Truffle Asset Management

Economic Commentary

February 2023

Global resilience means longer rate path

Resilient economic data across global markets in February suggests expectations of an imminent pause to interest rate hikes (and the start of rate reductions) need to be reassessed. The prospect of high interest rates for longer saw major equity markets slowing significantly after a January rally.

Manufacturing activity and buoyant labour markets add resilience

An improved economic outlook was evident in higher PMIs across developed markets. In China, the post-pandemic reopening is driving a sharp rebound, pushing Chinese PMIs into expansionary territory. China's construction sector index also reflected a significant improvement, which may provide some support for metal demand.

In Europe, lower gas prices and fiscal support from EU governments during the energy crisis boosted European PMIs while the services sector continues to lift PMI data in the US.

Labour markets remained strong in February with many economies posting unemployment rates below pre-pandemic levels and continued wage growth.

Rates higher for longer

Continued economic strength provides limited scope for central banks to ease monetary policy and pause rate hikes, as policymakers continue to pursue a path to target inflation. The ECB and Fed both raised rates at the beginning of February with both maintaining a hawkish rhetoric, indicating further rate hikes are likely necessary to curb inflation. Interest rates expected over the year are in, what appears to be, restrictive territory at over 5% in the US and 4% in Europe. This is well ahead of expected inflation. The full impact of these higher rates will take time to filter into the economy.

Lending standards are also tightening in both regions which will impact mortgage lending affordability and housing markets.

We maintain the view that a risk of recession is high over the next year in both the US and Europe given tight monetary policy and low unemployment rates. However, elevated equity valuations especially in the US suggest markets are not discounting a recession.

South Africa: ongoing reputational setbacks

The electricity crisis in South Africa remains a dominant theme with the risk of higher stages of load shedding a significant concern over the next year. President Ramaphosa's announcement of a state of disaster, coupled with an action plan to deal with energy security and the recent appointment of an electricity minister to oversee implementation suggests progress, however, immediate action is required. Profit expectations for many domestic companies remain overly optimistic in light of the severity of the current crisis.

South Africa suffered a number of reputational knocks in February including the well-publicised comments from the outgoing Eskom CEO relating to government complicit corruption and the announcement by the Financial Action Task Force (FATF) of the much expected, although disappointing, grey listing of SA. We believe the associated risks of South Africa being added to the FATF grey list have largely been discounted in the current exchange rate and domestic share prices however this coupled with the corruption publicity and additional media coverage of South Africa's close ties to Russia have likely weighed on the rand dollar which depreciated by 5.2% over the month. These factors have done little to endear foreign investors and will also impact the attractiveness of South Africa as an investment destination and a country with which to do business.

Outlook

The short-term outlook for South Africa remains both concerning and uncertain. Currently the extremely cheap valuations of domestic assets and SA currency represent our only silver lining.

A continued reopening of the Chinese economy coupled with at least a limited attempt from government to rectify the power situation and associated corruption could unlock value.

Important markers of direction or progress over the next month will include the new cabinet announcement and the naming of the SA minister accused of enabling

Disclaimer

Truffle Asset Management (Pty) Ltd is a registered Financial Services Provider (FSP Number: 36484). Registered for Categories I and II. This document does not constitute an offer or solicitation to any person in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it would be unlawful to make such offer or solicitation, and is only intended for the use by the original recipient/addressee. If further distributed by the recipient, the recipient will be responsible to ensure that such distribution does not breach any local investment legislation or regulation.

Prospective investors should inform themselves and take appropriate advice as to any applicable legal requirements and any applicable taxation and exchange control regulations in the countries of their citizenship, residence or domicile which might be relevant to the subscription, purchase, holding, exchange, redemption or disposal of any investments. Opinions expressed are current opinions as of the date appearing in this material only. The information is confidential and intended solely for the use of Truffle's client's and prospective clients, and other specific addressee's. It is not to be reproduced or distributed to any other person except to the client's professional advisers.

While information obtained is from sources we believe to be up to date and reliable, Truffle does not guarantee the accuracy or completeness thereof. Truffle does not accept any liability for inaccurate or incomplete information contained, or for the correctness of any opinions expressed. Past performance is not an indication of future performance. on the outcomes of many variables, including a potential US recession, sustainability of Chinese growth and capital investment, European energy demand and, importantly, the path of monetary policy by Central Banks. The uncertain macro environment continues to fuel financial market uncertainty

Morningstar Award was awarded to Truffle Asset Management (Pty) Ltd on 23 March 2022. Details available on request..

Contact

Get in touch with us

Telephone numbers
Johannesburg Office: +27 (0)11 325 0030
Cape Town Office: +27 (0)21 007 0532

Email Addresses
General queries: info@www.truffle.co.za
Institutional services: institutional@www.truffle.co.za