OVERBERG MARKET REPORT

Tuesday 14th July 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Kirk Swart

- On Friday the 10th of July 2020, the ANC released its framework for the reconstruction of the South African economy following the Covid-19 pandemic. The document named "Reconstruction, Growth and Transformation: Building a New, Inclusive Economy" is merely a discussion piece with none of its recommendations being binding. However, it does give some insight on how the ANC plans to grow the South African economy post Covid-19. The document follows the presentation by Enoch Godongwana, the head of the Economic Transformation Committee (ETC), on the 22nd of May 2020 titled "Economic Reconstruction". Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The FNB/BER Consumer Confidence Index plummeted from an already depressed levels of -9 in the first quarter of 2020 to an appalling -33 during the second quarter. This reading is 3 points shy of its all-time low, recorded 35 years ago in 1985, a year that was marked by a violent protest, a partial state of emergency, PW Botha's Rubicon speech and a national debt crisis. The collapsing consumer confidence index mirrors that of business confidence, which fell to its lowest level on record in the second quarter. The overall decline in consumer sentiment was attributed in particular to sub-indices measuring the economic outlook, household finances and the time-to-buy durable goods. The economic outlook sub-index slumped to -21 from -16 and the household financial outlook sub-index fell to -13 from +14. That means most households across all income groups expect their finances to deteriorate over the next 12 months. The time-to-buy durable goods sub-index, measuring the appropriate time to buy durable goods, plunged to a record low -64, signalling an "extreme wariness" by consumers to purchase vehicles, furniture, and household appliances. Given the uncertain outlook for the economy and intense pressure on household budgets, the retail sector, especially durable goods retailers, face a long and difficult road to recovery. On the other hand, sales of necessities including food, pharmaceuticals and toiletries are likely to hold up in the near term.

- Manufacturing production slumped by 49.4% year-on-year in April, the deepest decline since the series began. The April print marks the 11th consecutive month that manufacturing output declined. The staggering decline comes on the back of the level-5 lockdown that was implemented nationwide during April which brought most of the sector to a near standstill. Declines were evident across the board, across the various sub-sectors - basic iron and steel industry production fell by 65.4%, the production of petroleum, chemical products and rubber and plastic products shrank by 41.5%, and motor vehicle production dropped by 98%. The production of wood, wood products and paper declined by 49.2%. In comparison, the decline in food and beverage production was tamer, at 19.4%. Seasonally adjusted manufacturing production decreased by 16.9% in the three months ended April 2020 compared with the previous three months. All ten manufacturing divisions reported negative growth rates over this period. Manufacturing production is also anticipated to show year-on-year declines in May as the country remained under level 4 locked down, although a general recovery is expected in June as lockdowns were eased and businesses returned to work. However, it is expected that the recovery in the sector to pre-Covid 19 levels will take some time, due to the severe capacity destruction resulting from the nationwide lockdown. Load shedding, weak domestic demand, low global competitiveness, and Covid-19 induced interruptions will continue to constrain manufacturing output in the sector in the short to medium term.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Mining Production: Due Tuesday 14th July 2020. After mining production plunged 47.3% year-on-year in April, recording the largest decline on record, overall output is expected to have continued contracting in May, albeit at a decelerated pace. A slight rebound is expected as lockdown measures eased and miners were allowed to scale up operational capacity, although external demand and capacity utilisation rates remained weak. Consensus forecast is that mining production contracted 35% year-on-year and 28% month-on-month, compared with respective figures of 47.3% and 34.1% in April.

- Consumer Price Index: Due Wednesday 15th July 2020. Following a sharp decline in consumer price inflation (CPI) in May, it is expected to have dropped further in June breaching the lower bound of the South Africa Reserve Bank's target range of 3-6%. The expected fall is attributed to the R1.74/l reduction in the petrol price at the start of May. Consensus forecast is that CPI fell to 2.2% year-on-year down from 3% in April. Core CPI is however expected to have remained stable at 3.3%.

- The South African Chamber of Commerce and Industry Business Confidence: Due Wednesday 15th July 2020. After the South African Chamber of Commerce and Industry (SACCI) Business Confidence Index (BCI) sank in April to the lowest reading since the series began in January 1985, it is expected to have recovered slightly in May with an easing in lockdown restrictions. Consensus forecast is that the BCI recovered to 80 in May up from 77.8 recorded in April.

- Producer Price Index: Due Thursday 16th July 2020. The producer price index (PPI) is expected to have continued on the downward trajectory it has been on since the start of 2020 with consensus forecast expecting a drop to -0.1% year-on-year in May down from 1.2% recorded in April. The expected decline is attributed to the fall in the petrol price during the month.

GLOBAL

Contributed by Nick Downing

- The Organisation for Economic Cooperation and Development warned that global employment levels would not return to pre-pandemic levels by the end of 2021. Its forecasts comprised two scenarios, one with and the other without a second wave of infections. Assuming a second wave of Covid-19, global unemployment is expected to rise to 12.6% by end 2020, falling to 8.9% by end 2021. If a second wave can be avoided the figures improve to 9.4% and 7.7%, respectively. The "second wave" US forecasts for end 2020 and 2021 are 12.9% and 11.5% and 11.3% and 8.5% if that scenario is avoided. The difference between the US and Europe is striking, explained by the relative inflexibility of European labour markets. In the base scenario forecast, unemployment in the US is expected to be 7.6% higher by the end of this year compared with end 2019, whereas the increases in Germany and France are relatively mild at 1.4% and 2.5%. The OECD warned governments not to let-up in their fiscal support of labour markets, warning that complacency runs the "risk of a second wave, not of the virus, but of unemployment." At the same time, the OECD recommended that furlough schemes should be wound down in economic sectors which have no medium- or long-term future, and to let "market forces play a role."

NORTH AMERICA

Contributed by Nick Downing

- Amid daily records of new Covid-19 infections and further restrictions in some of the worst hit states, including California, Texas and Florida, some Federal Reserve officials have warned that the economic recovery may be losing momentum. Federal Reserve Vice Chairman Richard Clarida cautioned that "as we've said many times, ultimately, the course of the economy is going to depend on the course of the virus, and we're following it very closely." While infection rates are rising to new records, the positive news is that the mortality rate is declining, which suggests the virus is being managed better or that younger less vulnerable people are getting infected. Declining mortality should reduce voluntary social distancing. Nonetheless, Raphael Bostic, president of the Federal Reserve Bank of Atlanta observed that "there are a couple of things that we are seeing and some of them are troubling and might suggest that the trajectory of this recovery is going to be a bit bumpier than it might otherwise." Randal Quarles, Fed chairman of the Financial Stability Board cited the potential for increased financial risks, warning that the pandemic will "inevitably involve an increase in nonperforming loans and provisions as demand falls and some borrowers fail."

- With the rapidly approaching expiry of enhanced unemployment benefit payments of $600 per week on 31st July, and no new fiscal stimulus yet tabled, some economists are concerned that the US is heading for a fiscal cliff. The Senate is now on recess, and only returning to business on 20th July, which leaves little time to agree on a supplementary fiscal package. However, Treasury Secretary Steven Mnuchin offered reassurance that "it will be our priority to make sure between the 20th and the end of the month that we pass the next legislation." The Democrat proposal for a $3.5 trillion package is likely to be watered down by Republicans to around $1 trillion, due to lower enthusiasm for state government aid, especially for states which have been poorly administered. The White House is proposing that the annual income threshold for the once-off $1200 economic impact payment to individuals made in April, is reduced from $70,000 to $40,000. In addition, the administration is proposing that the $600 per month enhanced unemployment benefit payment is reduced so that it matches rather than exceeds individuals' prior earnings, while also focussing on worst-hit industries. Although the fiscal package is likely to be less generous than the CARES Act signed into law in March, the impact is nonetheless expected to be substantial.

- The monthly Wall Street Journal survey of economists found that optimism over the economic recovery is gradually improving. Economists now expect GDP to contract in the second quarter (Q2) at an annual pace of 31.9% and to grow in Q3 by 15.2% better than last month's respective consensus forecasts of 33.5% and 14.2%. Similarly, the forecast for year-end unemployment has reduced from 9.6% to 9.1%. The increasingly optimistic outlook is reflected in an upbeat consensus forecast for company earnings. Earnings of companies making up the S&P 500 Index are expected to fall by 21.5% in 2020 but rise sharply in 2021 by 28.2%. Some analysts are wary of "V" shaped earnings recovery forecasts, citing uncertainty over successful containment of the virus and the potential for corporate tax increases under a Joe Biden presidency. The bond market emitted a gentle warning this week that the economic and earnings recovery may not be as smooth as some are predicting. At the latest Treasury bond auction, the 10-year yield fell to 0.605% its lowest since end April, while bids amounted to 2.62 times the amount of bonds sold compared with a ratio of 2.26 at the last auction. Investors favour bonds when economic uncertainty rises.

CHINA

Contributed by Nick Downing

- The CSI 300 Shanghai and Shenzhen Index gained 16.5% in the eight trading days to 9th July, its biggest 8-day increase since May 2008, lifting its gains for the year-to-date to 12.5%, making it one of the best performing indices in 2020. The market is being powered by better than expected economic data and the benefits of China's uncompromising approach to the Covid-19 pandemic. According to China's Association of Automobile Manufacturers, new vehicle sales and production increased in June on a year-on-year basis by 11.6% and 22.5%. While passenger vehicle sales increased by 1.8%, sales of commercial vehicles surged by 63%. Meanwhile, industrial company earnings grew in May by a solid 6% year-on-year. Bank lending is also recovering strongly, rising to its highest level in three months in June, helped by the combination of easing monetary policy settings and increasing credit demand. Despite growing evidence of a "V" shaped economic recovery, some analysts are concerned that the equity market is becoming increasingly speculative, as illustrated by the surge in margin lending. Margin lending has grown to its highest level in 5 years, although is still at 40% of its previous peak in 2015, suggesting capacity for further growth. Foreigners are also powering the China stock market boom, evidenced by the yuan regaining the key Y/$7.0 level for the first time since March. Adding to the economic recovery foreign investors also maintain that a potential Joe Biden presidency would be more constructive to US/China relations.

JAPAN

Contributed by Carel La Cock

- Japan's latest Economy Watchers Survey results showed a marked improvement in economic activity in June compared to May. The survey conducted at the end of each month asks 2,050 participants who work in industries that allow them to observe developments in key economic areas, their assessment of current economic conditions and expectation of future conditions. The June diffusion index for current economic conditions went up from 15.5 in May to 38.8 in June, reflecting the pickup in eating and drinking services as well as retail sales and general services. This followed the lifting of the state of emergency on the 25th May. The three-month outlook has also improved for a second consecutive month from 36.5 in May to 44.0 in June. The Cabinet Office upgraded its overall economic assessment saying, "Severity caused by the coronavirus continues but sentiment showed a sign of recovering. Looking ahead, there is concern over development of infectious disease, but improvement is likely to continue."

EUROPE

Contributed by Carel La Cock

- The eurozone is likely to experience a divergence in economic recovery with contrasting fortunes between consumer spending and industrial production as well as along geographical lines. Retails sales for May surprised on the upside, recovering to near last year’s levels. Germany, Denmark and the Netherlands saw a V-shaped recovery in retail sales whereas France, Spain and Italy are still below retail sales volumes of last year. Although retail spending is only a small part of household consumer spend, it is a reliable barometer of the financial health of households and an indication of the trajectory of the economic recovery. Government initiatives have been successful in supporting households and there is evidence of pent-up demand in some regions. However, the real test will come when furlough schemes end, and businesses must stand on their own again. Industrial production remains well below levels seen last year and although there has been a rebound in May it has not offset the fall in April at the height of preventative measures. Export dependent nations, such as Germany and France have seen a marked decline in the value of exports, down by 35% and 40% from last year. Many of Europe’s major trading partners still had some form of lockdown in place during May and although these measures might have been lifted during June, it is expected that demand will remain weak in the coming months. ECB president, Christine Lagarde warned that export dependent nations will have to think how they can diversify their economies because there will be a lasting impact on global trade from the covid-19 pandemic. Countries highly dependent on tourism such as Italy and Spain have seen a slow recovery from the pandemic and the ECB has revised its economic growth forecasts down for those nations. It is hoped that the ECB’s €750bn recovery fund and the ECB’s pandemic emergency programme will help to narrow the divergence in economic recovery although the two paced recovery trajectories are becoming ever more evident along a northern and southern divide.

UNITED KINGDOM

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- The IHS Markit UK Business Outlook, a survey of participants in the manufacturing and services sectors, revealed that in June 40% of participants expected an expansion in business activity compared to 46% in February. Although the figure remains well above the neutral zero level, indications are that there will be a decrease in staffing numbers in the coming months as furlough schemes come to an end. Capital spending and research and development budgets will be cut back and firms are also planning pay freezes for the coming year. The survey was concluded prior to UK chancellor of the exchequer, Rishi Sunak's summer statement in which he revealed further measures to ease pressure on businesses to reduce staffing and announced a further £30bn for job support. The additional support to the economy will see the total covid-19 support since March increase to £189bn and the UK's budget deficit for the financial year rise to £350bn or 18% of national income. Of the measures announced, the most significant is the £1,000 per re-employed furloughed staff for businesses which could cost the treasury as much as £9bn if all furloughed workers are brought back. The chancellor also aims to reignite the tourism and entertainment sectors by reducing VAT in those sectors from 20% to 15% for the next six months and subsidising patrons eating out in a scheme dubbed "eat out to help out". Furthermore, the threshold on stamp duty has been raised from £125,000 to £500,000 and a "kick-starter" work creation scheme to alleviate unemployment amongst young people was announced. The measures were well received by the business community although opposition parties have warned about the mounting debt burden caused by the pandemic. The response to the pandemic by developed nations has been in stark contrast to developing nations, highlighting the importance of fiscal prudence during the good times. The UK government's jobs support, if successful after the furlough scheme ends, will prove to be vital in getting the economy back on track.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- Google, the US tech giant has unveiled plans to invest $10bn in India in the next five to seven years following a meeting with prime minister Narendra Modi this week. Google follows Amazon and Facebook which have pledged investments in India in recent months in a bid to expand in a country with a population of 1.3bn. India, the second-largest mobile market in the world, represents a big opportunity for US tech firms and the escalating tensions following border clashes has given them an advantage over Chinese rivals such as Tencent and Alibaba. Google Pay, the digital payment facility has been a great success in India since its launch in 2017 and increasing its footprint in the country has become ever more important after being shutout in China. Google is also investing in Africa through a subsidiary named Loon and recently launch a pilot project which uses balloons to provide 4G internet access to remote areas in Kenya. The internet balloons, which float twelve miles above earth and out of reach of commercial airlines, are solar powered and autonomously navigate airstreams using algorithms to remain in place. The project in Kenya will test if internet balloons can be more cost effective than digging cables in remote areas and will likely lead to a change in how people are connected in remote African regions. Currently just over 25% of the sub-Saharan population has access to internet and data cost remains a debilitating factor. Providing affordable internet access to the rest of Africa could prove very profitable to US tech firms.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 1.55	56199
JSE Fini 15	- 31.72	10703
JSE Indi 25	+ 10.98	76910
JSE Resi 20	+ 8.26	53327
R/$	- 16.93	16.85
R/€	- 19.12	17.93
R/£	- 12.30	21.16
S&P 500	- 2.34	3155
Nikkei	- 3.69	22784
Hang Seng	- 8.58	25772
FTSE 100	- 18.11	6176
DAX	- 3.39	12799
CAC 40	- 15.42	5056
MSCI Emerging	- 3.88	1071
MSCI World	- 4.44	2253
Gold	+ 18.36	1804
Platinum	- 13.74	838
Brent oil	- 34.63	43.24

BOTTOM LINE

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- On Friday the 10th of July 2020, the ANC released its framework for the reconstruction of the South African economy following the Covid-19 pandemic. The document named "Reconstruction, Growth and Transformation: Building a New, Inclusive Economy" is merely a discussion piece with none of its recommendations being binding. However, it does give some insight on how the ANC plans to grow the South African economy post Covid-19. The document follows the presentation by Enoch Godongwana, the head of the Economic Transformation Committee (ETC), on the 22nd of May 2020 titled "Economic Reconstruction".

- The document focuses mainly on the plan to kickstart the South African economy through infrastructure development projects. Infrastructure projects have repeatedly been referred to by Cyril Ramaphosa as a good way to get lower skilled workers economically active. If these projects are managed properly, they can be a much-needed catalyst to kickstart an economic recovery. There are some good ideas such as infrastructure investments in energy, water, roads, technology, and digital infrastructure. It highlights where South Africa`s problems lie and how infrastructure can help to alleviate some of these issues. The goal of the document is to show the path to economic growth and job creation.

- Unfortunately, the ideas and concepts on how to get there are nothing new. Similar plans, with similar sounding names, have been presented many times since 1994 - most recently in the Reconstruction and Development Plan (RDP) and the National Development Plan (NDP). In fact, there are a plethora of ANC economic policy documents that all capture a similar stance on economic development and social construct. Without implementation, supported by a timeline for implementation, the best plans mean nothing. Action is important - we need to get boots on the ground.

- Although the document is more benign in terms of government`s role in the economy than the presentation by Godongwana on the 22nd of May 2020, it is still deeply rooted in ideology. An ideology that is based along the lines of a developmental state, with substantial "government guidance" to achieve economic equality. This stands in stark contrast to the deregulation of the economy and improving the ease of doing business promoted by Tito Mboweni. On the face of it, it seems that Godongwana did not consult Mboweni. Almost a year ago, in August 2019, Mboweni presented Treasury's 77-page page economic policy paper titled: "Economic Transformation, Inclusive Growth and Competitiveness". In the document Mboweni called for a series of "deliberate and concerted actions". Nothing has happened since then.

- The new Godongwana document calls for a possible amendment to Regulation (Reg) 28 of the Pension Funds Act to allow infrastructure projects to be financed by pension funds. By amending Regulation 28, the government will obtain funds from private pensions as the

Government Employee Pension Fund (GEPF) is not governed by Reg 28. Godongwana did mention afterwards that this does not mean that pension funds will be forced to invest in infrastructure projects.

- The latest policy document takes care to underline the fact that the government intends to promote localised procurement of South African goods and services in infrastructure projects, whilst minimising the reliance on imported goods and services. This is a positive that would ordinarily promote the development of local industries, especially in manufacturing. Unfortunately, references to 'reciprocal commitments' by local manufacturers to transformation, investment and pricing will secure government's control over the assignment of contracts and the setting of market prices, thereby promoting added regulation at a time when less regulation is needed.

- The ANC has no shortage of plans on how to get the South African economy growing again. Sadly, none of these plans have been properly implemented and they remain rooted in the developmental state ideology. The ANC does not need all these grandiose rescue plans. All that is required is to release the handbrake on the economy through deregulation, thereby allowing the private sector to be get into action. It is a time for pragmatism, not ideology.