



SAKELIGA

SELFSTANDIGE SAKEGEMEENSKAP

**Economic update for business
decision makers**
November 2019 update





Considerations for corporate strategy

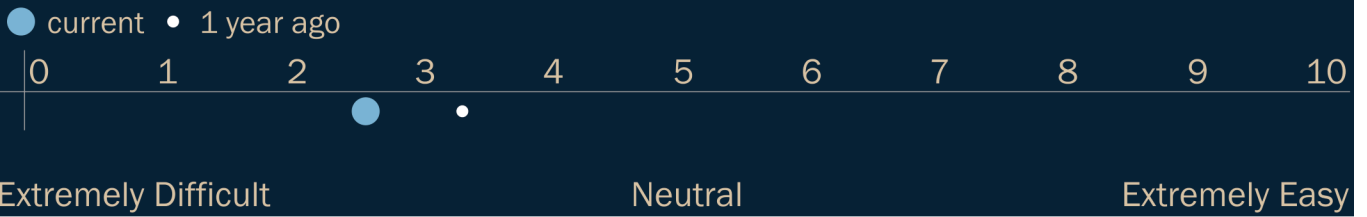
What should you be focusing on as a business owner in South Africa as 2019 draws to an end? We don't think South Africa's credit rating is of much significance, despite all the media attention it gets. It's not South Africa's 'official' rating that matters, but the reality on the ground. In that sense, South Africa slid into junk status a number of years ago and this has ALREADY been reflected in a weaker rand, higher interest rates and more cautious banks.

As we've explained this year, South Africa is a de-developing country. In a de-developing country, the middle-class shrinks, products and services become less abundant and competitive, and supply chains become thinner and less well developed and integrated. The quality of state services declines. Affording a good quality lifestyle becomes disproportionately expensive. The country's poor become more radicalised and discontented. State corruption doesn't lessen.

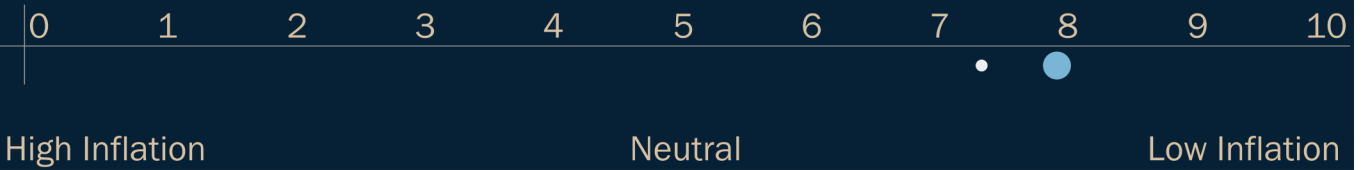
More specifically, we believe business pricing power remains very weak unless you are willing to lose volume. If you can protect revenue by raising prices enough to offset lower volumes, and if lower volumes allow for shedding of overhead cost, then one should reconsider repricing products to raise margin. Aim for product niches, protectable IP, low overhead, high margin lines of business.

South Africa Business and Economic Dashboard (November, 2019)

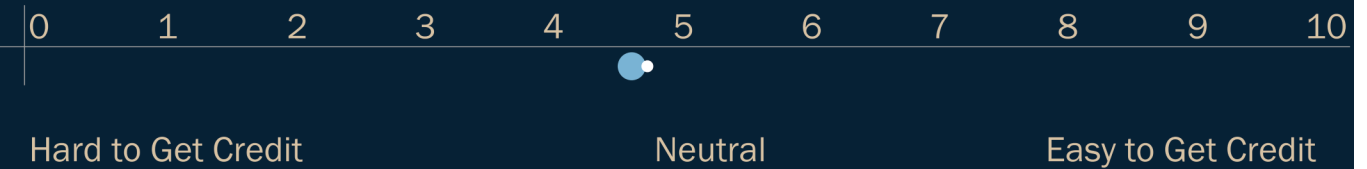
How Easy/Difficult are SA Business Conditions?



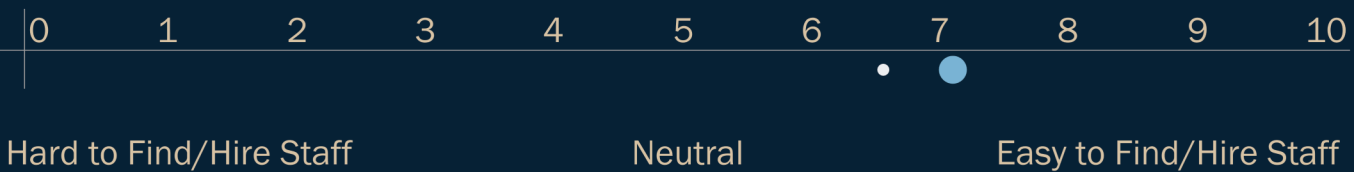
Is Price Inflation Low or High?



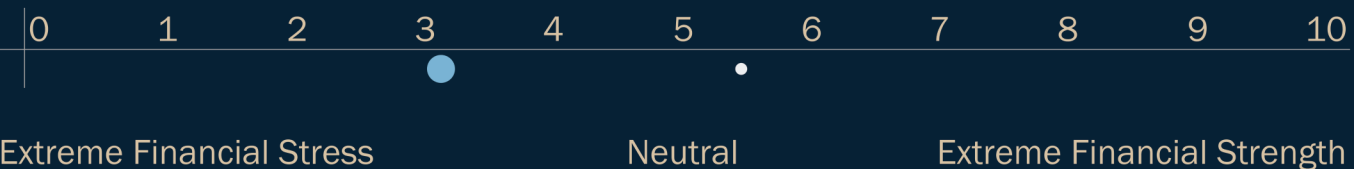
Is it Easy/Hard for Consumers & Businesses to Get Credit?



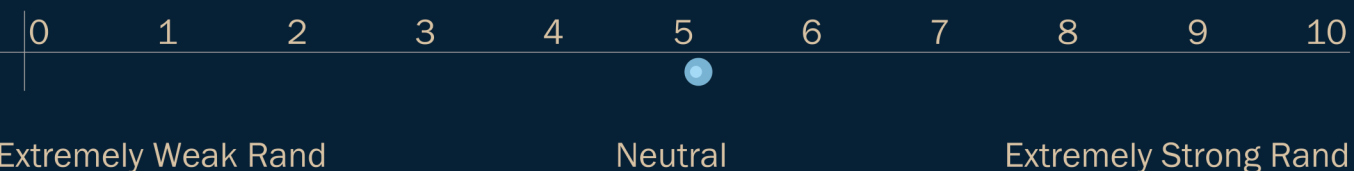
How able/unable are SA businesses to expand their workforce?



How Financially Stressed Is Government?

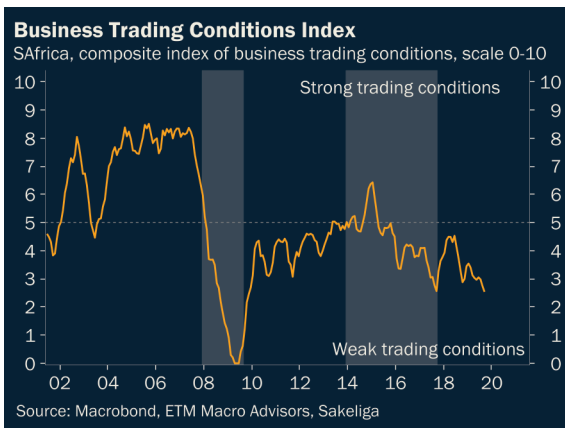


Is the Rand Strong or Weak?

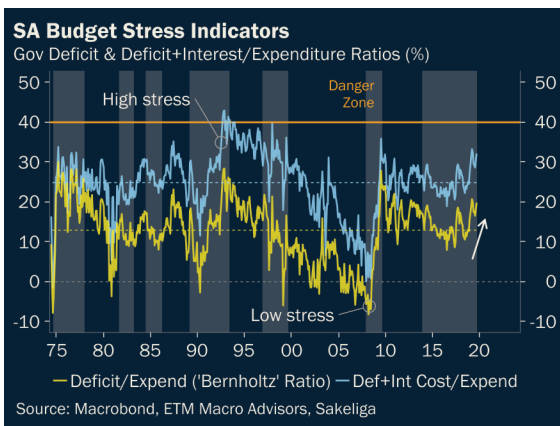


South Africa Economic Summary

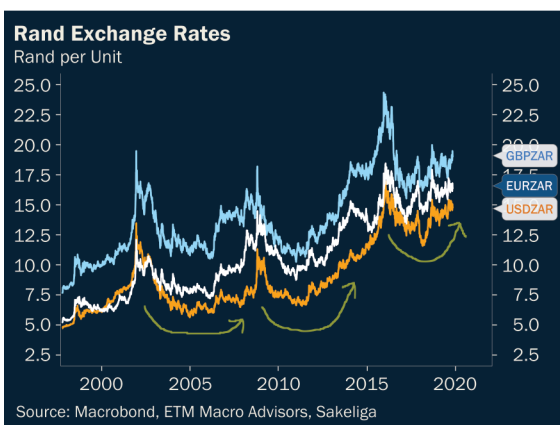
Bottom Line: Business conditions remained weak in Q3 and government fiscal stress remained high. Early signs in Q4 imply that the economy remains in stagnation mode as 2019 draws to an end.



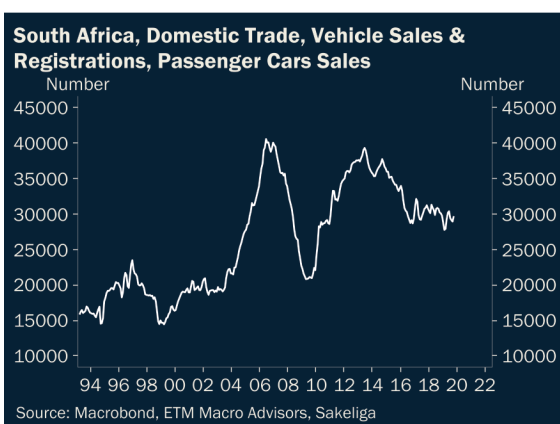
South Africa's **business trading conditions index** slumped further in Q3 2019 as company profitability struggled to improve. Given the weak job market and low inflation environment, weak earnings growth implies that consumer and corporate demand conditions remained poor during the quarter. The index is back below levels seen just before the ANC leadership conference in December 2017, implying that **business conditions haven't been this weak since the slump in late 2008. A mix of domestic and offshore economic headwinds are keeping conditions difficult.**



The mini-budget speech by the finance minister in late October alerted onlookers to the intractability of South Africa's fiscal problems. The government is clearly unable 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. **Of every rand government spends, 20 cents are borrowed. When these ratios climb above 40% it is regarded as risking a major fiscal crisis.**



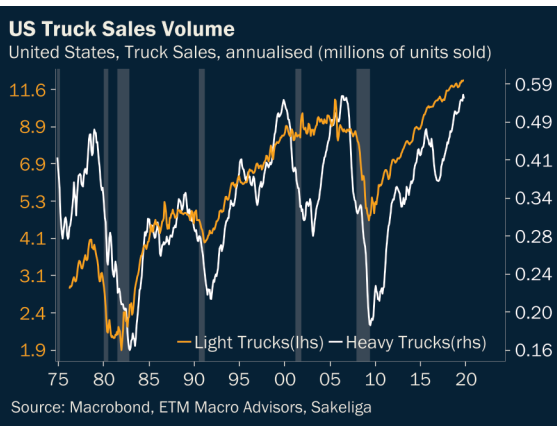
The **rand exchange rates** against major currencies have been relatively stable for the past year. However, looking at the bigger picture, the currency is taking on a familiar trend as seen in the mid-2000s and early 2010s. After the rand crashes in 2001/02 and 2008, the currency roared back for around 3 years before embarking on its next depreciation wave. **While these patterns provide no guarantee of future rand performance, rand weakness since early 2018 has been worrying and indicates a loss of confidence in the ability of the new ANC leadership to reform a failing economy.**



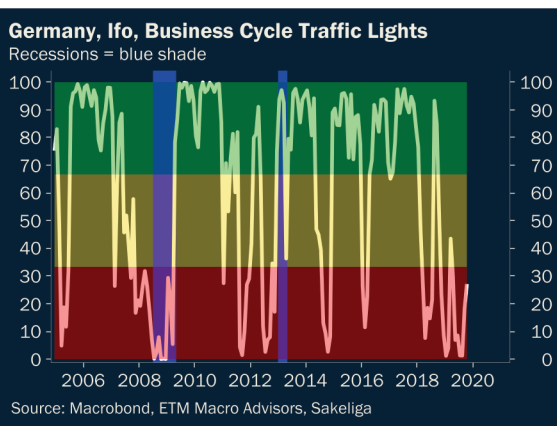
The pain for SA consumer markets continues as car sales remained weak in Q3. The volume of **passenger car sales** is almost at decade lows, and hasn't grown since 2004, 15 years of market stagnation. The lack of car sales growth shows the challenges customers face in terms of affordability, which keeps banks cautious in their provision of vehicle finance. **It should be no surprise that the slump in employment conditions is happening along with this trend. Weak job security keeps banks cautious, retrenchments cause a loss of income, and no job growth means minimal new demand for commuting.**

Global Economic Summary

Bottom Line: The world does not seem to be at risk of a global recession. US business activity is holding up, while China and Europe have slowed meaningfully. Commodity prices have been soft, supporting the business cycle.



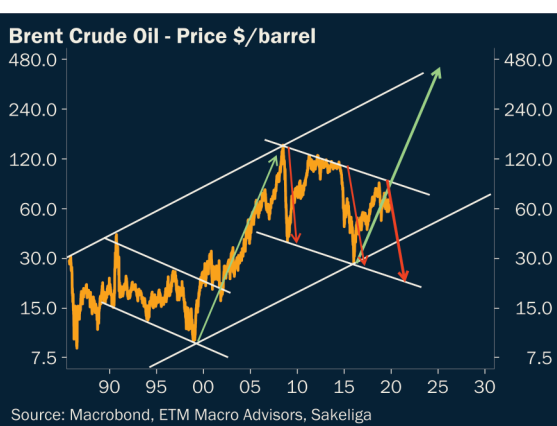
Despite much economic gloom around the world in 2019, **US truck sales** continued to power upwards, confounding the recession forecasters. Truck sales have been a fairly good predictor of past recessions, tending to fall sharply ahead of a major downturn. In 2019 there has been no such sign of weakness in the truck market, suggesting that logistics remains buoyant and therefore that production and sales activity is holding up ok. **Many business cycle indicators have indeed weakened in the US in 2019, but we have not yet a broad enough slump in the available data to indicate an imminent recession. Instead, US revenue growth is recovering, albeit gradually.**



The **German Ifo Business Cycle Traffic Lights** index is an indicator of business and economic conditions between zero and 100 where being in the top third signals “green” for strong economic conditions, the middle third “amber” for moderate conditions, and the bottom third “red” for weak or declining business activity. Germany has been mostly in the red zone since early 2018 as manufacturing production slumped and the economy lurched toward another recession. **As of October 2019, the indicator continued to show that businesses can expect weak sales conditions in the months ahead. This will keep negatively impacting on South Africa’s exports to Europe.**



Tencent Holdings, the Chinese technology company that forms the bulk of the asset value of South Africa’s Naspers, has seen its share price struggling again in recent months as China’s economy has slowed and global tech giants have come under greater scrutiny from investors. This is an important company for South Africans, not just because it reflects some aspects of China’s economy, but also because it drives Naspers’ share price, a JSE company that forms a substantial part of SA retirement portfolios. **China’s growth is slowing meaningfully as decades of rampant debt accumulation and capital misallocation make it difficult for companies to keep growing earnings.**



The **oil price** remains a key component of the global economy. Brent crude has spent much of 2019 in a fairly tight range. The lack of significant oil price inflation is one important reason why so far the global slowdown hasn’t seemed to graduate into a more acute recession. Will oil stay in the downward channel according to the rightmost red arrow, or adopt a similar pattern to 2000-2008 (green arrow)? **We advise Sakeliga members to keep an eye on the oil price. A significant break above \$80 will indicate increasing cost pressure risk. A break below \$40 would be very supportive of containing business cost and relieving consumer budgets.**



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