OVERBERG MARKET REPORT

Tuesday 2nd February 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Nick Downing

- The last time the global environment was so favourable for emerging market currencies was 16 years ago. The opportunity presented for bold emerging market monetary policy is rare. To waste the opportunity and not cut interest rates would be devastating. Mr. Kganyago, it is time to act BIG! Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Gielie Fourie

- In December 2020, the composite leading business cycle indicator in South Africa rose 1.0% from a month earlier, the smallest increase since May. The modest increase is attributed to the second wave of the coronavirus pandemic. A surge in five out of the ten available components outweighed declines in the remaining five. The main positive contributions came from an improvement in the business confidence index and an increase in the US dollar-denominated South African export commodity price index. This indicator could pick up some momentum going forward following the lifting of certain COVID-19 restrictions announced last night by pres. Ramaphosa.

- Headline producer price inflation (PPI) was unchanged at 3% y-o-y in December, increasing by 0.2% over the month. The main contributors to the annual figure were the 'food products, beverages and tobacco products' and 'transport equipment' categories, which added a combined 2.6 percentage points to the total. Among the major categories, 'paper and printed products' prices accelerated for the fourth month, while the 'metals, machinery, equipment and computing equipment', 'coke, petroleum, chemical, rubber and plastic products' and 'non-metallic mineral products' rose at a faster pace, benefitting from a recovery in commodity prices. Food prices have moderated since August's price increases, with meat prices also softening over the reporting period.

- Annual M3 money supply growth rose to 9.5% in December but is still below the 10% plus growth rate in August, although higher than the 6.1% rate recorded at the end of 2019. During the month, M3 increased by 0.1%, driven by continued increases in net other assets and liabilities (up by R29 billion) and net claims on the private sector (up R13.8 billion), which outweighed the effect of declines in net foreign assets and net government claims, which fell by R18.5 billion and R20.9 billion, respectively.

- South Africa's Private Sector Credit Extension (PSCE) growth increased slightly to a four-month high of 3.6% y-o-y in December, way below the 6.1% recorded in December 2019. The annual rise was mainly a result of higher investments and bills. Growth in instalment sales and leasing finance remained below 3% for four consecutive months, edging down further to 2.5% in December, while growth in mortgages was steady at 4.3%, the lowest since December 2017. The 'other loans and advances', which mainly consists of unsecured loans to companies, remained in contraction territory for seven consecutive months, but the annual rate of contraction has been slowing down since October to end the year at -2.2%.

- South Africa's trade surplus decreased to R32 billion in December from a downwardly revised R35 billion the prior month. Exports fell by 8.2% to R125.9 billion, dragged down by lower sales of precious metals and stones (-24%); vehicles & transport equipment (-24%) and prepared foodstuff (-17%). Meantime, imports fell 7.8% to R93.9 billion, amid lower acquisitions of machinery and electronics (-10%); base metals (-22%); original equipment components (-19%) and textiles (-20%). Considering the full year of 2020, the country's trade surplus widened sharply to R270.6 billion from R23.7 billion in the previous year, as exports surged 7.5% whereas imports slipped 11.8%.

- South Africa's Absa Manufacturing Purchasing Managers' Index (PMI) rose slightly to 50.9 in January from 50.3 in December. Despite the improvement, the latest reading is much lower than the average recorded in the final quarter of 2020. Indeed, the business activity index declined for a fourth consecutive month which points to a further loss in recovery momentum. However, there were gains in the forward-looking sub-indices tracking new sales orders and expected business conditions in six months' time, which bodes well for a pick-up in activity towards the middle of the year amid the rollout of the vaccination programme.

- The National Association of Automobile Manufacturers of South Africa (NAAMSA) reported on new vehicle sales statistics for the month of January. It reported that the gradual monthly recovery in the domestic new vehicle sales volumes continued during the month. Aggregate domestic sales at 34,784 units reflected a decline of 5,629 units, or 13.9%, from the 40,413 vehicles sold in January last year. Export sales recorded a second consecutive month of solid growth in January and at 22,771 units reflected an increase of 6,468 units, or 39.7%, compared to the 16,303 vehicles exported in January 2020. Vehicles and components are exported to 151 international markets. Combined with the industry's strong multiplier effect, the industry is responsible for approximately 457,000 jobs across the South African economy's formal sector. The automotive industry contributes 6.4% to our GDP.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Standard Bank/IHS Markit Purchasing Managers Index (PMI), due Wednesday 3 February 2021. After the easing of the Markit PMI during the last quarter of 2020, the implementation of adjusted level-3 lockdown restrictions in January in addition to renewed load-shedding by Eskom are expected to have led to tightened business conditions. Consensus forecast is thus for the PMI to drop below 50 in January down from 50.2 in December.

GLOBAL

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- The IMF raised its economic growth forecasts in its semi-annual Global Financial Stability Report, citing the rollout of vaccine programmes and additional fiscal stimulus, particularly in the US and Japan. Compared to its previous set of forecasts made last October, the IMF raised its global GDP forecasts for 2020 from -4.4% to -3.5% and for 2021 from growth of 5.2% to 5.5%. The 2022 forecast remained unchanged at 4.2%. For the three successive years, the US forecast was upgraded from -4.3%, 3.1% and 2.9%, to -3.4%, 5.1% and 2.5%. China's forecast barely changed from 1.9%, 8.2% and 5.8% to 2.3%, 8.1% and 5.6%. However, India's forecast was lifted sharply from -10.3%, 8.8% and 8.0% to -8.0%, 11.5% and 6.8%, helping to boost the average for emerging and developing economies from -3.3%, 6.0% and 5.1% to -2.4%, 6.3% and 5.0%. Unfortunately, South Africa's forecast changed little from -8.0%, 3.0% and 1.5% to -7.5%, 2.8% and 1.4%, coming in well below the peer group average. The IMF cautioned that "premature withdrawal of policy support" and Covid mutations were the biggest risks to the improving outlook. In its assessment, the IMF did not view inflation as being a risk due to the substantial slack in global labour markets. It expects consumer price inflation will average 1.5% in developed economies and 4% in emerging economies. However, the IMF's Monetary and Capital Markets Department head Tobias Adrian warned that "With investors betting on persistent policy backstop, a sense of complacency appears to be permeating markets", which is raising "legitimate concerns around excessive risk-taking and market exuberance."

NORTH AMERICA

Contributed by Nick Downing

- GDP increased in the fourth quarter (Q4) by 4% quarter-on-quarter annualised, down sharply from the 33.4% growth recorded in Q3. The slowdown is attributed to slower growth in consumer spending, which contributes two-thirds of US GDP. Consumer spending increased 2.5% compared with its 41% pace in Q3. However, the pace of consumer spending growth is expected to recover as lockdown restrictions are eased, which should especially benefit spending in service sectors. Meanwhile, the household savings rate remained elevated at 13.4% in Q4, compared with 7.3% in Q4 2019, which combined with the $0.9 trillion fiscal stimulus implemented at the end of December and President Biden's proposed $1.9 trillion relief package, will significantly boost consumer spending power. Investment spending remained strong in Q4. Residential fixed investment spending grew by an annualised 33.5% building on the 63% increase in Q3. Non-residential fixed investment spending was also robust, rising by 13.8% in Q4. For 2020 as a whole US GDP shrank by 3.5%, its first contraction since the 2008/09 Global Financial Crisis, when GDP shrank 2.5% in 2009. A strong recovery is expected in 2021, especially in the second half of the year once the vaccination programme takes effect. The IMF predicts GDP growth of 5.1% for the full year.

- The Federal Reserve maintained its ultra-accommodative monetary policy settings, keeping the fed funds interest rate at 0-0.25% and the monthly asset purchase programme of $120 billion. Fed Chairman Jerome Powell reiterated the message given in previous policy meetings that current monetary accommodation would continue until employment fully recovered and inflation exceeded its 2% average target for some time. Powell stated that "The economy is a long way from our employment and inflation goals and is likely to take some time for substantial progress to be made." The Fed forecasts US GDP will grow 4.2% in 2021 below the IMF's estimate of 5.1% and that unemployment will drop to 5% by the end of the year, and 4.2% by end 2022, which would still be above the 3.6% low recoded in 2019 prior to the pandemic. The Fed expects base effects to contribute to a spike in inflation in the first half of the year but does not expect high inflation readings to persist and will therefore look past the data.

CHINA

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- The official National Bureau of Statistics purchasing managers' indices (PMIs) measuring conditions in manufacturing and non-manufacturing sectors of the economy, both dropped in January. The manufacturing PMI fell from 51.9 to 51.3 with its forward-looking total new orders and new export orders sub-indices also dropping from 53.6 to 52.3 and from 51.3 to 50.2, signalling further loss in momentum at the headline level over coming months. The non-manufacturing PMI, which covers the services and construction segments of the economy, slumped from 55.7 to 52.4 with the new orders sub-index dropping from 51.9 to 48.7 below the contractionary 50-level and its lowest since February last year at the height of China's Covid-19 outbreak. The recent weakness in PMI business survey readings is attributed to a surge in new Covid cases in the north of the country, which has prompted authorities to discourage travel during the upcoming Lunar New Year festival in mid-February. The People's Bank of China (PBOC) is likely to take note of the easing in economic data, which may prompt it to enhance its monetary accommodation. High interest rates compared with other countries, weak inflation data, modest domestic demand and a strong currency provide the PBOC with ample leeway to boost monetary stimulus.

EUROPE

Contributed by Carel la Cock

- The eurozone's manufacturing sector expanded for a 7th consecutive month as the region saw a continued improvement in new orders and sustained output but delays in supplier deliveries because of challenges securing inputs from Asia, has seen a steep increase in purchase prices. The IHS Markit Eurozone Manufacturing PMI at 54.8 was down 0.5 points from December but remains amongst the highest readings in the past two and a half years. Amongst individual nations, Netherlands (58.8), Germany (57.1) and Italy (55.1) experienced the steepest rate of expansion while France (51.6) and Greece (50.0) had modest growth. Spain (49.3) reported a mild contraction in manufacturing which was a 7-month low. All three broad market groups experienced growth at the start of the year although consumer goods producers experienced less favourable conditions due to the current lockdown measures, compared with intermediate and investment goods producers. Employment continued to fall in general however there were some bright spots in Italy and Netherlands, both reporting net rises. Respondents were largely more upbeat about the coming 12-months, reaching a 3 year high on hopes that the successful roll-out of the vaccine will lift current restrictions and unlock pent-up demand.

UNITED KINGDOM

Contributed by Carel la Cock

- The UK has applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a trade group in the Pacific which includes countries such as Japan, Australia, New Zealand, Canada and also emerging market economies including Vietnam, Malaysia and Mexico. The aim is to establish new partnerships post-Brexit. Prime minister Boris Johnson was hoping that new US president, Joe Biden, would also sign-up to the CPTPP giving the UK a back channel to align closer with the world's largest economy. The likelihood of a comprehensive trade deal between the UK and US has dwindled in recent weeks as Mr Biden has made it clear that he will be focusing on America's domestic economy and looking to upgrade the economy before dismantling any more trade barriers. A quick UK-US trade deal was regarded as the first prize for Brexiteers as it would have validated the struggles in concluding the final decoupling with the European trade bloc.

However, UK trade secretary Liz Truss is determined to forge ahead with minor trade deals and does not expect a UK-US deal to be negotiated this year. Critics of the CPTTP say that it will have minimal economic benefits for the UK as the vast distance between the countries will prove a crucial factor. This compared to leaving the free trade area of its most immediate neighbours which the Treasury has calculated will cost the UK economy as much as 5% over the long term. Meanwhile, the US will be in no hurry to negotiate a trade deal with a medium sized economy such as the UK, essentially putting it at the "back of the queue". As former US president Barack Obama once said prior to the UK voting for Brexit, the UK will have to be content in clinching minor trade deals on equal or slightly better terms than before Brexit.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- India has opened the fiscal taps in an effort to support an economy which was on its knees following the devastation caused by the covid-19 pandemic. The government of Narendra Modi will increase capital investment spend and implement much needed financial sector reforms this year. Bank privatisations and the liberalisation of the insurance industry are welcomed reforms; however, the dilution of the 2016 Insolvency and Bankruptcy Code is regarded as a weakening of the most important reform since the turn of the century and will allow gross misallocation of capital. Furthermore, a return to higher tariffs is seen by free marketeers as a step in the wrong direction. It is feared that protectionism through higher tariffs will ultimately lead to lower productivity and will see a return to the times when ordinary citizens paid higher prices for food and inferior quality products. India might also experience retaliatory tariffs on its own successful services exports which will impact thousands of jobs especially in the IT services industry. The government will borrow a further $11bn in the next two months for final capital spend this fiscal year, putting the fiscal deficit at 9.5% of gross domestic product (GDP) for the year ending in March. This compares to the 3.5% deficit previously targeted before the pandemic. The target for the coming fiscal year starting in April will be a deficit of 6.5% of GDP driven largely by higher capital spending, which will be nearly a third higher than this year and will include the upgrades of roads and railways. The new policy is seen as a departure from the government's previous stance which was to protect its investment-grade credit rating above all else. The Indian economy has made a decent recovery since the 24% year on year contraction in the second quarter of 2020. The IMF has forecast that India's economy will grow by 11% in 2021.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 5.70	62796
JSE Fini 15	- 3.84	11596
JSE Indi 25	+ 8.72	84690
JSE Resi 20	+ 6.60	61374
R/$	- 2.53	15.07
R/€	- 1.23	18.17
R/£	- 2.46	20.59
S&P 500	+ 0.47	3773
Nikkei	+ 2.36	28091
Hang Seng	+ 6.10	28892
FTSE 100	+ 0.09	6466
DAX	- 0.71	13622
CAC 40	- 1.62	5461
MSCI Emerging	+ 5.41	1361
MSCI World	+ 0.29	2697
Gold	- 2.49	1846
Platinum	+ 1.22	1082
Brent oil	+ 6.25	55.04

BOTTOM LINE

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- In her Senate confirmation hearing the new US Treasury Secretary Janet Yellen advocated acting BIG. She said "Neither the president-elect, nor I propose this ($1.9 trillion relief package without an appreciation for the country's debt burden… But right now, with interest rates at historic lows, the smartest thing we can do is act big." We should be paying attention, as the need to act big is relevant to our excessively conservative monetary policy. We should be taking note of what Yellen says. She is the only person in history with the trifecta of top financial jobs, the other two being chair of the Council of Presidential Economic Advisers and chair of the Federal Reserve. The World Bank and IMF have joined the clarion call for bold fiscal activism. Low interest rates are a gift, which should not be squandered. President Biden argued that "With interest rates at historic lows, we cannot afford inaction."

- The South African Reserve Bank cut its benchmark repo rate last year from 6.50% to 3.50%, certainly a bold move by its own standards. The repo rate is at its lowest since the 1960s but there has been no change since last July despite 2 of the 5 policy makers consistently voting for a further rate cut at subsequent policy meetings.

- At the last policy meeting on 21st January, Reserve Bank Governor Lesetja Kganyago stressed that the Reserve Bank cannot do much more to help the economy and that a "faster growth rate depends on implementing prudent macroeconomic policies and structural reforms." We can't disagree but we may have to wait forever for structural reforms. Due to continued state patronage and ideological constraints, these reforms are unlikely, especially amid weakening opposition politics. The lack of impetus in Eskom's unbundling and the shameful protection of South African Airways are key metrics in this regard.

- There is ample scope for the Reserve Bank to make further interest rate cuts. South Africa's real interest rates are amongst the highest in the world. Consumer price inflation (CPI) is 3.1%, almost a full 400 basis points below the current Prime Rate at 7%. In stark contrast, businesses, homeowners and consumers in most of the developed world, are enjoying negative real interest rates. According to the Reserve Bank's own current forecasts, CPI is benign and will remain at 4% in 2021, and 4.5% in 2022. It only exceeds, very slightly, the mid-point of its 3-6% target range in 2023 at 4.6%. Economic growth forecasts are dismal. GDP is forecast to rise by just 3.6% in 2021 following an expected 7.1% contraction in 2020. Moreover, GDP growth is forecast to drop to just 2.4% and 2.5% in 2022 and 2023, respectively. At those rates of growth, our country will have to wait patiently for three full years before reclaiming its pre-Covid economic output level.

- The Reserve Bank's reluctance to ease monetary policy stems from concern over the deteriorating fiscus and the risk of rand volatility. Both concerns are unreasonable. The fiscus would improve greatly if only GDP could grow at a faster rate. The budget deficit and government debt are measured as a percentage of GDP, so if GDP rises the metrics improve. What better way to boost GDP than via reduced interest rates? As interest rates drop businesses and households are encouraged to borrow in order to invest and spend, and domestic demand rises. There is currently negligible propensity to borrow. Private sector credit extension is growing at a paltry 3.4% year-on-year. Clearly PSCE needs a boost to generate a recovery in domestic demand.

- The outlook for the rand is extremely encouraging. Our trade balance is in rude health. While imports have dwindled exports have grown in line with resurgent commodity markets. The trade surplus rocketed from R71.4 billion in the second quarter (Q2) last year to R453.6 billion in Q3, eradicating the current account deficit. The current account increased to a surplus of R297.5 billion in Q3, equivalent to 5.9% of GDP, its highest since Q3 1998. This bodes well for rand stability.

- The global backdrop of extraordinary liquidity expansion is extremely positive for cross border capital flows into emerging market currencies. The trend is boosted further by the interest rate differential between negative real yields in developed market currencies and elevated real yields in emerging market currencies. Since South Africa offers among the highest real yields worldwide and with one of the world's most liquid EM currencies, there is a very high probability of rand appreciation on a 12-24 month view. Global liquidity increased by 25% in 2020 and according to central bank pledges already given, a further 15% increase is forecast in 2021.

- Moreover, the lion's share of liquidity expansion is likely to come from the People's Bank of China (PBOC). Commodity prices and emerging market currencies are highly correlated with PBOC liquidity expansion. Add to this the prospect of further US dollar weakness over the next 12-24 months due to massive Fed easing and President Biden's fiscal spending programmes, and the outlook for the rand is one of stability and potential appreciation. The last time the global environment was so favourable for emerging market currencies was 16 years ago. The opportunity for bold emerging market monetary policy is rare. To waste the opportunity and not cut interest rates would be devastating. Mr. Kganyago, it is time to act BIG!