OVERBERG MARKET REPORT

Tuesday 13th October 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Nick Downing

- Despite Ramaphosa's increased authority and grip on power, he appears reluctant to implement structural economic reforms, which would be the answer to creating economic growth and jobs. We are shifting incrementally from our earlier optimistic stance, founded on Ramaphosa's New Dawn. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Following a sustained recovery since June, the South African Chamber of Commerce and Industry (SACCI) business confidence index declined slightly by 0.1 index points in September to 85.7 down from 85.8 in August. The further easing of the country's lockdown restrictions boosted manufacturing output, exports, and imports. On the other hand, a sustained decline in retail sales volumes, lower share prices on the JSE and less real credit to the private sector weighed on business confidence. The SACCI BCI, which gauges sentiment and forward-looking expectations of firms, provides insight into businesses' willingness to invest and incur capital expenditure. SACCI said South Africa's economy remains in a fragile situation and therefore the government should continue to pursue enabling policies that will encourage the business sector to fast track growth and employ people.

- South African factory output contracted for a fifteenth month in August even as coronavirus-lockdown measures were eased allowing activity to resume in the sector. Manufacturing production decreased by 10.8% year-on-year in August 2020. The largest detractors were the following divisions: motor vehicles, parts and accessories and other transport equipment (-30.6%); basic iron and steel, non-ferrous metal products, metal products and machinery (-11.7%), food and beverages (-6.8%); wood and wood products, paper, publishing and printing (-11.9%); and petroleum, chemical products, rubber and plastic products (-5.4%). Seasonally adjusted manufacturing production increased by 3.6% in August 2020 compared with July 2020. This followed month-on-month changes of 5.9% in July 2020 and 21.3% in June 2020. On a three-month basis ending August manufacturing production increased 20.7% when compared to the previous three months which shows an uptick in production as lockdown restrictions eased. Looking ahead, the manufacturing sector still faces several headwinds in the form of electricity supply and cost constraints, low domestic demand and declining global competitiveness. Should government reforms be realised, the longer-term growth outlook for the sector will improve.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Mining Production: Due Tuesday 13th October 2020. Mining production is expected to have contracted year-on-year for the sixth consecutive month in August, albeit at a slower pace as a result of the economy returning to normal activity levels with the easing of lockdown restrictions, the recovery in global manufacturing conditions and the recent increase in commodity prices. Consensus forecast is that mining production contracted 7.7% year-on-year and increased 3.4% month-on-month in August and is expected to remain weak for the remainder of 2020 although at much better levels than experienced at the height of the lockdown.
- Retail Sales: Due Wednesday 14th October 2020. Looser lockdown restrictions and the recommencing of alcohol sales during August are expected to result in an improvement in retails sales for the month. Expectations are that retail sales contracted 7% year-on-year and increased 1.9% month-on-month during August. The strong recovery in retail sales is however not expected to continue as consumers' discretionary income is under severe pressure due to the job losses recorded in the second quarter.

GLOBAL

Contributed by Nick Downing

- The IMF and World Bank are holding their annual meetings this week, in which they are expected to lower their forecasts for global economic contraction in 2020, premised on a stronger than expected recovery in manufacturing activity and global trade. The improving trade outlook is reflected in the WTO's forecast for this year's global trade. It now forecasts a contraction of 9.2%, a marked improvement from April's forecast of 12.9%. In August, the US registered its largest trade deficit on record, at $67.1 billion, indicative of a surge in domestic demand and imported goods. China meanwhile reported its August exports increased year-on-year by a solid 9.5%. However, the Brookings Institution warned that the global economic recovery was not broad-based. While manufacturing and trade were rebounding strongly, close quarter services such as hospitality and entertainment were being left behind in the two-speed economic recovery. The key culprits are uncertainty over Covid-related health risks and a growing reluctance by governments to provide fiscal support. In its analysis, the IMF stressed the benefits of fiscal support. According to its research, a 1% increase in public investment leads to a 10% increase in private sector investment. In separate research, the IMF found that voluntary social distancing related to Covid-health risks have as big an impact on economic activity as government-imposed lockdowns. The IMF's findings support the case that fiscal stimulus packages and positive vaccine news would provide positive catalysts for economic activity and equity markets.

NORTH AMERICA

Contributed by Nick Downing

- In the space of just three days President Trump flipped from discontinuing bipartisan coronavirus relief negotiations, only to return with an augmented proposal of $1.8 trillion, closing the gap with the $2.2 trillion Democrat aid package. However, Democrat House Speaker Nancy Pelosi rejected the White House package as being insufficient. The White House is struggling to garner the full support of the Republican controlled Senate, which is concerned about excessive deficit spending. The Congressional Budget Office published its federal budget figures for Financial Year 2020, showing the budget deficit increased to $3.1 trillion from $984 billion in 2019, rising as a percentage of GDP to 15.2%, its highest since 1945. Meanwhile, federal debt has increased to 102% of GDP, exceeding the economy's annual economic output for the first time since World War 11. However, due to the sharp decline in Treasury bond yields, net interest charges were 20% lower than the prior year. Federal Reserve Chairman Jerome Powell gave his strongest urging yet of the necessity for additional fiscal support, observing the asymmetry between the risks of too little and too much support: "Too little support would lead to a weak recovery, creating unnecessary hardship … (while) Even if policy actions ultimately prove to be greater than needed, they will not go to waste." The Bank Credit Analyst expects Congress to finally settle on a $2 trillion Covid relief package, although Senate's current preoccupation with confirming Judge Amy Coney Barret to the Supreme Court before the presidential election, makes any imminent fiscal deal unlikely.

- The latest polls show Joe Biden as likely to win the presidential election on 3rd November. There is also a growing chance of a "blue wave", a clean Democrat sweep of all three institutions, the White House, Senate and House of Representatives. Financial markets are starting to price-in this outcome, for instance rewarding renewable energy versus fossil fuels, and selling longer-dated Treasury bonds in the expectation of greater fiscal spending by the Democrats. Biden has proposed increasing the corporate tax rate from 21% to 28%, which would impact earnings growth, but economists believe the negative effect would be compensated by stronger economic growth stemming from increased fiscal stimulus and lower trade tariffs. Although Biden says he will remain tough on China he will seek consensus from US allies in his trade negotiations, which should reduce the risk of a trade war. The yield curve, which measures the interest rate differential between short-term and longer-dated Treasury bonds and tends to steepen ahead of expected improvement in economic growth, has steepened sharply in recent weeks, as investors factor-in a Biden victory. A Biden victory spells out more stimulus spending and increased issue of new bonds on the market to finance the spending, which may reduce their appeal. Therefore, a Biden victory could simultaneously spur economic growth but also cause weakness in the dollar, a scenario which would champion the appeal of non-US equity markets and more cyclical value-sectors of the market such as industrial, material and financial sectors. The great rotation from technology and digitally enabled growth sectors, which have outperformed so strongly over the past year, into traditional value sectors could be a theme for investors in 2021, likely to be enhanced by a Biden win and a Democrat sweep.

- Minutes from the Federal Reserve's policy meeting on 15-16th September, the first since it changed its policy framework to Average Inflation Targeting, did not elaborate on its decision to leave the fed funds interest rate at zero until key macro-economic conditions are met. These conditions include the economy reaching full employment and inflation continuing to run moderately above 2% for some time but the Fed remained intentionally vague on what it meant by "full employment", "moderately above 2%" and "for some time". Keeping its terminology open to interpretation allows the Fed flexibility to alter course in the event of major economic or market shifts, such as the emergence of an asset bubble, prompted by prolonged ultra-low interest rates. The Fed stressed that it was not unconditionally committed to ultra-low interest rates. No change in policy is expected at the next policy setting meeting on 4-5th November, by which time the results of the 3rd November presidential election will only just be known. The Fed has upgraded its economic forecast, but this view is premised on additional fiscal support, while the minutes also cautioned against the risk of additional virus outbreaks.

- The Wall Street Journal (WSJ) economists' survey conducted in the first week of October found that 73.2% of respondents believe the current presidential election is causing more economic uncertainty than usual in the election season. Economists cited election uncertainty, uncertainty over the pandemic and the lack of further fiscal support as the key reasons for the slowdown in the jobs market recovery. Compared with the WSJ survey in April, when more than half of respondents expected the jobs market to recover its pre-pandemic state by 2022, more than half now believe the full recovery will only be achieved in 2023. However, GDP is expected to recover more quickly, reaching its pre-pandemic level in 2021. The survey's average forecast predicts GDP will drop in 2020 by 3.6% and grow in 2021 by 3.7% and in 2022 by 3%. The slowing jobs recovery was illustrated by the past week's jobless benefit claims, which decreased modestly from 849,000 to 840,000 failing to meet the consensus forecast of 820,000. The claims figure has been stuck between 800-900,000 for the past five weeks, remaining well above its 2008/09 Global Financial Crisis peak of 695,000.

CHINA

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- During China's National Golden Week holiday from the 1-8th October domestic passenger traffic at Shanghai's airport jumped by 17% compared with the same period last year, confirming the country's solid economic recovery from the Covid pandemic. Positive anecdotal data emanating from Golden Week consumer spending powered the yuan to its strongest daily gain in 15 years when China's financial markets reopened on Friday 9th October. The yuan has been on a tear over the past four months helped by relatively high interest rates, the country's success in beating the pandemic and the rapid V-shaped economic recovery. China is the only major economy expected to post positive GDP growth in 2020. The yuan is likely to catch an extra boost if Joe Biden wins the US presidential election, given his more conciliatory approach to US/China trade relations. The yuan's rapid appreciation and potential for further gains prompted the People's Bank of China (PBOC) to reduce the deposit requirement on forward foreign exchange hedging from 20% to zero, which should slow the currency down. The PBOC's move illustrates its growing confidence in the currency's prospects. There has been a notable increase in cross border inflows into China's bond markets since the start of the year, which is likely to gather pace in 2021 when the country is admitted into major global bond indices. Some economists predict index inclusion could boost 2021 bond inflows by an additional $140 billion, providing even more support for the yuan.

EUROPE

Contributed by Carel la Cock

- The euro area unemployment rose for a fifth consecutive month from 6.5% in February at the start of the covid-19 pandemic to 8.1% in August. However, traditional measures fail to capture the reality on the ground. Europe's labour market slack, defined as unmet supply of paid labour, rose 1.2 percentage points to 14% amounting to 29.6 million people wanting to work. There has also been a significant shift in the number of discouraged workers. Economists estimate that unemployment could worsen by as much as 4.5 percentage points when many short-term workers become unemployed as furlough schemes end. Employment figures will be closely watched in the coming months and could hold the key in a consumer driven economic recovery. Encouragingly, retail volumes increased in August by 4.4% on the month and 3.7% year-on-year, reflecting further relaxation of lockdown measures. Belgium (+9.6%), France (+6.2%) and Germany (+3.1%) reported the largest month-on-month increases while Portugal (-1.4%) saw reversed fortunes. Non-food products and in particular internet orders were key drivers of higher volumes, highlighting the shift into online retailing.

UNITED KINGDOM

Contributed by Carel la Cock

- With two days left before UK prime minister Boris Johnson's deadline for a political deal, Brexit negotiations are still being fought without much progress on issues such as fishing and farming subsidies. Karen Ward, chief market strategist for Europe, Middle East and Africa at JPMorgan Asset Management, looks at the impact on the markets of a Brexit deal versus no deal in an opinion piece for the Financial Times. According to Ms Ward, a Brexit deal could lift sterling by 5% on a trade-weighted basis, while a "no-deal" could cause the currency to fall by 10%. There has long been an understanding that a weaker pound is positive for the FTSE100 as more than 70% of revenue earned from the index is from abroad, however Ms Ward warns that this is not always the case and that there are many more factors at play. Empiric evidence suggests that in the last decade the correlation between the two was closer to zero. Furthermore, although the impact of a no-deal will be more pronounced in the UK, it will undoubtedly also affect European activity and disrupt revenue streams from elsewhere in the world. For instance, the UK and Europe contributes 40% of revenue to FTSE100 companies, whereas North America adds 27% and developed Asia and emerging markets 30%. Ms Ward also points out that the FTSE100 has a disproportionally large weighting towards financial, energy and materials sectors, which could suffer in the event of a "no-deal" and the resultant impact on risk sentiment that will follow. Although it is expected the FTSE 250 which is more domestically focussed will underperformed the FTSE 100 in a no-deal event, JPMorgan Asset Management still believes in their base case of the two parties agreeing on a Brexit deal and that it is a good time to invest in the UK market.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- India announced plans to support the economy with a $10bn stimulus aimed at increasing capital expenditure, encouraging consumer expenditure, and helping ailing states. The Reserve Bank of India recently announced that gross domestic product is likely to contract by 9.5% during the current financial year ending in March, confirming the impact of the eclectic response to the covid-19 pandemic. Economists dismissed the new measures as inadequate arguing that they will do little to alleviate the impact on the economy, which contracted in the second quarter by 24% quarter-on-quarter annualised. Thus far the Indian government has been cautious to expand the fiscus and public debt fearing it might lead to a ratings downgrade. Although the government's plan to increase capital expenditure on infrastructure is a well-tested strategy, the 6% increase, or additional $3.4bn in this year's budget seems just too small to really make a significant impact. Economists agree that

India's government has done too little to revive the economy and that more stimulus is needed to get the economy back on track.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 2.68	55552
JSE Fini 15	- 35.89	10049
JSE Indi 25	+ 8.62	75278
JSE Resi 20	+ 11.30	54826
R/$	- 15.20	16.51
R/€	- 19.55	19.50
R/£	- 13.98	21.57
S&P 500	+ 9.39	3534
Nikkei	- 0.41	23558
Hang Seng	- 12.56	24649
FTSE 100	- 20.43	6001
DAX	- 0.83	13138
CAC 40	- 16.71	4979
MSCI Emerging	- 2.02	1137
MSCI World	+ 5.06	2477
Gold	+ 26.32	1925
Platinum	- 8.69	886
Brent oil	- 36.93	41.72

BOTTOM LINE

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- In the nine months to end September, the JSE All Share index lost 4.9%, which seems a modest loss, but this figure belies the tremendous volatility which took place along the way. Over the period, the Covid pandemic wreaked havoc on the economy and the markets. The second quarter (Q2) suffered the full brunt of the virus, with GDP dropping by an unprecedented 51% quarter-on-quarter annualised. While agriculture, fishing and forestry, deemed essential services, grew by 15.1%, the construction, manufacturing and mining sectors fell by 77%, 75% and 73%. Household consumption dropped 50% and gross fixed capital formation, which measures investment in the economy, collapsed by 60%.

- Incredibly, despite the carnage, the unemployment rate fell in Q2 from 30.1% to 23.3%, but this is only because 5.2 million people dropped out of the denominator, as they gave up looking for work. The number of payrolls in the country dropped by 2.2 million to 14.1 million, lifting the expanded definition of unemployment from 39.7% to 42%, the highest of any country in the world. Of the 14.1 million lucky enough to still have jobs, only 81% received salaries and of these 21% endured salary cuts. Unlike developed economies, which during Covid were awash with massive fiscal transfers of wealth to households and struggling businesses, massive liquidity expansion and credit growth, South Africa's Private Sector Credit Extension (PSCE) fell off a cliff. Even after lockdowns were eased, PSCE growth continued to decelerate, falling in August to 3.9% year-on-year down from 5.1% in July. The two main components, household and corporate credit growth, slowed from 3.2% to 3.0% and from 6.7% to 4.6%, constrained by rising joblessness, weak real income growth, a deterioration in credit standing, and a reluctance by banks to take on credit risk.

- With domestic demand collapsing, at least the trade balance turned into surplus, registering elevated back-to-back surpluses in July and August, of R37.9 billion and R38.9 billion, the latter being the second largest on record. In the year to end August, the trade surplus lifted to R134 billion, good news for the current account. Weak domestic demand also contributed to the benign inflation figures. Consumer price inflation slowed in August from 3.2% to 3.1% year-on-year, capping 21 straight months below the midpoint of the South African Reserve Bank's 3-6% target range. Emboldened by the relatively stable rand and the swift and aggressive policy easing by the world's central banks, the SARB cut the benchmark repo rate by a further 25 basis points at its July policy meeting. The repo rate has been cut by an accumulated 300 basis points since the start of the year to 3.5%. It is the lowest repo rate since its introduction in 1998, bringing the prime rate down to 7%.

- There have been other positive developments, notable in the recovery of business survey data. The ABSA manufacturing purchasing managers' index (PMI) ticked up in September from 57.3 to 58.3, the highest level since the data series began and its 5th straight month above the expansionary 50-level. The sub-index measuring expected business conditions in six months' time increased from 63.4 to 64.5, in contrast to the highly contractionary level of 27.3 recorded in April. The RMB/BER Business Confidence Index rallied from its all-time low of 5 in Q2 to 24 in Q3, although this is still disappointing, given that a fully satisfied business community would result in a score of 100. The FNB /BER Consumer Confidence

Index lifted off its 35 year low of -33 recorded in Q2 but only slightly, recording a score of -23 in Q3.

- A key victory against corruption was achieved at the National Executive Committee at the end of August, in which it was decreed that officials will automatically have to stand down from government posts and senior ANC positions if charged with corruption. Working closely together, the Hawks, NPA and SIU have made numerous corruption related arrests including those linked to the Bosasa scandal, with more imminent arrests relating to the VBS Mutual Bank scandal expected. Ramaphosa appears to be cementing his authority, which is once again lifting optimism that he may finally get serious about adopting and implementing urgently needed structural economic reforms.

- Despite considerable resistance from within the ANC, the government arranged a $3.4 billion loan from the IMF through its unconditional Rapid Financing Instrument. This could be a precursor of a formal budget support package from the IMF, which would come with onerous conditions and enforced structural reforms. In this eventuality the ANC would have no choice but to put its ideologies aside. Energy market reform has been encouraging. New electricity capacity of 14,000 MW was gazetted in September, comprising 2,000 of emergency power, which is likely to be gas powered, and 11,800 MW renewable energy, almost double the 6,000 of renewable capacity created since 2011. The new capacity will be sought from the private sector with bid documents to be issued in December.

- More broadly however, structural economic reforms still remain conspicuously absent despite assurances given at the Nedlac meeting. There was no mention made at the Nedlac meeting of state-owned enterprise (SOE) reforms and to much dismay, a further R10.4 billion was earmarked for the business rescue of SAA over and above the R16 billion allocated to the failed airline in February's budget. The reluctance to let go of SAA despite all the obvious benefits speaks volumes of the political and ideological resistance within the ANC to structural economic reforms. It was hoped that the Covid crisis would engender greater urgency in economic reforms, given the country's rapid fiscal deterioration. Finance Minister Tito Mboweni projected a 6.8% budget deficit in the 2021 financial year. The revised figure is 14.6%. According to the National Treasury's projection, the debt to GDP ratio is expected to rise from 65.6% in February this year to a peak of 87.4% in FY 2024 but this may be too optimistic as it is premised on public sector wage cuts, cuts in support for state-owned enterprises, and cuts in social benefits. Without Mboweni's firm hand on budgeted expenditure and without growth enhancing reforms, the debt to GDP may surge irretrievably to 140% by FY 2024.

- Despite Ramaphosa's increased authority and grip on power, he appears reluctant to implement structural economic reforms, which would be the answer to creating economic growth and jobs. We are shifting incrementally from our earlier optimistic stance, founded on Ramaphosa's New Dawn. While there are still pockets of exceptionally well managed companies in South Africa, linked to solid investment opportunities, domestic investors should increasingly take refuge in global equity markets, both to diversify risk and to capture the better earnings potential in the world economy. Investors may consider exceeding the prudential investment guideline of 30% allocation to overseas investments. In local portfolios, there should be an increased emphasis and weighting to multinational dual listed and rand hedge shares.

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