FG ASSET MANAGEMENT

ECONOMIC EXPRESS

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Over the course of February, we saw two distinct themes play out in markets. The first half of the month continued to be dominated by concerns over the extent of monetary policy tightening from global central banks as inflation remained elevated. The annual US inflation came out ahead of expectations at 7.5% for January, following the annual gain of 7% in December. This is the highest level US inflation has been since February 1982.

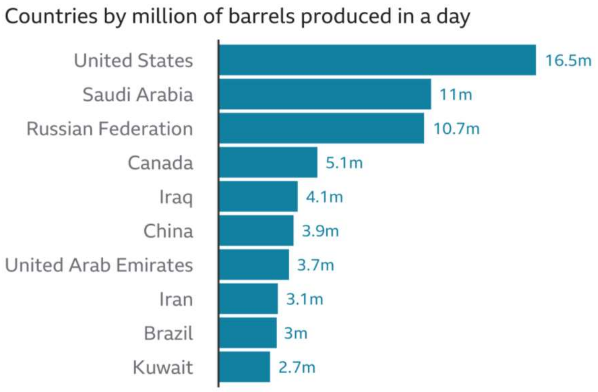
Figure 1: United States inflation rate

Source: Tradingeconomics.com, US Bureau of Labor Statistics

The increase reflected broad based price increases in food, electricity and housing. As a result, the market started pricing in even more aggressive rates hikes for the coming year (a total of seven rate hikes for 2022), with some economists even calling for a 0.50% rate increase at the March meeting. Even in Europe, sentiment changed over the first half of the month with expected interest rate increases brought forward to the last quarter of 2022 given the inflationary backdrop.

The second half of the month, focus shifted to geopolitical developments as Russia invaded Ukraine. In response, most Western nations have imposed very broad-based sanctions on Russia since the invasion started, which have led to the Russian rouble selling off 24.4% since the start of the year relative to the US dollar. Although Russia and Ukraine's combined GDP is not material in a global context, the real concern lies with the world's dependence on Russian oil and gas. Russia is the world's third largest producer of oil and Europe in particular is very reliant on its supply of gas.

Figure 2: Top 10 global oil producers



Source: Bloomberg (2020), BBC

If Russian oil and gas supply had to be cut off in retaliation to the sanctions, there would be significant negative consequences on economic growth and inflation. This risk of reduced supply was already reflected in the spike in oil prices into month end, with Brent crude oil finishing the month over $100 per barrel. Higher energy prices have significant global inflation implications and together with inflation already at elevated levels post COVID, it leaves global central banks with little alternative but to continue to tighten monetary policy to try and keep inflation under control. As we saw in February, we expect that the uncertainty around the Ukrainian invasion will continue to weigh down on market sentiment and create volatility.

Locally, an important event over the month was the South Africa's Budget Review for 2022, which was held in the second half of the month. Overall, it was a positive budget in line with expectations. It was reassuring to see the new Finance Minister, Enoch Godongwana, maintaining his firm stance to reduce debt and government spending. There was a large revenue overrun predominantly from higher-than-expected corporate taxes from commodity companies, some of which will be used to reduce government debt. The revenue overrun is however not sustainable and can therefore not be depended on going forward to provide support to reduce debt or finance expenditure. Future spending remains highly uncertain and successful policy implementation will be needed to drive higher economic growth, something South Africa has struggled with in the past.

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Local annual inflation for January fell to 5.7% from 5.9%. The reduction was driven mainly by lower fuel prices; however, this reduction was partly offset by higher food prices. Going forward, given the significant oil price increases together with food and electricity prices also increasing, the risks to inflation remains to the upside. This will continue to be closely watched by the SARB and determine whether a less gradual rate hiking cycle will be warranted.

Index	Asset Class	February 2022
STEFI Composite Index	Local Cash	0.32%
FTSE/JSE All Bond (Total Return)	Local Bonds	0.54%
FTSE/JSE SA Listed Property (Total Return)	Local Property	-3.26%
FTSE/JSE Africa All Share (Total Return)	Local Equities	2.95%
JP Morgan World Govt Bond index (USD)	Global Bonds	-0.88%
FTSE EPRA/NAREIT Global Index (USD)	Global Property	-2.44%
MSCI AC World (USD)	Global Equities	-2.55%

Source: Morningstar

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