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Economic Newsletter

How to Spot a Recession

Talk of a looming recession has been gaining traction in financial markets in the wake of stubbornly high inflation numbers and the resulting aggressive interest rate hikes by central banks.

United States Federal Reserve chairperson Jerome Powell has repeatedly made it clear that the US Central Bank is fully committed to stamping out inflation and getting price pressures under control. In a speech in late August, Powell vowed that the Federal Reserve would "keep at it" until inflation is stamped out and prices begin to normalise. Fed officials have since indicated that they are more concerned about doing too little to quell inflation than doing too much, reinforcing their plans to continue tightening monetary policy in an effort to constrain price rises.

The risk the Fed runs by continuing to aggressively raise rates is that it pushes the global economy into recession. Already several countries with weaker public finances have urged the Fed to slow the pace of its interest rate hikes due to their inability to repay their international debts at these higher interest rates.

Many economists believe that at the very least a mild recession is likely next year in the wake of the Fed's tightening campaign. BlackRock, the largest asset manager in the world, with over $10 trillion in assets under management, stated in a recent economic commentary that they expect inflation to decrease, but still stay above target, and that a recession will still hit.

What defines a Global Recession?

A global recession is described as a contraction in global per capita GDP (that is, a decline in a country's overall economic output per person). A recent report published by the World Bank analysed the five global recessions experienced since 1970 in order to provide greater insight into our current economic situation.

While each recession is unique in nature, their analysis highlighted two common factors which preceded every global recession since 1970:

- Significant weakening of global growth
- The economies of several major countries going into a recession or a sharp slowdown

The first point should seem fairly evident to most readers. Current headwinds to growth in a global context include Russia's invasion of the Ukraine, the resulting oil and gas shortages, continuing supply disruptions persisting in part from the pandemic, as well as low earnings numbers reported for many large global firms.

The second, and often more pertinent, factor is generally what truly heralds an incoming global recession. The Covid-induced global recession of 2020, although short lived, was certainly the most synchronised of all the previous global recessions, with almost every country in the world experiencing a significant slowdown at precisely the same time.

In today's context, the common issue for most countries around the world is that of inflation. In order to combat these levels of inflation, many countries are withdrawing both monetary and fiscal support in a very synchronised manner. Again, the key factor is the *synchronous nature* of the restrictive policies. Most of these policies in isolation are not strong enough to provoke a global recession, however their collective impact is far more pronounced.

Encouragingly, if a global recession were to materialise in 2023, it is generally expected to be mild in nature; well-below the extent of the 2008 Global Financial crisis. That being said, any pause in the upward interest rate trend could easily prove very stimulative for markets and shift investments into a risk-on phase. If inflation rolls over faster than anticipated, it would allow the Fed time to pause their hiking policy and for markets to regain their footing.

On the Local Front

Local economic news has been centered on the Medium Term Budget Policy Statement (MTBPS) that took place in late October. Market participants were eager to hear Finance Minister Enoch Godongwana's views regarding the SARB's spending on infrastructure, as well as government spending on salaries and social payments. In addition, comments surrounding ESKOM's debt levels, as well as the overall debt-to-GDP trajectory of the country, would be closely scrutinised.

Key take-outs from the budget speech included the following factors:

- Tax revenue is expected to reach R1.68 trillion for the 2022/2023 financial year, R 83.5 billion above the initial budgeted figure
- R30 billion has allocated to assist ailing SOE's, including SANRAL, Transnet, and Denel
- The South African Government has pledged to take on between one and two-thirds of ESKOM's debt
- Government Debt to GDP has been meaningfully revised downward and is now forecast to drop to 70.4% by 2024/2025. This is significantly lower than the MTBPS 2020 forecast which had 2024/25 government debt at 90.4% of GDP
- The government infrastructure spend is projected to increase from R66.7 billion to R 112.5 billion in 2025/2026

Overall, the MTBPS was received positively by market participants, particularly regarding National Treasury's commitment to reining in debt levels whilst also maintaining a high degree of fiscal discipline. Whilst the plans are all positive, implementation of the above factors will be key. A recent comment by Stanlib's economic team stated, "Ultimately, there is no substitute for higher economic growth to resolve SA's fiscal constraints. This can only be achieved through a concerted and coordinated effort to lift business and household confidence, improve private sector fixed investment, and enhance skills development and productivity. This will require a much greater effort in implementing key policy reforms. Without these reforms, private sector investment is likely to continue to stagnate, exacerbating the already-high level of unemployment and increasing the risk of further social unrest."

A global recession certainly won't assist South Africa in meeting the goals outlined above, however South Africa has had remarkably resilient market performance in the midst of the current global economic pressures. As at end October, the ALSI was down -5.7% for the year, well above the -18.4% for its Emerging Market peers (as measured by the MSCI Emerging Market Index, both in ZAR). The ALSI has also fared better than its Developed Market counterparts, who are currently down -7.6% for the year, also in ZAR.

Couple with this the attractive local bond environment and South Africa is a fairly appealing investment destination.