Capricorn Asset Management
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Economic Update: September 2019

It seems that the domestic recession is deepening. The Namibian Statistics Agency released the GDP numbers for the second quarter and it paints a bleak picture. Overall, the economy contracted by 2.6% (all the comparisons refer to the year-on-year percentage change, i.e. it compares this quarter to the same quarter last year). The weakness emanates mainly from the primary sectors of Agriculture (-28.1%), as it succumbs to the decimating drought and Mining (-20.2%). Fishing registered marginally positive growth (+0.6%).

In the secondary sector the performances were somewhat better. Manufacturing (+18.8%) and Electricity & Water (+2.7%) registered improving trends. However, Construction (-5.5%) continued to contract, albeit at a slower rate, it contracted by about 30% in each of the previous three quarters. There are signs that building activity is picking up.

In the tertiary sector only two out of nine industries achieved positive growth, Finance (+1.9%) and Real Estate & Business services (+0.2%). The others registered negative growth of between -0.6% and -2.8%. These include Wholesale & Retail Trade, Tourism, Transport & Communication, Government, Education, Health and Other Services.

This means that in 2019 as a whole, GDP growth is likely to be around -2.0%. The Bank of Namibia was right to sharply downgrade the economic outlook in their recent publication to -1.7%. The weak economy and benign inflation outlook continues to argue for monetary easing.

Over the next month we expect to hear from the respective Ministers of Finance of Namibia and the RSA how the economic malaise in both countries are affecting Government finances. The absence of economic growth is likely to impact revenue collection very negatively, while the pressures on spending will remain high. Both countries are dealing with big fiscal threats emanating from the parastatal arena. This means that the borrowing requirements are likely to be much higher than previously expected. For instance, for Namibia the deficit is probably going to be closer to 6% of GDP than the 4.7% budgeted. In SA this “fiscal slippage” is likely to be worse with the deficit higher than 6% and debt at 75% of GDP (including guarantees on the likes of Eskom debt). The comparable number for Namibia is about 55%. Fiscal policy is therefore in a strait jacket, unable to help stimulate the economy. Very tough decisions will have to be made regarding the allocation of scarce, and diminishing, resources to where it can be most productively used.

The past month or so has been dominated by monetary policy debates and the eventual decisions of a large number of Central Banks to lower interest rates. In the USA the Federal Reserve reluctantly delivered another cut on the 18th of September. They also opened the door to the possibility of restarting QE (quantitative easing, that is buying of bonds). The European Central Bank also lowered its range of rates further into negative territory and actually restarted its QE program. The Bank of Japan maintained its ultra-loose policy stance with negative policy rates, while targeting a 10-year Government Bond yield of 0%. As many as twenty Central Banks have now loosened policy, mainly by lowering interest rates.

These actions have all been taken in order to ward off the "growth scare". Fears of a coming global recession have been largely stoked by a cooling Chinese economy, sogginess in Europe, the Brexit situation, unstable LATAM economies, the Sino-US trade wars and a growing sense that the US economy may be peaking and "rolling over". Not to mention ad hoc exogenous shocks like the disruption of oil supply in a volatile region. Any one of these can trigger an "all-fall-down" scenario, but it's not our base case.

However, there seems to be a dichotomy between the global arena, which is negatively impacted by international engagements (or the lack thereof) and the domestic arena of many economies. The latter is looking reasonably healthy, unemployment is at multi-decade lows, consumer confidence is holding up and house prices are rising at a healthy clip. Yet the globe appears to be in a liquidity trap. This means that both households and corporates have a preference for holding cash rather than for consumption and/or fixed asset investments. This is borne out by the amounts of cash on the balance sheets of corporates and banks. This is a key reason why Central Banks feel obliged to force policy rates and long rates down, even into negative territory, in order to make cash less attractive and force people out on the risk spectrum, albeit with limited success so far.

Therefore, the main macro views, themes and trends that we highlighted in the recent past, continues:

- Global economic weakness and fears of deflation. We think these are somewhat overblown, we are unlikely to experience outright deflation, nor is full-blown global recession imminent.
- Domestic recession continues to intensify. This year will be contractionary with no visible catalyst to trigger an exit out of the malaise.
- Lowering of domestic inflation expectations. Inflation is to end this year close to 3%, rising thereafter to average around 4% in 2020 and 5% in 2021.
- Monetary easing in the form of lower interest rates. We expect the next cut by the Bank of Namibia to come in February 2020.
- Difficulties in the Fiscal arena. Fiscal slippage and funding pressures threaten creditworthiness. It is however mostly priced in, otherwise bond yields and the currency would be stronger.

Our investment related conclusions remain largely unchanged. Money Market yields continue to tick downwards in line with the outlook for rates generally. The liquidity position of Namibian banks has also improved lately which puts downward pressure on deposit rates. However, low inflation means that a fair real return is still achieved with minimal risk.

Lower interest rates and the "hunt for yield" should continue to benefit high yielding bond markets like our own. There will no doubt be volatility in bonds around the Budget statements of October, but a spike above 9% would certainly present a buying opportunity. We expect neither Namibia nor South Africa to default on Government debt obligations anytime soon.

Listed property remains a "value proposition" with its yield being higher than ten-year bond yields. So far, the asset class has not rerated mainly due to weak fundamentals such as low rental escalations and high vacancies, combined with cost escalation. We have increased our exposure to this asset class somewhat based on the high yield and the expectation that earnings will not suffer that much.

Equity markets are unlikely to perform well if earnings growth remain constrained and will be subject to risk-on-risk-off swings driven by geopolitical tensions and views on the most likely actions of policymakers. It is said that "markets stop panicking as soon as policymakers start to". But in the end it is about whether companies are able to make profit or not. Lower interest rates make these profits more valuable for investors and thus support share prices.