OVERBERG MARKET REPORT

Tuesday 3rd November 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Last Wednesday our Finance Minister, Tito Mboweni, delivered his 2020 Medium Term Budget Policy Statement (MTBPS). We highlight some of the key points. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Kirk Swart

- Last Wednesday the South African minister of finance tabled the 2020 Medium Term Budget Policy Statement (MTBPS). Emphasis was placed on controlling government expenditure and debt stabilisation over the forecasted three years to 2023/24. According to the MTBPS, the economy is expected to contract by 7.8% in 2020/21, returning to real GDP growth of 3.3% in 2021/22. The National Treasury estimates that economic growth can rise to over 3.0% over the next 10 years and create more than a million jobs. Unfortunately, a million jobs are only 2.56% of the working age population. According the Bureau of Economic Research the rating agencies Fitch and Moody's both gave "lukewarm responses to the MTBPS". Fitch highlighted that a fiscal consolidation plan, given the governments track record, holds lots of uncertainty. More information on the MTBPS appears in our Bottom Line.

- On a more positive note the inflation rate remains at the lower end of the SARB`s inflation target. Annual headline consumer inflation declined by 0.1% from August to September declining on a year-on-year basis from 3.1% to 3.0%. This was in line with market expectations. Core inflation, which excludes food and energy prices due to their inherent volatility, registered 3.3% in September. Annual producer inflation registered 2.5% slightly higher than August's reading of 2.4%. The benign inflation outlook facilitates the potential for further monetary easing by the Reserve Bank, especially given the recent strength and stability in the rand exchange rate.

- South Africa recorded a large trade surplus in September of R33.5 billion. This is the fifth consecutive month that a trade surplus has been recorded. The trade surplus is rising for two reasons, (1) exports are surging and (2) imports advanced, albeit at a slower pace. Merchandise exports of R135.8 billion were recorded versus imports of R102.2 billion. The cumulative data showed that exports rose by about 3% y-o-y during the first nine months of

2020. The key driver of the trade surplus was a 15% y-o-y decline in imports over the same period.

- The ABSA Purchasing Managers' Manufacturing Index (PMI) rose to 60.9 points in October, the highest reading since record-keeping began in September 1999. The reading is up from 58.5 points in September. It was the third consecutive month of expansion in factory activity. Readings above 50 indicate expansion. A big driver of the increase was the inventory index which came in at 61.6 points, and the employment index which came in at 49.1 points but showed a solid increase on the month. The forward-looking new sales orders index was strong at 67.0 indicating further improvement in activity in the months ahead. A slight concern however is the index measuring expected business conditions in six months' time, which slipped over the month from 64.5 to 56.7. It is important to note that PMI figures do not reflect actual conditions but the trend. Despite the sharply improving trend, conditions are still far off their best levels since the PMI data series began in 1999.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- South Africa Standard Bank Purchasing Managers' Index: Due Wednesday 4 November 2020. After recording an eleven-month high in October, the Standard Bank Purchasing Managers' Index (PMI), a composite indicator of private sector business performance, is expected to have continued benefitted from loosened Covid-19 restrictions in its November reading. Despite the positive movement, the PMI is expected to remain in contractionary territory with a sub-50 reading. An expansion in output and demand are needed to revive businesses confidence.

GLOBAL

Contributed by Nick Downing

- The MSCI World Index slumped in the week ended 30th October with a decline of 5.3%, its largest weekly drop since March despite stronger than expected earnings from the tech giants and solid third quarter US GDP numbers. The US S&P 500 index fell by 5.6%. The chief culprits were rising Covid infection rates across Western economies and anxiety that the US presidential elections would be inconclusive. While vaccine development has been delayed by safety concerns it is a fairly secure bet that widespread vaccination will be available by the second quarter of next year together with improved medical treatments and testing methods. Provided the US election is conclusive, markets should enjoy a relief rally as according to MRB Partners Research "Both parties will be primarily focused on accelerating the economic recovery. Major ideological policies will await until after there is a medical remedy for Covid-19 and the economic expansion has transitioned into something more self-reinforcing." The election results pertaining to the Senate and House of Representatives are almost as important as who wins the White House. The most favourable outcome for equity markets would be a "blue sweep", with the Democrats winning all three, providing unfettered access to the Treasury's fiscus. In this scenario the fiscal package would exceed market expectations and provide a significant boost to economic activity.

NORTH AMERICA

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- GDP grew in the third quarter (Q3) by a stronger than expected 7.4% quarter-on-quarter or 33.1% annualised, the fastest growth rate since WW11. In Q2 the economy shrank by 5% on the quarter or 31.4% annualised. The V-shaped recovery is attributed to unprecedented fiscal support. Substantial government financial assistance to households via once-off cash payments and enhanced unemployment benefits combined with pent-up demand helped consumer spending increase by 40.7% annualised. Consumer spending accounts for two-thirds of US GDP. The bulk of consumer spending was allocated to durable goods. Consumer durable goods spending grew at an astonishing 82.2% annualised rate while residential fixed investment surged by 59.3%. Non-residential fixed investment grew by a more modest 20.3%. Unfortunately, government spending fell in Q3 by 4.5% amid the fiscal stalemate in Congress. Economists cite the recent surge in Covid cases and the lack of additional fiscal support as the key risks to continued economic recovery. While the rebound has been V-shaped so far, leaving GDP only 2.9% below the Q3 level in 2019 and 3.5% below the end 2019 level, the outlook is for a more gradual recovery over coming months. Encouragingly, Q3 corporate earnings have beaten expectations by a wide margin with aggregate profits, reported so far, around 20% higher than earlier forecasts made around the start of the quarter. Positive news relating to Covid vaccines and fiscal relief should act as a catalyst for economic activity.

- The economy's main engine of growth, personal consumption expenditure, grew in September for a fifth straight month, increasing by 1.4% month-on-month. The bulk of consumer spending has been allocated to goods rather than services due to enforced and voluntary social distancing but in September spending on services grew by an encouraging 1.1% on the month albeit below the 2% increase in goods spending. Despite elevated unemployment and shrinking fiscal support, personal income increased in September by 0.9% on the month, helped by rising wages, falling interest rates and a buoyant stock exchange. Initial jobless benefit claims reduced sharply in the week ended 24th October from 791,000 to 751,000 indicating a gradual improvement in the jobs market, which should help to boost personal incomes over coming weeks. However, whether households spend their income depends on containment and treatment of the Covid virus. The household savings rate registered 14.1% in August, down from the peak of 33.6% in April but well above the long-term average of 5-7%. High savings, although crimping potential current expenditure provides a reserve for future expenditure. A high savings rate, the likelihood of vaccine approvals by the second quarter of 2020 and prospects of a fiscal stimulus package post the presidential election all bode well for continued growth in personal consumption expenditure over coming months.

CHINA

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- The ruling party's Central Committee concluded its annual planning meeting, issuing a summary document outlining its 14th 5-year plan for the period 2021-2025. Although no formal growth targets were issued, the 5-year plan emphasised the need for technological self-reliance and the need for strong domestic demand, inspired by an "increasingly complicated international environment." The planning session hints at greater investment in climate change technology, greater emphasis on private sector investment and the opening-up of China's capital markets. Coinciding with the conclusion of the planning meeting, authorities announced further financial deregulation, granting foreign investment companies the permission to lend locally listed securities. This facilitates hedging strategies via short selling. Increased hedging capabilities will increase the demand for and involvement by foreign investment firms in China's capital markets.
- Purchasing managers' economic survey data were stronger than expected in October. The official National Bureau of Statistics (NBS) manufacturing purchasing managers' index (PMI) slipped slightly in October from 51.5 to 51.4 but beat expectations and remained above the expansionary 50-level for an eighth straight month, helped by a rise in the forward-looking new export orders sub-index from 50.8 to 51.0, while the total new orders index remained unchanged at a solid 52.8. The NBS non-manufacturing PMI increased from 55.9 to 56.2 its highest since October 2013, with the services sub-index, which has been lagging over the past few months due to social distancing, picking up from 55.2 to 55.5. Meanwhile, the Caixin/Markit manufacturing PMI, which focuses on smaller private sector companies rather than state-owned enterprises, increased in October from 53.0 to 53.6 its highest level since January 2011. Its forward-looking new orders sub-index increased to its highest since November 2010, indicating continued activity growth over coming months. The senior economist at Caixin Insight Group, Wang Zhe noted that "As the economic indicators for consumption, investment and industrial output for September were generally better than expected, it is highly likely that the economic recovery will continue for the next several months."

JAPAN

Contributed by Carel la Cock

- The Bank of Japan (BOJ) has kept monetary policy on hold with overnight rates at -0.1% and maintained the cap on 10-year yields at 0% for a third consecutive monetary policy meeting. However, it slashed its economic outlook for the current fiscal year ending March 2021 from a contraction of 4.7% to a decline of 5.5%. The following year will see a rebound of 3.6% followed by growth of 1.6% in 2023. Furthermore, inflation expectations were also lowered as the BOJ now expects prices to fall by 0.7% compared to 0.5% at the last meeting. The BOJ will continue to purchase exchange traded funds (ETFs) and Japan real estate investment trust (J-REITs) as well as commercial paper and corporate bonds. The BOJ warned that a lack of business investment poses a significant headwind to the economic recovery and that any recovery depends on an effective vaccine and that both firms' and households' outlook on the economy do not deteriorate significantly. Japan has so far not experienced a resurgence in covid-19 cases and has been successful in containing the virus without a hard lockdown. The county has also seen an uptick in industrial production and increased demand for exports. Mr Kuroda, the BOJ governor, reiterated that the bank stands ready to ease monetary policy further "without hesitation" if downside risks materialise.

EUROPE

Contributed by Carel la Cock

- Europe has seen a resurgence in covid-19 cases, prompting authorities to institute a second lockdown which will impact an already stalling economy. Analysts are slashing their economic recovery rates, forecasting a 2.3% drop in the fourth quarter following the eurozone's record 12.7% quarter on quarter growth achieved in the third quarter. Economic output is still below pre-pandemic levels and was down 4.3% compared to a year earlier. France (+18.2%), Spain (16.7%) and Italy (16.1%) recorded the highest growth, although from a low base, while Lithuania (+3.7%), Czechia (6.2%) and Latvia (6.6%) reported the slowest growth in the euro zone. Although all member states showed growth compared to the second quarter, they were all still below levels a year ago, most notably Spain (-8.6%) and Portugal (-5.8%) while Germany (-4.2%) and France (-4.3%) fared better. The manufacturing sector has shown good progress in recent months, but the much larger services sector which has weakened in the last few months will be further hampered by the latest restrictions and will likely be a drag on fourth quarter economic output. Analysts predict that the latest lockdown will be less severe than the summer as firms are better prepared and that manufacturers' supply chains will be less affected than before, meaning exports will remain largely intact. However, retailers fear that the lockdown will impact the Christmas shopping season and that consumers might be more cautious and save for potential future lockdowns. Most analysts expect a contraction in the fourth quarter with a slow recovery in the first quarter of 2021.

UNITED KINGDOM

Contributed by Carel la Cock

- The UK has followed Europe's lead implementing a second lockdown as a resurgence in covid-19 cases threatens to overwhelm medical services. Prime minister, Boris Johnson has called for restrictions of movement and a closure of all non-essential businesses for a month starting this Monday. He previously dubbed a second lockdown a "nuclear deterrent" and then warned that it will bring "misery" on the people, but given the resurgence in the virus, the alternative is even more unpalatable. The lockdown will be reviewed on the 2nd December although there exists the possibility that it could be extended indefinitely. Chancellor of the exchequer, Rishi Sunak, announced further support for the economy in the form of a further £1.1bn in business grants and reinstated the original furlough scheme at 80% of wages for employees affected by the lockdown and a less generous 40% for the self-employed. The Bank of England will meet later this week and it is expected that they will cut their fourth quarter growth forecast and announce further stimulus. The consensus is that the second lockdown will impact the economy less severely than in the spring, as many industries have already adapted where others have simply disappeared.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- Analysts predict that emerging markets (EM) will benefit from Joe Biden, the democratic candidate in the US election, moving into the White House. They further add that investors have not yet positioned themselves for that outcome and that there could be an uplift in EM equities if Biden wins. The argument goes that EM have suffered at the hands of Trump and his administration's protectionist agenda and that there has been a net outflow of funds from EM this year, partly because of a risk-off move following the covid-19 pandemic. However, a win for Biden would lead to improved global trade which will benefit EM. Furthermore, there has been a correlation between a weak US dollar and EM strength and if the democrats can secure both the House of Representatives and the Senate, we could see bigger fiscal stimulus causing both dollar weakness and stronger US growth. EM countries exporting base metals such as South Africa and other more cyclical economies could benefit from the increase in demand. Polls leading up to election day showed Biden the likely winner, but large institutional investors, still scarred by getting the last election wrong, will probably wait on the side lines until a Biden win has been confirmed, something reporters have warned could take several day if not weeks.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 7.82	52618
JSE Fini 15	- 38.77	9597
JSE Indi 25	+ 7.08	74209
JSE Resi 20	- 0.74	48893
R/$	- 13.59	16.20
R/€	- 16.81	18.86
R/£	- 11.36	20.94
S&P 500	+ 2.46	3310
Nikkei	- 1.53	23295
Hang Seng	- 13.23	24460
FTSE 100	- 25.02	5654
DAX	- 11.03	11788
CAC 40	- 21.53	4691
MSCI Emerging	+ 0.01	1114
MSCI World	- 1.54	2322
Gold	+ 23.61	1884
Platinum	- 12.18	853
Brent oil	- 42.65	37.94

BOTTOM LINE

Contributed by Gielie Fourie

- THE BIG FIVE ISSUES: This year Finance Minister Tito Mboweni had a particularly tough task preparing the Medium Term Budget Policy Statement (MTBPS). There were five big issues: (1) The SA economy is in the grip of a technical recession, (2) our foreign debt has been downgraded to junk status, and (3) we are in the midst of the Covid-19 pandemic. In addition (4) our national debt is rising, and (5) our GDP is shrinking. Mboweni's 13-page budget was light on details. We concentrate on a few important issues.

- DEBT MOMENTUM VS GDP MOMENTUM: The upward momentum of our Debt is faster than the upward momentum of our GDP. The goal is to prevent debt from catching up, and God forbid, overshoot the GDP. Mboweni's started his budget with these words: "We table a five-year fiscal consolidation pathway that (1) promotes economic growth while (2) bringing debt under control. The goal is to stabilise the Debt-GDP ratio at around 95% within five years. The figures are big – both Debt and GDP will overshoot R5 trillion (tn). One can argue that other countries also have high debt levels, even higher than our debt levels. But other countries pay only 1% interest on their debt, while we pay 9%. Our cost of capital is nine times higher. Government caused the problem – can they fix it? Nobel Prize winner, Milton Friedman, once cautioned: "Government's solution to a problem is usually as bad as the problem and very often makes the problem worse."

- FISCAL DISCIPLINE AND GOVERNANCE: The only way to slow down the upward momentum of debt is through (1) fiscal discipline and (2) responsible governance. Both Mboweni's MTBPS and Pres Ramaphosa's Economic Restructure and Recovery Plan (ERRP), announced on 17 October, need strong backing from within cabinet. The three pillars of discipline, governance, and implementation remain a risk – government's track record on delivering on its promises is not good. The execution risk is high. This time is different – government cannot afford to make mistakes - we need results. Friedman again: "One of the great mistakes is to judge policies and programs by their intentions rather than their results."

- DEBT: Debt is expected to rise from around R4 tn this year to R5.5 tn in 2023/24. Some of the bigger expenses during this fiscal year will be learning and culture (R1.2 tn) social development (R978 bn (billion) and health (R724 bn). An extra R6.7 bn has been allocated for Social Housing for the poor. A massive Student Housing project of R96 bn is underway – it will service 300,000 students. Expense control is crucial. Mboweni's good news was: "We intend to run primary surpluses on the main budget by 2025/26 by constraining non-interest spending growth. We will shift spending from consumption to investment". This is a radical shift.

- GDP: The economy is expected to grow by 3.3% in 2021 dropping to 1.7% growth in 2022 and 1.5% in 2023. At this rate, the GDP could grow to R5.8 tn. With debt at R5.5 tn the Debt-GDP ratio could stabilise at 95%. To drive economic growth municipalities will be allowed to buy electricity from independent power producers. Infrastructure projects will also be prioritised.

- GOVERNMENT SALARIES: Mboweni said: "Over the past five years, public sector employee compensation grew by 7.2% a year on average – well above inflation. Over the next five years, it will need to grow much, much slower. Consideration should be given to the proposal for across-the-board compensation pay reductions to management-level positions, across national, provincial, and municipal governments, state-owned entities, and all other senior public representatives". The wage bill accounts for about one-third of the budget. Over the last 15 years, public service compensation spending has grown at a rate that is almost 1.5 percentage points faster than the rate of GDP growth. Employee perks are attractive. Mboweni said this is unsustainable. He proposed a public service wage bill that will grow by only 1.8% this year and by an average 0.8% over the next three years - well below inflation.

- REGULATION 28: Mboweni expects our GDP to contract by 7.8% in 2020. Tax revenues will drop. To address this drop, government aims (nothing is sure yet) to review Reg 28 to make it easier for retirement funds to invest in infrastructure. Importantly, Mboweni mentioned that trustees of retirement funds are expected to put the interests of retirement fund members first.

- BAILING OUT STATE-OWNED ENTERPRISES (SOEs): The struggling South African Airways (SAA) will get another cash injection of R17.0 bn. Another R23 bn has been allocated to Eskom. Other SOEs such as the SABC, Denel, and the Post Office will have to wait until February 2021. Flying is an obsession with our politicians. Our 400 Members of Parliament, and their spouses, fly for free. Cabinet Ministers fly for free for the rest of their lives. Once again, the perks are attractive. We certainly have much more pressing issues than this. There are increasing threats from the public to boycott SAA. If this happens SAA will have no income – expect another crash landing and another bailout. In addition, there is Inkwazi ("fish eagle" in Zulu), a Boeing 737 Business Jet for the use of the president. Most countries do not own an airline, let alone presidential jets. Government wants to turnaround SAA. Three words of advice from Warren Buffett: "Turnarounds seldom turn".

- SUMMARY: Mboweni often includes quotes from the Bible in his budgets. His closing remark: The Gospel according to John 12:35 warns us: "You are going to have the light just a little while longer. Walk while you have the light, before darkness overtakes you. Whoever walks in the dark does not know where they are going." Wise words indeed.

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