially increased by 18.9% but shedding 17.4% towards month-end.

Financial shares added 20.2% for the quarter with most banks and some insurers achieving strong gains. Some shares listed on the industrial board still struggled (e.g. Naspers, as a result of continued steps to regulate internet-based businesses in China). The contributions from the money market and domestic bonds were more modest for the quarter. The best bond performance for the quarter was achieved in the 12 years plus maturity bucket (2.8%).

The exchange rate of the rand strengthened over the quarter from R15.94 in December 2021 to R14.60 by March 2022. As a result, the already negative US dollar-based returns posted by offshore investments for the quarter were moved further into negative territory.

The US dollar gold price showed positive price movement for the quarter, but this was countered by the stronger rand. In rand terms, the gold price lost 3.3% of its value over the quarter.

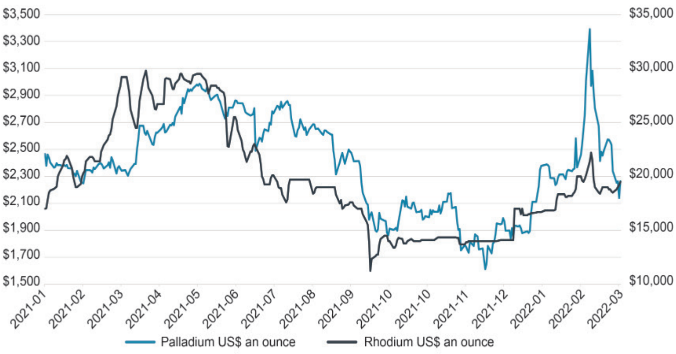
The performance of the major asset classes to March 2022 was as follows:

% change March 2022	Most recent quarter (%)	1 year (p.a.)	3 years (p.a.)	5 years (p.a.)
All Share Index	3.8%	18.6%	16.3%	14.3%
Listed Property	-1.3%	27.1%	-3.7%	-4.4%
STeFI Composite	1.0%	3.9%	5.5%	6.9%
BEASSA ALBI	1.9%	12.4%	9.2%	10.7%
MSCI All Country World ZAR	-13.3%	6.5%	14.6%	14.1%
Barclays Global Aggregate ZAR	-13.8%	-7.5%	0.9%	3.4%
Rand (+ strengthening, - weakening)	9.2%	1.2%	-0.3%	-1.6%
Inflation (estimate)	1.5%	5.7%	4.5%	4.6%
Gold ZAR	-3.3%	13.3%	14.6%	10.9%

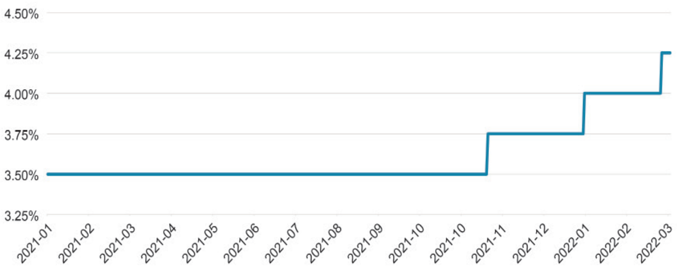
A final thought to consider is that the petrol price in South Africa is expected to reach record levels because of the high oil price. If interest rates in South Africa had not been increased, the rand exchange rate may have been weaker resulting in much higher fuel price increases. As it is, National Treasury has indicated that the fuel tax included in the retail fuel price will be reduced temporarily by R1.50 a litre to alleviate the pressure on consumers. The fuel tax reduction is to be funded by the sale of some of the country's oil reserves at the current higher oil price. The reserves will be replenished as the oil price comes down in the future.

Graph 1: Oil price (Brent spot) US$ a barrel

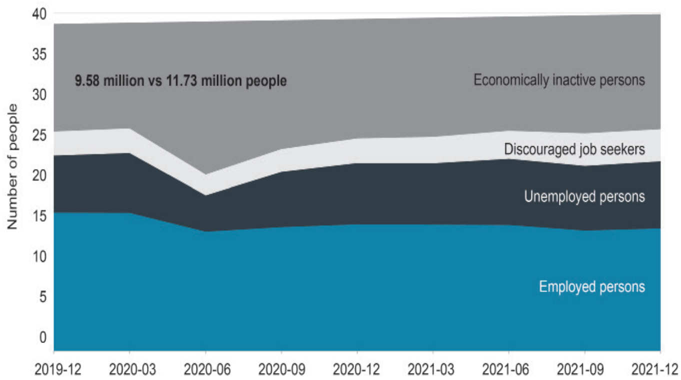
Graph 2: Palladium and Rhodium US$ an ounce



Graph 3: South African Reserve Bank repurchase rate



Graph 4: Unemployment



Prepared by:
Marcus Rautenbach
Principal Investment Consultant

11 April 2022

Information for this article obtained from several sources:
The Department of Mineral Resources and Energy, Stats SA and IRESS