

MAY 2021

## Economic recovery and the contribution of policy intervention



### Economic policy responses in 2020 combined efforts of both fiscal and monetary policy.

Monetary policy intervention is often mistaken for a short-term fix to the challenges facing an economy and this may be driven by the immediate response by financial markets. Monetary policy can take a long time before the effects show, the lags can vary from three months to two years. The effect on inflation could take even longer.

It has been more than a year since global economies started implementing response measures to minimize the spread of COVID-19, this is therefore a good point to start looking at the effects of monetary policy easing.

### Global economic recovery underway

The IMF has increased its forecasts for global growth to 6% and 4.4% in 2021 and 2022 respectively. These represent much stronger numbers compared to the projections in the world economic outlook in the fourth quarter of 2020.

The upward revision reflects additional fiscal support in a few large economies, the anticipated vaccine-powered recovery in the second half of 2021 and the recovery of economic activity.

Locally, South Africa's GDP contracted by 7% in 2020, which was one of the bigger contractions globally. This outcome was still better than anticipated last year, however, at the height of the pandemic. This also contrasts with Thomson Reuters' consensus predicting a contraction of 8.5%. This means that the country's economic recovery has been faster than anticipated.

### Strong fiscal and monetary stimuli behind the robust recovery in advanced economies

Sentiment is now less negative compared to six months ago. However, the new virus mutations, high debt levels and the slow growth of vaccine coverage continue to be serious risk factors.

There is divergence in economic recoveries across countries and sectors, and this reflects the differences in the nature and intensity of pandemic-induced disruptions and the policy responses thereto.

Growth outcomes in 2020 were mostly better than anticipated due to additional fiscal support measures

implemented late in 2020, monetary policies of major central banks remaining accommodative and positive news around vaccines. These were helpful in normalizing economic activity faster than initially anticipated.

The recovery in advanced economies has been strong and this was fueled by the significantly large fiscal relief measures. According to the IMF, the change in global government gross debt was 18.7% in 2020 due to the pandemic versus 10.5% in 2009 during the global financial crisis.

**CADIZ MONEY MARKET FUND – The number one ranked South African money market fund over 1, 2, 3, 5, 7 and 10 years with an annualised yield of 7.51% from inception.**

Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 30/04/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STeFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%.

## Emerging market recovery muted as the scope of policy intervention was limited.

The hit on emerging markets was more severe than initially anticipated as the fiscal responses in most emerging markets were limited given the pre-existing fiscal vulnerabilities. According to the SARB, the fiscal stimulus of advanced economies averaged 16% of GDP, while emerging markets could only inject an average of 4% of GDP (Figure 1).

South Africa was already operating within a crisis level budget deficit and debt-to-GDP was already high before the pandemic. This limited the scope for fiscal policy to provide enough cushion to the economy during the crisis. Revenue losses caused by lockdown restrictions have left most emerging markets, including South Africa, with high debt burdens and fiscal deficits which will take long, painful years to recover fully.

## Global inflation on the rise but contained.

Global inflation has been increasing modestly after a sharp decline in 2020 at the height of the pandemic. The increasing inflation follows the economic recovery as economic activity heads towards normalisation. In 2020, inflation in the US, Japan, and Eurozone (the G3) averaged 0.7%, while the target range is around 2%. The IMF forecasts for 2021 see inflation for the US increasing sharply to 2.3% and the Eurozone and Japan increasing to 1.4% and 0.1% respectively.

Emerging markets' inflation has already started to increase. The IMF forecasts 3.5% for 2021, which is well below the historical average for emerging markets. Similarly, in South Africa, inflation is on a rising trajectory largely on the back of fuel price base effects. However, it will remain contained within the reserve bank's target band in the near term and remain below 4.5% (the mid-point of the target range) (Figure 2).

## Some emerging markets have started tightening, but major central banks remain largely accommodative.

With inflation expectations well anchored in advanced economies, monetary policy should remain accommodative to support economic recovery. In emerging markets, the picture is slightly different as some economies may have limited scope to remain accommodative for prolonged

periods given rising inflation (Figure 3). Most central banks are trying to maintain monetary support, however, some major emerging markets such as Russia, Turkey and Brazil have started tightening.

## The SARB expected to remain accommodative for as long as inflation is contained.

In the last three meetings the MPC left rates unchanged, which came as no surprise as their communication was clear that they have "frontloaded" repo rate cuts earlier into the crisis. With the large output gap (the shortfall

between actual GDP and potential GDP) and contained inflation, the SARB is most likely to remain accommodative and keep interest rates on hold until a point where inflation starts posing a serious threat.

## Conclusion

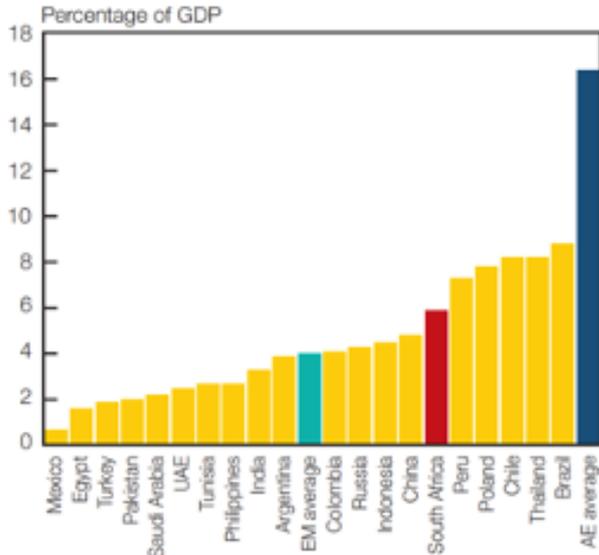
The global economy is recovering gradually, yet the pace of recovery is divergent across different countries. Continued monetary policy accommodation by major central banks and the improved pace of vaccine rollouts, especially in poorer countries, support the recovery.

Notably, however, the mutated and resistant variants of the virus, the slow pace of vaccination, a high debt burden and power interruptions are just some of the potential risks to the local recovery.

## CADIZ MONEY MARKET FUND – The number one ranked South African money market fund over 1, 2, 3, 5, 7 and 10 years with an annualised yield of 7.51% from inception.

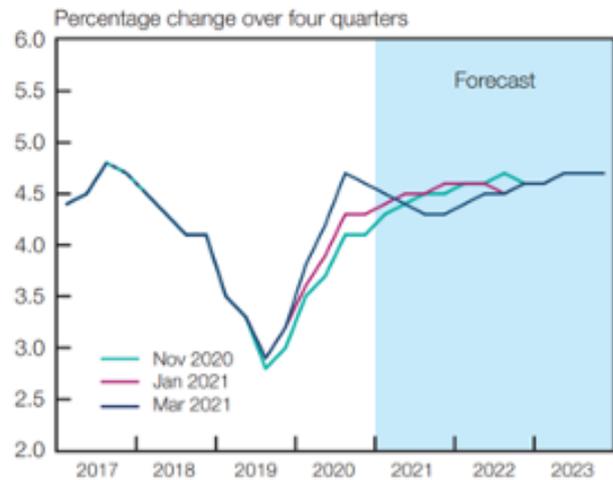
Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 30/04/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STeFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%.

Figure 1: Emerging market fiscal response



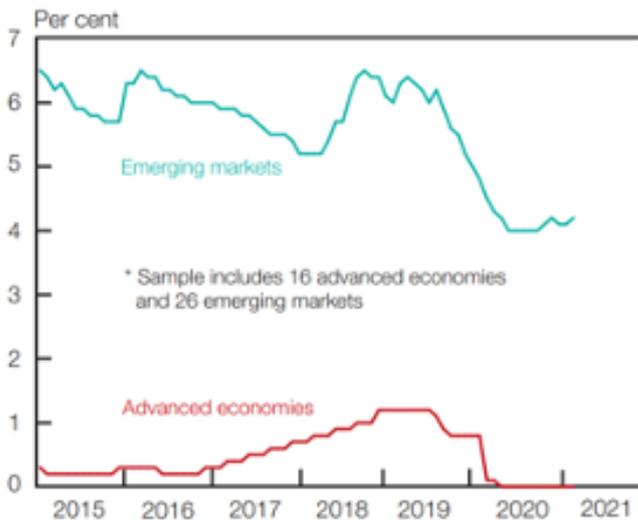
Source: IMF

Figure 2: Average Inflation (3-5 quarters ahead) - South Africa



Source: SARB

Figure 3: Policy rates – Advanced economies and emerging markets



Source: SARB

**CADIZ MONEY MARKET FUND** – The number one ranked South African money market fund over 1, 2, 3, 5, 7 and 10 years with an annualised yield of 7.51% from inception.

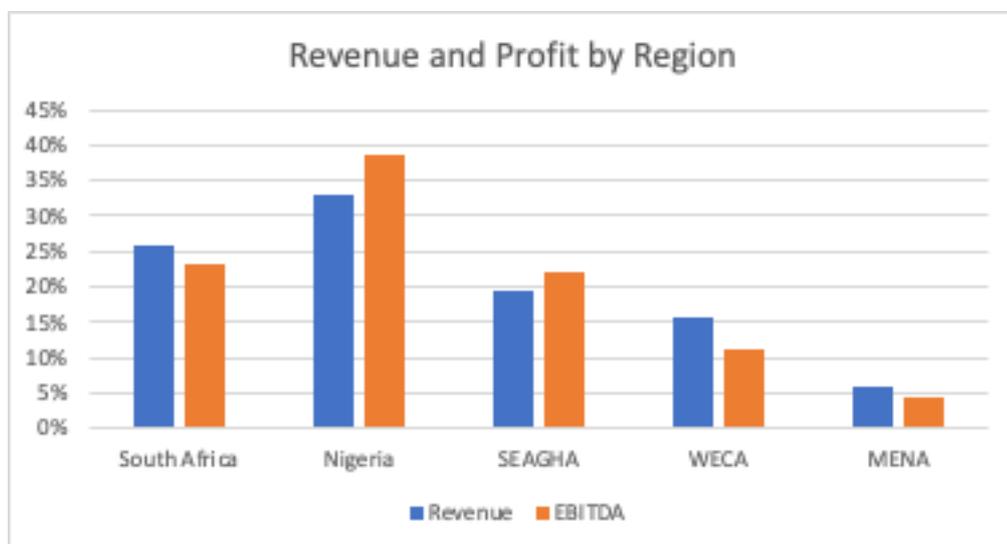
Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 30/04/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STeFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%.

# MTN – Africa’s Largest Telco



MTN is an emerging market focused mobile telecommunications company operating across 21 countries in Africa and the Middle East. In just over two decades, MTN has grown rapidly to offer voice, data, digital, fintech, enterprise and wholesale services to 278 million subscribers. MTN has been voted as one of the most admired and valuable brands in Africa, and in 2020 they had the leading Net Promoter Score (NPS) in 15 of their 21 markets. MTN enjoys the largest market share in most of the markets in which they operate, and their blended market share has increased to 46.1% in 2020 from 40.7% in 2017. In the markets where MTN do not hold the number one position, they are the number two operator.

MTN generates most of its revenue and profits from just two markets – Nigeria and South Africa. MTN is the number one operator in Nigeria, and it is the group’s biggest market in which they generate about a third of their revenue and 40% of their operating profits. MTN is the number two operator in South Africa, which is MTN’s second biggest market. The group generates approximately 26% of their revenue and 23% of their operating profit from South Africa. Other important individual markets for MTN include: Ghana, Uganda and Côte d’Ivoire.



Source: Company Reports; Cadiz Asset Management

MTN still generates most of its revenue from voice (c.52%), although data revenue has been growing quickly over the last few years and now makes up c.27% of

group revenue. Fintech currently makes up c.8% of group revenue, and management have set a target of lifting this to around 20% over the next three-to-five years.

**CADIZ MONEY MARKET FUND – The number one ranked South African money market fund over 1, 2, 3, 5, 7 and 10 years with an annualised yield of 7.51% from inception.**

Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 30/04/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STEFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%.

## MTN Benefits from High Barriers to Entry and Scale

MTN operates in an industry where barriers to entry make it difficult for new competitors to enter the market and compete for a share of MTN's customers and profits. These barriers to entry come about due to government regulations and the high fixed cost nature of the industry, as well as the upfront capital investment required to roll out a network.

Regulations require mobile operators to obtain a license to operate and limited spectrum usually leads to a maximum of four or five operators in a market, with the number one and two operators earning good returns, while the remaining operators struggle. The cost of compliance can also be high, as MTN has experienced in the recent past, and can further prevent new competitors from entering the market.

The high fixed costs and upfront capital investment needed to bid for spectrum, roll out a network, and invest in marketing and distribution requires access to a large pool of upfront capital. It can take years to generate a return on this investment as the new network will require scale in order for the economics to work. Over the last couple of decades, MTN have invested heavily in their network to establish their leadership position and provide excellent

coverage for their subscribers. This reduces the likelihood of customers switching to another network that offers inferior network coverage. MTN also has approximately 278m subscribers and this scale allows the group to spread their fixed cost base over more subscribers, essentially lowering the cost per subscriber. This, in turn, enables the group to generate strong cash flows and reinvest into their network to further strengthen their position. This again makes it more difficult for smaller operators that do not have sufficient scale to compete.

MTN still has good growth prospects, as it operates in fast growing markets with large and growing populations that will drive subscriber growth, and where smartphone penetration is still relatively low. This, combined with the increasing adoption of data, digital and fintech services, is likely to drive revenue growth for years to come. Management's strategy of moving more into the digital service offering should also see lower capex intensity which will improve free cash flow and boost return on capital metrics. Management also intends to spin off or list certain business units which could unlock value for shareholders.

## Risks to Watch Out For

No investment comes without risks, and some of the risks to the MTN investment case include political and regulatory risk in certain markets where MTN operates (most notably Nigeria and some of their Middle Eastern markets).

Operating in emerging markets can also result in complex environments, presenting unique challenges and execution risk. The group is also vulnerable to depreciating currencies and restrictions on repatriating funds, both of which can impact the cash flow it is able to generate from some of these markets.

With regard to financial risk, although we do not believe the group is currently at risk of breaching debt covenants, the holding company (Holdco) leverage ratio is above management's target range. The Holdco also has c.48% of its debt is USD, which can make the group vulnerable to a weakening ZAR (versus USD). This is something management is addressing, and we expect the USD denominated debt to be reduced.

**CADIZ MONEY MARKET FUND – The number one ranked South African money market fund over 1, 2, 3, 5, 7 and 10 years with an annualised yield of 7.51% from inception.**

Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 30/04/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STeFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%.

## How Are We Positioned?

Although MTN has enjoyed a strong run recently (+60% YTD), we are still comfortable holding the share at current levels. As the number one or two operator in each of their markets, we believe this dominant position will allow the group to take advantage of the explosive

growth in data traffic, and the acceleration of the digital economy along with financial inclusion across Africa in the years ahead.

**Physical Address:** Alphen Estate, Alphen Drive, Constantia 7848, Cape Town / [www.cadiz.co.za](http://www.cadiz.co.za)

This document is confidential and issued for the information of the addressee and clients of Cadiz only. It is subject to copyright and may not be reproduced in whole or in part without the written permission of Cadiz. The information, opinions and recommendations contained herein are and must be construed solely as statements of opinion and not statements of fact. No warranty, expressed or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such recommendation or information is given or made by Cadiz in any form or manner whatsoever. Each recommendation or opinion must be weighed solely as one factor in any investment or other decision made by or on behalf of any user of the information contained herein and such user must accordingly make its own study and evaluation of each strategy/security that it may consider purchasing, holding or selling and should appoint its own investment or financial or other advisers to assist the user in reaching any decision. Cadiz will accept no responsibility of whatsoever nature in respect of the use of any statement, opinion, recommendation or information contained in this document.

This document is for information only and do not constitute advice or a solicitation for funds. Investors should note that the value of an investment is dependent on numerous factors including, but not limited to, share price fluctuations, interest and exchange rates and other economic factors. Performance is further affected by uncertainties such as changes in government policy, taxation and other legal or regulatory developments. Past performance provides no guarantee of future performance.

Cadiz Funds (Pty) Ltd (Reg. No. 2013/118580/07) is an authorized financial services provider (FSP 45442)

Boutique Collective Investments (RF) (Pty) Ltd ("BCI") is a registered Manager of the Boutique Collective Investments Scheme, approved in terms of the Collective Investments Schemes Control Act, No 45 of 2002 and is a full member of the Association for Savings and Investment SA.

Collective Investment Schemes in securities are generally medium to long term investments. The value of participatory interests may go up or down and past performance is not necessarily an indication of future performance. The Manager does not guarantee the capital or the return of a portfolio. Collective Investments are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees, charges and maximum commissions is available on request. BCI reserves the right to close the portfolio to new investors and reopen certain portfolios from time to time in order to manage them more efficiently. Additional information, including application forms, annual or quarterly reports can be obtained from BCI, free of charge.

Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax.

A money market portfolio is not the same as a bank deposit account. The price is targeted at a constant value. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but that in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average.

Actual annual figures are available to the investor on request.

Investments in foreign securities may include additional risks such as potential constraints on liquidity and repatriation of funds, macroeconomic risk, political risk, foreign exchange risk, tax risk, settlement risk as well as potential limitations on the availability of market information.

Boutique Collective Investments (RF) Pty Ltd retains full legal responsibility for the third party named portfolio.

Although reasonable steps have been taken to ensure the validity and accuracy of the information in this document, BCI does not accept any responsibility for any claim, damages, loss or expense, however it arises, out of or in connection with the information in this document, whether by a client, investor or intermediary. This document should not be seen as an offer to purchase any specific product and is not to be construed as advice or guidance in any form whatsoever. Investors are encouraged to obtain independent professional investment and taxation advice before investing with or in any of BCI/the Manager's products.

## CADIZ MONEY MARKET FUND – The number one ranked South African money market fund over 1, 2, 3, 5, 7 and 10 years with an annualised yield of 7.51% from inception.

Source: Morningstar | Performance reported for A Class net of fees in ZAR as at 30/04/2021 (ASISA) South African IB Money Market, Inception: 01/03/2006 | Annualised return is the weighted average compound growth rate over the period measured | Benchmark: STEFI Composite ZAR, Category Rank is against the (ASISA) South African IB Money Market Category | Highest Annual Return 12.27%; Lowest Annual Return 5.58%.