

THE QUART 401FO

OFFICIAL QUARTERLY NEWSLETTER OF **THE OSRIN GROUP**
INCORPORATING OSRIN WEALTH & OSRIN ADVISORY

Quarter Four 2020 and Quarter One 2021 in Review

Introduction

It gives me great pleasure to present a double feature edition of The Quart covering economic developments during some of the most exciting months in recent history.

The Quart Q4 2020 / Q1 2021 edition incorporates inter alia:

- The US election and post-election periods.
- The ongoing Covid pandemic and its impact on the global economy.
- Record levels of US fiscal and monetary policy stimulus.
- Style and sector rotation in the US equity market.
- Market trading mania and short squeeze shenanigans.
- The operation of the EU-UK Trade and Co-operation Agreement.
- The South African economic scene.

[A QUART] Def; A unit of liquid measure of capacity, equal to one fourth of a gallon, or 57.749 cubic inches (0.946 liter) in the U.S. and 69.355 cubic inches (1.136 liters) in Great Britain. Or a unit of dry measure of capacity, equal to one eighth of a peck, or 67.201 cubic inches (1.101 liters).

As is the norm, I endeavoured to curtail the Judge's well-constructed commentary and as usual I struggled to keep it to just 10 pages.

The past six months, since our last edition, have continued to prove challenging. The Osrin Group has managed admirably to keep the flag flying, working remotely for long periods of time from home with occasional forays into our 2 Long Street office. We are pleased to advise that a concerted Covid protocol policy has been implemented in the building by the building management company and our colleagues have been spending more and more time in the office since February.

Gone, sadly, are many of the surrounding coffee shops, deli's and restaurants. Gone too are the parking attendants. Many of the shops in the CBD are boarded up with 'To Let' signs prominently displayed. The mood in the Cape Town CBD is really subdued.

On my first trip to Johannesburg in over a year just a few weeks ago, I came across a similar atmosphere in Sandton – Africa's richest precinct. I experienced empty Gautrain carriages, empty buildings and streets around the Sandton station and there were only five guests staying at my hotel.

Hopefully the roll-out of the long-awaited national vaccine programme will turn things around and breathe vital oxygen into the economy in general and these traditionally vibrant commercial areas in particular.

Despite all the doom and gloom caused by the pandemic coupled with the uncertainty of the US elections, when looking at the performance numbers for 2020 one would not think there is anything untoward taking place. The performance of the offshore funds in particular were stellar. In the context of negative and close to zero interest rates in much of the developed world, mid to high double-digit returns were exceptional. Current bond and equity market levels raise concerns for investors.

What to do?

We hope you enjoy the double edition of The Quart.

All the best from all of us at The Osrin Group.

Jonathan & Bernard

OSRIN GROUP

The Quart is in Session

Market activity - squad rotation

Q4 2020

The fourth quarter (Q4 2020) was again characterised by sharp stock inclines other than for a brief sell-off in mid-to-late October due inter alia to:

- a. A record US budget deficit for the financial year of US\$3.1 trillion;
- b. concerns regarding the size and timeline of Covid relief legislation;
- c. electoral uncertainty; and
- d. disruptions in the economy associated with extremely high infection numbers.

The S&P500 (S&P) put on 11.69% in Q4 2020 for a gain of 16.3% on the year. The Dow Jones Industrial Average (DJIA) added 10.17% so that a hitherto annual loss to Q3 2020 was turned into 7.3% return for the year. The Russell 2000 Index, which is biased towards smaller US companies focused on the US market, expanded 31% in the quarter alone to ensure an annual increase of 18.15%. Meanwhile the tech-heavy Nasdaq Composite rose 15.41% in Q4 to take its annual improvement to a full 43.6%.

It was apparent that while the fourth quarter was still dominated by technology stocks, attention had shifted to some extent to other sectors. Although the Nasdaq saw the greatest advance by far on the year, the proportion of that advance was the smallest at 35% on the quarter. The S&P, which has a large tech component, made around 71% of its total gain in the final quarter. But the Q4 movement of the DJIA, by contrast, constituted all of its annual increment, as did that of the Russell.

Even last year, with the yield on the 10-year Treasury rising to multi-month highs, investors were beginning to rotate out of growth stocks (stocks that offer substantially higher performance in terms of earnings and the stock price in the long term) that dominate the Nasdaq to more economically cyclical stocks such as consumer discretionary, energy stocks, miners, industrials and financials, many of which were beaten down and represented good value relative to fundamentals (what are termed 'value stocks').

Global markets were mixed for the year, but generally had better final quarters. Overseas bourses mostly trailed their US counterparts. In the UK, the FTSE100 moved to a yearly performance of minus 14.3%, from a decline of nearly 23% at end-Q3 2020.

Here in South Africa, the FTSE/JSE AllShare Index (Alsi) rebounded from an annual loss of 5.5% after Q3 to a gain of just over 4% for 2020. The FTSE/JSE Top40 Tradeable Index (Top40) likewise moved from minus 2.4% in Q3 to an annual improvement of 8.5%.

South Africa fared poorly in relation to many other Emerging Market (EM) indices, that saw steeper Q4 gains. In Brazil, the Bovespa ended the year up 27%, the Sensex was better by 15.8%, the Shanghai Composite added 12.3% and the MSCI EM Index, which is denominated in US dollars, put on 15.8%.

The US Dollar Index (DXY) shed over 7% in 2020, with much of the weakness following from largescale selling of US Treasuries.

Q1 2021

Sector rotation continued into Q1 2021. But there was still a lot of money going into tech shares, and the Nasdaq continued to outperform other indices. Technology stocks saw occasional dips but were quick to recover.

Indices like the Nasdaq are dominated by what are termed 'growth stocks', being stocks that offer the prospect of far higher earnings and better stock price performance over the long term, justifying loftier present valuations. They are stocks that typically benefit from a very low yield environment where

financial conditions are very loose and borrowing is easy. They suffer too from the effect of higher inflation reducing the current value of cash flows expected in the future, a critical aspect of present valuation. Simply put, growth stocks do not do nearly as well in a higher inflation environment. A trend shift came into play after the week ending February 12.

Investors became increasingly concerned about largescale bond selling that was driving up bond yields sharply (remember, when bond prices fall their yields rise). The yield on the US 10-year Treasury rose nine basis points to get through 1.3% on February 16 (it stood at 1% in early January). This was a level not seen since February 20 2020, and served to lift the entire yield curve.

The 10-year Treasury yield is used as a benchmark for a number of rates like mortgages, student loans and credit cards, so rising yields affect access to credit.

Medium-term inflation expectations as measured by the five-year breakeven inflation rate, an indication of what bonds expect for inflation, got through the Fed's average inflation objective of 2%. Investors saw rising yields as in part reflecting expectations for higher growth, but concerningly also of far higher inflation, which could force the Fed's hand far sooner than anticipated. Bonds are the asset class that performs worse in an inflationary environment and when they sell off, it is often an indicator of inflation to come.

Inflation is far worse for growth stocks than it is for value stocks.

When yields rise enormously there comes a time that the inflation adjusted (real) risk free return on bonds becomes attractive at the expense of equities as an asset class.

Over the next four weeks, the yield on the 10-year Treasury surged. The February 25 session proved extraordinary as the yield pierced 1.5% and 1.6% in a single day, a level higher than the average S&P500 dividend yield. The Nasdaq sagged 3.5% in the worst sell-off since October and the DJIA was lower by 1.8%. On 18 March, the 10-year US Treasury yield hit 1.75% occasioning another stock sell-off. On the same day the yield on the 30-year Treasury topped 2.5%.

The 5-year breakeven inflation rate rose to 2.38% on 24 February, its highest level since the financial crisis of 2008. It subsequently and briefly got above 2.5%.

The Nasdaq not only materially underperformed the other indices during this time, it actually began to sell-off in what was a concerted style rotation out of growth stocks into value stocks. Out of the final six weeks of trade to end of March the DJIA and S&P outperformed the Nasdaq for five of them. In the end the DJIA lifted 6.6% in March alone with the S&P up 4.3% and the Nasdaq 0.4%. For Q1 2021, the DJIA got higher by 7.8%, the S&P 5.8% and the Nasdaq a more restrained 2.8%. Outside the US, the FTSE managed a gain of 3.96% in Q1, which despite the country's advance on the vaccine front, was lower than other major European bourses.

In South Africa the FTSE/JSE All Share Index surged 11.91% on the quarter, while the FTSE/JSE Top40 Tradeable Index rose 11.96%. Returns were strong on the local bourse because of the performance of mining stocks.

Quarterly Themes

1. US Federal Reserve - Rising Transfer Fees a Concern

In Q4 2020 the Fed met twice, in early November and mid-December.

We have spoken at length about the Fed's policy shift in 2020, mainly in respect of achieving even higher employment than the supposed natural rate of unemployment would suggest as well as tolerating inflation above 2% for longer, such that inflation averages 2% over time.

The December meeting served to quantify the Fed's purchases of Treasury bonds and mortgage-backed securities at a figure of 'at least US\$120 billion per month'.

The January 27, 2021 Federal Open Market Committee (FOMC) meeting was notable for the Committee's identification of the role of progress made on vaccinations as key to the course of the virus and to the future path of the US economy. In Chairperson Powell's words, "sufficiently widespread vaccinations would enable us to put the pandemic behind us and return to more normal economic activities".

On February 23, Powell delivered his semi-annual monetary report to Congress. As we have seen, by this time the yield on the US 10-year Treasury bond had risen to a one-year high due to an extraordinary bond sell-off, amid rising inflation expectations. The US 10-year to 2-year Treasury bond spread was at its widest since January 2017. Stocks were selling off on the prospect of inflation eroding future earnings. But, during the address Powell merely pointed to the downward pressure the pandemic had had on inflation, and noted that prices in sectors most adversely affected were particularly soft. He made the mistake of not tackling the future inflation issue head on.

On March 4 Powell moved to do just that. He noted that while realised inflation was still low, longer-term inflation expectations had been rising. He stated that there would be a temporary rise in core inflation above 2% when the ultra-low early Covid price readings were stacked up against current prices. A surge in pent-up consumer demand might also place upward pressure on inflation when the economy fully re-opened, but this would be a transitory phenomenon. The markets were anything but reassured. The DJIA fell 1.1%, the S&P 1.3% and the Nasdaq 2.1%, while bond yields spiked principally because Powell did not commit the Fed to countering recent bond market moves via even easier monetary policy.

There was no doubt that the Fed officials were looking on market developments with a measure of trepidation. Powell admitted to watching bond market fluctuations and said he would be apprehensive if the cost of credit was to be affected for borrowers.

Between early March and the FOMC meeting on 16-17 March the Fed got its communicative act together.

The post-meeting policy statement contained no material changes, but the updated summary of economic projections did all the talking.

The FOMC median view for GDP for 2021 was lifted materially to 6.5% from a prior 4.2%, with growth expected to tail off to 3.3% in 2022 and 2.2% in 2023 (still well above trend growth).

The median projections for the unemployment rate for the 2021-23 period were also reduced substantially and for 2023 the rate was seen at a very low 3.5%.

The view of the relevant core inflation measure was lifted to an above-target 2.2% in 2021 (previously 1.8%), but easing thereafter. The adjustment was not that large and was of a passing nature.

The view of FOMC members of the desired mid-point of the Fed funds rate going forward was instructive. While more members saw rate hikes in the medium term, 11 members out of 18 took the view that no rate hikes were required through 2023.

Markets were receptive to the message of a transient rise in inflation to a still relatively low level together with a commitment to not raise rates until after 2023. The Fed would remain reassuringly 'low and slow' and initially hesitant markets moved higher with the Dow punching through the 33,000 level for the first time.

2. US Election Aftermath - New Manager Bounce

The market responded favourably to the Biden presidential victory. Mostly this was about the promise of greater fiscal stimulus. In addition, markets foresaw a now coherent Federal approach to tackling the pandemic through the organised rollout of vaccines.

Investors looked on somewhat dispassionately as a mob of Trump supporters trashed the United States Capitol to prevent the certification of electoral college votes and the orderly transfer of power. Instead, investors cheered Democrat victories in Georgia runoff elections, which gave the party control over the Senate, in addition to the House of Representatives. This outcome made Covid relief legislation easier to pass.

On the day of the Capitol building attack, the DJIA elevated 1.4% to a new record, while the S&P500 climbed 0.6% and reached an intra-day all-time high.

The S&P and Nasdaq Composite were both higher after Trump's second impeachment on January 13, and all three of the major indices hit new highs on January 20, the day of President Biden's inauguration.

From the election to the inauguration, the S&P lifted 13%, the best ever market result for an American President.

Fiscal stimulus promises a more robust economic recovery and Biden's election made more pronounced the rotation out of more highly-priced growth stocks to cyclical counters best positioned to benefit from the new economic cycle. We have talked at length about this trend.

The President's immediate concern was the signing of executive orders. Some reversed Trump's own executive orders such as the Muslim travel ban, and the building of a border wall. Biden introduced rules to compel the wearing of masks and social distancing in Federal buildings and by Federal employees. He ordered that the US re-join the Paris Agreement on climate change and that the country re-engage with the World Health Organization.

He also pledged to vaccinate 100 million Americans in his first 100 days utilising the National Guard and the Federal Emergency Management Agency (FEMA) to establish vaccination sites, as well as getting pharmacies to assist with the vaccination effort. After initial hiccups, and at the time of writing, the US has managed to administer 120 million doses of vaccine to approximately 21% of its population.

From the outset the President had promised a US\$1.9 trillion relief package to provide support to individuals, enhance the vaccination programme and deliver assistance to states and local governments. Biden was supported in his effort by his Treasury nominee, former Fed Chair Janet Yellen, who in her nomination hearing stated that the "smartest thing we can do is to act big".

Congressional debate over the bill began in early February and after some back and forth between House and Senate, the President signed the US\$1.9 trillion relief bill into law (the American Rescue Plan Act of 2021) on March 11. The US\$15 minimum wage provision was disallowed from inclusion in what was a budget reconciliation bill passed by a simple majority.

This stimulus measure followed the original US\$2.2 trillion and US\$900 billion packages that were passed on Trump's watch. Despite what some regarded as fiscal profligacy, on the day of the signing the S&P rose 1% to a new record high and the Nasdaq increased 2.5%. But, the yield on the 10-year Treasury did touch 1.64%, its highest since February 7, 2020, reflective of higher expectations for growth, as well as inflation concerns.

The Act inter alia extended supplemented unemployment benefits, provided for direct payments of up to US\$1,400 to lower-earning taxpayers, included a series of progressive tax measures and grants to small businesses, made provision for housing and education benefits, and allocated US\$350 billion to state and local authorities to repair budgets. A total of around US\$165 billion was allocated to Covid funding, including US\$50 billion to FEMA for vaccine distribution and assistance, and US\$47.8 billion for virus testing and transmission prevention.

The legislation was popular for the manner in which it was crafted to provide assistance to those most adversely affected by Covid and to reinforce the vaccine rollout programme. Over 70% of the population, including 45% of Republicans, supported the law, yet not one Republican politician voted for it.

President Biden's next priority following Covid relief, is infrastructure. At the end of March, he laid out a proposal for US\$2 trillion in economic and social infrastructure investment over eight years. A hike of the corporate tax rate to 28% from a Trump reduced rate of 21%, plus measures to counter the offshoring of profits were the preferred mechanisms to pay for the spend. While infrastructure development is a bi-partisan concern, the difference between Democrats and Republicans is how to pay for it. It is unlikely that the GOP will support a bill entailing a tax hike.

On China, Biden has indicated that he will oppose Chinese expansionism by restoring old alliances. He has no intention of lowering or eliminating current tariffs on Chinese imports and is embarking on a programme of reconfiguring supply chains for essential items such as pharmaceuticals and semiconductors to exclude China. There will be no going back to the pre-Trump approach. This much was apparent at an acrimonious meeting between America's Secretary of State and China's Foreign Minister on March 18. Subpoenas have been issued to Chinese communications companies present in the US, as part of a national security measure to prevent China from infiltrating the American telecommunications sector. This was originally a Trump initiative, which is being carried forward by the Biden administration.

The reality on the ground is that the two countries' economies are highly interdependent. China at present is importing record amounts of agricultural products from the US, and the US reliance on cheap Chinese goods remains undimmed and so vital as a mechanism to control US inflation.

3. Retail Traders Make Their Mark - Taking on The Big Boys

The final week of January saw heightened volatility in US markets with retail investors, for the most part traders, impacting activity in an unprecedented manner.

On Monday January 25 retail investors active on discussion website Reddit (particularly on the 'r/wallstreetbets' forum) as well as on Twitter, launched an attack on a stock heavily shorted by hedge funds - GameStop. AMC Entertainment, Koss, and Rocket Companies were among many other shorted stocks that were later targeted. Even the silver market was affected as retail investors took advantage of US banks' short positions on the silver futures contract. The price rise in Dogecoin was also driven by the forum. And in truth, it was not just a retail investor phenomenon. Some institutional investors went along for the ride as well.

Short-selling is a process in terms of which the seller borrows a stock via a broker and immediately sells it into the market for a price expecting the stock to decline, whereupon the stock is reacquired for a lower price and returned to the lender at a profit. Data about short selling is in the public domain with short interest ratios available from leading indices and specific company figures obtainable from company SEC filings, and available on several websites.

GameStop rose nearly 145%, before settling 18% higher on the Monday. The stock was halted for volatility several times during the day. The stock had been downgraded by several investment firms and was believed extremely expensive after a 400% rise in the four months to January. Hedge funds short the stock, were caught in what is termed a 'short squeeze' and many fearing still higher prices were forced to cover their positions and buy back the stock, resulting in huge losses.

GameStop was an obvious target being one of the most shorted stocks on Wall Street. The aim of the retail investors was precisely to generate a short squeeze and then benefit from hedge funds being forced to mitigate losses by acquiring dwindling amounts of stock at inflated prices. This concerted effort conducted by a large aggregate of retail investors made the intervention pretty historic. And effective too. It is thought that short sellers racked up losses of around US\$50 billion in January alone. But by early February stocks like GameStop had tanked 70%. Many retail investors were actually badly burned.

This does not mean that such retail investors and strategies like targeting heavily shorted stocks are going away. If anything, the market involvement of retail investors using online cheap trading platforms is going to increase exponentially.

There is nothing wrong with retail investors acting in this manner to gain a market advantage and they have serious resources (thought to be in the region of US\$350 billion) to do so. It is just that financial institutions have far greater resources and can out-duel their retail investor counterpart. Once short sellers cover their positions in any event, the share trades down prodigiously leaving many retail investors out of pocket. The retail brokers, whose platforms are used to effect the attack, become overwhelmed and suffer financial constraints forcing them to massively hike margin requirements or temporarily halt trading occasioning a huge reversal in the price of the targeted stock.

The process also results in stocks becoming completely detached from any underlying fundamentals, that is to say the ordinary manner for determining fundamental value and thereby which stocks to buy and which to sell, becomes obsolete.

This undercutting of fundamental analysis and the volatility (for which read 'uncertainty') that accompanied the stock moves gave the broader investors base pause with many believing trading was becoming too frothy. This dovetailed with concerns that crypto-currencies were trading at levels unhinged from any economic underpinnings, with the increase in trading of penny stocks as well as with the wild popularity of Special Purpose Acquisition Companies (SPAC's) often backed by celebrities. SPACS are listed as shell companies before any deal is actually undertaken. They represent a kind of blank cheque investment.

Typically, when speculative trading is seen as rife, markets are approaching a peak and losses ensue.

These apprehensions motivated a sell-off for the week commencing January 25, in which the three major indices fell over 3%, and the DJIA plummeted 620 points on the Friday to close below the 30,000 level for the first time since mid-December.

4. Brexit Accord Difficulties - A Niggly Encounter

The United Kingdom left the European Union on January 31, 2020. Parties were given until end-2020 to fashion an EU-UK Trade and Co-operation Agreement ('the Agreement') to govern the relationship inter partes. This Agreement was struck on schedule on 24 December, 2020. The Agreement was ratified by the UK Parliament on 30 December, 2020, and applied by the EU from the 31st.

The Agreement brought into being wide-ranging changes to the once free movement of people, capital, goods and services between the UK and Europe.

So, (1) travel rules for UK nationals were tightened, (2) UK nationals living in countries in the EU, in some cases, have had to apply for new residency permits, as well as other documentation, and Britons desirous of moving to the EU now no longer had an automatic right to live, work, study or retire there, (3) businesses offering services to the EU like banking and accounting lost their privileged access to EU markets, (4) the UK authorities would treat EU citizens and non-citizens equally when it came to assessing immigration and a new points-based system for foreign citizens would be applied, (5) the UK would gain an increasing share of fish from its own waters over the next five years.

Further, the parties agreed that there would be no tariffs, nor limits imposed on goods traded between the UK and the EU, but in the case of transporting to Northern Ireland, traders in the UK would need to make customs declarations, and in some cases, require licences and certificates. This is because Northern Ireland was treated as an exception in the Agreement in order to preserve the Good Friday agreement and keep the Irish border open. Checks would therefore be required on certain goods entering Northern Ireland, which for the most part remained subject to EU regulation. Such checking meant that a hard customs border in the Irish Sea had to be operational. Supermarkets were given a three-month grace period in which foods would not have to be checked and there were longer grace periods for some other foodstuffs.

These are just a few of the more material provisions contained in a 2000-page document.

The operation of the Agreement has proved to be extremely acrimonious in the early going.

In late January, the EU in the guise of the head of the European Commission, invoked Article 16 of the Northern Ireland protocol (an extreme provision meant to be used as a last resort) to prevent EU exports of Covid vaccines to Northern Ireland and via Northern Ireland to the rest of the UK. The EU took this drastic step because its own vaccine procurement and rollout programme was in a shameful state. The UK regarded this as an act of hostility, one which brought into doubt the EU's good faith in relation to the Irish protocol and broader Trade and Co-operation Agreement. The EU later reversed the decision after condemnation from the Irish and UK governments.

In early March, the UK unilaterally extended the grace period by six months for UK supermarkets and suppliers to adjust to the Agreement. This meant in effect that the UK would not be undertaking the required checking of supermarket goods entering Northern Ireland for the foreseeable future. The EU called this a breach of international law, and threatened retaliation.

At the present time the UK is looking at the EU with a measure of schadenfreude, as its vaccine rollout programme moves relentlessly forward and that of the EU, lags. But it is worth stressing that in the post-Covid period, the balance of power will shift to the EU. Prime Minister Johnson got his desired UK sovereignty, but at the expense of UK firms' market power.

What is of most concern is how this the Agreement will affect the UK's financial services sector.

The EU could in the future disallow UK financial institutions from transacting euro deals and trades in the UK. The end of passporting rights would see an exodus of financial sector activity from the UK to Europe.

5. The South African Economy - Parking the Bus

The South African economy shrunk a full 7.0% in 2020 despite a sharp recovery of 13.7% in Q3 2020 and another spurt of 1.5% in Q4 2020. These numbers were simply not enough, however, to offset the devastating effects of shuttering the economy in the second quarter. According to stats sa this was the worst annual performance since at least 1946, and in current times is comparable only with the 2.1% annual contraction in 1992.

The one bright light in the SA economy has been agriculture. The sector expanded 13.1% in 2020. But other sectors were, in the words of the release, 'pummelled'. Construction saw a 20.3% annual contraction, the fourth consecutive year of decline. In 2020, manufacturing contracted 11.6%, transport, storage and communication 14.8%, and trade, catering and accommodation 9.1%. Household consumption expenditure was down 5.3% for the year, and gross fixed capital formation decreased by 17.5%.

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) met once in Q4 2020, on November 19. The Committee kept the benchmark repurchase rate unchanged at 3.5%, with two members of the MPC preferring a cut, while three members opted for no change.

In Q1 2021 the MPC met twice, on January 21 and March 25.

At the January meeting, the MPC noted that the risks to the domestic growth outlook were balanced, while the outlook for inflation was also balanced in the near and medium terms. Again, a majority of three opted for no rate cut, while two dissenters wanted a rate cut of 25 basis points. The market viewed this as a glaring missed opportunity to stimulate growth via policy easing.

In the March 25 statement, the SARB cut the growth forecast for Q1 2021 to minus 0.2% from 1% at the time of the January meeting. But thereafter, with strong quarterly outcomes expected for the rest of the year, the Bank took up its 2021 GDP growth forecast to 3.8% from a prior 3.6%. For 2022 GDP is seen growing at 2.4%, and at a rate of 2.5% in 2023, both forecasts unchanged from the January meeting. Overall, the risks to the domestic growth outlook were seen as balanced.

Headline inflation averaged 3.3% in 2020. But with stronger growth from Q2 2021 onward, the forecast for the average rate of headline CPI was lifted to 4.3% for 2021 from a previous 4.0%. In 2022 it was taken to 4.4% from a prior 4.5%. Core inflation on the other hand was seen lower at 3.3% versus a previous 3.4% for 2021, rising to 4.0% in 2022.

The overall risks to the inflation outlook appeared balanced. Despite higher oil and electricity prices, inflation expectations were continuing to moderate.

Against this backdrop, the MPC unanimously decided to keep the repurchase rate on hold at 3.5%. It was apparent that inflation wildcards – electricity and other administered prices – played on the minds of Committee members. Rising Treasury yields in the US, which had the potential to destabilise South African bond yields and general financial market volatility were also concerns.

The annual budget was presented on February 24 by Finance Minister Mboweni. The Minister spoke of “getting our fiscal house in order”, and the budget represented a continuation of the policy of fiscal consolidation even amidst the fallout of the pandemic. Fiscal prudence remained “the best way forward”.

Given government’s stronger fiscal position now compared to last year, mainly due to the recovery in mining amid booming commodity prices, the Minister even provided a measure of tax relief and the spectre of the once-proposed R40 billion in additional taxes for FY2021/22 was banished for now.

Minister Mboweni saw a domestic growth rebound of 3.3% in 2021, getting to 2.2% in 2022, figures which stand to be revised after the final 2020 GDP numbers came in later in March.

In FY 2020/21 government’s borrowing requirement soared to R670 billion or 13.6% of GDP.

The revised budget deficit for 2020/21 was put at 14% of GDP (the largest on record), but the deficit was set to get close to 9.3% of GDP in fiscal 2021/22, 7.3% the year after and 6.3% in FY2023/24.

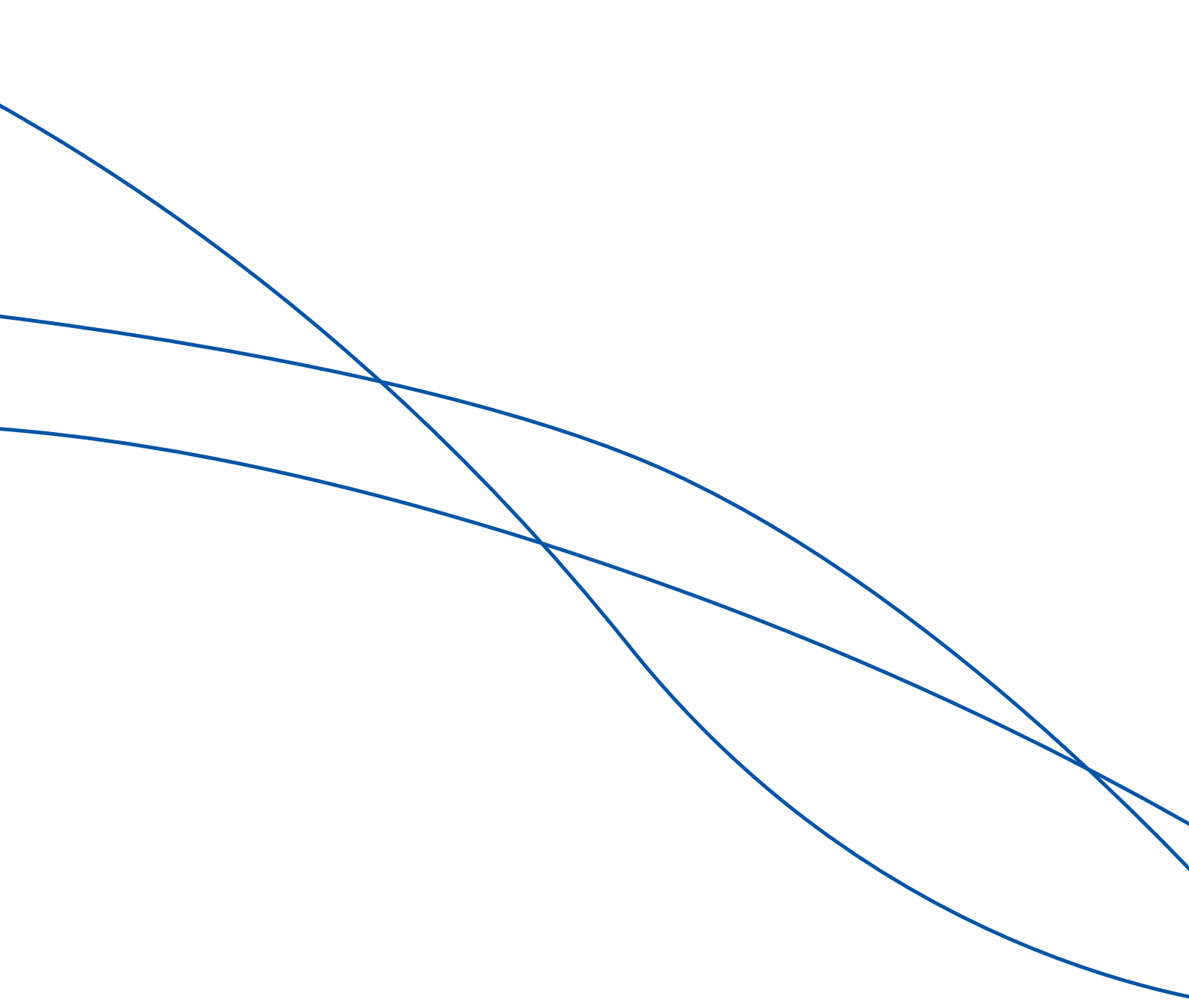
Gross tax revenue would be R213.2 billion lower than anticipated in the 2020 budget (a new record miss). However, due to the recovery in the economy after the initial lockdown (in the main mining), expected revenue collection would be nearly R100 billion more than forecast in the October 2020 Medium-Term Budget Policy Statement.

State expenditure would be lowered by R30 billion in FY 2021/22 from a revised estimate of R2.052 trillion in FY 2020/21 and kept steady thereafter.

Gross national debt as a percentage of GDP now stood at a revised 80.3% in FY2020/21 with debt servicing costs at 4.7% of GDP. Debt as a proportion of GDP would remain over 80% for the period ending 2023/24 rising to 87.3% in that fiscal year. Debt servicing would in future rise to more than 5% of GDP in an amount of R338.6 billion.

The budget received a mixed reaction. There was significant relief at the absence of any additional taxes, but severe criticism for the meagre increases to grant recipients at this time, decreased spending on education, as well as the paltry budgetary allocations for the vaccination programme.

**The Quart is adjourned
By order of the Judge (GPP)**



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