Shudders and Fundamentals

Summary:

The shudders we warned about in July and August have materialised, creating much uncertainty. A few more should be expected. At the same time, a number of fundamental trends are very favourable. We list some and discuss one of them, Exports, in some detail.

- ***Our overall investment strategy remains unchanged: cash at 30% and use the shudders to upgrade portfolios.***

Shudders

In July we warned that a number of disruptions, coined "shudders" by one of my colleagues, will destabilise the markets in August and September. Our July newsletter listed a number of them, many of which have now have materialised:

- The auto industry strike lasted longer than two weeks.
- Zimbabwe deteriorated further.
- Cosatu launched its anti-privatisation strikes.
- The Racism Conference in Durban is gathering momentum, with agenda items that will unsettle investors, e.g. reparations and paying-for-the-sins-of-the-past.
- The rand reached new all-time lows, generating very negative psychological effects.

Some risks remain, including:

- Civil society organisations have lodged papers in the High Court to sue Government for not providing retrovirals to pregnant mothers with Aids.
- Possible strikes in the civil service and the tyre and rubber industries.
- Possible changes at Finance.
- Contagion from Zimbabwe and Argentina. Our impression is that Zimbabwe can only get worse.
- The shudder with the highest profile will be Cosatu's attempted putsch against Government's economic policies. This will include:
    - ➢ The anti-privatisation strikes.
    - ➢ Demonstrations at the Racism Conference in Durban.
    - ➢ Picketing of well-known retailers for selling imported products (really a protest against the philosophy of an open economy).

Conclusions:

- This season of shudders was expected and is not a surprise.
- It will continue for a while longer.
- Although they have a high profile, these shudders are not strong enough to undo the fundamental progress being made in the economy.

Fundamentals

That brings us to the second part of this article – the fundamental progress being made in the SA economy. We list a number:

- ✓ Labour productivity – last year produced the highest increase in 30 years, i.e. 6%. This helps to offset the wage increases negotiated by unions. Last year's level is unlikely to be repeated, but productivity will continue to increase at a much higher rate than in the past.

- ✓ Tax collection is far better than budgeted and consequently the fiscal deficit should come in below 2% of GDP. With capital expenditure above 2% of GDP, it means Government dissaving will be eliminated for the first time since 1981 (when the gold price was $850). This is positive for interest rates and it helps to pave the way for tax cuts.
- ✓ Inflation is falling, despite the rand's depreciation.
- ✓ Most dramatic of all is the change in exports. We did some research and wish to present the following to you:

1. Measured in CONSTANT rands, SA has increased its exports of *manufactured products* since 1994 by more than 100%. The growth has been from R59,6 billion in 1994 to R123,4 billion in 2000.
2. This is corroborated by the fact that manufactured exports as a proportion of production capacity increased from 15,1% in 1994 to 27,5% in 2000.
3. Most significantly of all, manufacturing exports as a percentage of total exports (including mining commodities and agricultural products) increased from 37,3% in 1993 to 57,2% in 2000. This increase occurred in spite of a 25% rise in mining exports last year.
4. Using our old favourite of constant prices (to get rid of the distortions of inflation), exports as a percentage of GDP rose from 19% in 1993 to more than 25% in 2000.
5. These five sectors have registered the highest increases in manufactured exports:

Furniture	=	942,0%
Petroleum products	=	868,9%
Motor vehicles and components	=	478%
Beverages	=	459,6%
Rubber products	=	418%

Unfortunately only a few companies operating in these sectors are listed on the JSE. Thus there are limited opportunities for stock market investment.

Conclusions on exports:

′ SA is no longer predominantly a commodity economy. More than half of all export earnings come from manufactured goods. The Africa Growth and Opportunity Act and EU agreement will reinforce this trend.

′ This also debunks the myth about country competitiveness. Competitiveness cannot be discussed without reference to the value of the currency. The more a country's currency depreciates, the more competitive its exports become.

′ It is clear that some sectors are taking advantage of currency weakness to broaden the base for manufactured exports.

Overall conclusions:

- SA remains a market of severely contradictory signals – shudders versus fundamentals; high-profile socialist marches versus a more open economy; rhetoric versus reality.
- We remain confident that the fundamentals are stronger than the shudders.
- Therefore our strategy remains in place: the uncertainties caused by the shudders are creating selected buying opportunities. We feel that your cash component should remain at 30%, and the shudders should be used to upgrade your portfolio.

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