OVERBERG MARKET REPORT

Tuesday 28th July 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Nick Downing

- The Oxford University vaccine is now in a Phase 2/3 expanded human/efficacy trial in the UK and Phase 3 human trials in Brazil and South Africa, in which the vaccine is given to thousands of people. Phase 3 is the final stage before final regulatory approval, which AstraZeneca is predicting will be in September. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) cut the repurchase rate by a further 25 basis points to 3.5% on Friday, 24 July, bringing the total interest rate cuts to 300 basis points for the year. The repo rate is at its lowest since the repo system was introduced in 1998 and the latest cut brings the prime lending rate down to 7%. The rate cut will bring further financial relief to businesses and consumers. The inflation outlook also appears to be balanced, the bank said in its press release, with the currency depreciation risk expected to be muted and food price inflation stable. The weak oil price further supports the stable inflation outlook. However, the SARB expects electricity and other administered prices to be a concern. Further upside risks to inflation could also emerge from heightened fiscal risks and sharp reductions in the supply of goods and services. Nevertheless, inflation is expected to be well contained with headline consumer price inflation forecast to average 3.4% in 2020, and 4.3% in 2021 and 2022. In its press statement the SARB noted that the Quarterly Projection Model indicates one more repo rate cut of 25 basis points in the fourth quarter of 2020 with no further change in the first quarter of 2021. At the policy meeting, three members preferred a cut of 25 basis points and two preferred to keep rates on hold. This indicates that the SARB will likely err on the side of caution before easing the policy rate further, in order to maintain a buffer against unforeseen inflation shocks. The SARB's forecast for Gross Domestic Product (GDP) for 2020 was revised downwards to -7.3% for the year. The Governor of the SARB, Mr Lesetja Kganyago, again stressed that monetary policy cannot on its own create economic growth or reduce fiscal risks. What is needed to get the economy back on a growth path are the implementation of prudent macroeconomic policies and structural reforms that lower costs and increase investment opportunities.

- The South Africa Reserve Bank's (SARB) leading business cycle indicator declined 0.7% month-on-month in May after plunging by 6.8% in April, as South Africa experienced the harshest phase of the nationwide lockdown imposed to slow the Covid-19 pandemic. Six of the nine available components decreased, most notably the average number of hours worked in the manufacturing sector and the BER Business Confidence Index. Positive contributions came from an increase in the number of new passenger vehicles sold and an increase in the US dollar-based South African export commodity price index. The leading business cycle indicator offers a projection of South Africa's economic growth cycle for the next six to twelve months. The composite coincident business cycle indicator- which measures current economic activity- decreased sharply by 22.0% on a month-to-month basis in April, extending its downward trend further and illustrating the severe impact of the extended lockdown on economic activity. Coincident indicator contractions exceeding 20% have never been recorded before. Economists expect the contraction in South Africa's Gross Domestic Product (GDP) during 2020 to be the worst on record with economists' forecasts ranging from -7.2% to -10.1%.

- The Covid-19 pandemic and lockdown regulations since 27 March 2020 have had an extensive impact on economic activity. Measured in real terms, retail trade sales declined by 12.0% year-on-year in May. The main contributors to the annual decline in May were all other retailers; retailers in food, beverages and tobacco in specialised stores; and general dealers. Month-on-month retail sales increased 74.2% in May as the country moved into Level-4 lockdown, which permitted more consumer goods to be sold. However, retail sales were still down sharply compared to 2019 levels. Overall, retail numbers are very mixed and future consumer spending and a further recovery in retail sales is hard to predict. UIF payments and special Over the short-term, Covid-19 grants are expected to support consumer spending resulting in a continued recovery in retails sales. However, once payments stop around August, sales are expected to slow. Meanwhile, after contracting by 35.4% month-on-month in April, wholesale trade sales rose by 29.7% in May although on an annual basis, wholesale trade was still down in May by 20.7%.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Private Sector Credit Extension: Due Wednesday 29th July 2020. Private Sector Credit Extension (PSCE) is expected to have remained at depressed levels in June. The consensus forecasts a 6.5% year-on-year increase in June up from 6.4% in May. PSCE is expected to remain under pressure in the short term as a result of low consumer sentiment, elevated uncertainty, and the deterioration in households' capacity to take up more credit due to rising unemployment, low real income growth and the weakening of household balance sheets. Cashflow pressure and lower borrowing costs are however expected to lead to increased credit uptake from corporates, especially those with stronger balance sheets

- Consumer Price Inflation: Due Wednesday 29th July 2020. The Consumer Price Inflation (CPI) figures are expected to indicate that the disinflationary shock caused by the Covid-19 pandemic continued in June. Consensus forecast is that CPI decreased to 1.9% year-on-year in June down from 2.1% in May. Core CPI, which measures the changes in the price of goods and services, excluding food and energy, is expected to have also decreased to 2.6% year-on-year in June, down from 3.1% in May.

- Producer Price Index: Due Thursday 30th July 2020. The producer price index (PPI) is expected to have made a turnaround in June from the downward trajectory it has been on since the start of 2020. The consensus view expects an increase of 0.6% year-on-year in June up from 0.4% in May. The expected increase is attributed to the increase in the petrol price at the beginning of June.

- Balance of Trade: Due Friday 31st July 2020. According to consensus forecast the trade balance recorded a R20 billion surplus in June up from the surplus of R15.94 billion recorded in May. This rising surplus is attributed to the combination of easing global trade restrictions combined with continued weakness in domestic demand.

- ABSA Manufacturing Purchasing Managers' Index: Due Monday 3rd August 2020. After recording its fastest increase since August 2013, the ABSA Manufacturing Purchasing Managers' Index (PMI) is expected to have increased in June to its highest level since July 2007. The PMI is expected to have increased to 55 index points in June, up from 53.9 in May, with further easing of lockdown restrictions resulting in increased economic activity.

- Total New Vehicle Sales: Due Monday 3rd August 2020. New vehicle sales are expected to have continued their recovery from the depressed levels reached in the middle of the lockdown. Regardless, the overall industry is expected to remain under severe pressure as consumer confidence, which was already at very low levels prior to the lockdown, continues to deteriorate due to declining disposable household income.

GLOBAL

Contributed by Nick Downing

- Following seven consecutive weeks of gains the gold price surged past its previous record high of $1921 per ounce set in September 2011, reaching a new record of $1944 on Monday. Conditions are perfect for the precious metal's rally. Besides the growing geopolitical risk emanating from reciprocal consulate closures by the US and China in Chengdu and Houston, and the rising tide of new coronavirus infections, unprecedented levels of fiscal and monetary stimulus are providing the ultimate driving force for the gold rally. Unlimited bond purchases by the Federal Reserve and other central banks and zero interest rate policies have rendered bonds, the traditional safe haven asset, unattractive. Over 60% of the $60 trillion global bond market is trading at a yield of less than 1%, compared with less than 10% at the turn of the millennium. In this low yielding environment, the opportunity cost of holding gold, which pays no income, becomes negligible and in fact gold provides a positive carry when compared with the growing volume of negative yielding bonds. The weakening US dollar also favours the gold price rally. The trade-weighted dollar index has dropped to a 2-year low and predicted to decline further due to the Fed's outsized balance sheet expansion and burgeoning government debt. Over the longer-term, the magnitude of unlimited quantitative easing programmes is expected to result in rising inflation, placing even greater upward pressure on the price of gold, which is traditionally favoured as an inflation hedge. The gold price could reach the $2500 level over the next 12-18 months according to a growing number of economists.

NORTH AMERICA

Contributed by Nick Downing

- Following a steady decline over the past four months in the number of weekly initial jobless benefit claims from a peak of 6.9 million in March, the trend was broken in the week ended 18th July with a rise of 109,000 to 1.4 million. The weekly employment reading corroborates other high frequency economic data such as restaurant bookings and mobility, indicating a dip in the economic rebound. The main culprit is the rising incidence of coronavirus infections, most notably across Florida, Texas and California, the most populated states in the US. The rising infection rate is prompting a rise in both voluntary and mandated social distancing, with many bars and restaurants being closed for a second time since the pandemic struck. While fear of the virus has declined in line with a falling mortality rate, no amount of fiscal or monetary stimulus will return economic activity to pre-pandemic levels until an effective vaccine is approved and administered.

- With little time to spare before the $600 per week enhanced unemployment benefit payments expire on 31st July, Senate Republicans proposed a $1 trillion supplementary coronavirus relief bill. The bill still needs to be agreed by the Democrat-led House of Representatives. Among the key aspects of the proposed bill, the $600 weekly payments reduce to $200 through to the end of September. On the other hand, the worker-retention tax credit is increased, incentivising businesses to bring people back to work. The bill proposes a second round of helicopter cash drops, unchanged at $1200 per individual. The Democrats have criticised the bill as offering too little too late, in contrast with their own proposed bill of $3.5 trillion. However, many Republicans are concerned over the burgeoning government deficit, which excluding any additions to the $3 trillion relief provided so far is already expected to set a post WW2 deficit to GDP record. With evidence of growing discord between Republicans it is unlikely the bill will be revised much higher than the current proposed level.

- The Federal Reserve policy meeting on 28-29th July is not expected to deliver further policy initiatives despite the recent easing in the pace of economic recovery. Fed policy makers have highlighted the fragile economic recovery in recent speeches but their assessments centre on shortfalls in the public healthcare response, which monetary policy is not best equipped to deal with. According to the Dallas Fed President Robert Kaplan, "How well we follow the health-care protocols from here is going to be the primary economic tool we have." The Fed's upcoming policy discussion is expected to move from crisis response to economic recovery support measures. Through unlimited asset purchases, the Fed's balance sheet has surged from $4.2 trillion prior to the pandemic outbreak to $7 trillion and expected to grow to $9 trillion by the end of the year. However, the Fed is expected to take a wait-and-see approach before launching any additional forward guidance measures such as yield curve control or linking asset purchase policy to specific economic outcomes such as inflation or GDP growth targets.

- The housing market provided a bright spot in an otherwise faltering economic recovery. Sales of new single-family homes increased in June by 13.8% month-on-month to the highest annual rate since June 2007. Existing home sales surged 20.7% on the month, the biggest monthly increase since 1968. Housing starts, which measure new home construction, increased in June by a solid 17.3% on the month while the National Association of Home Builders confidence index returned to pre-pandemic levels in July, signalling further improvements in residential construction activity over coming months. Economists cite pent-up housing demand, which accumulated in 2018 and 2019, quiet years in the housing market due to excessive pricing and a lack of housing inventory. The housing supply bottlenecks appear to have eased at the same time that a sharp fall in mortgage lending rates has boosted affordability and demand. The average yield on the 30-year fixed rate mortgage has declined to a record low of 2.98%. In the past week mortgage applications for home purchases gained by a massive 19% year-on-year. Including the ancillary effect of renovations, home furnishings and electric appliances, the housing market can contribute as much as 20% to US GDP growth.

JAPAN

Contributed by Carel La Cock

- Japan's seasonally adjusted household savings ratio, calculated as net savings/real disposal income, has more than doubled in the last six months from 3.7% to 8% in the first quarter of the year, a level not seen in nearly two decades. It gives further evidence that Japanese households are tightening belts despite historic low interest rates. Japan has traditionally been known for its strong savings culture during periods in the '70s and '80s when the savings ratio was above 20% hitting a peak in 1974 of nearly 24%. The ratio has been coming down in the decades that followed as an aging population draws down life savings during retirement. The savings ratio even turned negative briefly at the end of 2013 and at the start of 2014 but has generally remained between 2% and 3% in recent years. A higher household savings ratio coupled with lower demand for consumer loans are both headwinds for a consumer driven recovery in Japan. Thus far the response to the covid-19 pandemic has largely been from the Bank of Japan by way of increased liquidity. However, there is little scope for further monetary stimulus with interest rates at -0.1% and 10-year yields at 0%, which means the Japanese government would have to step up its fiscal stimulus in line with Europe and the UK if Japan has any hope of making a swift recovery this year.

EUROPE

Contributed by Carel La Cock

- European leaders have agreed on a historic post-pandemic relief package of €750bn centred around a €390bn programme of grants to member states worst affected by the covid-19 pandemic. Furthermore, heads of states also signed-off on the EU's next seven-year budget worth €1.074tn. It is the first time in the EU's history that leaders have agreed on a federal deficit funded in the capital markets with member states that don't have the means to fund their recovery, receiving funds in the form of grants rather than loans. The rate at which the EU can borrow funds as a collective is far lower than some of the indebted southern members. The package was spearheaded by German chancellor, Angela Merkel and European Counsel president, Charles Michel. The negotiation was the second longest in European history and culminated in a deal that Ms Merkel called "the financial foundation for the EU for the next seven years." She added that "Europe has shown that it is able to break new ground in a very special situation such as this one." Negotiations were at times locked in heated debate as frugal states such as Austria, Denmark, the Netherlands and Sweden argued against borrowing funds to hand out as a budget expenditure, instead favouring loans to struggling member states. These states won some ground as the original grants programme was toted to be €500bn compared to the final agreed €390bn and they will have higher budget rebates. Other compromises include cuts in top-up funding for EU programmes, side-lining a solvency instrument to recapitalise ailing companies to the tune of €26bn as well as a €20bn reduction in funding to help poorer countries reduce carbon emissions. The deal will provide much needed assistance to an already stretched monetary policy stance in which interest rates are already at record low levels.

UNITED KINGDOM

Contributed by Carel La Cock

- The UK government is weighing up an online sales tax to prop up the high street and the fiscus. Online retailers have benefited during the lockdown period when all non-essential stores had to close their doors for three months. High street stores have been battling online retailers for many years as the popularity and convenience of online shopping has steadily increased and booming property prices in cities such as London and Manchester have increased overhead costs making physical stores less competitive. It has left many high streets in the UK with boarded up facades and urban decay in once thriving retail areas. The online shopping tax could take two forms: a two percent levy on all online sales and a tax on consumer deliveries, the former potentially raising as much as £2bn. The covid-19 pandemic has impacted the way the world does business and it will become more evident as the fallout continues. As businesses migrate evermore online, governments will have to be pragmatic about how to level the playing field for bricks and mortar shops, which are more likely to be local taxpayers than the tech giants domiciled in tax havens.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- Singapore contracted by a record 41.2% in the second quarter of the year, on a quarter-on-quarter annualised basis, and fell into a recession for the first time since the global financial crisis following a contraction of 3.3% in the first quarter. Year on year the economy contracted 12.6%, worse than a Reuters poll expecting a 10.5% drop. It was also the worst year on year quarterly drop since the city state won its independence in 1965. The fall in output, as expected, was due to covid-19 preventative measures which locked the city down for nearly two months. The export driven economy was also hit by a lack of global demand as most countries were still grappling with the pandemic. Concerns about unemployment are warranted and it is expected that nearly 100,000 residents could become unemployed, lifting the unemployment rate to 4.2%. Manufacturing grew 2.5% year on year in the second quarter and outpaced the services sector, but economists expect that the services sector will make a recovery in the second half of the year as social distancing rules become more relaxed. Construction fell by 54.7% year on year as foreign workers from Malaysia were restricted to their dormitories, a strategy that proved successful at first in containing the virus, but ultimately led to a spike in infections due to close proximity living conditions. Singapore has one of the highest number of cases in south-east Asia at 46,283 and 26 deaths. In June when the lockdown ended, the government announced a stimulus package of S$100bn or 20% of GDP and it is expected that the recovery in the second half of the year could outpace other nations in the region. Singapore has also benefited from the turmoil in Hong Kong. In the past year Singapore's banks have seen a steady increase in deposits from non-residents. Foreign currency deposits at Singapore's banks increased fourfold in April and non-resident deposits grew by 44%. Any further escalation in Hong Kong after China imposed national security laws, will likely see further fund flows to Singapore with the city state cementing its position as a leading global financial hub in the region.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 1.33	56326
JSE Fini 15	- 33.84	10371
JSE Indi 25	+ 6.65	73913
JSE Resi 20	+ 16.14	57209
R/$	- 14.74	16.42
R/€	- 18.68	19.29
R/£	- 12.29	21.16
S&P 500	+ 0.27	3239
Nikkei	- 3.98	22715
Hang Seng	- 12.72	24603
FTSE 100	- 19.06	6104
DAX	- 3.10	12838
CAC 40	- 17.37	4939
MSCI Emerging	- 3.72	1073
MSCI World	- 1.99	2311
Gold	+ 26.88	1934
Platinum	- 3.56	936
Brent oil	- 34.38	43.41

BOTTOM LINE

Contributed by Nick Downing

- The world economy is being underpinned in its recovery from the Covid-19 pandemic by central bank easing and government spending on an unprecedented scale. The massive monetary and fiscal stimulus is helping, the patient is alive but is still on life support. Even though lockdowns have been lifted in many countries, consumers remain fearful and businesses uncertain about committing new investment. The helicopter money drops and emergency unemployment pay-outs, rather than being spent by households have largely been saved. Household precautionary savings are likely to remain elevated and businesses will continue to hoard their cash until an effective vaccine is rolled-out.

- The Covid-19 vaccine will be the silver bullet to restoring the world economy back to its pre-pandemic activity levels. Fortunately, the vaccine news is good. The World Health Organisation confirms that more than 165 vaccine development programmes are in progress, 27 vaccines already in human trials, with five reportedly in the final stage-three trials. Developing a vaccine normally takes years but regulators have fast-tracked the process, by compressing and combining the different trial stages.

- Vaccine development programmes are at an advanced stage across Western economies as well as Russia, China and according to claims, in North Korea. Different types of vaccine are being developed, including the traditional vaccines, whereby live or inactivated doses of actual Covid-19 are introduced into the body to provoke the immune system into mounting a response. For the first time ever, mRNA vaccines are also being developed, the frontrunners are US firms Moderna and Pfizer. Rather than introducing a pathogen into the body, the mRNA uses DNA instructions to trick the body into producing the viral proteins itself. The mRNA vaccines will be able to boost not just the acquired immune system, like traditional vaccines, but also the innate immune system, thereby providing an extra layer of defence and making the immune response much stronger. Furthermore, by getting the body to produce the viral proteins itself, the manufacturing process is easier and quicker, enabling larger scale production.

- The current front-runner is a vaccine developed by British-Swedish company AstraZeneca and Oxford University's Jenner Institute, based on the chimpanzee adenovirus called ChAdOx1. Recent results from the Phase 1/2 human trials reported on the 20th July found that the vaccine was safe, causing no severe side effects. The vaccine is now in a Phase 2/3 expanded human/efficacy trial in the UK and Phase 3 human trials in Brazil and South Africa, in which the vaccine is given to thousands of people. Phase 3 is the final stage before final regulatory approval, which AstraZeneca is predicting will be in September. The company envisages the delivery of emergency vaccines by October and several billion doses ready by the end of the year.

- The ultimate aim of an effective vaccine is to create global herd immunity, putting a definitive end to the pandemic. However, there are risks and pitfalls. The greatest is probably the fear, not just of Covid-19, but of the vaccine itself. The measles, mumps and rubella (MMR) vaccine created a major public scare, lasting for years, due to its reported link with autism. Before that, the whooping cough vaccine was linked to brain damage. A recent opinion poll conducted in May found that 20% of Americans would refuse to receive a Covid-19 vaccine. The fast-tracking of the vaccine development process may exacerbate safety concerns. Due to its novelty the mRNA vaccine may be especially mistrusted.

- The live vaccines have the advantage of being so similar to the natural infection that they create a strong and long-lasting immune response, but large scale and efficient administration is problematic as the vaccine needs to be kept refrigerated and does not travel easily. Inactivated vaccines do not need to be refrigerated, they have a long shelf life and travel easily, improving the ability for rapid large-scale global administration. The drawback of inactive vaccines is that they tend to provide only partial protection, or protection which wanes relatively quickly, requiring several booster shots, or even worse newer vaccines, making the end result of herd immunity harder to attain.

- Despite vaccine safety risks, limited efficacy of inactivated vaccines and practical drawbacks of effective vaccine administration, the positive economic response a vaccine approval would generate is unequivocal. Vaccine approval is by far the biggest upside risk for global financial markets.

- However, there is an interesting paradox. If the timescale for vaccine approval is a matter of years, people may be inclined to take their chances and return to normal life. If the timescale is reduced to months, the risk/reward for normalising early is greatly reduced. Hence, economic activity may actually reduce in the key period between vaccine approval and administration.

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