OVERBERG MARKET REPORT

Tuesday 11th June 2019

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Last week a shocking Gross Domestic Product (GDP) figure for the first quarter (Q1) of 2019 was announced. Compared to the last quarter of 2018 our economy contracted by 3.2% quarter-on-quarter (Q-o-Q). Year-on-year (Y-o-Y) it was 0.0%. This is called – stagnation. We must avoid a double dip. Should the GDP dip again in 2019 Q2, we will have our second technical recession in two years. See more detail in our Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The Gross Domestic Product (GDP), seasonally adjusted and annualised, for the first quarter of 2019 contracted by 3.2% quarter-on-quarter. The contraction in GDP, although well below the consensus forecast, was somewhat expected given the weak economic data that was released prior to the GDP announcement. The quarterly decline was the sharpest since the first quarter of 2009. Year-on-year GDP was very much flat with a slight increase of 0.1%. On a quarter-on-quarter basis seven of the ten sub-sectors contracted. The sectors that recorded the biggest contraction included; agriculture (-13.2%), mining (-10.8%) manufacturing (-8.8%) and electricity (-6.9%). The only three sectors that recorded a quarter-on-quarter increase included the following; personal services (1.2%), finance (1.1%) and government (1.2%). GDP growth will need to improve dramatically in the remaining quarters of 2019 if South-Africa is to achieve the 1% GDP growth rate forecasted by the South-African Reserve Bank for 2019. Incoming data for the second quarter also remains poor. The first tranche of economic data does not suggest a strong GDP recovery in the second quarter following the sharp contraction in quarter one. Nevertheless, the expectation is that GDP will improve over the rest of the year especially in the second half.

- The Standard Bank Manufacturing Purchasing Managers' Index (PMI) dropped below the neutral 50-mark which separates contraction from expansion. The PMI for May was 49.3 down 1 point from its reading of 50.3 in April. This signalled a slight decline in the overall business environment of the private sector. The sector has now failed to post consecutive monthly improvements in operating conditions for over a year. Businesses were hampered by a faster drop in new orders and a fourth successive fall in export sales, leading them to reduce output and cut back on purchases. Also, rising input prices prompted firms to increase selling charges for the first time in three months. Despite this, future sentiment improved amid hopes of post-election stability.

- Business confidence, as measured by the South African Chamber of Commerce and Industry Business Confidence Index (SACCI BCI), declined slightly to 93 in April, down 0.7 index points from 93.7 in March. This is the second lowest monthly reading for the year. Year-on-year business confidence is also down from its reading of 94 in 2018. This indicates that business conditions have not improved as expected with the 5-month average of 93.4 for 2019 lagging the 5-month average for 2018 of 95.5. On a month-on-month basis only four of the thirteen sub-indices were positive; Energy supply, exports, inflation and real private sector borrowings. The nine sub-indices that were negative included; imports, vehicle sales, retail sales, construction, share prices, real financing cost, precious metal prices and the exchange rate.

- The Current Account deficit in the first quarter of 2019 widened to R142.5 billion down R32.3 billion from the fourth quarter deficit of R110.2 billion. The widening deficit was expected, although the deterioration is slightly less than the expected consensus forecast. As a percentage of Gross Domestic Product (GDP) the current account deficit deteriorated to 2.9% in the first quarter of 2019 from 2.2% in the fourth quarter of 2018. The widening of the current account deficit was mainly a result of the decline in the trade surplus as well as a widening of the (net) services, income and current transfer deficit. The worsening of the current account and trade balances occurred despite an improvement in the terms of trade, which was supported by a decline in import prices (down 4% quarter-on-quarter) as well as an increase in export prices (up 0.4% quarter-on-quarter). The terms of trade increased around 4.7% quarter-on-quarter. This increase follows declines in the two preceding quarters.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Werner Erasmus

- Retail Sales: Due Wednesday 12th June. Retail sales for April are expected to increase 1.2% month-on-month and 1.2% year-on-year from 2018. Consumer spending represents 60% of South-Africa's GDP. Healthy retail sales points to improving company revenues and profits within the retail sector, which tends to be positive for equity markets.

- Mining Production: Due Thursday 13th June. Mining production in the first quarter of 2019 recorded a third consecutive quarter of contraction. Given its importance to GDP all eyes are on the April figures to determine if there will be a second quarter improvement. Consensus forecast is however that mining production for April will contract by 10% month-on-month and 0.6% year-on-year.

- RMB Bureau of Economic Research (BER) Business Confidence Survey: Due Thursday 13th June. The second quarter's BER business confidence survey is likely to maintain the downward trajectory which started in the second quarter of 2018. Consensus forecast is that it will come in at 25 points, down from 28 points in the first quarter of 2019. This will be the lowest level recorded since the third quarter of 2009 when South Africa was in a recession. However, business confidence is expected to increase gradually after the State of the Nation Address (SONA) 2019 which will be held on the 20th June.

GLOBAL

Contributed by Nick Downing

- In its semi-annual review, the World Bank cut its forecasts for global economic growth and global trade growth for 2019 from a previous 2.9% to 2.6% and from 3.6% to 2.6%, respectively, citing trade tensions as the biggest culprit. According to World Bank President David Malpass, "There's been a tumble in business confidence, a deepening slowdown in global trade, and sluggish investment in emerging and developing economies." Surprisingly, GDP growth forecasts for the US and China, the two main instigators of the trade tensions, were left unchanged from the previous review at 2.5% and 6.2%. Instead the economic growth downgrades were spread elsewhere across all six other global regions, illustrating the widespread impact of the US/China trade dispute.

- Central bank and ministry of finance representatives from the G20 group of major economies meeting last weekend in Japan fretted about global trade, but the communique skirted the issue of trade tariffs and refrained from any direct mention of the US and China in that context. The G20 communique stated that, "Trade and geopolitical tensions have intensified" and that central banks were ready "to address these risks and stand ready to take further action." The meeting was a precursor to the G20 meeting of global leaders on the 28th and 29th of June in Osaka at which President Trump is expected to meet China's leader Xi Jinping.

- President Trump backed down from implementing the threatened 5% trade tariff on all imports from Mexico. Trump stated that, "The tariffs scheduled to be implemented by the US on Monday, against Mexico, are hereby indefinitely suspended." He confirmed that Mexico had agreed to "strong measures" to combat illegal immigration. The breakthrough in the trade impasse with Mexico should facilitate the ratification of the US-Mexico-Canada Agreement, which was negotiated last year and promulgated to replace the North American Free Trade Agreement.

NORTH AMERICA

Contributed by Nick Downing

- Fed funds futures are ascribing a 20% probability of a 25 basis-point rate cut at the Fed's policy meeting on the 18th and 19th June and a 70% probability of a rate cut by the following meeting on the 30th and 31st July. The probability of the Fed embarking on a rate cutting cycle of three 25 basis-point rate cuts has risen to 65%. The Fed has refrained from pushing back against these market expectations, adding to the certainty of an imminent rate cutting cycle. However, Goldman Sachs analysts wrote in a report that, "we still think the market is too hopeful about Fed cuts this year." Markets are being affected by a souring in sentiment rather than actual economic fundamentals. Elevated geopolitical risk, which is affecting sentiment, could subside just as quickly as it escalated. However, in addition to monitoring trade issues Fed Chairman Jay Powell also stated that the Fed takes seriously, "the risk that inflation shortfalls that persist, even in a robust economy, could precipitate a difficult-to-arrest downward drift in inflation expectations."

- Non-farm payrolls were surprisingly weak in May, rising by just 75,000, while the payrolls in March and April were revised lower by an aggregate of 75,000. The monthly payroll numbers over the past three months average 151,000 down from an average of 198,000 in the prior three months. Wage growth also slowed to 3.1% year-on-year from 3.2% in April compared with a recent peak of 3.4% in February. Some analysts attribute falling jobs growth to tightness in the labour market, which may be forcing companies to increase automation. This view is supported by the unemployment rate which remained at a 50-year low of 3.6%, and a sharp fall in the broader U6 unemployment rate from 7.7% to 7.1% its lowest since 2000. The U6 rate includes part-time workers who would rather have full-time employment. Nonetheless, job creation is undoubtedly slowing. As a lagging economic indicator, the softening jobs market indicates that factors other than the recent escalation in trade uncertainties are affecting business confidence and hiring, including a fading in last year's tax stimulus and the broader-based global slowdown.

- The Fed's quarterly Flow of Funds report shows the aggregate net wealth of US households surged in the first quarter (Q1) by 4.5% quarter-on-quarter, the largest gain since Q4 2004, more than reversing the 3.7% slide in Q4 of last year. The bulk of the gain is attributed to the sharp recovery in equity markets. Household equity market wealth increased in Q1 by 12.4% on the quarter, while real estate wealth increased by a more subdued 1.7%. Surprisingly, despite the healthy increase in net household wealth, the pace of household credit extension slowed while the savings rate increased, which both point to a potential decline in consumer confidence and household expenditure. Growth in household debt slowed in Q1 to 2.3% annualised down from 2.8% and 3.5% in Q4 and Q3 2019, respectively. Meanwhile, the household savings rate, as a percentage of disposable income, increased to 6.7% up from 6.5% in Q4 last year.

- The Fed's Beige Book, a summary of anecdotal information on business conditions collected throughout the Fed's 12 regional districts, and published eight times a year, reported a surprising resilience to the escalation of trade tensions with China. The Beige Book, which surveyed information over April and May, observed "a slight improvement on the previous year". Among the sectors of the economy which stood out, retailers were upbeat while the agricultural sector noted concern over heavy rains in the Midwest, which were delaying crop planting. The tightness of the labour market and upward pressure on wages remained a recurring theme.

- While the Institute for Supply Management (ISM) manufacturing index fell in May from 52.8 to 52.1 its lowest since October 2016, the ISM non-manufacturing index, measuring conditions in the services sector of the economy, bounced from its 20-month low of 55.5 to 56.9 in May. Services account for an estimated 88% of US GDP while the manufacturing sector accounts for just 11%. While the relative resilience of the services sector suggests little chance of an imminent recession, GDP growth is nonetheless expected to slow to around 1.5% quarter-on-quarter annualised in the second quarter (Q2) down from the robust pace of 3.1% recorded in Q1. Inventory stocking and the front loading of exports ahead of trade tariffs, which boosted Q1 GDP growth, will reverse and detract from growth in Q2, while the earlier stimulus from tax cuts and increased government spending in 2017 will continue to fade.

CHINA

Contributed by Nick Downing

- China's trade surplus surged from $13.8 billion in April to $41.6 billion in May, its highest since the start of the year, attributed to a steep decline in imports rather than rising exports. Imports declined in May by 8.5% on the year, after rising 4.0% in April. Despite increased trade tariffs the trade surplus with the US gained from $21.0 billion to $26.9 billion although the pick-up may be attributed to the front-loading of exports ahead of the additional tariffs implemented in June. In aggregate, China's exports gained 1.1% year-on-year after falling 2.7% in April. While exports to the US slowed, exports to the EU increased 6.1% on the year and to the Association of Southeast Asian Nations by 3.5%. The overall data points to a significant weakening in domestic demand conditions and weakening external demand, which may prompt a greater urgency in monetary and fiscal stimulus, especially if trade relations with the US continue to deteriorate.

JAPAN

Contributed by Carel la Cock

- Real wages in Japan were down for a fourth consecutive month in April by 1.1% year on year although slowing from the 1.9% contraction in March. The outlook for wage increases remains subdued. There are few signs of a recovery in the economy for the remainder of the year due mainly to lower global growth and especially the fallout from the US-China trade dispute. A slowing economy will put pressure on the labour market and keep wages down. The overall effect is that inflation will remain well below the target of 2% set by the Bank of Japan. The government is still going ahead with the planned increase in consumer tax in October and together with the disappointing wage growth figures, there is concern that the economy could slip into a recession in the last quarter of the year. Household spending in April increased 1.3% year on year, but lower than the 2.1% increase in March and could still be lower in May once the figures are released. This will dash any hopes that consumer spending can help support growth this year. Although economic growth in the first quarter was revised upward to 2.2% annualised from the initial estimate of 2.1%, growth remains finely balanced with greater risk towards the downside.

EUROPE

Contributed by Carel la Cock

- As was expected, headline inflation in the eurozone has reverted to the weaker trend of earlier this year as prices grew 1.2% in the year to May compared with 1.7% in April. Core inflation which strips away the more volatile energy and food prices, fell from 1.3% to 0.8%. The outlook for inflation remains weak and the consensus is that the European Central Bank's (ECB) target of just below 2% will be out of reach for some time still. This was confirmed when the ECB released its updated forecast. Inflation is expected to be 1.3% for this year, 1.4% for 2020 and 1.6% by 2021. The ECB's forecast for economic growth has been revised upwards for this year from a previous 1.1% to 1.2%, however growth in 2020 is now expected to be lower at 1.4% from the previous 1.6% and 1.4% in 2021 down from the previous 1.5%. Mr Draghi, ECB president, said "Despite the somewhat better than expected data for the first quarter, the most recent information indicated that global headwinds continue to weigh on the euro area's outlook." This outlook prompted the ECB governing council to commit to leaving interest rates unchanged until mid-2020. Deposit rates are currently at -0.4% while the repo rate is at zero. Mr Draghi further announced that the ECB will use all measures available if inflation and economic growth continues to weaken. These could include more quantitative easing and rate cuts.

UNITED KINGDOM

Contributed by Carel la Cock

- UK gross domestic product (GDP) in April fell 0.4% month on month and marks the worst decline in three years. The main driver behind the decline was lower car production due to the annual closure of factories in April rather than August, which would normally be the case. Manufacturers brought forward the closures in anticipation of a potentially disorderly Brexit and fears of supply chain disruptions. The result was that car production output fell by 24%

in April the worst such decline since records began. Although the decline can be explained away, manufacturers have already played their trump card and with Brexit now postponed until the end of October, they will not have the ability to close factories again to minimise losses in the event of a no-deal Brexit. Discounting for the fall in car production, the UK economy is still growing very slowly as the continued uncertainty around Brexit remains a drag on growth.

FAR EAST AND EMERGING MARKETS

Contributed by Carel la Cock

- South Korea's gross domestic product contracted in the first quarter by 0.4% quarter on quarter, the steepest decline since 2008, driven largely by weak demand globally for electronics. Home to global electronic brands such as Samsung and LG Electronics, South Korea has found itself amidst the throws of the ongoing US-China trade dispute and has experienced a fall in manufacturing of 3.3%, largely due to weak demand for semiconductors. Exports were down 3.2% driven by lower volumes in LCD's and semiconductors. Economic growth year on year was 1.7% while inflation was 0.7% in May, up from 0.6% in April.

- India's manufacturing purchasing managers' index (PMI) rose 0.9 points to 52.7 in May coming in ahead of expectations. The survey showed that there was an increase in manufacturing production driven by both domestic and global demand, which gave rise to higher employment in these industries. Respondents to the survey said they expected more pro-business policies to follow since Narendra Modi has secured his second term in office. Furthermore, India's central bank has cut interest rates for a third time this year to the lowest level since 2010. The benchmark rate was reduced by 25 basis points to 5.25% in a move to arrest declining economic growth. With the new governor of the Reserve Bank of India, Shaktikanta Das, seemingly more sympathetic to Mr. Modi's cause, there is optimism that India can return to GDP growth of above 7%.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 10.89	58481
JSE Fini 15	+ 4.33	17089
JSE Indi 25	+ 15.35	73460
JSE Resi 20	+ 12.72	46266
R/$	- 3.19	14.83

R/€	- 1.80	16.77
R/£	- 2.57	18.81
S&P 500	+ 15.15	2886
Nikkei	+ 5.59	21134
Hang Seng	+ 8.13	27578
FTSE 100	+ 9.62	7375
DAX	+ 14.08	12045
CAC 40	+ 13.78	5382
MSCI Emerging	+ 5.84	1022
MSCI World	+ 13.36	2135
Gold	+ 3.53	1326
Platinum	+ 1.14	802
Brent oil	+ 16.22	63.27

BOTTOM LINE

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- Massive Mistake - High Expectations: In 2019 Q1 retail sales continued to remain weak, new vehicle sales dropped, the Purchasing Managers' Index (PMI) stayed below 50 index points, confidence figures remained low. Our exports declined. Our trade surplus dropped, and our current account deficit increased. There is red ink all over the place. The quantum of the GDP contraction in Q1, 3.2%, was the biggest in 10 years. A Bloomberg consensus poll predicted a contraction of 1.6% for the quarter. National Treasury expected growth for 2019 of 1.5%. They misread the state of the economy - massive mistake. Projected tax collections were based on that. Government will struggle to repay the country's debts. Unemployment will increase. Economists have lowered their growth expectations to between 0.5% and 0.8% for 2019. We are at the edge of a fiscal cliff. The risk of a downgrade by Moody's has increased. On the bright side, two positive developments are the recent rise in the gold price and the drop in the oil price.

- GDP Calculation: To calculate our GDP, the economy is divided into ten subsectors. The GDP figure is the (weighted) average of growth recorded in the ten subsectors. The data from the subsectors reflects broad-based weakness in the economy. Seven (70%) of the subsectors contracted. Load-shedding was the big culprit, causing a moderate drop in inventories of R11 billion. Only three (30%) of the subsectors recorded real growth.

- Two subsectors recorded double-digit contraction: Agriculture contracted 13.2% and mining contracted 10.8% in 2019 Q2. These are vital sectors of our economy. Food security is vital. Mining exports are a major earner of the foreign exchange we need to repay our debts. The news caused the Rand to drop >3%.

- How can the downturn be turned around? The Treasury and investors need lower interest rates. Investors need a business-friendly government and regulations - less Red Tape, more Red Carpets. We need strong leadership. Ramaphosa has said he will introduce performance measurement for his cabinet.

- Crime and Corruption: A priority is to eradicate our widespread crime and corruption. In agriculture we have farm attacks and farm invasions. In construction the Construction Mafia has stopped projects worth billions. In transport there are attacks on truckers. Truckers have been advised by the police to avoid travelling at night. Schools are subject to gangsterism. In hospitals doctors are attacked. Gangsters have gang fights in court buildings. There are daily protest actions, with roads being blocked. This must stop. The police must create a safe environment for everybody.

- We believe Ramaphosa and his team have the capacity to govern SA out of this mess. He is not impulsive. He consults widely – he moves slowly, but with discipline. In the fable of the race between the tortoise and the hare, Ramaphosa would be the tortoise, who won the race. Ramaphosa has had a successful career spanning several disciplines. He built up the NUM, the most powerful trade union in SA. The son of a policeman, he qualified as a lawyer. In business he made a fortune. He is the wealthiest president we have ever had – probably wealthier than all the others put together. Ramaphosa has put capable people in charge of the National Prosecuting Agency (Shamila Batohi) and SARS (Edward Kieswetter). Can he make South Africa Great Again? Time is running out. It is going to be an interesting year!

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