Capricorn Asset Management
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Economic Update: Outlook for 2020

Over the past six quarters there has been a global macroeconomic slowdown, so much so that it turned into what is rightly termed a growth scare. As 2020 approaches we start looking forward with increasing hope to an upswing. However, we need to ask whether such hope is warranted and, also, whether it will assist Namibia in getting out of its slump.

We sketch the context and trends that we foresee in broad brush strokes. Usually we tend to think about the future in terms of three scenarios – a good one, a bad one and a base case. A good scenario comes about when a number of factors and trends come together in a positive fashion, a bad one when these turn nasty. Usually, the base case comes about, which in most instances amount to the dreaded "muddle through" scenario. The main factors and trends that we see, globally and domestically, that will determine which way things will turn out are the following:

- **Splintered politics.** Ruling parties are plagued by internal factions and the political landscape is divided amongst more players. Populations are seething in protest from Hong Kong to Iran. "It is a symptom of fundamental dissatisfaction with self-serving elites" is but one of many reasons being put forward to explain popular anger. This makes for incoherent and ad hoc policy making.
- **Polarisation.** Alternative economic systems of organising societies are being held up as models to be followed. These range from free market capitalism and social democracy to socialism, communism and Islam. In the US and UK, the left are proposing socialist measures which are likely to be rejected by voters.
- **The Sino-US trade war.** There will not be a quick, clear end to this drawn-out saga. It is essentially a clash of value systems and an arm-wrestle for dominance. It is also likely to add to polarisation as nations are forced to "choose sides". A cooling Chinese economy will remain a drag on global growth and commodities.
- **Limits to monetary policy.** In most Developed Markets (DM's) interest rates have been cut to the bone or even deeper – into negative territory. However, these economies seem to be caught in a liquidity trap. This means that corporates and households prefer cash above all other investable assets, which, in turn, means less borrowing, less spending and less investing. Emerging Markets (EM's) generally maintain higher interest rates and therefore have the ability to cut rates further, which should be growth positive.
- **Revival of Keynesianism.** The liquidity trap has ignited a view that fiscal policy needs to step in to stimulate aggregate demand and get economies growing again. However, for most economies there is little room for this. Debt levels are already very high and increasing deficit funding could tip many into a scarier trap called the debt trap. Namibia is not in a debt trap yet, but overall debt is reaching dangerous levels.
- **Technological revolution.** Disruption of industries will continue as automation, AI and big data continues to grow apace. As the fields of robotics, nano technology and genetics open up new horizons, their full impacts on current industries are yet to be felt. Not to mention moral dilemmas that will arise.

- **Supremacy of ESG.** Environmental, Social and Governance considerations will be at the forefront, impacting a wide range of decisions from policy making to investing to spending patterns. Namibia seems to be making headway in the move to clean energy, but continue to struggle in the governance of SOE's.

Global growth is likely to bottom in the 4th quarter of 2019 and 1st quarter of 2020. Consumer confidence has held up quite well in most regions and unemployment remains low. Business confidence have taken the brunt of geopolitical tensions, but there has been a thawing in the trade war and the Brexit process has taken a somewhat more sensible turn. Central Banks, emboldened by the Fed about face, have been lowering interest rates in a concerted fashion. The latest move is from China where the repo rate is being lowered.

Against this backdrop we foresee that the Namibian economy should achieve marginally positive growth in 2020. However, we will be fortunate if it is much above 1%, following on a 2% contraction in 2019.

Similarly, in South Africa, the outlook is not great. Economic growth is likely to be marginally positive this year and next, but not enough to change the overall sense that recessionary conditions will persist.

Global inflation pressures remain low. It seems that the technological revolution, lack of bargaining power, changing spending patterns and a long-term decline in food inflation are the main reasons for the absence of inflationary fears. Policy makers and investors are more concerned about the possibility of deflation (constantly falling prices) than inflation (constantly rising prices).

In Namibia, inflation has also been very subdued. In fact, it has dropped to 3% in October. However, so far it has been a cyclical move down. It remains to be seen whether it constitutes a permanent, structural shift lower. We estimate that the inflation rate is close to its bottom for the cycle and will gradually rise in 2020 from around 3% to just above 4%. In 2021 it is likely to remain in the 4% to 5% range.

Monetary easing is likely to continue. Interest rates are being lowered everywhere one cares to look. The key shift in 2019 in this arena has been the move from hiking to cutting rates by the Fed. However, there is a new shift by the Fed from cutting to holding rates. We reiterate what we said in a previous note: "The USA economy is still looking quite strong. Unemployment is at an all-time low, which means that, from a domestic perspective, the USA economy is not in need of policy stimulation. There is indeed a debate amongst the members of the Federal Reserve on this issue. Some members are against further interest rates cuts, while some are in favour of further easing as 'insurance' against the knock-on effects that will emanate from the weakness in global trade and falling manufacturing confidence." The Namibian economy is weak, inflation risk is low and no, we do not expect Namibia to exit the slump convincingly. We therefore expect the Bank of Namibia to lower rates further through the course of 2020.

Pressures on the Fiscus will remain heavy. October's interim Budgets, both in South Africa and Namibia, in our view, have not revealed the full scale of fiscal slippage yet. Revenues will be severely constrained by general economic weakness while there will be no shortage of demands on the Fiscus to spend more. In Namibia, the deficit is likely to be 5.5% of GDP rather than the budgeted 4.3% and in South Africa 6.0% rather than 4.5%. The result is a continuing deterioration of creditworthiness as debt levels soar amidst weak growth. All the while SOE's remain a drain on the fiscus. However, we do not foresee defaults by either Namibia or South Africa anytime soon.

Market implications

Money market rates will drift lower which means expected returns of 6.0%-7.0% (albeit virtually risk free). Reflecting the deterioration of creditworthiness, bond yields will probably remain in the 8%-9% range which is a reasonable running yield (with risk of loss if yields move sustainably higher than this). Listed property remains a value proposition with yields exceeding that of 10yr bonds (with risk of loss if fundamentals deteriorate further).

Domestic equities are also priced attractively compared to history and relative to bonds, which means low double-digit returns are quite possible as earnings grow. Offshore fixed income offers very low running yields which provides support for equity markets. The latter ought to also deliver low double digit returns as firms get on with business despite the headlines. Note that the S&P500 is up 20% year to date. In DM's dividend yields exceed bond yields.

This is an environment where, in our view, investors should not expect to "shoot the lights out", but should follow what is for them a sensible, lower risk approach which could either be in low volatility assets or in a well-diversified portfolio.

The "new normal" of low growth, low inflation and low rates, amidst political turmoil, does not negate sensible principles of investing, but perhaps calls for a revision of return expectations.