Our Weekly Paid Newsletter

Richard Cluver Predicts

In our 36th year of service to the investing public of South Africa

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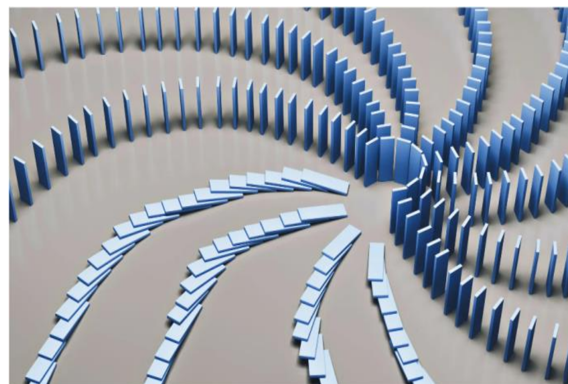
The stock market has entered a crisis era. On the one hand, surging tech stocks pushed the Nasdaq to its [best week](#) since January last week. On the other, global banks have shed $459-billion in market value this month alone, the Financial Times calculates, as the sector faces a growing crisis of confidence.

Playing out before our eyes is the misery of millions of investors fearing they might have lost their life savings as bank shares tank all over the world and the contagion of the Silicon Bank collapse spreads its dark tentacles into the lives of ordinary hard-working people who have saved all of their lives in the seeming safety of big corporate banks towards a comfortable retirement which might now be no more!



PHOTOGRAPH: LAN ZHANG/GETTY IMAGES

Yet most ordinary folk are not yet aware that their lives have been even remotely touched. Reality is still to come!

Investors were still digesting the Silicon Bank story when, last Friday, Signature Bank customers who had been spooked by the sudden collapse of Silicon Valley Bank withdrew more than $10 billion in deposits. That run quickly led to the third-largest bank failure in U.S. history as regulators announced that Signature was being taken over to protect its depositors and the stability of the U.S. financial system. Next, troubled Swiss giant Credit Suisse tumbled 30 percent before the Swiss Government stepped in at the weekend to stabilise things and sell the bankrupt shell to its rival UBS.

Even here in South Africa where our banking system is one of the world's best regulated, the best of them, FNB took a nine percent knock, Standard shares fell 11.27 percent and Capitec 11.6,

In an uncomfortable play back of a similar shock in 1929 which set the dominoes falling and took almost the whole world into the "Great Depression," Silicon Bank was one of the biggest providers in the world of loans to incubator companies – almost half of all US start-up-ventures which are estimated to collectively employ more than a quarter of a million workers. If they and other SVB customers suffer cash crunches or cut back expansion plans, rent payments in many parts of the world may be delayed and staff may no longer buy coffees and lunches at the corner deli.

Cautious about the future, businesses may withhold new hires, and staff who remain may respond in kind, cutting local spending or delaying home purchases or renovation work. Extending the analogy, Sarah Kunst, managing director of Cleo Capital, a San Francisco firm that invests in early-stage start-ups, explained, "When you say: 'Oh, I don't care about Silicon Valley,' yes, that might sound fine. But the reality is very few of us are Luddites."

"Imagine you wake up and go to unlock your door, and because they're a tech company banking with SVB who can no longer make payroll, your app isn't working and you're struggling to unlock your door." Perhaps you try a rideshare company or want to hop on a pay-by-the-hour electric scooter, but can't because their payment system is provided by an SVB client who now can't operate."

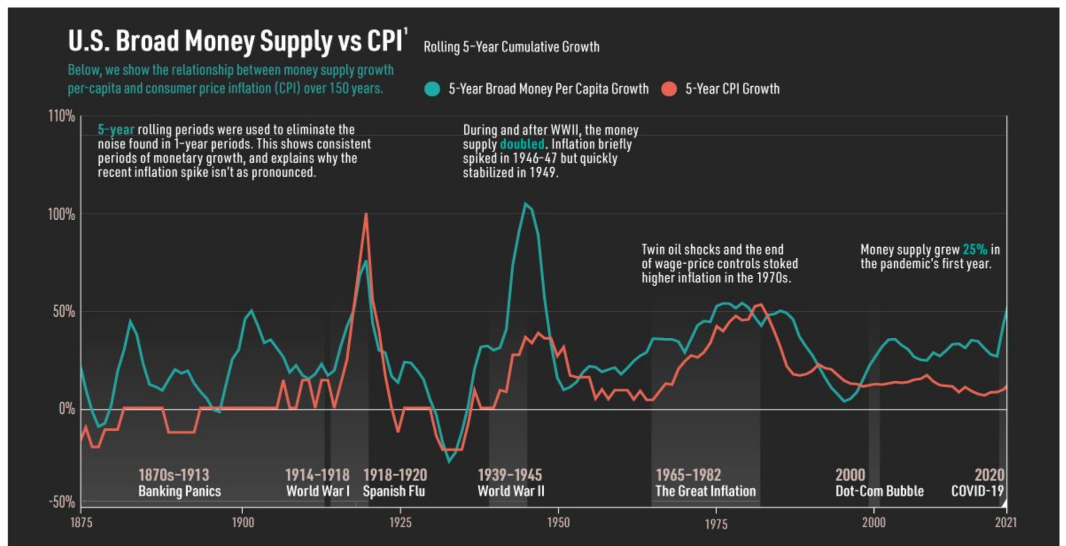
After Signature Bank became the second failure in days, consternation understandably gripped the monetary world and bewildered investors began to panic. It was a classic repeat of 1929, an event we thought could never again happen. Signature, a New York-based institution with deep ties to the real estate and legal industries had 40 branches, assets of $110.36-billion and deposits of $88.59-billion at the end of 2022, according to a regulatory filing. How could this be happening in this era of monetary sophistication?

What is new, in addition to the fact that the Chinese industrial miracle is no longer there to dampen down consumer prices with its cornucopia of cheap products, is that central banks across the world have been simultaneously hiking interest rates with a degree of synchronicity not seen over the past five decades. As a result, as the World Bank recognised in a detailed study published in September last year, "….in response to inflation, the world may be edging toward a global recession in 2023 and a string of financial crises in emerging market and developing economies that would do them lasting harm."

The World Bank prophetically argued, however, that the then expected trajectory of interest-rate increases and other policy actions might not be sufficient to bring global inflation back down to levels seen before the pandemic. At that stage investors were expecting central banks to raise global monetary-policy rates to almost 4 percent through 2023—an increase of more than 2 percentage points over their 2021 average. But, unless supply disruptions and labour-market pressures subsided, the World Bank's economists feared this could leave the global core inflation rate (excluding energy) at about 5 percent in 2023—nearly double the five-year average before the pandemic and signalling further inflation challenges in the future.

Actually, it's not at all new as I detailed last week. It's almost a century since the world went off the gold standard and began using central bank promissory notes as our everyday medium of exchange. Remember when every bank note contained the message, "I promise to pay the bearer..." because every central bank had, back in the day, promised to hold an equivalent amount of gold bullion in its vaults. The blue line in the following graphic, courtesy of the Visual Capitalist, underlines the fact that the United States, which throughout this period was arguably the most powerful economy in the world, did not truthfully keep that promise:

Note, furthermore, how closely the red line detailing the five-year moving average of US monetary inflation mirrored the money supply graph line. To explain that relationship, when governments run out of the ability to tax their people, they tend to resort to the hidden tax of printing money which destroys the value of their citizen's life savings.



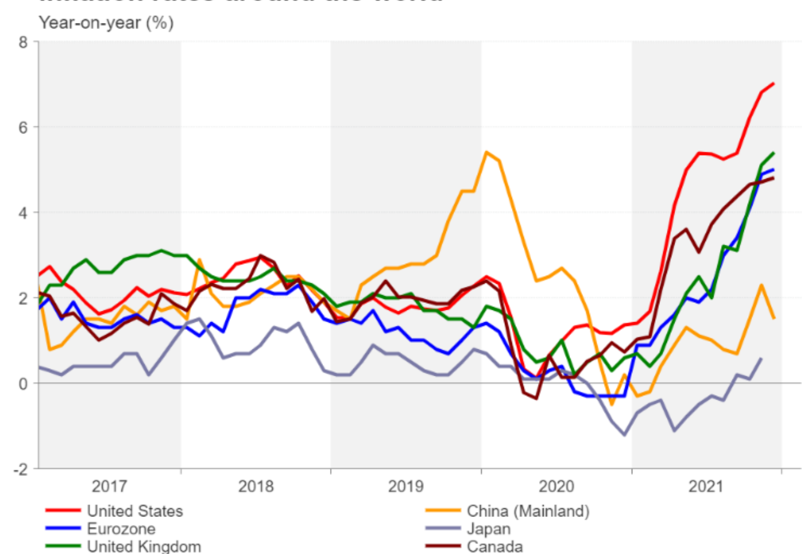
I know that statement is a bit of a stretch because central banks are supposedly – in the West anyway – independent of government but that graph is the proof that they actually are not! But, most importantly you need to take note of how the red line continued declining during the first 20 years of the new millennium

because, as I have explained in previous columns, the world was experiencing the impact of the Chinese economic miracle. Because billions of Chinese peasants were giving up lives as subsistence farmers and pouring their cheap labour expectations into the new factories of the Far East, the West effectively exported its manufacturing capacity to China and consumer prices fell everywhere for nearly 30 years, dampening the inflationary effects of monetary inflation.

But that benefit could not last forever. The following graph, courtesy of the Federal Reserve of Dallas illustrates how the central banks of the world's major economies have played fast and loose with money supply over the past two decades, in 2008 to ward off the "Sub Prime" recession and, although they used the excuse of Covid-19, the latest money- printing spree actually began long before Covid, from 2018 onwards, which they were in truth using to lower the debt-burden of over-borrowed governments.

NOTE: The chart plots MZM in the U.S, M2 in the Euro Area, Japan and Canada and M4 in the U.K.

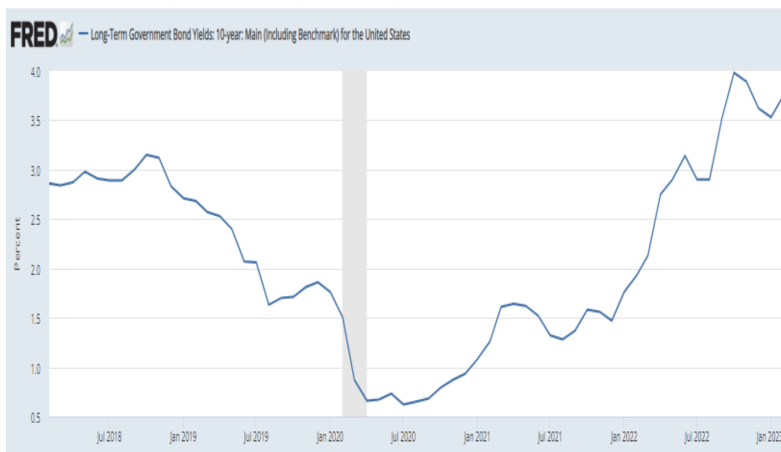
So look what has been happening to global inflation rates since 2017 in this graph from Refinitiv Datastream. Governments around the world have been reassuring their citizens that concerted central bank action has been bringing down inflation. However, the current generation of bankers has, courtesy of the Chinese phenomenon, had no practical experience of inflation nor, more importantly, of the devastating effects of rising interest rates upon the value of government bonds which have built up a debt pile of an unimaginable $120-trillion in recent years.



Source: Refinitiv Datastream

To understand bonds, you need to appreciate that they are traded by yield. Thus if you have an AAA grade economy you are able to attract investors at a lower interest rate than if you are an over-borrowed country like South Africa which is currently borrowing a billion Rands a day to meet the gap between its tax revenue and its spending and has to thus offer lenders 10.1 percent compared with the 3.554 percent the US Government has to pay.

Governments borrow very long with redemption dates as far away as 30 years from now and accordingly lock in their taxpayers for whole generations having to foot the bill. A benchmark US sovereign bond, however, arguably provides the best picture of what has happened lately. As, courtesy of the US St Louis Federal Reserve, the graph on the right so aptly illustrates, back in July 2020 the US was able to place 10-year notes at a yield of 0.62 percent while in February this year they were having to offer 3.75 percent. In simple terms, the cost of US debt has thus risen over six times.



Put that the other way around; if the Silicon Valley Bank was lending money to the US Government back in July 2020, the bonds they bought then are now worth only 16 percent of their issue price. The banks have LOST 84 percent of their value and, were investors to demand repayment of the money they lodged with their bank, it is simply clear the bank would have been unable to pay. That's why Silicon Valley Bank collapsed last week…..and why it is not alone!

So now central banks have another problem on their hands. Inflation remains steadfastly high. But if they keep raising interest rates in order to counter inflation they risk a domino effect which could bring on another Great Depression. One might accordingly conclude that global interest rates are thus at, or close to a peak and precisely the issue which sank the Silicon Valley Bank could massively enrich speculators who have to courage to buy bonds now. For example, if the demand for high-yielding bonds like South Africa's RSA series were such that the yield were to fall from 10 percent to 5, speculators would double their money.

Now, of course, with Julius Malema sensing a killing at the forthcoming general election a year from now; if the ANC gets below 40 percent of the vote and needs a coalition partner like the EFF in order to retain power, Julius's top manifesto demands include the immediate nationalization and re-distribution of ALL South African property to his followers. So you would obviously be deeply foolish to invest in RSA bonds if you believed that scenario!

But now consider that with SARS having already moved on Malema's first lieutenant Floyd Shivambo for his part in the VBS bank plunder, perhaps you might understand why Julius was prepared to risk everything in an attempt to shut down the country. Julius is obviously desperate as the Hawks close in on him and would arguably stop at nothing in trying to convince the authorities that he is untouchable!

So, maybe President Cyril Ramaphosa now has Julius on a tight rein. If ever Julius were prepared to drop his demands in return for a vice-presidency….and perhaps a quiet assurance that the VBS matter might remain buried in the background….now might be exactly the right time for the flamboyant EFF leader to turn to his apostles with a new vision of how to restore jobs and South Africa's economic promise within a new voting alliance with the ANC……just saying!

Now I personally do not think that the ANC retaining power in this manner might fill overseas investors with any sense of optimism, but then that's what makes bond speculation so interesting.

Then, to take things further, you do not actually have to buy bonds in order to go along for the ride. If you KNEW the above scenario were actually going to happen, you could buy bond futures for a tenth of the face value.

So let's speculate that Julius and Cyril secretly got together to use some of that seemingly inexhaustible supply of Phala Phala dollars to take a future position on RSA bonds and then opted to do what the world's best economists have been advising the ANC to do throughout its period in power: to take South Africa on a growth path like that achieved by the Chinese in the 1990's. If they could thus take the RSA bond yield to five percent, then Julius and Cyril could make at least a 20-fold gain.

It is said that Osama bin Laden took out similar futures positions on Wall Street just before his assault on the Twin Towers…and raked in fabled riches. But then who ever said that politics was not a dirty game?

Look out for The Investor next Wednesday when I plan to expand on this theme!

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The month ahead:

New York's SP500: I correctly predicted the recovery which I still expect to last until today ahead of the next retraction to April 12 and then gains until early July within a long drawn-out recovery.

Nasdaq: I correctly predicted a recovery trend until now ahead of weakness until the end of April followed by a modestly-rising trend until early June when I see a declining trend again setting in until the end of August when the next recovery phase should kick in.

London's Footsie: I warned last week that long and short-term pressures were, opposing one another and so the jury was out for the next fortnight within an overall weakening trend to the end of May. Now I see losses until April 10 within a long-term recovery until the end of the year.

France's Cac 40: I correctly predicted the start of a recovery likely to last until late May. But in the short-term the market is likely to fall until the end of March.

Hong Kong's Hangsen: I correctly predicted a continuing decline which I still expect to last until early May before the next long recovery begins.

Japan's Nikkei: I correctly predicted the protracted decline which was likely to last until early May before the next long but volatile recovery trend begins and is likely to last until late October.

Australia's All Ordinaries: The recovery I predicted is now likely to be over ahead of declines to mid-April ahead of gains until June 8 when another five-month decline looks likely.

JSE Top 40 Index: I correctly predicted a very brief interim recovery to March 30 followed by losses until mid-May and then modest gains until mid-July. But the overall trend remains down to mid-October.

ShareFinder JSE Blue Chip Index: I correctly predicted weakness until mid-May which is likely to be the beginning of a recovery into the New Year.

Rand/Dollar: I correctly predicted brief weakness would end this week. But the recovery has been very short and now I see further weakness until April 6 followed by gains to May 18 then weakness until June 13 followed by gains until early November.

Rand/Euro: I predicted gains until March 21 but they only lasted until the 17th followed by weakness likely until April 4 ahead of a recovery to mid-May ahead of weakness to mid-June when a long recovery is likely until next February.

The Predicts accuracy rate on a running average basis since January 2001 has been 86.93 percent. For the past 12 months it has been 94.57 percent

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JABULANI SIKHAKHANE: Municipalities find it increasingly difficult to balance books

Income and expenditure for the first half of the 2022/2023 don't inspire much confidence

BL PREMIUM

We all live within the boundaries of a municipality. We rely, or so the constitution says, on that municipality's supply of clean water, reliable electricity and refuse removal. Much economic activity takes place within those municipal boundaries.

But the latest figures on municipal income and expenditure for the first half of the 2022/2023 financial year don't inspire much confidence about National Treasury, shows that municipal finances worsened over the past decade. This at a time when municipal infrastructure is in a terrible state and local governments can barely meet the socioeconomic needs of residents.

Data for the second quarter (October to December) of the 2022/2023 financial year shows total municipal expenditure budgets for the full-year at R557.8bn. More than half of this is accounted for by the eight metropolitan municipalities. The expenditure budget is almost double the 2012/2013 figure of R282bn (of which almost 60% was accounted for by metros). However, municipal capital budgets for the current financial year (R69.8bn) are up just 35% on the budgeted amount a decade ago (R51.8bn). Therein lies the problem.

Back in 2012/2013 municipalities set aside more than 18c of every rand of budgeted expenditure for capital spending. For this financial year that has fallen to just under 13c in the rand. This at a time when most municipal infrastructure — electricity distribution, water reticulation and roads — is collapsing because of age (especially in major cities) and lack of maintenance.

In recent years many residents have often experienced water cuts, for two main reasons. The first has had to do with the weak infrastructure of bulk water suppliers such as Rand Water. The other relates to aged and poorly maintained municipal water infrastructure.

The situation is similar when it comes to electricity. In addition to Eskom's rolling blackouts, aged and poorly maintained municipal electricity distribution networks have been worsening the power crisis. This means sorting out Eskom's generation capacity and introducing independent power producers may not necessarily end power cuts for households and businesses that are supplied by municipalities. Nor will allowing municipalities to source power directly from independent power stations.

To reduce blackouts residents and businesses will require an upgraded municipal electricity distribution network, something that doesn't appear to be uppermost in the minds of politicians. But even if the political will was there, municipal finances wouldn't permit it.

Debt relief

Other than the shift in expenditure away from capex towards consumption, municipalities are under pressure on another front. That's the ballooning of the monies they are owed from R305.8bn in December 2022 to R83.7bn in December 2012. The biggest driver of this debt is households, which accounted for 71% of the total at end-December, compared with 63% in 2012.

Of the December debt, only 16c out of every rand (R49bn) is collectable, according to the Treasury. That is because R256.7bn was older than 90 days. This amount included interest on the debt. The Treasury qualified its statement on the bulk of the debt not being collectable, saying it should not be read as encouragement for municipalities to write the debt off. The reality, though, is that whichever political party runs a municipality will find it difficult to collect. That's especially the case in those municipalities where no political party governs on its own.

The amounts municipalities owe to their suppliers has also soared more than 80% since 2012/2013. The bulk of this, R56.3bn out of the R86bn, was due to Eskom. The Treasury says the increase in what municipalities owe creditors could be an indication that they “are experiencing liquidity and cash challenges and consequently are delaying the settlement of outstanding debt owed”.

In his budget speech in February finance minister Enoch Godongwana said Eskom would “provide incentivised relief to municipalities whose debt is unaffordable”. Relief would come with conditions, including the requirement that municipalities convert from postpaid to prepaid electricity sales. Godongwana said the Treasury would publish a circular this month, with implementation due to start on April Fools’ Day.

Implementing Godongwana’s conditions will require political will, a scarce commodity in SA. All of which means municipal finances aren’t going to improve any time soon — delaying any possible improvement in the level and quality of public services.

• Sikhakhane, a former spokesperson for the finance minister, National Treasury and Reserve Bank, is editor of The Conversation Africa. He writes in his personal capacity.