OVERBERG MARKET REPORT

Tuesday 4th August 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- We are living in the age of Covid-19. Negativity and pessimism abound. But some of the world's greatest success stories were started during dark times. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Inflation continued to hover close to multiyear lows, despite edging higher in June. Consumer price inflation (CPI) edged up slightly in June to 2.2% year-on-year from 2.1% in May and registers as the second consecutive print below the lower bound of the South African Reserve Bank's 3% to 6% inflation target. Similar to May, a lower fuel price was a significant driver of the subdued annual inflation seen in June. Although fuel prices increased by 7.5% month-on-month, they were still down 20.9% year-on-year. Additionally, rentals remained subdued and registered only a moderate annual uptick. Both actual rentals and owners' equivalent rent rose by well below 2%. On a monthly basis, CPI rose by 0.5%. Going forward, the inflation outlook also appears to be balanced, 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, electricity and other administered prices is a concern. Eskom is likely to increase the price of electricity after its recent court victory over the electricity regulator. The court outcome will effectively let Eskom up its tariff revenues by R69 billion, on top of other tariff clawbacks it has previously won against the regulator. 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 as consumer spending is anticipated to remain constrained for the foreseeable future. Furthermore, corporates are limited in their ability to pass price increases on to consumers as households continue to grapple with muted income prospects and increased indebtedness.

- Manufacturing output levels are stabilising, but employment prospects are still worrying, the Absa Purchasing Manager's Index (PMI) for July revealed. The Absa PMI eased to 51.2 in July from 53.9 in June. Nevertheless, this print registers as the third consecutive reading in expansionary territory, as the sector continues to rebound amid the easing of stringent lockdown restrictions. The PMI gives an indication of activity in the manufacturing sector, which accounts for about 13% of South Africa's GDP, and is an early indicator of underlying economic activity. A reading below 50 indicates a contraction in activity, while a reading above 50 indicates expansion. The July reading registered the first time since the start of 2019 that the index spent three straight months above 50, albeit from a low base. It has been flirting between expansion and contraction for most of the past decade as power shortages and low business confidence weigh on the sector. Two important subcomponents — business activity index and new sales orders — showed monthly declines from June, but both remained in positive territory. The business activity index dipped to 62.9 from 64.6 and the new-sales orders sub-index fell to 53.4 from 60.3. Furthermore, business conditions in six months' time rose to 51.8, the highest level in a year. ABSA did however note in its report that business activity is still "fairly subdued" compared to the long-term average. Particularly worrying they said, was the employment sub-index which is lingering at record-lows. The sector is still shedding jobs, despite activity recovering. The PMI employment indicator suggests that further job losses are likely after an initial hit to employment in the second quarter. Going forward, the manufacturing industry is expected to see a recovery from the low levels resulting from lockdown, although the longer-term outlook remains weak. Unstable electricity supply, higher input costs (electricity), a subdued economic environment and inflexible labour laws will continue to weigh on output and global competitiveness of the industry.

- New vehicles sales declined by 29.6% year-on-year in July to 32 396 units. The July print is down 13 646 units from the 46 042 vehicles sold in July 2019. Export sales at 24 706 units also registered a fall of 29.6%, down 10 381 units compared to the 35 087 vehicles exported in July 2019. While the rise in new vehicle sales since the easing of level 5 lockdown restrictions in April, when just 574 new vehicles were sold, is encouraging, overall purchases will need to be much higher to revert to pre-crisis levels. Cyril Zhungu, head of automotive retail finance at Standard Bank explained that much of the demand is moving into the used-vehicle market. In good times, new vehicles outsell used ones. Furthermore, consumers are expected to continue to lengthen their vehicle replacement cycle in order to reduce costs amid a weak labour market and low confidence levels. The domestic automotive industry's vehicle export performance for the second half of the year hinges on the successful implementation of the lockdown exit strategies in the domestic industry's major export destinations. There is reason for optimism that exports will gain upward momentum as international markets ease lockdown restrictions while many are also stimulating their new vehicle markets with financial incentives.

SOUTH AFRICA POLITICAL REVIEW

Contributed by Gielie Fourie

- On 27 July 2020, the International Monetary Fund (IMF) approved a R70 billion (US$4.3 billion) loan, at an interest rate of 1.1%, for South Africa to help the country manage the immediate consequences of the fallout from Covid-19. The IMF has provided the funding through its Rapid Financing Instrument (RFI). The RFI provides financing quickly and without strict conditions. The country merely needed to show the IMF that it is facing a crisis, that it will use the funds to deal with the crisis, that it will cooperate with the IMF to solve the balance of payments problems caused by the crisis, and to describe the economic policies that it proposes to follow. South Africa provided the requisite information to the IMF in the form of a letter of intent. South Africa's economy is expected to contract by about 7% this year and the budget deficit to increase to about 15% of GDP. This means that the government will need to increase the amount it has to borrow. Given that it has been downgraded by credit rating agencies, and that the economy is in bad shape, there is a substantial risk that both local and foreign investors will have a limited appetite for South African debt. This will complicate the government's efforts to finance the deficit. The IMF loan helps resolve this problem.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- IHS Markit South Africa Purchasing Managers' Index: Due Wednesday 5th August 2020. The IHS Markit purchasing managers' index (PMI) is expected to reflect an improvement in private-sector business conditions during July as sentiment started to recover on the back of eased lockdown measures. Trading Economics expect the IHS Markit PMI to record a reading of 52 in July up from 42.5 recorded in June, breaching the 50-threshold which indicates an improvement in operating conditions.

GLOBAL

Contributed by Nick Downing

- The US dollar index, measuring the greenback against a basket of currencies, fell 4.5% in July to its lowest in two years, marking the sharpest monthly decline since 2011. There are various reasons for the fading allure of the world's reserve currency. Most notably, the interest rate differential between the US and other major currencies has dropped precipitously since the Federal Reserve cut the benchmark fed funds rate to zero. At the same time, the Fed's unprecedented level of quantitative easing has compressed the yield on the 10-year US Treasury bond to such an extent that its real yield, after taking inflation into account is at minus 1%, close to a record low and hardly attractive to foreign capital inflows. The surge in new coronavirus cases is exacerbating the dollar's decline, with global investors instead rewarding the euro for its relative success in containing the virus. The rapid increase in new US cases suggests that the Fed and Congress will have to do even more quantitative easing and fiscal spending, which may culminate in an inflation spike down the road, eroding the fundamental value of the dollar. However, it is not all bad news for global financial markets. A weakening dollar is traditionally associated with buoyant risk appetite especially in riskier markets such as emerging economies. A weaker dollar also lowers the value of dollar-denominated debt loads, raises the price of dollar denominated securities such as gold and commodities, and increases the competitiveness of exported US products and services. Sustained periods of dollar weakness are normally associated with equity bull markets and a cyclical rebound in the global economy.

NORTH AMERICA

Contributed by Nick Downing

- GDP contracted in the second quarter (Q2) at a post WW2 record pace of 32.9% quarter-on-quarter annualised, accelerating from the Q1 decline of 5%, as the full impact of the coronavirus lockdown reverberated through the economy. The economic decline was broad based with steep declines reported across personal consumption, investment spending, exports, inventories, and state and local government spending. Disposable personal income provided a silver lining to the dismal figures, rising by a massive 42.1%, helped by the $3 trillion fiscal package authorised by Congress in late March. In addition, the Q2 GDP contraction was mildly better than the 34.1% consensus forecast. However, high frequency data such as credit card transactions and restaurant visits show the pace of economic rebound slowed at the start of Q3 in July, attributed to the resurgence in coronavirus infections. Following four straight months of declines since peaking in late March, initial jobless benefit claims increased for the second straight week in the week ended 25th July, adding to evidence that the economic rebound may be stalling. Analysts may have to scale back their Q3 GDP growth forecasts, currently lying in the 20-25% range. According to Beth Ann Bovino, US chief economist at S&P Global Ratings, "We're expecting a longer and slower climb from the bottom unfortunately, and here the virus will dictate the terms." Mark Zandi, chief economist at Moody's Analytics was similarly cautious, "It's a very deep and dark hole and we're coming out of it, but it's going to take a long time to get out."

- As expected, the Federal Reserve refrained from additional monetary stimulus at its policy setting meeting last week, although Fed Chairman Jerome Powell indicated a readiness to add further stimulus if required. He observed that "the pace of the recovery looks like it has slowed since the cases began to spike in June" and that the fate of the economy would "depend significantly on the course of the virus", requiring additional fiscal stimulus from Congress. Powell raised expectations that results of the Fed's comprehensive year-long policy review would be published at the next policy meeting on 15-16th September, in which the Fed is likely to announce a shift from symmetric 2% inflation targeting to average 2% targeting. Under the new policy, the Fed would allow inflation to run ahead of the 2%

target to make up for the below-target periods. The expected shift in policy is prompted by the steady decline in policy rates to the zero level and Japan's damaging experience with deflation over the past two decades. If inflation remains below its target for prolonged periods, as has been the case in the US over the past few years, consumers and businesses begin to lower their inflation expectations, running the risk of deflation taking hold. Deflation is far more damaging than inflation especially when indebtedness is elevated. The Fed's expected policy shift signals that zero interest rates are likely to remain for a prolonged period, probably well into 2023.

- The Democrat-controlled Congress rejected the Senate Republicans' $1 trillion supplementary coronavirus relief bill, describing it as woefully inadequate. Democrat House speaker Nancy Pelosi likened the reconciling of the two parties to mating "a giraffe and a flamingo." The Democrats have proposed a $3 trillion relief bill. While both parties agree on a further $1200 helicopter cash drop to individuals, key sticking points remain. The Democrats favour a further $900 billion pay-out to state and local governments while the Republicans want no further pay-out. The Republicans want to protect businesses from any coronavirus litigation, which the Democrats are against. The biggest point of disagreement relates to the $600 per week enhanced unemployment benefit payments, which expired on 31st July, and which the Democrats want to maintain at the current level until January 2021, while the Republicans want the payments reduced to $200 per week and only until the end of September. The Democrats have rejected the Republican proposal of piecemeal short-term extensions to the enhanced benefit payments, thereby forcing parties to the negotiating table. Although the impasse increases the risk a sharp decline in household disposable income, potentially derailing the economic rebound, it is likely that Congress will reach a constructive compromise in the near term, providing the catalyst for an additional lift to financial markets.

CHINA

Contributed by Nick Downing

- The Caixin manufacturing purchasing managers' index (PMI) maintained its recovery in July, rising from 51.2 in June to 52.8, well above the expansionary 50-level and its highest since January 2011, providing evidence of a strong rebound in industrial activity. According to IHS Markit, which compiles the PMI survey, "growth forecasts were underpinned by expectations that economic activity and client demand will continue to recover from the pandemic." Among the PMI sub-indices, the forward-looking new orders index gained to 54.4, indicating expected strength in domestic demand in the second half of the year, although the export orders index remained mired in contractionary territory at 48.3, illustrating the continued impact of Covid-19 on global demand. The official National Bureau of Statistics manufacturing PMI, which focuses more heavily on the larger state-owned enterprises, also gained in July from 50.9 to 51.1, the fifth straight month above the key 50-level. The PMI survey data are strongly positive, pointing to economic output rapidly reclaiming its pre-pandemic levels, which according to Julian Evans-Pritchard, senior China economist at Capital Economics, will be achieved by year-end.

JAPAN

Contributed by Carel La Cock

- Japan's Consumer Confidence Index edged higher in July rising by 1.1 to 29.5. Consumer optimism picked up across all sentiment sectors - Overall Livelihood (+1.3), Income Growth (+1.4), Employment (+0.8) and Willingness to buy durable goods (+0.8). The cabinet Office left its assessment unchanged from last month saying that consumer confidence remains subdued but showed signs of recovering. The percentage of respondents expecting prices to rise in the year ahead rose to 73.7% from 71.5% in June while only 9.5% expect prices to go down, a decrease of 1.5 percentage points from June.

- The fall in output from the manufacturing sector eased in July to the slowest rate since the start of the covid-19 pandemic. The Jibun Bank Japan Manufacturing PMI at 45.2 in July was up 5.1 points from June and less than five points shy of the neutral 50-level. Although the PMI indicates that manufacturing is still contracting, it remains a remarkable recovery given the reading of 38.4 in April, which was an eleven-year low. Goods producers indicated that they continue to be negatively impacted by a lack in demand following the covid-19 pandemic and the weak global economic outlook. Tim Moore, director at IHS noted "that the headline PMI recovered some of the ground lost in the second quarter, helped by the smallest declines in output and new orders for five months during July. Consumer goods fared better than the rest of the manufacturing sector. Production of consumer goods was close to stabilisation in July. Capital goods was the worst-performing segment for export sales, highlighting that reduced global investment spending and constrained trade flows are holding back the Japanese manufacturing sector."

EUROPE

Contributed by Carel La Cock

- The IHS Markit Eurozone Manufacturing PMI has moved above the key 50-level indicating growth in the sector after months of contraction. The reading of 51.8 in July was 3.7 points higher than June and the first reading above the neutral mark since February 2019. Growth was broad based with all market groups coming in above 50 for the month. However, consumer goods were the standout marking the fastest expansion in over 18 months. Spain had the highest manufacturing PMI reading at 53.5 followed by Austria (52.8), France (52.4), Italy (51.9) and Germany (51.0). Chief Business Economist at IHS, Chris Williamson, remarked "Growth of new orders in fact outpaced production, hinting strongly that August should see further output gains. The job numbers remain a major concern, however, especially as the labour market is likely to be key to determining the economy's recovery path. The next few months' numbers will therefore be all important in assessing whether the recent uplift in demand can be sustained, helping firms recover lost production and alleviating some of the need for further cost cutting going forward."

UNITED KINGDOM

Contributed by Carel La Cock

- The latest activity data in the UK is signalling an uptick in the economy although still well below pre-pandemic levels. The Financial Times has compiled a data set to track real time changes in the economy to supplement official data which can be outdated by the time it is published. Consumer spending is more than 20% below levels seen a year ago despite an increase in online shopping. According to Fable Data, which measures card use across the country, spending has lifted from the lows in April, but has not yet recovered completely and that could be as a result of higher unemployment and reduced job vacancies. There are more than 9m people on the furlough scheme, all facing an uncertain future once the scheme starts to unwind this month and they are likely to delay consumer spending. Job vacancies are still well below levels last year but have seen an improvement since May. Increased job vacancies would be an early indicator that economic activity is picking up and signal a turnaround in the job market. Lastly retail footfall picked up when shops opened in mid-June but remains about 40% below last year. Although consumers have been spending more online, retail centres remain an important hub for consumers via pubs, restaurants and evening entertainment. The hospitality and entertainment sectors have been particularly hard hit and despite the government's initiatives such as "eat out to help out" the number of patrons remains about 30% below a year ago. Consumer spending makes up roughly two thirds of the UK's GDP and although activity has improved, there is still a long road to a full recovery.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- Mexico is the latest emerging market country to report dismal economic output for the second quarter. The economy contracted by 17.3% quarter-on-quarter annualised and by 18.9% year-on-year, marking the fifth consecutive quarterly contraction and biggest drop in history. The labour market has been severely impacted, and it is estimated that as many as 12m people employed in the informal market have lost their jobs and that 55% of workers did not earn enough to afford a basic basket of food. Mexico has thus far refrained from large stimulus packages and has instead focussed on loans to microbusinesses, which has done little to stem the tide of job losses. Mexico is expected to emerge from the pandemic in far worse shape and is unlikely to experience a V-shaped recovery. A credit downgrade at the end of the year seems inevitable and analysts expect the 2021 budget, due next month, will do little to avoid that fate. Losing its investment-grade rating will further hamper the country's recovery efforts and some analysts expect that Mexico will only be able to recover to pre-pandemic levels as late as 2022.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 2.20	55829
JSE Fini 15	- 37.45	9805
JSE Indi 25	+ 7.84	74738
JSE Resi 20	+ 14.87	56585
R/$	- 18.56	17.19
R/€	- 22.40	20.22
R/£	- 17.45	22.48
S&P 500	+ 1.98	3294
Nikkei	- 6.18	22195
Hang Seng	- 13.24	24458
FTSE 100	- 20.01	6032
DAX	- 4.54	12646
CAC 40	- 18.44	4875
MSCI Emerging	- 3.30	1077
MSCI World	- 1.46	2324
Gold	+ 29.52	1974
Platinum	- 6.94	903
Brent oil	- 33.26	44.15

BOTTOM LINE

Contributed by Gielie Fourie

- RISING FROM THE ASHES: We are living in tough times, but not for the first time. Last week, on 28 July, we commemorated the start of World War I in 1914. It lasted until 1918 – 20 million people died. Then, in 1918, the Spanish Flu hit the world – 50 million people died. In 1929 the Great Depression hit the world. Ten years later in 1939 WWII started. Another 75 million people died. Total deaths? At least 145 million. The future looked dark and bleak. But mankind rose from the ashes of two world wars, a pandemic, and an economic depression. Tough times have always produced extremely successful entrepreneurs.

- ANTON RUPERT (1916 – 2006): Rupert was born in Graaff Reinet – one may think, the wrong place at the wrong time. He studied to become a medical doctor at the University of Pretoria. He dropped out because his father, a lawyer, could not afford the university fees. Rupert switched to a course in chemistry. After graduation he lectured for a short while. He then started a dry-cleaning business. Later, with an initial investment of £10.00 he started manufacturing cigarettes in his garage. Going door-to-door he sold shares in his company, Voorbrand Tobacco. Voorbrand laid the foundations for a global empire. Rupert's £10.00 investment grew into an empire of several billions. Rupert created many millionaires. Today the main companies in the Rupert stable include Remgro, Richemont, British American Tobacco, Mediclinic, Reinet (named after his hometown, Graaff Reinet), and interests in banking and the wine industry. Rupert died at the age of 90 - it took him 60 years to create an "overnight" success. After his death, his son, Johann Rupert, took over management. Today, with a fortune of $6.0 billion, Johann Rupert is number 324 on Bloomberg's Billionaires Index.

- GUCCIO GUCCI (1881 – 1953): Guccio was born in Florence, Italy, the son of a leather craftsman. As a teenager he worked as a lift boy at the luxury Savoy Hotel in London. The luxurious luggage of hotel guests impressed the young Guccio. On his return to Florence, he started making travel bags and accessories. In 1921 he founded the House of Gucci. He hired the best craftsmen and soon built a reputation for fine leather goods with classic styling. His four sons joined the business. He expanded the House of Gucci internationally. WWII was tough on Gucci, but Gucci survived. In 1999 Gucci bought the French luxury fashion house, Yves Saint Laurent. With 550 Gucci stores globally, it is one of the most iconic brands in the world. Gucci products became notable fashion statements and international status symbols. The Gucci headquarters are still in Florence.

- GABRIELLE "COCO" CHANEL (1883 – 1971): Coco Chanel was a French fashion designer – she was the founder of the Chanel brand. Her signature perfume, Chanel No. 5, became an iconic product. Ninety years later Chanel No. 5 is arguably still the world's most iconic, and bestselling, perfume. When asked what she wore to bed, Marilyn Monroe famously replied, “I only wear Chanel No. 5.” Coco was credited in the post-World War I era with liberating women. Yves Saint Laurent (1936 – 2008), once remarked: “Coco Chanel gave women freedom; I empowered women.” Coco Chanel managed to survive the toughest of times. Time magazine listed Coco as one of the 100 most influential people of the 20th century. She was the only lady on the list. Van Loveren Vineyards saw a marketing opportunity – they produce a 100% Chenin Blanc and market it as “Chenin No. 5”.

- ISAAC CARASSO (1874 – 1939): Isaac Carasso founded Danone. Carasso, born in Greece, was a Jewish doctor. In 1912, with the unrest of the Balkan Wars, he moved his family to Barcelona in Spain. Carasso noticed that many young children suffered from digestive and intestinal problems. He recalled that such conditions were treated with yogurt in the Balkans. In 1919, he opened a small yogurt business named "Danone", named after a nickname of his son, Daniel Carasso. Daniel took over the family business. In 1942, during WWII, Daniel expanded Danone globally. He made several acquisitions, including Evian mineral water in France. Today Danone is an international consumer brand, headquartered in Paris and listed on the Paris Stock Exchange. Due to its narrow focus and relatively small size, Danone is an attractive takeover target for companies like Pepsi and Nestlé. The French government stepped in by drafting a law to protect companies in "strategic industries" such as Danone from takeovers. This law has been dubbed the "Danone Law".

- SUMMARY: Not one of these products are essential in our lives – they are all luxuries. We do not need cigarettes, Gucci, Chanel No. 5, Yves Saint Laurent fashions, Danone, nor even Evian, in our lives. Through brilliant marketing, entrepreneurs create needs. Entrepreneurs are often considered crazy. Steve Jobs said it best: “Here’s to the crazy ones. Because the ones who are crazy enough to think they can change the world, are the ones who do”. Johann Rupert remembers how his parents experienced hardships – it caused them to remain frugal despite their wealth. The message is clear: Be frugal, be crazy, stay positive, stay foolish, stay hungry. It could lead to untold fortune.

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