OVERBERG MARKET REPORT

Tuesday 25th May 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- The Covid-19 pandemic ruined economies and scarred the lives of people. We look at what needs to be done to recover from the pandemic. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Inflation accelerated at its fastest pace in more than a year but remains within the Reserve Bank's 3%-6% target band. Consumer prices rose 4.4% in April, slightly faster than economists expected and the most since February 2020. The key driver of the year-on-year CPI jump was of course fuel prices, and food and non-alcoholic beverages. On a month-on-month basis, the rate of change was 0.7%, compared to a 0.5% drop in the same period in 2020, the first full month of the lockdown. The SARB in its latest MPC statement expects the headline consumer price inflation forecast for 2021 to be slightly lower at 4.2% (down from 4.3%) and for 2022 and 2023 unchanged at 4.4% and 4.5%, respectively. Higher electricity and fuel prices have recently put upward pressure on inflation expectations, although going forward a stronger exchange rate, ongoing moderation in unit labour costs, and sustained economic slack are expected to offset higher electricity and food price inflation, keeping the headline inflation forecast relatively stable. Overall, the SARB expects inflation for the year to remain stable despite overall inflation risk increasing, before rising to around the midpoint (4.5%) of the inflation target range in 2022 and 2023.

- The South African Reserve Bank kept its repo rate unchanged for a fifth straight meeting. The Monetary Policy Committee (MPC) kept the repurchase rate at 3.5% (prime rate at 7%), the lowest level since it was introduced in 1998. The bank's growth forecasts were lifted slightly, largely in response to stronger support from the elevated terms of trade as a result of higher commodity prices. The SARB expects Gross Domestic Product (GDP) to grow by 4.2% in 2021 up from 3.8%. Getting back to pre-pandemic output levels, however, will take time with SARB expecting GDP to grow by 2.3% in 2022 and 2.4% in 2023, little changed since the March meeting. The bank's Quarterly Projection Model (QPM) still indicates an increase of 25 basis points in each of the second and fourth quarters of 2021 although the overall tone of the MPC statement gives the impression that the bank will keep rates lower for longer. The

SARB noted important macroeconomic gains would be realised by achieving a stable public debt level, increasing the supply of energy, moderating administered price inflation, and keeping wage inflation low into the recovery.

- Real retail sales declined by 2.5% year-on-year March, following a downwardly revised 2.2% rise in February and surprising markets that expected a 1.9% gain. The biggest drag came from general dealers declining 9.3% year-on-year. However, despite falling by 3.7% month-on-month, sales volumes still rose by 1.5% quarter-on-quarter in the first quarter of 2021. This was on the back of a solid 6.9% month-on-month gain recorded in February. Looking ahead household balance sheets are likely to remain under pressure for some time as high unemployment persists and debt as a percentage of disposable income remains elevated. Only a modest lift in household consumption expenditure is expected in the near term with tighter restrictions remaining a risk to economic recovery although the vaccination roll-out, which commenced on 17th May, should boost consumer confidence somewhat.

- Both S&P Global and Fitch Ratings left their long-term sovereign credit ratings for South Africa unchanged at BB-, which is three levels below investment grade, retaining their stable and negative outlooks, respectively. While expected, the confirmation will come as somewhat of a relief for the National Treasury, which is trying to make headway in getting the country out of 'junk' status. S&P Global Ratings warned that while the South African economy should rebound from 2020's steep contraction, growth prospects are clouded by downside risks. They noted that structural constraints, a weak pace of economic reforms, and low vaccination rates will continue to constrain medium-term economic growth and limit the government's ability to contain the debt-to-GDP ratio. Earlier last week, Moody's had commented in its annual report (not a rating review) that South Africa faces the risk of even more tense socioeconomic relations amid slow economic growth, too little job creation, and rising public debt. On a more positive note, the rating agencies also listed South Africa's strengths including a credible central bank, a flexible exchange rate, an actively traded currency, deep capital markets as well as a favourable debt structure [low share of foreign currency debt] with long maturities, which should help counterbalance low economic growth and fiscal pressures.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Composite Leading Business Cycle Indicator, due Tuesday 25 May. No radical change is expected in the South African Reserve Bank's (SARB) composite leading business cycle indicator for March. The consensus forecast is for a 1.8% increase, a slight decrease from the 2% growth recorded in February.

- Producer Price Inflation, due Thursday 27 May. The consensus forecast is that April PPI increased 6.7% month-on-month and 1.6% year-on-year, up from 5.2% and 1.3%, respectively in March. The expected jump is attributed to the base effect of last year's low readings, along with continued high fuel and transport prices, higher intermediate input prices and supply chain difficulties caused by the Covid-19 pandemic.

- Balance of Trade, due Monday 31 May. After recording the largest ever monthly trade surplus of R52.77 billion in March South Africa's trade surplus is expected to narrow to R25 billion in April. The trade surplus is nonetheless expected to come in strong as a result of the increase in export commodity prices albeit smaller than the previous month.

NORTH AMERICA

Contributed by Nick Downing

- According to minutes from the Federal Reserve's latest policy meeting on 27-28th April, Federal Open Market Committee (FOMC) members voted unanimously to keep settings unchanged with the fed funds interest rate at 0-0.25% and asset purchases at $120 billion per month. The median forecast among members of the FOMC was for the fed funds rate to remain at zero until 2024. However, the minutes revealed the first hint that some committee members are open to discussion of a "tapering" or reduction of monthly asset purchases: "A number of participants suggested that if the economy continued to make rapid progress toward the committee's goals, it might be appropriate at some point in upcoming meetings to begin discussing a plan for adjusting the pace of asset purchases." The meeting took place before the release of April shock inflation data, which saw consumer price inflation rise sharply on a year-on-year basis from 2.8% to 4.2%. Former Treasury secretary Larry Summers spoke out against the Fed's monetary policy, which he regards as being excessively easy and contributing to economic overheating, asset price inflation and excessive leverage. He said fiscal and monetary policy makers "Underestimated the risks, very substantially, both to financial stability as well as to conventional inflation of protracted extremely low interest rates." However, the Fed remains steadfast in its belief that the inflation spike is transitory, explained by the temporary effects of sudden economic reopening and supply chain disruptions. Fed governor Randal Quarles cautioned against exiting zero interest rate too early, saying "If we were to try now to stay ahead of the inflation curve, we could end up significantly constraining the recovery."

- Purchasing managers' index (PMI) survey data unexpectedly surged higher in May, confounding expectations for a slight pullback from already elevated levels. According to survey company IHS Markit's chief business economist, Chris Williamson, "The US economy saw a spectacular acceleration of growth in May, the rate of expansion of business activity soaring well above anything previously recorded in recent history as the economy continued to reopen from Covid 19 restrictions. The service sector saw an especially impressive surge in growth, beating all prior records by a wide margin, accompanied by another solid expansion of manufacturing output." The services and manufacturing PMIs gained respectively from 64.7 to 70.1 and from 60.2 to 61.5, powering the composite PMI from 63.5 to 68.1, all substantially above the neutral 50-level. Moreover, the forward-looking new orders sub-indices also marched to record heights, signalling continued gains in activity levels over coming months. Among the PMI sub-indices, input prices also surged due to supply chain delays and difficulties in restarting businesses quickly enough. The jury is still out on whether these factors will have a transitory or longer-term structural impact on inflation. According to IHS Markit, "Average selling prices for goods and services are both rising at unprecedented rates, which will feed through to higher consumer inflation in coming months."

- Home sales, which helped prop-up the economy in the dark days of the pandemic last year as buyers sought larger homes to work from, showed further signs of slowing in April. Existing home sales fell for a third straight month, falling by 2.7% month-on-month. The slowdown is attributed to a shortage of housing inventory and increasingly unaffordable prices. The median home price increased in April by 19% year-on-year, the sharpest increase since the National Association of Realtors (NAR) began collecting the data in 1999. The inventory of homes for sale would last just 2.4 months at the current sales pace. The shortage is exacerbated by surging building costs, such as lumber which has increased in price by over 250% over the past 12 months, which are constraining new construction activity. Housing starts fell in April by 9.5% on the month. Despite the slowdown in the residential property market, sales remain at elevated levels. NAR chief economist Lawrence Yun observed that "Even with home sales declining modestly, one can describe the market as being hot." The NAR reported that the typical home sold in April only spent 17 days on the market.

JAPAN

Contributed by Carel la Cock

- Japan's private services sector has suffered a setback in May contracting at the fastest pace in four months due to a resurgence in covid-19 cases with the accompanying more stringent lockdown measure imposed in certain cities across the country. While manufacturing in the private sector continued to expand, the rate of expansion has slowed from April causing a drag on the overall performance of the private sector. The key index readings were as follows: Jibun Bank Japan Flash Composite Output Index down to 48.0 from 51.0 in April, Flash Services Business Activity Index down to 45.7 from 49.5 and Flash Manufacturing Output Index down to 53.1 from 54.3 in April. The services sector reported lower new business inflows, but employment levels rose for a fourth consecutive month while optimism about business condition for the next twelve months remained positive although slightly less so than in April. The manufacturing sector reported softer new business inflows and lower output levels, but higher job creation continued from last month while positive sentiment rose to levels last seen in 2012. Finally, input costs within the manufacturing sector saw another sharp rise in May, a trend experienced across the developed world.

EUROPE

Contributed by Carel la Cock

- The Eurozone private sector is emerging from a first quarter slump and is gaining momentum according to the latest PMI prints for May. Business conditions have improved markedly amid an increasing pace of vaccinations while demand has improved at the fastest pace in 15 years. The Flash Eurozone PMI Composite Output Index at 56.9 was up 3.1 points from April and the strongest in more than three years. The services sector saw business activity grow at the fastest pace in 35 months. The Flash Eurozone Services PMI Activity Index coming in at 55.1 compared to 50.1 in April, was driven by a sharp rise in new order inflows not seen for a decade and a half. Business optimism for the next twelve months is also at all-time highs, underpinned by the belief that further relaxations of covid-19 restrictions will follow the successful vaccination roll-out and stimulate regional and global demand. The brighter outlook has prompted the private sector to increase staffing levels in anticipation of higher order volumes. Manufacturing is surging ahead for an eleventh straight month, although at a slightly slower pace. Factories reported that backorders were piling up and that inventories of finished products were being depleted at a record pace. The lengthening time of input deliveries is still causing disruptions in supply chains and leading to demand outstripping supply. The service sector has seen a revival in demand as lockdown measures are relaxed in centres across the region. The surge in demand has left some firms with capacity constraints and increasing backlogs while input prices shot up at the fastest pace in a decade. Despite the inflationary pressure on input costs, the average price of services only rose modestly supporting the idea that inflation in the eurozone will be temporary, coming off a low base.

UNITED KINGDOM

Contributed by Carel la Cock

- The UK's private sector has reported the fastest expansion in more than two decades according to survey results from the CIPS Flash UK Composite PMI. The Composite Output Index for May was 62.0 from 61.0 in April and marked the highest survey result since the survey began in 1998, reflecting generous contributions from both manufacturing and service sectors. The Flash UK Services Business Activity Index improved marginally to 61.8 while the Flash UK Manufacturing Output Index shot up to 63.2 in May from 59.2 the month before. Key drivers for both sectors were the successful vaccination roll-out causing looser lockdown measures and the unwinding of pent-up demand. Improved conditions in both sectors also saw a faster than expected labour market turnaround which has added to a sharp rise in cost pressures together with raw material shortages and higher shipping costs in the manufacturing sector. Firms were able to pass the higher costs on to customers and reported the fastest rise in average prices charged since the survey started in 1999. Unsurprisingly, business optimism for the next twelve months has hit new records. Commenting on the survey result, Chris Williamson, Chief Business Economist at IHS cautioned that despite consumer prices rising by 1.5% in April, "the inflationary spike could prove temporary, as many of the price hikes have reflected surcharges on shipping and other shortage-related issues emanating from the pandemic. As these constraints ease, price pressures should abate, but there remains a great deal of uncertainty as to how long it will take for global business and trade to return to normal functioning, especially if new virus variants appear."

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- Brazil's minister of infrastructure has announced that the country will embark on an infrastructure improvement drive worth nearly $50bn in concession projects by the end of 2022. The project aims to renew the country's ailing ports, highways, and railways. The concessions will allow the private sector to invest in the design, build, and operation of these long-term projects and will reduce the role of the state which has become a relatively large participant in the economy in recent times. The value of the concession projects is estimated to be the equivalent of nearly 30-years of state infrastructure spend and will alleviate the rising transport costs on deteriorating road networks. To date nearly $10bn in concessions have been auctioned off with international firms successfully bidding on several projects, testament that international investors are attracted to the country because of the strides it has made in its fiscal discipline, regulatory environment, and legal framework. Environmentalists have criticized the initiative saying that civil society has not been involved in many of the infrastructure projects in recent years. Brazil and in particular president, Jair Bolsonaro, has come under increasing pressure for its fallings in protecting the Amazon rainforest and the rate of deforestation has soared to decade highs under Mr Bolsonaro. Local firms are taking the new ESG investment trend more serious and are concerned with the reputational and commercial aspect of protecting the environment. Retail investors have also become more focused on ESG issues and together with large corporations are lobbying government to implement more sustainable environmental policies. Infrastructure spend should not be to the detriment of the environment and getting the balance right could once again attract the foreign investment Brazil so desperately needs.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 11.19	66054
JSE Fini 15	+ 5.83	12763
JSE Indi 25	+ 8.48	84504
JSE Resi 20	+ 15.35	66414
R/$	+ 5.52	13.92
R/€	+ 5.52	17.01
R/£	+ 1.87	19.71
S&P 500	+ 11.74	4197
Nikkei	+ 3.35	28364
Hang Seng	+ 4.34	28412
FTSE 100	+ 9.15	7051
DAX	+ 12.53	15437
CAC 40	+ 15.44	6408
MSCI Emerging	+ 2.74	1326
MSCI World	+ 10.27	2966
Gold	- 0.54	1884
Platinum	+ 9.84	1175
Brent oil	+ 28.26	66.44

BOTTOM LINE

Contributed by Gielie Fourie

- DIVERGENT RECOVERIES FROM COVID-19: How will the Covid-19 pandemic affect businesses and labour, and how will they recover? Basically, there are two divergent channels to recovery, both are painful and scarring. Firstly, there is a risk that we might see firms that are in illiquid situations being forced into closures - we have seen a spike in the exit of firms. The second channel: The longer people stay out of employment, the greater the risk that it becomes harder for them to re-engage with the workforce. We already saw exits from the workforce and diminished labour force participation. The pain may go away, but the scars will remain forever.

- CHILDREN WILL SUFFER THE MOST: One key aspect of this crisis, which is going to have long lasting consequences, is the aftermath of all school closures. Children were staying home for many months in many countries, even more so in low income developing countries, than in advanced economies. Substitutes such as virtual learning have been far more limited in low income developing countries. Children will be scarred the most.

- A GLOBAL RECOVERY IS VACCINE DEPENDENT: Global economic prospects are looking better than they were a year ago. The International Monetary Fund (IMF) places growth at 6% for 2021 compared to 2020's unprecedented contraction of -3.3% but recovery is by and large vaccine dependent and the lack of access to vaccines is making recovery hard to imagine for some countries while others are well on their way to recovery. According to the IMF these two divergent recoveries are a big concern. Long before the pandemic hit, there was already a widening gap between rich and poor people, and countries. The pandemic exacerbated this divergence. After a synchronised downturn last year, the recovery is not at all synchronised. Countries are emerging out of the downturn at different paces. The variation in recovery speeds has a lot to do with the severity of the pandemic and, crucially, the speed of vaccine rollout.

- THE SPEED OF ECONOMIC RECOVERY: Too quick a recovery in the advanced economies could hinder the recovery in developing countries and emerging markets. A strong recovery in advanced economies is generally good for emerging market economies because that helps the exports that they send to the advanced economies when there is stronger demand for their products. The reaction of interest rates could negate these advantages. The crucial factor is the speed at which these interest rates go up. A very rapid increase in interest rates in advanced economies will increase the cost of capital and could create financing difficulties for emerging market economies. Institutions could rebalance their portfolios, leading to capital flows out of emerging markets back to advanced economies.

- A SYNCHRONISED RECOVERY: How do you assure a synchronised global recovery when countries have their own specific challenges and agendas? How do you put the brakes on in some countries without slowing the overall recovery down? What is interesting is that even with the differences in countries' circumstances, there is a commonality, a shared set of priorities across countries. First and foremost, it is crucial to beat back the pandemic globally. A multilateral response is needed. Firstly, it means prioritising health spending on vaccines to ensure that we reach herd immunity in every country. Secondly, and at the same time, it means to also support the economy, to cushion the impact of this crisis on the economy, by offering targeted support to those who are worst affected by this crisis. The USA is doing this with stimulus packages worth trillions of dollars, backed up by quantitative easing of $120 billion per month. Unfortunately, poorer countries do not enjoy this luxury.

- SOUTH AFRICA: South Africa has not escaped the effects of scarring. Many businesses closed and unemployment spiked to 32%. Our government's attitude to tolerate our high rate of unemployment, high crime rate, grand corruption at the highest levels of government, poor governance, failure of State-Owned Enterprises (SOEs), red tape, non-functioning schools, and hospitals, to name a few, are the spoilt fruit of bad governance. During the Covid-19 pandemic government excelled in its incompetence – reports of corruption were abundant. The process of acquiring vaccines was unprofessional. Now the vaccination process is slow and sloppy.

- STRUCTURAL REFORMS: South Africa continues to face a constrained economic and fiscal environment due to structural problems. Structural reforms needed include relaxing labour law inflexibility, privatising state-owned enterprises, reducing the government wage bill, stopping corruption, creating policy certainty, increasing the savings rate and becoming export driven. In a country where unemployment, specifically youth unemployment is high, structural reform aimed at the relaxation of labour law inflexibility and the reduction of youth unemployment should be prioritised.

- PRIVATE SECTOR: On the positive side, our private sector is world class. In 2021 the Johannesburg Stock Exchange (JSE) is one of the best performing stock exchanges in the world. While the IMF expects global GDP growth of 6% for 2021, the JSE is up 12% year-to-date. The world likes our businesses – just last week Heineken Breweries announced that they are in takeover talks with Distell – a transaction worth R33 billion. In August last year Heineken stopped a R6 billion project in South Africa because of government's ban on liquor sales. That Heineken still had an appetite for an SA business after that episode is remarkable. We are Proudly South African. We are proud of our country, but we are ashamed of our government.