ECONOMIC NEWSLETTER

SPEKTRA FINANCIAL SERVICES

A MOTELY START TO THE FINAL QUARTER OF 2023

US GDP GROWTH SURPRISES TO THE UPSIDE

The US economy once again beat expectations and has proved stubbornly more resilient than anticipated, with third quarter GDP growth coming out at 4.9% – comfortably ahead of the 4.3% expectation. The growth of the world's largest economy over the third quarter (and indeed for the bulk of 2023) has been driven by one predominant factor – consumer spending. The strength of the American consumer has consistently outpaced expectations and has enjoyed robust growth, despite the best efforts of the US Federal Reserve to cool the US economy through its interest rate tightening campaign.

Despite the rigid credit conditions, the American consumer remains in a secure position, to a large extent still buoyed by the stimulus checks and resultant excess savings accumulated during the covid-19 pandemic. For now, it appears as though the American public is more than happy to draw down on their savings, with an estimated $1 trillion in US savings being spent post the covid lockdowns. With an unemployment rate of only 3.8% and an estimated 1.5 job openings for every unemployed person in the US, the American economy seems far from stalling any time soon. The earnings season in the US has also surprised to the upside, with about 80% of companies beating their earnings estimates, with both earnings and revenue growth surprising to the upside.

That being said, as long as the US economy maintains its robust position, the Federal Reserve will be compelled to keep interest rates at elevated levels to prevent a potential surge in inflation. Currently, there is little evidence which would encourage the Federal Reserve to cut interest rates in the near term. This message was reiterated at the latest Federal Reserve Meeting on the 1st of November, when Fed chairperson Jerome Powell opted to hold rates steady at their current 22-year high level of 5.25%, citing strong economic data, a robust labour market, and resilient consumer spending.

ISRAELI-GAZA CONFLICT

On October 7th, the 50th anniversary of the Yom Kippur War, Hamas fighters launched a co-ordinated attack on Israeli outposts and settlements, firing an estimated 5,000 rockets into Israeli territory. The estimated death toll of this initial attack is judged to be in excess of 1,400 people, the vast majority of whom were Israeli civilians. Less than a month later, the intense escalation of the conflict has seen the estimated death toll rise to 10,000 individuals, with the number of injured closer to 30,000.

At this juncture, the full humanitarian, geopolitical, and economic extent of the Israel-Hamas war is unknown. However, if history is anything to go by, wars have a worrying tendency to escalate. Generally, the economic impact of any geopolitical conflict is first felt by the oil price, driven primarily by fear/risk premiums. Maintaining the historical trend, the price of Brent Crude rose to over $90/barrel by mid-October, before retracing to the mid-$80/barrel level. Together, Israel and Gaza contribute a negligible amount to total global oil production, and as such the conflict is not expected to have a material impact on global energy prices.

The primary risk to this scenario surrounds the possibility of Iran joining the fray and intensifying the conflict. Already Iran has been suspected of funding and training Hamas, and even orchestrating selected attacks against Israel. If the US retaliates by imposing strict sanctions on Iranian oil production (which currently stands at 3 million barrels per day), the price of Brent Crude could move above $100/barrel for a sustained period.

A more direct impact of the conflict in Gaza is the potential impact it may have on global fertilizer prices. Currently Israel exports around 6% of the world's potash and 8% of phosphate fertilizers. Should the conflict escalate or be drawn out, farmers may be somewhat negatively impacted on a global scale due to rising fertilizer costs.

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MEDIUM TERM "MUDDLE-THROUGH" BUDGET

Probably the most highly-anticipated announcements coming out of the MTBPS were those surrounding South Africa's debt-to-GDP projection alongside the tax revenue collection for the fiscal year. As widely anticipated, tax revenues came in significantly below the 2023 Budget, undershooting the initial projections by close to R57 billion. Several factors have contributed to the revenue shortfall, chief among them being weaker global growth, increased loadshedding, lower commodity prices, and the various logistical constraints that have weighed heavily on mining sector corporate tax collections. As a result, government debt-to-GDP is now forecasted to rise from its current level of 72.2% to a peak of 77.7% by the 2025/26 fiscal year.

Encouragingly, fixed investment is expected to grow by its largest degree in over a decade, largely supported by the government's infrastructure development plan which will allow the private sector to play a larger role in the supply of electricity amongst other infrastructure projects. Arguably the most positive outcome from the MTBPS, a greater involvement from the private sector will be key to funding (and hopefully completing) infrastructure projects and providing the required technical competence.

CLOSING THOUGHTS

After a particularly strong start to the year, markets have proven particularly tenuous for even the most patient of investors. The last three months in particular have been especially challenging, with global markets down -9.5% in USD and our local market down -10.4% in ZAR, both to the end of October. In times of volatility such as these, it is worthwhile remembering that sticking to a sound and pragmatic investment process is key to achieving your financial goals. While the safety of cash may seem appealing during bouts of soggy market returns, capitulating and moving to cash risks missing out on subsequent market rebounds, and as a result not participating in the capital growth required to meet your financial goals. Furthermore, a well-constructed portfolio should provide investors with adequate levels of diversification, providing a suitable degree of downside protection should markets fall.

Staying the course and maintaining a well-considered investment strategy will enable one to navigate the unpredictable waters of financial markets with confidence, knowing that the decision to stay invested is grounded in sound financial principles.

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