## OVERBERG MARKET REPORT

Tuesday 6th October 2020

### IN THIS WEEK'S BOTTOM LINE

*Contributed by Nick Downing*

- The MSCI World Index gained 44.2% between its March low this year to the end of September. The US S&P 500 Index gained 51% over the same period, both meeting the bull market qualification of a 20% upward move. Read more in the Bottom Line.

### SOUTH AFRICA ECONOMIC REVIEW

*Contributed by Werner Erasmus*

- The official unemployment rate in South Africa artificially declined by 6.8% from 30.1% in the first quarter to 23.3% in the second quarter. The decline was because of a technical issue in the definition of unemployment which excludes people not actively looking for work. A massive 5.2 million people fell into the economically inactive category as individuals stopped actively looking for employment because of the Covid-19 lockdown. The number of employed people fell by 2.2 million to 14.1 million, its lowest level in 9 years. The expanded definition of the unemployment rate provides a better indication of the labour market. It includes people who were available for work but not looking for a job, and it increased to 42% from 39.7%. The Quarterly Labour Force Survey also highlighted the difficulties households are facing amid falling incomes. Of the 14.1 million people who managed to stay employed during the lockdown only 81.3% received salaries. Of those who were paid, about 21.1% had their salaries cut. The latest labour market data reflects the initial impact of the Covid-19 induced lockdowns. As the economy opens up and returns to normal, many jobs are expected to be regained. Nevertheless, there is a big risk that unemployment could increase further in the third quarter with many corporates hinting towards potential staff cuts to minimise operating costs in a low growth environment. The labour market is expected to remain fragile, reflecting a weak South Africa economy.

- Annual consumer price inflation slowed to 3.1% in August, down from 3.2% in July. The latest reading was in line with market expectations, and slightly higher than the bottom level of the South Africa Reserve Bank's (SARB) 3%-6% target range. Inflation has been at or below the midpoint of the SARB's target range for 21 months now. The main contributors to the 3.1% annual inflation rate were food and non-alcoholic beverages; housing and utilities; and miscellaneous goods and services. The consumer price index increased by 0.2% month-on-month. Core inflation (which excludes food and energy prices) rose to 3.3% year-on-year in August, up from 3.2% in July. Inflation is expected to remain subdued over the near term as weak demand-pull inflation keeps overall price pressure well contained and businesses struggle to pass on material price increases in the current highly price elastic consumer environment, characterised by a significant downturn in income prospects. The SARB, in its latest rates decision, lowered its inflation forecast, expecting it to average 3.3% in 2020, 4.0% in 2021 and 4.4% in 2022.

- Private sector credit extension (PSCE) growth slowed to 3.9% year-on-year in August, from 5.1% in July. The disappointment was owing to a moderate decline in the (volatile) financial investments category, and to a slightly smaller increase in "other" loans and advances. In monetary terms, total private sector credit extension increased R6.2 billion month-on-month notwithstanding a R4.1 billion month-on-month decline in the volatile financial investments category. The year-on-year growth in household credit slowed further to 3% in August from 3.2% in July, constrained by rising unemployment, weak real income growth, a deterioration in consumer credit standing and prudent lending from financial institutions. The corporate sector's total credit growth slowed to 4.6% in August from 6.7% in July. Waning pandemic-induced borrowing by the corporate sector and continued weakness in household borrowing suggests further deceleration in private sector credit extension in the near term.

- South Africa recorded its second-largest monthly trade surplus on record, aided by further easing of lockdown restrictions. Against expectations, the trade surplus increased slightly to R38.9 billion, from a downwardly revised surplus of R37.9 billion in July 2020. Exports grew by 6.6% month-on-month (+8.8% year-on-year), due to a sizeable increase in exports of precious metals and stones. Imports rose by 7.4% month-on-month but were still down 20.7% year-on-year. Year-to-date, the trade surplus lifted to R134 billion. Unsurprisingly, the positive trade data failed to inspire the rand, due to the market's preoccupation with the weak economy and the lack of fiscal intervention and structural reforms.

- Total new vehicle sales fell 23.9% year-on-year to 37 403 units in September. milder than August's 26.3% decline. The absolute number was the highest reading since February. Compared to the previous month, vehicle sales surged 12.4%. The new passenger car market at 22 798 units registered a decline of 31.2% year-on-year, new light commercial vehicles, bakkies and mini-buses recorded a decline of 8.9%, the medium and heavy truck segment declined 13.9% and heavy trucks and buses declined 5.8% compared to the corresponding period last year. For the year-to-date the new vehicle market is still down 33,4% or 132 878 units compared to the corresponding period last year. The easing of lockdown restrictions to level 1 during the month contributed to the uptick in business activity and new vehicle demand and drove the improvement in business conditions in the South African manufacturing sector. However, the vehicle manufacturing industry and vehicle sales are expected to remain under pressure as consumers continue to hold off on purchases of big-ticket items, as indicated in the latest FNB/BER Consumer Confidence survey, amid a sharp downturn in income prospects and a highly uncertain economic outlook

- Business conditions in the local manufacturing sector continued to improve as indicated by the ABSA Purchasing Managers' Index (PMI). Following a robust increase in August, the Absa PMI ticked up further to 58.3 in September, well above the expansionary 50-level. The reading pointed to the fifth consecutive month of expansion in factory activity and at the quickest pace on record, driven by improved business activity and new sales readings, likely helped by the shift to a lower lockdown level mid-month. The Stellenbosch Bureau of Economic Research (BER), which compiles the survey, warned that although the PMI levels are now above levels seen pre-lockdown, they should not be interpreted as if manufacturing levels have returned to pre Covid-19 levels, but should be seen merely as an improvement in conditions. Indeed, some respondents noted that although improving, conditions remain far from normal. Encouragingly, the BER noted that purchasing managers remain optimistic about business conditions going forward. The index tracking expected business conditions in six months' time ticked up to 64.5 from 63.4 in August compared with a low of just 27.3 index points in April. The sustained improvement in PMI offers hope of a broader manufacturing upturn and enhanced industrial activity.

## SOUTH AFRICA: THE WEEK AHEAD

*Contributed by Ingrid Breed*

- Manufacturing Production: Due Monday 12 October 2020. After beating market expectations in July, manufacturing production is expected to have continued on the road to recovery in August, although a negative year-on-year reading is still expected. Manufacturing production is expected to have increased 5.8% month-on-month in August, down from 7.6% in July, and to have contracted 7.5% year-on-year up from -10.6% in July.

## GLOBAL

*Contributed by Nick Downing*

- Global financial markets appear to have lost their upward momentum over the past month, held back by growing concerns over a contested US presidential election, the continued Congressional impasse over a supplementary fiscal support package, and the second wave of Covid-19 infections sweeping across Europe. A positive breakthrough on fiscal support would provide a boost to markets as would the approval of a reliable Covid-19 vaccine, although any vaccine needs to go through rigorous regulatory approval for it to be widely adopted on a voluntary basis. This probably excludes the four Chinese vaccines which are already in late stage human trials. The front runner is still the Oxford University/AstraZeneca vaccine but there are also three other contenders in late stage human trials. According to consensus forecast, a reliable vaccine will be available by the second half of 2021, and according to the OECD, depending on how rapidly it is distributed and adopted, it could lift projected global GDP growth next year from 5% to 7%. The potential lift to global economic activity could be substantial.

**NORTH AMERICA**

***Contributed by Nick Downing***

- The Democrat-led House of Representatives passed a $2.2 trillion fiscal aid package. In similar fashion to the $3.5 trillion package it passed in May, this one has also been rejected by the White House and Republican controlled Senate. However, the divide is narrowing. With growing evidence of a slowing jobs recovery, President Trump is urging Republicans to come to a bipartisan agreement and has lifted his proposed package from $1.5 to $1.6 trillion. US Treasury Secretary Steven Mnuchin and Democrat speaker of the House of Representatives, Nancy Pelosi, have been in intense negotiations to develop a fiscal compromise, raising the likelihood of some agreement prior to the November 3rd election. Any positive developments in this regard would shore-up household balance sheets, the balance sheets of state and local governments, and small and distressed companies including in the airline industry, which is on the verge of mass retrenchments. Economists from the private sector and from the Federal Reserve warn that the alternative scenario of no additional fiscal support would weaken and lengthen the economy's recovery time.

- At first glance, the unemployment decline in September from 8.4% to 7.9% appears encouraging. However, the details of the monthly nonfarm jobs report indicate that the employment recovery is losing momentum. The decline in the unemployment rate is attributed largely to 695,000 people quitting the jobs market, reducing the labour participation rate from 61.7% to 61.4%. Meanwhile, the number of job losses described as permanent increased over the month by 345,000 to 3.8 million, showing a steady increase from the 2 million level in April, when the unemployment rate peaked at 14.7%. A net 661,000 jobs were created in September, which although a high number by normal standards, is down sharply from the 1.5 million jobs created in August and well below the consensus forecast of 800,000. Of the 22.2 million jobs lost at the height of the pandemic, only 11.4 million have been recovered so far, a little less than half, and several new job losses, not factored into the September data, have been announced by large companies over the past week. United Airlines and American Airlines confirmed they will proceed with 32,000 job retrenchments. Job cuts may accelerate if smaller distressed companies and distressed industries in the travel, hospitality and public transport industries fail to receive relief, either financially from fiscal support or medically from early approval and adoption of a Covid vaccine.

- Household incomes fell in August by 2.7% month-on-month, attributed to the expiry of enhanced unemployment benefits, prompting households to dip into their savings. The savings ratio fell in August from 17.7% to 14.1%, although still well above the long-term average of 5-7%. Despite the recent drop, household incomes are still 2% above the pre-pandemic level, helped by earlier fiscal transfers, the rising equity market and firming property prices, as well as mortgage refinancing at lower interest rates. Household consumption increased in August by 1% on the month, but slower than July's pace of 1.5%, and June's 7% pace. Economists are concerned that in the absence of additional fiscal transfers that consumer spending, the main engine of the US economy, contributing two-thirds of GDP, will come under pressure. Fortunately, US consumer confidence, measured by the Conference Board, suggests growing confidence in the economic outlook. Following two straight months of decline, the consumer confidence index surged in September from 86.3 to 101.8, its highest level since March and the biggest gain since April 2003. Encouragingly too, the share of survey respondents describing jobs as plentiful, increased to 22.9%, up from 21.4% the prior month and the low of 16.5% recorded in May. As consumer confidence increases, households will be more inclined to spend rather than save.

- Although declining slightly in September from 56.0 to 55.4, the Institute for Supply Management manufacturing purchasing managers' index (PMI) was firmly above the expansionary 50-level for a fourth straight month. Among the sub-indices, the forward-looking new export orders index encouragingly gained from 53.3 to 54.3 and the employment index also firmed from 46.4 to 49.6. The IHS Markit manufacturing PMI corroborated the positive manufacturing outlook, rising from 53.1 to 53.2. IHS chief economist Chris Williamson said, "Companies reported a marked upturn in demand for plant and machinery, which suggests firms are increasing their investment spending again after expansion plans were put on hold during the spring." There is a strong correlation between the manufacturing PMI cycle and global trade. The upbeat PMI data emits a positive signal for global trade and a sustainable global economic recovery.

## CHINA

*Contributed by Nick Downing*

- China's economic rebound gained further traction in September according to upbeat purchasing managers' indices (PMIs). The official National Bureau of Statistics manufacturing PMI increased in September from 51.0 to 51.5, its seventh straight month above the expansionary 50-level and the strongest reading since March, prior to the worst of the Covid pandemic. Among the sub-indices, the export order index turned expansionary for the first time this year. The private sector Caixin manufacturing PMI slipped slightly from 53.1 to 53.0 but its new orders sub-index hit its highest level since 2011 and the export order index hit a three-year high. Since new orders are forward looking the data signals further gains in manufacturing activity over coming months. The recovery in export orders should also provide an added boost to China's economic recovery. Meanwhile, the service sector of the economy, which has so far been the weak link in China's rebound, showed up strongly in the Caixin non-manufacturing PMI, which increased from 55.2 to 55.9 its highest level since November 2013. The data suggests consumers are once again returning to the hospitality industry and other service providers requiring close-proximity interaction. The latest economic data solidifies China's standout economic outperformance in 2020, being the only major economy expected to show GDP growth this year.

## JAPAN

*Contributed by Carel la Cock*

- Japan's Consumer Confidence Index continued to rise in September and was up 3.4 points to 32. Consumer optimism again picked up across all sentiment sectors - Overall Livelihood (+3.7), Income Growth (+2.1), Employment (+4.8) and Willingness to buy durable goods (+2.9). The percentage of respondents expecting prices to rise in the year ahead fell by 2.3% points from August to 72.8% in September, while only 9.3% expect prices to go down, unchanged from August.
- The Bank of Japan's (BoJ) Tankan Survey for all industries and all enterprises edged higher in the third quarter to -28 from -31 in the second quarter. Iron and steel (-55), motor vehicles (-61) and production machinery (-43) remained subdued while services for individuals (-65) and the hospitality industry (-87) was still at unprecedented low levels. The only bright spot came from construction (21), retailing (18), and information (22) and communications (21) services. Economists are buoyed by the direction of the Tankan index rather than by the level and gave credit to government stimulus for the favourable financial conditions that allow companies to keep operating amid weak global demand.
- Unemployment has worsened for a third straight month from 2.9% in July to 3.0% in August. The number of unemployed increased by 90,000 in August accelerating from the 20,000 recorded in July and is 490,000 higher than a year ago. The job to applicant ratio dropped to 1.04 in August from 1.08 in July. The labour market continues to decline which will be a concern for new prime minister, Yoshihide Suga, as he tries to revive an ailing economy.

## EUROPE

*Contributed by Carel la Cock*

- **Business and consumer survey results in Europe continued to improve albeit at a slower pace in September, stoking fears that the economic recovery is running out of steam.** The Economic Sentiment Indicator (ESI) for the euro area was up 3.6 points to 91.1, recovering nearly 70% of the losses from the pandemic. The recovery in ESI saw lower increases in industry (+1.7), retail trade (+1.8), a slight improvement in consumer confidence (+0.8), while construction (+2.2) and services confidence (+6.1) advanced markedly. Across the euro area the ESI reflects fading pessimism in most industries and the largest economies, Italy (+8.4), France (+5.8), Netherlands (+2.1), Germany (+1.2) and Spain (+1.6), continued to show improved confidence, recovering between 55% (Spain) and 80% (Germany) of confidence losses during the pandemic. The Employment Expectations Indicator (EEI) at 91.8 improved by 2.3 points overall, the fifth consecutive monthly improvement, although at the slowest rate. Employment plans across all four business sectors improved. Furthermore, selling price expectations improved in industry, construction, and retail trade while unchanged in services. Consumer price expectations continued to fall from 16.9 in August to 12.5 in September.

## UNITED KINGDOM

*Contributed by Carel la Cock*

- **Car sales in the UK have recorded their worst September in two decades. Sales were down 4.4% year on year, but 15% below the September-average of the last decade according to figures from the Society of Motor Manufacturing and Traders (SMMT).** September is traditionally a busy month for car sales when buyers return from summer holidays and because of the system of new number plates issued in the month. Following the disappointment in September sales, there is little hope of the industry making up lost sales during the lockdown over the rest of the year. Sales for the year are likely to be down as much as 30%. SMMT chief executive, Mike Hawes, thinks that business and consumer confidence will wane as the government's furlough schemes end this month and unemployment continues to rise. Encouragingly, electric car sales nearly tripled as manufacturers brought new models to the market to meet strict European $CO_2$ targets. The car market is a good barometer of consumer confidence and healthy sales numbers would indicate a brighter outlook for consumer sentiment.

## EMERGING MARKETS AND THE FAR EAST

*Contributed by Carel la Cock*

- **Indonesia's government has passed a so-called omnibus law to attract foreign direct investment. The bill aims to reform a multitude of labour market and tax laws to help facilitate job creation and reignite the economy.** Indonesia fell into a technical recession in the second quarter, contracting 5.32% year-on-year, brought on by the covid-19 pandemic. The bill, that will see amongst other things corporate income tax cut from 22% to 20% by 2022, income tax for domestic dividends eliminated and the rigidness of the labour market reduced, was rushed through parliament presumably to take advantage of a global trend of restructuring supply chains away from China. Indonesia has one of the world's largest young populations and is south-east Asia's largest market. However, not everyone has praised the new bill. Labour unions have called for a three-day strike against the bill, saying that it violates workers' rights and effectively lowers the minimum wage. Indonesia had one of the world's most generous severance payments laws, which will now be reformed. Concerns were also voiced by a group of prominent global investors, highlighting the deregulation of environmental protection and the impact that it will have on society and the attractiveness for foreign investment over the long term.

**KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)**

| | | |
|---|---|---|
| JSE All Share | - 4.48 | 54524 |
| JSE Fini 15 | - 35.08 | 10176 |
| JSE Indi 25 | + 6.52 | 73823 |
| JSE Resi 20 | + 7.66 | 53031 |
| R/$ | - 15.55 | 16.58 |
| R/€ | - 19.68 | 19.54 |
| R/£ | - 13.78 | 21.52 |
| S&P 500 | + 5.50 | 3408 |
| Nikkei | - 1.46 | 23312 |
| Hang Seng | - 15.69 | 23767 |
| FTSE 100 | - 21.37 | 5930 |
| DAX | - 3.18 | 12828 |
| CAC 40 | - 18.50 | 4871 |
| MSCI Emerging | - 2.09 | 1091 |
| MSCI World | + 1.91 | 2403 |

| | | |
|---|---|---|
| Gold | + 24.17 | 1892 |
| Platinum | - 9.58 | 878 |
| Brent oil | - 40.63 | 39.27 |

**BOTTOM LINE**

***Contributed by Nick Downing***

- Global financial markets are in a powerful bull market. According to Investopedia "A bull market is the condition of a financial market in which prices are rising or are expected to rise… The term "bull market" is typically reserved for extended periods in which a large portion of security prices are rising. Bull markets tend to last for months or even years." The MSCI World Index gained 44.2% between its March low this year to the end of September. The US S&P 500 Index gained 51% over the same period, both meeting the bull market qualification of a 20% upward move. What is driving the global bull market, and does it have legs to continue for the remainder of the year and into 2021? The answer is yes. Despite numerous market risks, and the probability of short-term setbacks, equity markets are likely to enjoy further significant gains over the next year.

- The primary driver is the monetary policy response from the world's major central banks, which is unprecedented. Global liquidity, which drives financial markets higher, has ballooned and is set to increase by an additional 30% from current levels, based on current policy pledges. Liquidity is injected via bond purchase programmes, which have kept long-dated 10-year government bond yields at extraordinarily low levels, well below prevailing inflation rates, in the process bringing about negative real yields. The Federal Reserve has altered its policy framework. Rather than keeping a 2% lid on inflation, the guardians of the world's reserve currency are now actively pursuing higher inflation. Through its Average Inflation Targeting (AIT) policy, the Fed is now targeting inflation in excess of 2% to compensate for the extended periods of sub-2% inflation experienced over the past ten years, so that the long-term inflation rate averages out at 2%. As such, the Fed has committed to maintaining the fed funds interest rate at the zero bound until end 2023. Low interest rates, both short-term and long-term, and negative real yields, make equities extremely attractive. With interest rates anchored so low for so long into the future (markets love certainty), financial markets have latched onto the TINA trade, which stands for There Is No Alternative (to equities and higher yielding credit instruments).

- Unlike the 2008/09 Global Financial Crisis (GFC), which was met by fiscal austerity, governments around the world have embarked on the greatest fiscal easing since World War II. There has been a massive fiscal transfer of wealth to households, especially in developed economies. The US has been slow to follow-up its initial $3 trillion Covid relief CARES Act package with additional spending due to the bipartisan impasse between the Republicans and Democrats. However, political posturing will only delay the inevitable. The Bank Credit Analyst research institution forecasts an additional $2 trillion package, which will set the scene for other wealthy nations.

- In aggregate, household balance sheets have greatly improved over the past ten years, through a gradual but steady process of deleveraging since the GFC. In the US for instance, household debt to disposable income, at 99.4%, is at its lowest since 2001, and with interest rates at record lows, debt servicing as a percentage of disposable income is just 9.7%, its lowest since 1980. Due to limited spending opportunities and uncertainty over Covid, households have largely saved the fiscal windfall, lifting the US savings rate to a record high of 33.7%, compared with the long-term average of 5-7%. It has since reduced to around 20% but still provides an untapped resource to drive future consumer spending, the main engine of GDP growth in developed economies.

- Unlike 2008/09, when the banks were the chief culprits in the financial crisis, this time round they are part of the solution. While central banks have engineered a massive increase in global liquidity, actual credit growth is also rising sharply, leading to not just narrow liquidity supply but broad money creation. Central bank liquidity is finding its way into the real economy via a healthy banking system.

- The “reflationary bridge” engineered by central bank policy and government fiscal intervention, to take economies safely across the Covid chasm appears to be holding up. Although the service sectors of economies are still badly affected, industrial production is recovering strongly. Forward-looking survey data such as Purchasing Managers’ Indices (PMIs), point to a solid recovery in new orders and activity levels. Global trade is recovering faster than expected, and so too are business investment spending and residential property markets. US new home and existing home sales are at their highest rates since 2006, leading to a surge in home builder confidence and building activity.

- There are as always risks to the positive market outlook including delays over further fiscal easing, a contested US presidential election, a messy Brexit, a second wave of Covid infections, and any number of unexpected “Black Swan” events. Nobody saw it coming that Trump would test positive for Covid. However, the supporting factors far outweigh the market risks. Covid is perhaps the greatest unknown, but despite the second wave of infections, the mortality rate has dropped due to better treatment of the disease. Widespread lockdowns are therefore not expected and eventually a reliable vaccine will be available.

- As the year has progressed, the IMF, OECD, central banks and economists have consistently scaled back their 2020 economic contraction projections. Economic activity and earnings growth will likely continue to surprise to the upside. The disruptive effects of Covid such as working from home, less commuting and lower office rents have shown up as subtractions from GDP, but the efficiencies which have emerged from accelerated adoption of digital

**solutions should also reflect in greater productivity.** As a result, the economic rebound and earnings growth may well emerge stronger than expected.

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