OUR OPERATING ENVIRONMENT

Sanlam's performance is shaped by external and internal factors that span many geographies. These factors include economic and regulatory changes, combined with social dynamics. Sanlam's four strategic pillars focus the Group on achieving specific transformation outcomes while being responsive to our environment. This is possible with the support of a robust governance system that ensures that we act ethically and responsibly.

The global economy in 2019

Global real Gross Domestic Product (GDP) growth moderated in 2019. A number of factors contributed to the softening in economic activity, including increased uncertainty, due to looming events such as the exit of the United Kingdom (UK) from the European Union (Brexit), geo-political risks, including the trade dispute between the US and China, and the fading impact of US fiscal stimulus.

Increased trade protectionism proved especially damaging, dampening global trade and economic activity more generally in emerging market economies (EM). That said, EM benefited from easier global financial conditions as monetary policymakers in developed economies (DM) responded to the slowdown in growth.

After increasing the Federal Funds Target Rate by a cumulative 100 basis points (bp) in 2018, the US Federal Reserve cut its policy interest rate by a cumulative 75bp in 2019 to a level of 1,5% to 1,75% by year-end, while ending the reduction in its aggregate securities holdings in August 2019.

In Europe, the European Central Bank (ECB) Governing Council also maintained an accommodative monetary policy stance, reflected in its decision to cut the interest rate on its deposit facility by 10bp to -0,50% in September 2019, while restarting net purchases under its asset purchase programme (APP) at a pace of €20 billion per month, as from 1 November 2019.

In an uncertain global environment, the US dollar retained its relative strength throughout 2019. But, after losing ground through most of 2019 against the US dollar, pound sterling appreciated significantly in the fourth quarter of 2019, as negotiations between the UK and EU on Brexit 2019 yielded more productive results.

The risk surrounding Brexit lingered throughout in 2019 though – a development alluded to by the Bank of England's Monetary Policy Committee (MPC), which frequently noted uncertainty and downside growth risks could alter the expected path for its policy interest rate. Ultimately, the bank left its policy interest rate unchanged throughout the year.

The ongoing uncertainty related to Brexit clearly constrained fixed investment spending and the overall level of GDP growth in the UK, with the economy ending the year on an especially weak note. Growth may lift in 2020, though, given expected fiscal stimulus and some improvement in business confidence.

Encouragingly, from a global growth perspective, 2019 ended with hope that trade tensions had peaked. On 13 December 2019, the US and China announced phase 1 of a trade agreement, according to which 50% of US tariffs implemented in September 2019 are to be repealed, reducing the effective tariff on US imports from China; in addition to making apparent progress on lingering issues such as US agriculture exports, technology transfer and use of intellectual property. Despite the tariff concession, the effective increase in US tariffs since 2018 on imports from China is still high at 13%.

A notable feature of the current global business cycle is the absence of significant, sustained upward pressure on core inflation rates, despite the shift towards increased trade protectionism and significantly firmer wage growth in, for example, the US. While this continues, central banks are expected to maintain their accommodative monetary policy stances.

Although the global economic slowdown appeared to have bottomed in the fourth quarter of 2019, growth is not expected to accelerate strongly in 2020, unless global fixed investment spending lifts to buoy employment growth once again.

South Africa in 2019

The South African economy endured another disappointing year in 2019, partly reflecting significant electricity supply disruptions, which impacted production negatively in the first and fourth quarters of the year. Gross operating surplus growth remained soft, increasing just 4,3% (current prices) in the year to the third quarter of 2019. Fixed investment spending has been weak since 2016, given the profits downturn, low returns on investment and depressed business confidence levels. As a result, real GDP growth was barely positive at less than 0,5% in 2019.

Consumers remained constrained in the weak economic environment. By the third quarter of 2019, real personal disposable income growth had all but stalled, advancing 0,1% seasonally adjusted and annualised, reflecting a high unemployment rate of 29,1%, which is at its highest level since 2003, as well as soft total compensation growth of just 4,0% year-on-year (current prices).

Consistent downside surprises in inflation prints over the past year confirmed the South African Reserve Bank (SARB) is succeeding in its quest to lower inflation towards the mid-point of its inflation target range of 3% to 6%. Headline consumer price inflation advanced just 3,6% in the year to November 2019, while core inflation increased 3,9%. Although inflation should lift in 2020, it is expected to average only a little above the mid-point of the Reserve Bank's inflation target range. However, despite the benign inflation outlook, the SARB cut its repo rate only once in the year – by 25bp to 6,5% in July 2019.

South Africa's fiscal position deteriorated significantly in 2019, given the weakness in GDP growth and elevated government spending levels. The latter, in turn, reflects a high level of government consumption and large cash injections into Eskom, the ailing public sector energy corporation. As a result, a main budget deficit of more than 6% of GDP is expected for 2019/20, while the government's gross loan debt ratio is likely to exceed 60% of GDP at the end of March 2020.

In response to the deterioration in the government's financial position, Moody's Investors Service changed the outlook on South Africa's long-term sovereign debt rating, which is only one notch above investment grade, from stable to negative in early November 2019, highlighting the urgent need to return to a sustainable fiscal path and stabilise failing state-owned companies.

Following significant depreciation over the first three quarters of the year, the rand appreciated markedly as 2019 drew to a close, ending the year at US dollar/rand 13,98, firmer than its level of US dollar/rand 14,39 at end 2018. However, the potential for additional sovereign debt rating downgrades remains a risk to the currency in 2020.

Looking ahead, the improvement in South Africa's terms of trade in 2019 should, with a lag, benefit the economy. However, given the constraints weighing on activity, including persistent electricity supply cuts, real GDP growth of around 1% only is expected in 2020.

Despite the unfavourable economic backdrop, the JSE/FTSE All Share Index increased by 8,2% in the year to December 2019, recording a positive total return of 12% in local currency. This performance was driven by the mining sector. The JSE Africa Resources 10 index increased by 20,0% in 2019 and yielded a total return in domestic currency of 25,3%. Concomitantly, the FINDI 30 Index increased 5,6% in the year and yielded a total return of 8,8% in domestic currency.

Given the prevailing disinflationary environment and low real interest rates in risk-free markets, South Africa's 10-year bond yield declined through 2019, but remained elevated, given the country's deteriorating fiscal position. The All Bond Index yielded a total return of 10,3% in local currency in the year to end-December 2019.

Rest of Africa in 2019

Real GDP growth in sub-Saharan Africa (SSA) is expected to average 3,2% in 2019 – unchanged from 2018.

The marked divergence in economic growth rates between the buoyant non-resource economies and resource producers continued in 2019. Although oil prices have increased since their steep fall from late 2014 to early 2016, they were still significantly lower in 2019 than in 2014.

In Angola, where GDP probably contracted last year, a decline in oil production resulted in a substantial deterioration in the country's current account balance, since mineral fuels account for around 95% of total exports. Given the weak economic backdrop, the Banco Nacional de Angola (BNA) cut its policy interest rate, but was constrained to a cumulative decrease of 100bp as inflation remained elevated, despite a disinflationary trend.

Following the termination of the exchange rate peg in January 2018, Angola's policymakers allowed the exchange rate regime to shift towards greater flexibility and, ultimately, the BNA floated the kwanza in October 2019. In response, the currency plunged, before stabilising late in the year as the Bank left its policy interest rate unchanged. In addition, in recognition of Angola's economic reform efforts, which also included measures to improve public finances, the International Monetary Fund (IMF) approved the second disbursement of its US$247 million loan to Angola, under its extended fund facility, in early December 2019.

In Nigeria, economic activity was restricted by electricity supply disruptions and ongoing economic policy uncertainty. However, oil production increased through 2019 and the introduction of a minimum wage supported consumption, so that moderate economic growth of just over 2% is estimated for the year. Inflation eased, but given food price increases, it remained high and well above the central bank's inflation target range of 6% to 9%. This constrained the central bank to only one interest rate cut of 50bp early in 2019, leaving the monetary policy rate at 13,5% at year-end.

Despite a deteriorating current account balance and a sustained wide fiscal deficit, the Nigerian naira remained stable throughout the year, supported by central bank intervention. However, in the lacklustre economic environment Nigeria's equity market delivered a negative total return of 9,4% in US dollar in 2019.

In Zambia, real GDP growth slowed to an estimated 2% from around 4% in 2018, given weakness in mining output and drought conditions, which also impacted the country's hydro power facilities negatively. Despite the growth slowdown, however, the current account deficit widened. Meanwhile, the government budget deficit remained large (albeit smaller than in 2018), the country's debt ratio continued to climb and the level of foreign exchange reserves remained low.

In addition, persistent weakness of the kwacha maintained upward pressure on inflation, which averaged close to double digits in 2019, prompting the central bank to increase its policy interest rate by a cumulative 175bp through the year.

In West Africa, Côte d'Ivoire is an example, although the economy is influenced by weather conditions, given its cocoa and cotton production. In 2019 a supportive private sector business environment underpinned investment spending and real GDP growth remained strong at an estimated 7%. The outlook for 2020 is equally robust. However, the equity index of the West Africa Stock Exchange (the BVRM Composite all listed company index) yielded a negative total return of -7,55% in US dollar.

East African economies have also recorded notable improvements in GDP per capita relative to the world's high-income economies since the early 2000s. In 2019, Kenya, Rwanda, Uganda and Tanzania once again recorded robust real GDP growth and the equity markets of Kenya and Tanzania yielded total returns in US dollar of 27,1% and 4,5% respectively in 2019. Rwanda's equity market, however, yielded a negative total return of -0,68% in US dollar over the year, partly reflecting moderate depreciation of the Rwandan franc. Similarly, Uganda's Local Share Index delivered a negative total return of -11,6% in US dollar in 2019.

In Kenya, specifically, where real GDP growth is estimated to average around 5,5% in 2019, benign inflation and supportive inflation expectations prompted the MPC of Kenya's central bank to cut its policy interest rate by 50bp in November 2019 – its only interest rate cut during the year. The country also repealed its restrictive interest rate cap law, which should, looking ahead, underpin credit extension.

In the Common Monetary Area (CMA) Namibia continued to wrestle with fiscal consolidation against the backdrop of a weak economy. Real GDP likely contracted in 2019 amidst disinflation, while growth prospects for 2020 are also constrained – although some support is expected from infrastructure spending and an increase in mining production, which weakened in 2019.

Namibia's fiscal adjustment programme yielded smaller twin deficits in recent years. However, both the fiscal and current account deficits widened once again in 2019. Additional fiscal consolidation is likely to be elusive in the year ahead, given soft domestic income growth, so that the government's debt ratio is likely to continue increasing.

Ultimately, given Namibia's lack of international competitiveness, the risk is that growth will not recover sufficiently in the absence of economic reforms, leaving the currency's peg to the South African rand vulnerable over time. Despite the unfavourable economic environment, Namibia's equity market yielded a positive total return of 7,7% in US dollar, partly reflecting the relative appreciation of the South African rand over the year.

While resource producers have underperformed, there are a number of fast-growing economies in Africa that have favourable demographics and improving trends in human capital development.

Elsewhere in Southern Africa, real GDP growth slowed in Botswana, due to the impact of drought conditions and weak mining output. Even so, the economy expanded by 3,1% in real terms in the year to the third quarter of 2019. The government's fiscal deficit remains moderate though, its debt level is low, and the current account is just about in balance. Botswana's stable macroeconomic picture is completed by sustained low inflation, which allowed the Bank of Botswana to ease its policy interest rate by 25bp in 2019. Looking ahead, food price increases could lift inflation to an extent in 2020, but the overall inflation outlook is relatively benign. The equity market recorded only a modest positive total return of 1,8% in US dollar in 2019.

Zimbabwe's economy remained under considerable pressure in 2019, having been negatively impacted by severe drought, which has been widespread across Southern Africa. The impact on crops such as maize will still be felt in 2020 and millions of Zimbabweans are expected to require food aid, while a poor tobacco harvest is expected to weigh on export earnings. In addition, fuel and energy shortages are constraining industrial activity, including mining production, which decreased by double digits in the year to the third quarter of 2019.

The Reserve Bank of Zimbabwe reintroduced the Zimbabwean dollar in 2019, but the currency has not inspired confidence in an economy mired in hyper-inflation. At the same time, foreign exchange shortages persist.

An IMF staff monitored programme was implemented in the second quarter of 2019. Critically, though, an IMF debt relief programme would require the clearance of arrears with international lenders. In the interim, Zimbabwe remains in debt distress. Absent access to foreign funding and meaningful economic reform the outlook for the economy is bleak.

Looking forward, aggregate real GDP growth in SSA in 2020 is expected to remain similar to the outcome for 2019. Further, inflation in the region is expected to remain elevated at around 10%, but this, in large part, reflects high inflation rates in the larger economies of Angola and Nigeria, as well as Zambia.

Since the global financial crisis the governments of SSA have increasingly relied on funding in foreign currencies, given low DM real interest rates.

In 2019, the shift towards easier global financial conditions were supportive of high-yield sovereigns. Although African Eurobond spreads were elevated relative to US treasuries last year, total returns on these bonds were in double-digit territory for a number of issuers, including, for example, Angola, Ghana, Kenya, Namibia, Nigeria and Rwanda.

That said, in a number of economies, debt dynamics have turned unfavourable and progress in fiscal consolidation stalled last year. Looking ahead, the pursuit of fiscal consolidation on the continent requires careful monitoring.

In North Africa, the shift towards a lower fiscal deficit faltered in Morocco in 2019, while the current account balance narrowed, but remained relatively wide, partly reflecting energy imports. Further, real GDP growth remained positive, but eased to below 3%, given moderate investment spending.

Inflation remained low in 2019 and the Bank Al-Maghrib left its policy interest rate unchanged at 2,25% through the year. At the same time, Morocco's foreign exchange reserves held up at around 6,5 months' imports. Meanwhile, the dirham ended the year just about unchanged against the US dollar, as Morocco maintained its currency peg against a basket consisting of the euro and US dollar. A more flexible exchange rate system is expected to be allowed over the medium term.

Morocco's long-term potential growth rate remains firm (although there is some concern over the ongoing pace of economic reforms) and macroeconomic management is sound, although supervision of state-owned companies should be improved. Moreover, transition to a more flexible exchange rate would assist the economy in absorbing external shocks.

Against a relatively stable background Morocco's equity market recorded a positive total return of 6,4% in US dollar in 2019.

India and Malaysia in 2019

Real GDP growth slowed in India in 2019, to a significant extent reflecting strains in the non-bank financial sector (given non-performing corporate loans) and lower income growth. State-owned banks experienced capital constraints and loan to deposit ratios were high amongst private banks, which dampened credit extension.

A slowdown in final demand growth included softer investment spending. In addition, exports were adversely impacted by slower global economic growth and the knock-on impact of increased trade protectionism. However, the overall balance of payments remained in reasonable shape as reflected in the country's elevated level of foreign exchange reserves.

After cutting its policy interest rate by a cumulative 75bp in 1H19, the Bank of India responded to the deterioration in the financial system by cutting its policy interest rate by 35bp in early August 2019 to 5,4%, and thereafter by another 25bp in October 2019. However, it remained on hold at its monetary policy meeting in December 2019, after the release of higher than expected inflation data (although core inflation remained contained). Concomitantly, the government injected capital into ailing public sector banks and implemented the Insolvency and Bankruptcy Code, while corporate tax rates were also cut. Corporate non-performing loans have seemingly topped out since, as corporations deleveraged, but risk has lingered.

Fiscal policy was also a focal point in India in 2019 as the level of general government debt remained high at close to 70%, reflecting a large public sector borrowing requirement.

Overall, real GDP growth for 2019 is estimated at 5,0%, slower than the growth rate in excess of 7% recorded in 2018. Despite this, the country's equity market yielded a positive total return in US dollar of 11,0% in 2019.

Looking ahead, easier monetary policy should underpin growth in 2020. Also, the government has cut corporate tax rates, which should support corporate balance sheets.

From a longer-term perspective, economic reforms, including steps to promote foreign direct investment, in addition to measures to broaden the tax base and consolidate fiscal policy are expected to bolster growth prospects.

In Malaysia, real GDP growth was firm in 2019, estimated at more than 4%, supported by domestic demand growth, amidst progress on economic reforms. Since manufacturing accounts for more than 20% of GDP, the country is vulnerable to increased trade protectionism, which accentuates the importance of the de-escalation in trade tensions between China and the US in late 2019.

Malaysia's inflation outlook remains benign. Monetary policymakers will, however, be cognisant of the high level of household debt, although the IMF noted late last year that the banks are well capitalised and asset quality is sound.

Given this relatively stable background, real GDP growth is expected to remain firm in 2020 at a similar level to 2019.

The Malaysian equity market achieved total returns of -1,8% in US dollar in 2019.