OVERBERG MARKET REPORT

Tuesday 12th March 2019

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- South Africa's GDP grew in 2018 by a tepid 0.80%. The JSE did even worse – it lost 11.8% in 2018. There were valid excuses to justify this poor performance. We have had serious droughts and Eskom let us down. Money and highly skilled people are leaving South Africa. We need a catalyst or two to turn this trend around. Is it possible to turn it around?

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- GDP growth came in higher than expected for the fourth quarter (Q4) of 2018 at 1.4%, compared to the consensus forecast of 1.2%. The 1.2% growth for Q4 brings the full year GDP growth figure for 2018 to 0.8%. Although the expectation for GDP growth in 2018 was generally pessimistic the fact that South Africa came out of 2018, which had a technical recession, with positive growth of 0.80% is reason to be a bit more positive about where the country is heading. The most significant changes in Q4, affecting GDP growth, were the positive increase in international trade and the negative drop in the inventories of mostly mining and manufacturing. Inventories dropped by R 54 billion in Q4 dragging down overall Q4 growth by a massive 8.7 percentage points (%pts). This decline was fortunately nullified by the positive international trade that resulted from a 11% jump in exports and a 16% decline in imports during Q4. The positive jump in exports was mainly due to increased trade in precious metals, mineral products, vehicles and transport equipment, and the decline in imports mainly due to lower demand for machinery, electrical equipment and mineral products. Besides the massive contributions to Q4 GDP from the above-mentioned items, the economy continues to be driven by consumption and not by investment. Gross fixed capital formation decreased by 2.5%, its fourth consecutive decline, while final household consumption expenditure expanded by 2%. The main contributors to the decline were machinery and other equipment, residential buildings and construction works. As with the 2018 Q4 GDP growth, the current account deficit figure came in better than expected. The current account to GDP deficit declined by 1.3% quarter-on-quarter, from 3.5% in Q3 to 2.2% in Q4. This decline was the result of higher exports and lower imports during the quarter. For the full year, the deficit on the current account widened to 3.5% of GDP from 2.7% in 2017.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Werner Erasmus

- The RMB/BER Business Confidence Index (BCI): Due Wednesday 13th March. The BCI is the unweighted mean of five sectoral indices, namely manufactures, building contractors, retailers, wholesalers and new vehicle dealers. The BCI in the fourth quarter (Q4) of 2018 declined to 31 points from the Q3 measurement of 34. The BCI will provide some insight into the state of the economy for 2019 Q1 and is expected to remain more or less the same.

- Mining production and sales for January 2019: Due Thursday 14th March. Mining production decreased by 4.8% year-on-year for 2018 with gold being the main contributor to this contraction. Bloomberg consensus predicts a further fall of 3.5% in January 2019. The main culprits are the electricity-supply shortage as well as the uncertainty created by the potential electricity price increases. Furthermore, the mining outlook is supressed because of factors such as weakened global commodity demand and low commodity prices.

- Manufacturing production and sales for January 2019: Due Thursday 14th March. Bloomberg consensus predicts a growth of 0.8% year-on-year for January 2019 mainly because of a rebound from December which is common for consumers in January.

GLOBAL

Contributed by Nick Downing

- In its latest quarterly report, the Organisation for Economic Cooperation and Development (OECD) cut its 2019 forecast for global GDP growth to 3.3% from 3.5% in November. While all major regions were downgraded, the main casualty was the Eurozone where the growth forecast was cut from 1.8% to 1.0%. A recession is forecast in Italy and growth of just 0.7% in Germany, the Eurozone's largest economy. The US growth forecast was cut from 2.7% to 2.6% and China's from 6.3% to 6.2%, a steep decline from the 6.6% growth recorded in 2018. The OECD attributes the global slowdown to policy uncertainty, China's slowdown and the trade conflict. OECD chief economist Laurence Boon warned that an abrupt slowdown to global growth could exacerbate policy uncertainty and further impact consumer and business confidence. She urged a "sense of urgency" for the Eurozone, recommending coordinated fiscal stimulus comprising increased government spending and tax cuts in less indebted countries. Central banks around the world appear to have heeded the loss in global economic momentum, following the Federal Reserve's about-turn on monetary policy tightening. The ECB, Bank of England, Bank of Australia and Reserve Bank of India have all turned "dovish" in their outlook, indicating a reversal in policy. According to J.P.Morgan's chief economist, Bruce Kasman: "We're clearly seeing a dovish tilt that is broadening out."

NORTH AMERICA

Contributed by Nick Downing

- Federal Reserve chairman Jerome Powell cautioned that: "What's happened in the last 90 or so days is that we've seen increasing evidence of the global economy slowing down." He cited the slowdown in China and the Eurozone as posing the greatest risks to the US economy. Meanwhile, Dallas Federal Reserve Bank president expressed concern over the rising level of debt on non-financial US company balance sheets, which has risen over the past ten years from $2.2 trillion to $5.7 trillion: "An elevated level of corporate debt, along with the high level of US government debt, is likely to mean that the US economy is much more interest rate sensitive than it has been historically."

- Non-farm payrolls increased in February by just 20,000 its lowest since September 2017 and a far cry from the 311,000 created in January. However, economists and analysts are sceptical that the data marks the start of a slowdown in jobs growth. If anything, the low payroll number may be due to the tight labour market, as suggested by wages which increased by 3.4% year-on-year its fastest pace since April 2009. The National Federation of Independent Businesses reported that an elevated 37% of companies have job vacancies they are unable to fill. Meanwhile, the unemployment rate dropped from 4.0% to 3.8%. The Fed will likely wait for the March payroll data before drawing any conclusions which may affect monetary policy. A rebound from February's depressed payroll figure towards the rolling three-month average of 186,000 is likely.

- Productivity, measured as the amount of output per hour of non-farm work, increased in the fourth quarter (Q4) at an annual rate of 1.9% up from 1.8% in Q3. While productivity increased in 2018 by a modest 1.3% albeit better than the 1.1% recorded in 2017, there are encouraging signs of a sustainable pick-up. In the nine months to end December, productivity increased at an average annual pace of 2.2% the strongest productivity improvement since 2010 when it surged by 3.4%. The recent pick-up in productivity is attributed to the tightening labour market, which is encouraging companies to increase investment in plant, machinery and automation. Productivity is essential to lifting the potential growth rate of the economy, without which the growth rate would be capped by the rate of expansion of the labour force. In addition, higher productivity facilitates non-inflationary wage growth.

- The Institute for Supply Management (ISM) non-manufacturing purchasing managers' index (PMI), which measures conditions in the services sectors of the economy, accounting for the bulk of US GDP, increased in February by the most in a year. The services PMI surged from 56.7 to 59.7 led higher by the business activity and new orders sub-indices, both recording their highest levels since 2006. The forward-looking new orders index increased from 57.7 to 65.2, signalling solid business conditions in coming months. While the employment index slipped from 57.8 to 55.2 the prices index also fell from 59.4 to 54.4 indicative of easing inflationary pressure. The rebound in the PMI bodes well for US GDP growth in the second quarter. According to Anthony Nieves, head of the ISM survey: "Overall things look pretty good going forward, and this positive feedback was coming even before the good news on the trade negotiations."

- Despite increased US trade restrictions, the trade deficit in goods and services surged in December by 18.8% month-on-month to $59.8 billion the largest monthly deficit since October 2008. Imports increased by 2.1% while exports fell by 1.9%. In 2018, the trade deficit registered $621 billion the largest since 2008, up 12.5% from $552 billion in 2017, as exports grew 6.3% on the year and imports grew 7.5%. The goods trade deficit increased to a record $891 billion, with China accounting for almost half at $419 billion up 12% from $375 billion in 2017. The trade data is in stark contrast with President Trump's campaign promises of fixing the economy's trade imbalance, denting his credibility in the run-up to the 2020 presidential elections. The trade balance surged irrespective of trade tariff increases, due to the boost to US domestic demand from tax cuts and increased government spending at the same time that global demand was falling. Kenneth Rogoff, Harvard professor and former IMF chief economist observed that: "Policies that play around at the margins with tariffs are always going to get swamped by macroeconomic factors."

- According to the Federal Reserve's fourth quarter (Q4) Flow of Funds report, household net worth fell in Q4 by 3.5% quarter-on-quarter marking the biggest percentage decline since Q4 2008. The main culprit was the sharp year-end retreat in equity markets causing household net worth to decline by $3.7 trillion over the quarter to $104.3 trillion. As would be expected amid rising pressure on household finances, the savings rate increased slightly from 6.4% to 6.7% between Q3 and Q4. Encouragingly, the increase in non-financial corporate debt, which is increasingly being flagged as a potential risk to the economy, slowed in 2018 to 3.7% from 5.7% in 2017. However, growth in federal government debt accelerated to 7.6% from 3.7% the previous year. Although non-financial corporate and federal government debt remain a growing concern, the outlook for Q1 2019 bodes well for household net worth, which should benefit from the "V" shaped recovery in equity markets.

CHINA

Contributed by Nick Downing

- China's exports slumped in February by 20.7% year-on-year the steepest decline since February 2016, resulting from a combination of punitive trade tariffs and slowing global demand. Symptomatic of slowing domestic demand, China's imports also fell by 5.2% on the year. As a result, China's trade surplus fell sharply from $39.2 Billion in January to just $4.1

billion in February. Analysts point out the distorting effect on trade of the Lunar New Year holiday. However, combining January and February data to iron out the holiday effect, also makes for bleak trade data, showing year-on-year declines of 4.6% in exports and 3.1% in imports. Over the two months, exports to the US fell by an accentuated 14.6% while imports declined a massive 35%. Trade volumes should pick-up in the second half of 2019, helped by the expected resolution of the trade dispute with the US and with fiscal and monetary stimulus boosting Chinese domestic demand.

- At the opening of China's National People's Congress premier Li Keqiang lowered the country's GDP growth target for 2019 to a range of 6.0-6.5% down from a fixed 6.5% target over the past two years, providing authorities with a more flexible framework. While cautioning that there would not be the same scale of economic stimulus measures as in previous slowdowns, several fiscal measures were nonetheless announced at the Congress. The Ministry of Finance announced an increase in the budget deficit target from 2.6% in 2018 to 2.8% in 2019, significant cuts to VAT rates worth an estimated $120 billion and an increase of around $120 billion in the value of local government bond issues to be used for the infrastructure investment. At the same time, the steady easing in monetary policy over the past few months appears finally to be feeding through into increased credit extension. Total social financing, which combines bank credit and non-bank shadow funding, increased in January to a record high, indicating that the prolonged period of deleveraging may be over. The 26% year-to-date rise in China's Shanghai and Shenzhen CSI 300 equity index suggests China's economy has already bottomed-out and is set to recover momentum in 2019.

JAPAN

Contributed by Carel la Cock

- The Economy Watchers Survey conducted by the Cabinet Office of Japan, has shown that sentiment in February for current conditions has risen by 1.9 points to 47.5. Despite the first increase in three months, the figure was still below the key 50 level mark. Respondents to the survey, who hold jobs most sensitive to economic conditions, thought the economy will be weaker in two to three months driven by a slowing in the eating and drinking services. The outlook index was down 0.5 point to 48.9, however the Cabinet Office raised its overall economic outlook stating, "a moderate recovery continues" and "there are expectations for (higher sales and businesses) linked to the era name change and the planned holidays (from April 27 to May 6)."

EUROPE

Contributed by Carel la Cock

- The IHS Markit Eurozone Composite purchasing managers index in February showed a modest improvement of 0.9 to 51.9 and remains above the key 50 level mark. Ireland, Spain and Germany were highest ranked with readings of 55.4, 53.5 and 52.8 respectively. The divergence between manufacturing and services remains with the latter improving modestly compared to January. Chris Williamson, Chief Business Economist at IHS Markit added "Measured overall, the survey shows the quarterly rate of GDP growth picking up to 0.2% in February from 0.1% in January, meaning the first quarter could see the eurozone economy struggle to beat the 0.2% expansion seen in the fourth quarter of last year."

- The European Central Bank (ECB) has forecast that GDP in the Eurozone will grow by 1.1%, 1.6% and 1.5% year-on-year in 2019, 2020 and 2021 respectively. The figures were revised downwards from its previous prediction in December by 50 and 10 basis points (bps) for 2019 and 2020 respectively. ECB president Mario Draghi blamed weak economic data across the union in the last few months highlighting the manufacturing sector, but also geopolitical risks across the globe. The inflation forecast was also eased by as much as 40 bps for 2019 to 1.2%. Given the outlook the ECB has left interest rates unchanged and has pledged to keep the benchmark lending rate at current levels for the remainder of the year. The ECB also offered banks increased longer-term loan facilities at discounted interest rates, which together with negative interest rates on deposits with the ECB, would encourage banks to lend more.

UNITED KINGDOM

Contributed by Carel la Cock

- UK productivity growth has increased and may be increasing at a faster pace than reflected by official data. Silvana Tenreyro, an external member of the Bank of England's policy committee (BoE), has recently stated that productivity gains between 2014 and 2018 has left the UK economy with spare capacity and that there is no need to hike interest rates. She believes that the growth in productivity is one reason why recent inflation figures have come in below expectations. It also goes some way in explaining the strong labour market and uptick in the UK fiscus despite weak inflation figures. She warns however that the decline in business investment, because of uncertainty surrounding Brexit, could put a damper on further gains. Productivity gains are important as they allow for higher wages and output without putting pressure on prices. If Ms Tenreyro is correct in her analysis, it could mean that the BoE could keep interest rates lower for longer.

- As the Brexit deadline of 29th March looms large, the following dates will be key in the coming fortnight. On the 12th March members of parliament (MPs) will vote again on Prime Minister Theresa May's Brexit deal. Indications are that she will fail again to pass the deal. To date she has failed to get the necessary concessions to reverse the colossal defeat in

January. Failing to pass her Brexit deal, MPs will then have the opportunity to vote on the 13th March to leave the European Union without a deal. Previous votes have shown little appetite for a no-deal Brexit which would likely lead to a vote on the 14th March on whether MPs want a "short limited extension to article 50". The extension could not last later than June, because it would lead to the UK's participation in the election of the new European Parliament. The next important date will be the EU summit on the 21st March which could be used to decide whether to grant the UK an extension to article 50 and for how long.

FAR EAST AND EMERGING MARKETS

Contributed by Carel la Cock

- When the US Federal Reserve (Fed) sets interest rates for the dollar, it determines the cost of money globally, because the US dollar is the world's reserve currency. When rates are hiked, the cost of money increases and investment declines followed by slower economic growth. The effect on emerging markets (EM) are two-fold; capital is withdrawn because the risk-adjusted rates of returns becomes less favourable, which usually leads to increases in local interest rates. The effect on local EM economies is that investment decreases and it becomes more expensive to roll over sovereign debt. Typically, a decline in commodity prices follows, which impacts countries that rely on commodity exports. José Antonio Gonzáles, former Minister of Finance of Mexico points out in an analysis for the Financial Times that a Fed rate hiking cycle has preceded all but two global economic crises since the 1930's. Although it seems the Fed has halted rates for the time being, the likelihood that the tightening cycle may continue poses a risk to EM countries. Mr Gonzáles proposes that EM countries need "to make sure the basic macroeconomic indicators are in order…..fiscal accounts need to be balanced……the current account should be close to equilibrium……monetary policy should be conservative……the financial sector must be well capitalised, liquid and not overly exposed". The message is clear: for those EM economies that do not have in place or adopt these more prudent macroeconomic policies the consequences could prove costly.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 5.39	55580
JSE Fini 15	- 0.11	16362
JSE Indi 25	+ 6.32	67708
JSE Resi 20	+ 10.02	45157

R/$	+ 0.10	14.34
R/€	+ 2.13	16.12
R/£	- 2.80	18.85
S&P 500	+ 11.03	2783
Nikkei	+ 5.55	21125
Hang Seng	+ 11.76	28503
FTSE 100	+ 5.98	7131
DAX	+ 9.32	11543
CAC 40	+ 11.31	5266
MSCI Emerging	+ 7.82	1041
MSCI World	+ 10.13	2075
Gold	+ 1.18	1296
Platinum	+ 2.70	815
Brent oil	+ 22.32	66.59

BOTTOM LINE

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- South Africa's GDP grew in 2018 by a tepid 0.80%. The JSE did even worse – it lost 11.8% in 2018. There were valid excuses to justify this poor performance. We have had serious droughts and Eskom let us down. Money and highly skilled people are leaving South Africa. We need a catalyst or two to turn this trend around. Is it possible? There are African countries that perform much better than South Africa. Ethiopia is expected to grow at a rate of 8.5% in 2019. The figure may be small, but it's powerful. It will take them only 9 years to double the size of their economy. For SA it will take 90 years to double our economy at the current growth rate. We live in the most industrialised country in Africa. Certainly, we are able to do much better.

- First, we need to stop the capital flight and disinvestment. We don't attract enough Fixed Direct Investment (FDI). Furthermore, the traditionally more reliable International Capital

Flows have turned negative. For many years, foreigners used to be net buyers of SA shares and government bonds. Since September 2013, foreigners have been net sellers of R450 billion worth of SA shares and government bonds. In addition, SA companies are sitting on a cash pile of around R1 trillion. They are not investing in SA. Evidence is that they rather invest offshore, often with disastrous results.

- Second, we need to stop the brain drain. A recent presentation by a bank revealed that emigration is ripping both our economy and our communities apart. It revealed that 33% of kids leaving private schools are doing so because of emigration. 33% of these kids are black. Even teachers are emigrating. The effect of the brain drain is that our GDP per capita is showing no growth. It has been flatlining since 2010. We have already fallen far behind the rest of the world.

- What drives this capital flight and brain drain? The main drivers are our unreliable electricity supply, water restrictions, our rigid labour laws, high tax rates and state capture, to list a few. Add to this many extra layers of taxes and levies, BBBEE, employment equity, corruption, poor services and many more. No red carpets, just lots of red tape. Who in his right mind would invest in this scenario?

- Enter pres. Cyril Ramaphosa. A watershed moment for SA. In October 2018 he held a successful inaugural investment conference. R300 billion has been pledged by major companies – the target is R1.5 trillion. Add to this the fact that SA companies have around R1 trillion ready to invest. Hundreds of thousands of jobs will be created.

- Ramaphosa is committed to turning SA's economy around. There are many positives that he can rely on. We have an excellent financial system. The JSE is one of the best stock exchanges in the world. SA stocks are the cheapest on record against emerging market peers. Ramaphosa has put measures in place to "get our house in order". Our cabinet looks better, he appointed key commissions of inquiry, he replaced several bad apples, for instance Shaun Abrahams with adv. Shamila Batohi. He has brought back the Scorpions. Total has discovered oil off the coast of Mossel Bay, we have a new mining charter. The rains came, the drought has been broken.

- Expropriation of property without compensation (EWC) – turning consumers into producers. Turning tenants into landowners. There are an estimated 22 million landless black people living on tribal land. Giving them ownership would be a gamechanger. If they can get ownership of the portion of the land they live on, and cultivate it to produce food, consumers will become producers. If applied correctly, EWC has the potential to be a strong economic driver.

- Ramaphosa is often criticised that he did nothing to stop Zuma's senseless destruction of our economy. Maybe he heeded the advice of that master strategist, Napoleon: "Never interrupt your enemy when he is making a mistake". It brought him the presidency. Should he win the 8th May 2019 elections by a safe margin, we are optimistic that the New Dawn is upon us. It could be our finest hour. We won't have to wait 90 years for the economy to double.

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