OVERBERG MARKET REPORT

Tuesday 19th January 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Can our government protect us against Covid-19? The consensus is that they have done a terrible job. We missed a payment for Covid-19 vaccines. This means that initially we will get only 1.5 million vaccines, for 60 million people. Government has plans to procure an additional 33 million vaccines, but plans are vague. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- South Africa's latest manufacturing data, which came in worse than expected, suggest that the economic recovery in the manufacturing sector might have already slowed down before the resurgence of a new Covid-19 wave in December. Manufacturing production declined by 3.5% year-on-year in November following a 3.4% drop in October. The decline marks the 18th consecutive year-on-year drop and the largest since August last year. The largest contributors to the annual decline were petroleum and chemicals, food and beverages, and metals and machinery. On a monthly basis, manufacturing production contracted by 1.3%. The decline in the manufacturing sector output, an industry which accounts for roughly 14% of South African Gross Domestic product (GDP), shows that the economy is in for a patchy recovery, especially under the current level 3 Covid restrictions. Further lockdowns in key trading partner economies like the EU and local structural impediments such as electricity supply and low competitiveness weigh further on the domestic outlook.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Mining Production. Due Tuesday 19 January 2021. Following the accelerated decline recorded in October's mining production figures which indicated that the partial economic recovery that prevailed after the lockdown restrictions were lifted had begun to cool off, the November figures are expected to have improved. Consensus forecast is that mining production increased 0.8% month-on-month and contracted 5% year-on-year in November, up from a 0.3% month-on-month and 6.3% year-on-year contraction recorded in October. However, a persistent lockdown-related disruptions and lingering power outages will keep the recovery limited, thereby causing mining production to most likely end 2020 slightly lower compared to 2019.

- Consumer Price Index. Due Wednesday 20 January 2021. Consumer inflation is expected to have recorded a slight decline with consensus forecasting inflation at 3.1% year-on-year in December 2020, down from 3.2% in November 2020. As a result, inflation would average 3.3% in 2020 down from 4.1% in 2019. Inflation is expected to pick up in 2021 but remain below the mid-point of the South African Reserve Bank's (SARB) target range of 3-6%. Core inflation, excluding food and energy prices, is expected to have edged up slightly to 3.3% in December from 3.2% in November.

- Retail Sales. Due Thursday 21 January 2021 (postponed from last week). On the back of the sharp fall in physical store sales reported during Black Friday, November retail sales are expected to disappoint. Consensus forecast is that retail sales contracted 0.5% month-on-month and 4.7% year-on-year, compared with the respective 1.8% and 0.2% declines recorded in October. This expected deterioration will be the eighth consecutive month of decline in retail activity and is likely to persist until South Africa successfully executes a vaccine rollout and the economy starts to recover.

- Interest Rate Decision. Due Thursday 22 January 2021. The SARB's Monetary Policy Committee (MPC) will meet this week. It will decide whether to cut, increase, or keep the current interest and prime rate unchanged. Given a stable exchange rate helped by a large trade surplus, improving global risk appetite, benign inflation and a negative outlook for South Africa's Gross Domestic Production (GDP), there is some room for the SARB to cut policy interest rates. Analysts' outlooks, however, remain mixed. Another 25 basis point cut would take the repo rate to 3.25% and the prime lending rate for consumers to 6.75% It remains, however, a close call with another split vote likely.

NORTH AMERICA

Contributed by Nick Downing

- President-elect Joe Biden proposed a $1.9 trillion economic relief package to be implemented on top of the $900 billion package enacted by President Trump on the 27th December. It will have to be passed by both Houses of Congress, where the Democrats have a slim majority. Biden stated that there is more risk to doing too little than too much, as occurred after the 2008/09 Global Financial Crisis. Biden said, "A growing chorus of top economists agree that, in this moment of crisis, with interest rates at historic lows, we cannot afford inaction." The suggested stimulus would come at a cost, raising the budget deficit to an estimated 25% of GDP and lifting sovereign debt above 100% of GDP. The Republicans will argue strongly against the suggested $350 billion in extra state and government aid and the proposed increase in the minimal wage to $15 per hour. However, other measures will be easier to pass including the increased once-off payment to individuals from $600 to $2000, and the increased supplementary unemployment benefit from $300 to $400 per week. The bill emphasises handouts to the poor through additional child tax credits. It is estimated the relief spending will reduce poverty from 12.6% to 9% of the population. While a cost to the fiscus, the extraordinary combination of ultra-low interest rates and massive fiscal stimulus would provide an enormous boost to economic growth. From an investment viewpoint, the additional stimulus would accelerate the expected rotation from Covid winners or "growth" shares into cyclical "value" shares, especially in sectors most affected by the pandemic.

- The breakeven rate, the difference in yield between conventional 10-year US Treasury bonds and inflation-protected securities of the same maturity, which measures the expected annual inflation rate over the period, has spiked to 2.1%. The difference between expected inflation and actual inflation (CPI measured 1.4% in December) is the highest since 2013. Federal Reserve Chairman Jerome Powell cautioned that the central bank would look past any temporary spike in inflation, which may result from the low base effect of deflation readings at the start of the pandemic last March. He reiterated that the economy is a long way from a strong job market or a sustainable 2% average inflation rate. Referring to current ultra-accommodative monetary policy, which is expected to continue until at least 2023, Powell said, "Now is not the time to be talking about exit." The insistence that ultra-accommodative monetary policy is here to stay should, together with prospects for mass vaccination and increased stimulus spending, boost economic growth forecasts. The latest Wall Street Journal economists' survey predicts US GDP will grow by 4.3% in 2021 up from last month's forecast of 3.7%. Two-thirds of respondents said vaccination will have a significant positive impact on growth, although 85.7% cautioned that vaccination was occurring too slowly. Three of the largest banks in the US, JPMorgan Chase, Citigroup and Wells Fargo have just released a combined $5 billion in loan loss reserves in recognition of brighter economic prospects and a fall in expected default rates. Despite the probability of surging economic growth in the second half of the year, the Fed funds rate and the Fed's asset purchase programme are expected to remain constant. The next fed policy meeting is on 26-27th January.

- Retail sales unexpectedly fell in December by 0.7% month-on-month, the third consecutive monthly decline. Core retail sales, which exclude vehicles and gasoline, fell by 2.1%, the largest monthly percentage decline since April, attributed to a surge in Covid infections and a stalling in employment growth. By contrast, industrial production increased in December by 1.6% on the month, beating the 0.5% consensus forecast by a wide margin. Among the industrial sectors, manufacturing increased 0.9%, mining by 1.6% and utilities output by 6.2%. Michael Pearce, economist at Capital Economics observed, "The December production data underline that while new restrictions are holding back parts of the service sector again, the recovery in manufacturing continues largely unaffected." Despite the recent change in fortunes of the two sectors, industrial output was still down year-on-year in December by 3.6% while retail sales were up by 2.9%. The outlook for consumer spending, which contributes two-thirds of US GDP, should moreover recover rapidly as the vaccination programme is rolled-out and households feel the benefits of increased stimulus spending.

CHINA

Contributed by Nick Downing

- China's economy grew in the fourth quarter (Q4) by 6.5% year-on-year accelerating from 4.9% growth in Q3 and 3.2% in Q2. Full year growth in 2020 registered 2.3% making China an outlier compared to other large economies. By contrast the US is expected to have contracted in 2020 by 3.6% and the Eurozone by 7.4% with global GDP likely to have shrunk by 4.3%. China's share of global GDP has increased from 14.2% in 2016 to 16.8% in 2020. China's strong economic recovery is attributed to its relative success in containing the Covid pandemic, its rebound in industrial production and investment spending and the country's surging trade surplus. Industrial production grew in 2020 by 2.8% year-on-year and investment spending by 2.9%, while the trade surplus for the year increased to $535 billion, its largest since 2015, contributing 0.4 percentage points to the year's GDP growth. Consumer demand lagged the economic recovery, with retail sales falling in the year by 3.9% due to ongoing fears over Covid. However, the urban unemployment rate has dropped back to 5.2%, and as the vaccination programme is rolled out, consumer spending should contribute more strongly to economic growth in 2021. Economists' forecasts for growth in the current year range between 7-9%. However, there are concerns that growth may struggle to maintain momentum in subsequent years. In a recent report, the IMF notes that productivity growth has been on a declining trend due to the crowding out of private sector investment by public sector investment spending. In its report, the IMF found that productivity growth averaged 0.6% between 2012-2017, reflecting a sharp slowdown from the preceding 5 years when productivity growth averaged 3.5%. The IMF calls for reforms of the state sector and state-owned enterprises to boost productivity growth, which would in turn boost potential GDP growth. According to its estimates, the necessary reforms would lift GDP growth in 2022 from 5.7% to 6.5%.

EUROPE

Contributed by Carel la Cock

- The household savings rate in the eurozone decreased from 24.6% in the second quarter to 17.3% in the third quarter, marking the two highest savings rates since records began in 1999. The latest figure can be explained by a sharp 13.6% increase in the household consumption rate while gross disposable income grew by a more modest 3.9%. Furthermore, the business investment rate stabilised at 23.3% in the third quarter of 2020 compared to 23.2% in the second quarter, while household investment was up 0.9% points to 8.8% in the third quarter. Corroborating the higher levels of household investment, house prices rose by 4.9% in the euro area in the third quarter compared with a year earlier and maintained the growth rate achieved in the second quarter. Luxembourg (+13.6%), Poland (+10.9%), Austria (+8.9%) and notably Germany (+7.8%) recorded the highest third quarter growth compared to the same quarter in 2019. Although the figures are now slightly dated it shows that there was a recovery in the third quarter that has certainly unwound in the last quarter of the year, but that households have some pent-up demand and given a positive outcome from the vaccination roll-out, the euro area could see a sharp recovery in 2021.

UNITED KINGDOM

Contributed by Carel la Cock

- While chancellor of the exchequer Rishi Sunak is busy drawing up his government's budget due for release in March, analysts are speculating on how he might prop up the massive £400bn budget deficit for the current tax year. Mr Sunak must strike a delicate balance between supporting the economy by securing jobs and containing a public debt that has ballooned in the past year. It is expected that the government will try to avoid a cliff edge situation with regards to current emergency measures aimed at keeping workers employed and will aim to avoid joblessness by incentivising businesses to retain staff when furlough schemes end. Furthermore, there are talks that the government might extend the £20 a week universal tax credit and working tax credits which started in April last year and are scheduled to conclude in March. It has been a hotly debated subject and has cost the government £6bn. Prime minister Boris Johnson has indicated that the scheme will end as planned in March, saying that people "would rather see a focus on jobs and a growth in wages, than focusing on welfare", but the opposition party has taken a different stance and will debate it in parliament this week. Unemployment is expected to peak at 7% by the end of this year from the current 4.9%. Unemployment has risen from 4% before the pandemic but would have been much worse had it not been for the government's furlough scheme. However, balancing the books will be no easy task. There has been speculation that Treasury will look to increase capital gains tax (CGT) as well as corporate taxes. Mr Johnson has effectively taken a hike in personal income taxes, national insurance tax and value added tax off the table by vowing not to increase these in his election campaign, leaving Mr Sunak with few other options. A report last year on CGT done by Treasury, concluded that annual allowances should be lowered, and rates should more closely align with income taxes. The Office of Tax Simplification added that the current CGT rules incentivised people in odd ways in certain areas. It leaves the door open for a revamp of CGT rules in March. Furthermore, corporate taxes in the UK compare favourably to other developed nations with the UK raising 2.6% of GDP compared to an average of 3.1%. Every 1% increase in the corporate tax rate from the current 19% will add £3.4bn to the public coffers and Mr Sunak has said that there is no evidence that the UK is attracting more investment because of its lower corporate tax. Lobby groups have been quick to point out that with businesses still on their knees after the worst economic downturn in living memory, it would be irresponsible to raise taxes now, but instead government should look to extend some of the measures in aid of businesses. The March budget has the potential to plot the UK's path out of the pandemic but turning the taps off two early could stifle the recovery.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- Many of the world's leading investment managers agree that the biggest risk for investors this year is the delayed rollout of the vaccine which would cause much of the good news currently priced in the markets to unwind. However, if a successful vaccination program gets underway this year, the financial markets could have another bumper year and emerging markets and frontier markets stand to gain the most. Economies like Vietnam are in a unique position to benefit from a global recovery this year due to the ongoing diversification of supply chains away from China. Frontier markets in general are trading at a wide discount to emerging markets and have the biggest potential to outperform. Furthermore, leading investment houses expect a boost from pent-up demand following successful vaccination and a reopening from current lockdowns, but they caution that continued support by governments will be essential in maintaining momentum. They also highlight that there will be an uneven start in different sectors and that the recovery will not be a simple broad-based cyclical recovery. Most manger have Asian emerging market economies as their top pick for outperformance this year, building on the quick recovery from the pandemic and leveraging off the continued growth in China.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 6.97	63549
JSE Fini 15	- 1.19	11916
JSE Indi 25	+ 7.59	83811
JSE Resi 20	+ 10.91	63855
R/$	- 3.52	15.23
R/€	- 5.02	18.39

R/£	- 2.98	20.70
S&P 500	+ 0.32	3768
Nikkei	+ 3.92	28519
Hang Seng	+ 4.93	28573
FTSE 100	+ 4.26	6735
DAX	+ 1.97	13988
CAC 40	+ 1.09	5611
MSCI Emerging	+ 6.16	1370
MSCI World	+ 1.79	2738
Gold	- 2.26	1851
Platinum	- 2.21	1093
Brent oil	+ 8.92	56.42

BOTTOM LINE

Contributed by Gielie Fourie

- DEVELOPING VACCINES - THE FOUR VALLEYS OF DEATH: Prof. Shabir Madhi of Wits has led the South African leg of the Oxford/AstraZeneca vaccine Covid-19 vaccine trial. He explains: “Vaccines face four ‘valleys of death’. The first is getting licensed. The second is scaling up manufacturing to meet global demand. The third is affordability and access. The fourth is the implementation of an immunisation program. The last valley is the toughest valley. You can have the greatest vaccine but if you can’t eventually get people immunised then those vaccines count for very little. In addition, a country needs to have the infrastructure to realistically deploy a vaccine – whether that’s a cold storage chain or the ability to administer the vaccines.” The last mile of the supply chain is the most important mile.

- THESE ARE THE VACCINES SA COULD GET: (1) BioNTecH/PFIZER, a German company: It has a 95% efficacy. Patients need two doses. It must be stored at -70ºC. Cost per dose $20.00. Approved in the UK, Euro Union, and the US. Registered on 2 Dec 2020, it claims to be the first Covid-19 drug ever authorised. (2) OXFORD/ASTRA-ZENECA, a UK company: It has a 70% efficacy rate. Patients need two doses. It must be stored at between 2ºC to 8ºC. Cost per dose $4.00. This vaccine is likely to be widely used. It has been approved by the United Kingdom and India's drugs controller general. (3) JOHNSON AND JOHNSON, a US company: The vaccine will be submitted for approval this month. It is a single dose vaccine, which makes it more cost-effective and easier to administer. Cost per dose $10.00. (4) MODERNA, a US company: It has a 94.1% efficacy rate. It is a two-dose vaccine. It must be stored at -20ºC. Cost per dose $37.00. The vaccine has been approved by the US. (5) SPUTNIK V, a Russian company. It has an efficacy rate of 91.4%. It is a two-dose vaccine. Cost per dose $10.00. It claims to be the first registered drug against Covid-19, but no date is available. (6) SinoPharm and SinoVac, two Chinese companies. It has an 86.1% efficacy rate. Cost per dose $30.00. It must be stored between 2ºC - 8ºC Both Sinopharm and Sinovac have been approved for limited use in China. (Source: Statista).

- HERD IMMUNITY: It is estimated that for a country to achieve herd immunity, 60-70% (two-thirds) of its population needs to be vaccinated. The WHO states that about 50% of vaccines distributed globally go to waste, primarily because of a failure to properly control storage temperatures.

- MEMBERS OF COVAX: COVAX was launched in April 2020 by the WHO to fight Covid-19. COVAX is funded by wealthy donors, businesses, and governments. It is the only truly global solution to this pandemic because it is the only effort to ensure that people in all corners of the world will get access to COVID-19 vaccines once they are available, regardless of their wealth. COVAX will fund and support the research, development, and manufacturing of a wide range of COVID-19 vaccine candidates and negotiate their pricing. All participating countries, regardless of income levels, will have equal access to these vaccines once they are developed. In total 92 middle- and lower-income countries are part of COVAX.

- NON-MEMBERS OF COVAX: Only five African countries are not part of COVAX – Libya, Gabon, Namibia, Botswana, and SA. Even Swaziland is a member. Prof. Madhi: “SA did not engage early enough. That's where we are”. Treasury missed our payment – eventually the Solidarity Fund paid the Covax deposit. We are on our own – we are last in the queue. We can buy from COVAX, but limited supplies and at a price. We were allocated 1.5 million doses of the Oxford/Astra Zeneca vaccine. By comparison, Egypt, a COVAX partner, got 50 million doses for a population of 100 million people. Indonesia received 330 million doses for a population of 270 million people.

- THE PERCENTAGE OF PEOPLE VACCINATED: As of 18 January 2021, the following countries have vaccinated 2.00% or more of their populations: Israel 28.03%, UAE 19.04%, Bahrain 8.32%, UK 6.34%, USA 3.71%, and Denmark 2.88%. This weekend India has started the world's largest COVID-19 vaccination drive. SA stands at zero. (Sources: Bloomberg and ourworldindata).

- WHO WILL BE VACCINATED FIRST? Health Minister Zweli Mkhize and Professor Salim Abdool Karim, previous Chairperson of the Covid-19 Ministerial Advisory Committee gave the following guidelines. The goal is to ensure that at least 67% (two-thirds) of the population achieves herd immunity through vaccinations. There will be three distinct phases. PHASE 1: Our 1.25-million healthcare workers. PHASE 2: First, our 2.5-million essential workers (for example the police service, miners, retail food sector, banks, municipalities). Second, 1.1-million people in prisons, shelters and care homes. Third, people in the hospitality and tourism industry. Fourth, five million people older than 60. Sixth, eight million people older than 18 years who have comorbidities. PHASE 3: 22.5-million people over the age of 18. We only have 1.5 million vaccines available for our program.

- PUBLIC-PRIVATE PARTNERSHIP FUNDING: The CEO of Discovery Health, Ryan Noach, recently said the company is evaluating a funding model whereby 7.1 million of its medical aid scheme members could pay double the price for the vaccine and donate 50% of the cost to a funding vehicle such as the Solidarity Fund. This would go towards vaccines for the portion of the population without access to medical aid.

- WHY ARE WE SO LATE? Prof Barry Schoub, Chairperson of the Ministerial Advisory Committee on COVID-19 vaccine developments, says: “South Africa could not risk buying a COVID-19 vaccine earlier last year because it wasn't clear how effective or safe the vaccines would be. SA could not afford to pre-order vaccines. A number of high-income countries bought five times the amount required for their populations.” There is a risk in buying the vaccines: "Field behaviour doesn't necessarily totally equate how the vaccines behave in a trial situation”. In Norway there have been side effects. Prof Schoub added: “The high-income countries could afford to waste the money that we could not afford to waste. So, we were preparing but we didn't have the finance to buy at risk."

- TREASURY CONSIDERS A TAX HIKE: Treasury is considering a tax hike to pay for our vaccination drive. Government hopes to find 12 million doses from COVAX, Another 12 million from the African Vaccine Task Team, and 9 million doses from Johnson and Johnson. It is estimated that it will cost R20 billion to vaccinate the entire country. One of the funding mechanisms considered is a tax hike. (Sources: Dept of Health and the Treasury).

- SUMMARY: Consensus is that our government has done a terrible job. Who is in charge? We get different messages from different ministers. Even pres. Ramaphosa’s announcements have been turned around the very next day by Dr Nkosazana Dlamini-Zuma. What we need is a timeline spelling out the road ahead – how many vaccines will we get, when will we get them, when will vaccinations start? And government must stick to its timeline. This will put us at ease, improve consumer and business confidence and boost jobs growth.

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