OVERBERG MARKET REPORT

Tuesday 15th June 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Last week Statistics SA published our Gross Domestic Product figures for the first quarter of 2021 (1Q21). That exceeded our expectations. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus/ Ingrid Breed

- RMB/BER Business Confidence Index (BCI) jumped by 15 to 50 in the second quarter. This means that the number of respondents satisfied with prevailing business conditions now equals those that are unsatisfied – an outcome we have not seen in years. While the improvement in sentiment is no doubt encouraging, uncertainties remain. Confidence resumed its upward trend in all five sectors making up the BCI. Confidence rebounded particularly sharply in the manufacturing, retail trade, and motor trade sectors. By contrast, sentiment among building contractors and the wholesale trade sector improved only marginally. "At 50, the RMB/BER BCI is a far cry from its pandemic-stricken all-time low of just five points a year ago. This notable rebound, plus the fact that business confidence is now even higher than pre-Covid-19 levels is welcome news," said RMB chief economist Ettienne le Roux. However, emerging signs of the third wave of Covid-19 infections, the intermittent power cuts, and possible industrial action by public-sector unions could undermine confidence in the months ahead, he said.

- Real gross domestic product (measured by production) increased at an annualised rate of 4.6% in the first quarter of 2021, following an increase of 5.8% in the fourth quarter of 2020. The out-turn was higher than the SARB forecast of 2.7% quarter on quarter, and the Bloomberg consensus forecast of 3.1%. Eight industries recorded positive growth between the fourth quarter of 2020 and the first quarter of 2021. The largest positive contributors to growth in GDP in the first quarter were the finance, mining, and trade industries. The finance industry increased by 7.4%, the mining industry increased by 18.1%, and the trade industry increased by 6.2%. From the demand side, household final consumption expenditure was the biggest contributor increasing 4.7% in the first quarter of 2021. Disappointingly, gross fixed capital formation contracted. Fixed investment will be slow to recover, hurt by ample spare capacity, frequent power outages and the slow implementation of structural reforms. The pedestrian local vaccine rollout is also a major factor that can reduce the pace of further economic recovery. Looking forward, as per the MPC committee meeting notes, the South Africa Reserve Bank expects the economy to grow by 4.2% in 2021 (up from 3.8%). Robust commodity prices, the global vaccine rollout, and more economically sensitive tactics from the state are all factors that could help underpin South Africa's economic recovery in 2021. The current account data for the first quarter of 2021 came in better than expected, with the surplus widening by R69bn to R267bn. Relative to GDP, the current account surplus increased from 3.7% to 5%. The surplus was supported by an improvement in the trade surplus as the solid (nominal) export performance of recent quarters continued and the country's terms of trade improved for a seventh consecutive quarter.

- Mining production increased 0.3% month-on-month and 116.5% year-on-year in April, from an upwardly revised 4.7% month-on-month expansion in March. The statistical distortions caused by the strict lockdown in April last year make it meaningless to analyse year-on-year numbers. Nonetheless, the data are positive with the main contributors to the monthly figures being the heavyweights, platinum group metals (PGMs) (6.8%), manganese ore (5.9%), and coal (4.6%) while chrome, copper, and gold production declined significantly. The mining sector performed comparatively well in April with the total production level 4.9% higher than the three-year April average as a result of an increase in global demand. Looking ahead, the sector faces mixed factors with industrial activity and high commodity prices internationally anticipated to support activity while the resumption of load-shedding and uncertain legislative framework poses imminent downside risks on the domestic front. Lastly, the deteriorating Covid-19 situation and accompanying economic restrictions remain a threat to the pace of recovery.

- In contrast to mining production, which started the second quarter on a positive note, manufacturing production increased 87.9% year-on-year in April but contracted 1.2% month-on-month from an upwardly revised 3.7% month-on-month increase in March. The main contributors to the monthly decline were 'food and beverages (-2.7%), 'petroleum, chemicals, rubber and plastics (-4.1%), and 'textiles, clothing, leather, footwear' (-3.6%). The drag was partially contained by higher production of 'motor vehicles, parts and accessories and other transport equipment (1.6%) and 'basic iron and steel, non-ferrous metal products, metal products and machinery' (1.8%). The manufacturing sector disappointed in April with a total output 0.1% lower than the 2017 to 2019 April average. Looking ahead, the sector is expected to be supported by easing restrictions across the major trading partners and the gradual uptick in domestic activity. This outlook is supported by the recent manufacturing purchasing managers' index which indicated that both global and domestic indices remain in expansion territory. Unfortunately, the underlying structural constraints, resumption of load-shedding, and elevated input costs continue to pose downside risks to the sector's recovery.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Leana Kruger

- Retail sales, due Thursday 17 June. While the year-on-year numbers will be heavily distorted by the strict Level-5 lockdown measures that led to a virtual economic shutdown last year, we expect the recovery in the retail trade to continue in April, supported by higher household spending and low interest rates. The consensus forecast is that retail sales increased 99.6% year-on-year and 1.5% month-on-month, from a 3.7% month-on-month contraction in March.

GLOBAL

Contributed by Nick Downing

- Leaders from the G7 group of nations concluded their first summit since the start of the pandemic. The summit, which took place in the UK, unanimously backed continued economic stimulus to ensure a sustained recovery from Covid. Summit leaders also launched an initiative to promote infrastructure spending in the developing world, with an emphasis on healthcare, digital technology and climate change. Called the "Build Back Better for the World", B3W is purposed to counterweight China's Belt and Road global infrastructure project, although US Joe Biden was more explicit about the project being anti-China than his European counterparts. However, Biden tempered any extremism by saying, "We're in a contest, not with China per se, but with autocrats and autocratic governments around the world as to whether democracies can compete with them in a rapidly changing 21st century." Although the B3W was lacking in detail, the summit statement pledged 1 billion Covid vaccines to the developing world within 1 year. Following four difficult Trump years, when cooperation was elusive, the latest G7 meeting was widely hailed as a successful return to multilateralism.

NORTH AMERICA

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- The widely anticipated consumer price inflation (CPI) figures were higher than expected. CPI accelerated on a year-on-year basis from 4.2% in April to 5.0% in May, its highest since 2008. Core CPI, excluding food and energy prices, accelerated from 3.0% to 3.8%, the highest since 1992. On a month-on-month basis, CPI and core CPI gained by 0.6% and 0.7%, meaning annualised inflation is running very high at 7.2% and 8.4% respectively, but the bond markets took the data release in their stride, buying into the Federal Reserve's conviction that the inflation spike is temporary. Indeed, the 10-year US Treasury bond enjoyed its biggest weekly yield decline in 12 months, falling from 1.54% to 1.45%, down substantially from its recent peak in March of 1.75%. The inflationary impulse is attributed to supply chain disruptions, which in time will be resolved and to massive fiscal and monetary stimulus, which will not last forever at their current pace. Meanwhile, consumers are being driven to spend by the sudden lifting of restrictions but after a while their appetite will be sated, especially if prices rise too sharply. The inflationary increases were narrowly focussed. Due to semiconductor shortages and their effect on new vehicle production, demand for used vehicles has surged. Their price increased in May by 7.3% on the month and by 29.7% on the year, contributing a whole 40% to the monthly increase in core CPI and 30% to the headline CPI increase. Due to a lack of stocks and surging demand, car rental prices gained by a massive 110% on the year. Similarly, with travel opening-up, airfares increased 24.1% on the year but still remain 12% below February 2020 levels, just prior to the pandemic. Much of the inflationary spike is due to the base effect of ultra-low inflation when the pandemic first struck. When compared with May 2019, headline CPI was up last month by a far more modest 2.5%. Meanwhile, the base effect will start working in reverse this time next year. The consensus view is that inflation will peak over the next month or two, and then begin normalising. The caveat is that high inflation does not become "sticky", leading to an entrenched increase in inflationary expectations and excessive wage growth.

- The Federal Reserve's Federal Open Market Committee (FOMC) policy meeting, which concludes on 16th June, will be more closely watched than usual, with expectations running high that it will mark the first discussion of tapering the $120 billion per month asset purchase programme. Since the April policy meeting, when the Fed announced that the economy still needed to make "substantial further progress" towards its dual goals of maximum employment and sustained 2% inflation, economic activity and inflation data have surged. As a result, despite relatively subdued employment data, various FOMC members have announced that it may be time to begin taper discussions, even on an informal basis. Financial markets will also scrutinise the Fed's quarterly projections, which were last updated in March, when the Fed forecast US GDP of 6.5% in 2021 and consumer price inflation of 2.4% in the fourth quarter 2021. Both forecasts are likely to be upgraded. The Fed's so-called dot-plot, showing the fed funds rate forecast for each of the FOMC's 18 members, will also be watched for any clue of a changing interest rate outlook. In March, the median dot-plot forecast showed the fed funds rate lifting from its current zero bound in 2024, but in the June quarterly update the lift-off date may be brought forward to 2023, matching the financial markets' consensus forecast.

- The government's monthly Job Opening and Labour Turnover (JOLT) report showed job openings continued to grow in May adding to April's 1 million increase, fuelled by the leisure and hospitality sector. There are now 9.3 million job openings across the US, a record high, almost matching the total number of job seekers at 9.8 million. The JOLT data belies the relatively subdued May nonfarm payroll report, pointing instead to tightness in the labour market. The National Federation of Independent Business reported that an elevated 48% of businesses were facing difficulties in filling jobs and as a result over a third said they were required to raise compensation. Moreover, a majority intended passing on the cost of higher wages to their end customers. However, the JOLT report indicated that while job openings are rising sharply in the leisure and hospitality sector, they are starting to plateau and dip in previously tight sectors such as manufacturing and construction, possibly signalling the transitory nature of labour shortages.

CHINA

Contributed by Nick Downing

- Producer price inflation (PPI) surged from 6.8% year-on-year in April to 9.0% in May, its highest since September 2008 when it hit 9.1%. The acceleration is attributed to the low base effect stemming from the start of the pandemic last year. However, capacity constraints and rapidly rising commodity prices are also blamed. Ferrous metal prices increased by a substantial 38% on the year. The spike in producer price inflation is crimping company profits but also threatens to spill over into consumer price inflation (CPI), prompting Beijing's authorities to fight back against hoarding and speculation in the commodity markets. So far, consumer price inflation has been tame, rising in May from 0.9% to 1.3% on the year, and actually falling by 0.2% on the month, but the subdued reading has a lot to do with falling pork prices. Pork prices have dropped from peak levels marked by African swine fever, falling in May by 24% on the year. With elevated PPI attributed to supply side constraints rather than excessive demand and with CPI remaining benign, the People's Bank of China is unlikely to respond with any imminent tightening of monetary policy. However, China is a significant contributor to global trade, and so its PPI figures are bound to catch the attention of the Federal Reserve and the world's other major central banks.

EUROPE

Contributed by Carel La Cock

- The European Central Bank (ECB) has kept its policy rates unchanged and will continue with net asset purchases, keeping the pandemic emergency purchase programme (PEPP) in place until at least March 2022. The pace of bond purchases is set to gather pace in the coming quarter compared to the start of the year. ECB president, Christine Lagarde, reiterated that inflation is expected to rise this year, but will ease off next year. She cited "significant economic slack that will only be absorbed gradually over the projection period", making any monetary policy tightening "premature" at this stage, which would threaten the economic recovery underway. Furthermore, the ECB raised its inflation expectations for this year from 1.5% predicted back in March to 1.9%, whilst 2022 will see price increases of 1.5% compared to the previously expected 1.2%. Inflation in 2023 is unchanged at 1.4%. Real gross domestic product (GDP) is also expected to grow faster compared to the March forecast, increasing for this year from 4% to 4.6% and from 4.1% to 4.7% for 2022. GDP growth in 2023 is expected to be unchanged at 2.1%.

UNITED KINGDOM

Contributed by Carel La Cock

- The UK reported economic growth of 2.3% in the month of April, offsetting the decline in the first quarter. The output growth has beaten expectations and has left the economy only 3.7% below its pre-pandemic level in February 2020. While the services sector expanded 3.4% driven by solid retail sales volumes, up 9.2% in the month, and helped by an easing in restrictions for consumer facing businesses; output in the production sector contracted by 1.3%, impacted by planned maintenance closures at mining and quarrying sites as well as a slump in the construction sector, which fell by 2%. However, the economy was dealt another blow when prime minister Boris Johnson announced that the lockdown measures which were scheduled to end on 21st June, will now be extended until at least 19th July as data has shown that there are rising cases of the Delta variant of the virus in the UK. The government believes that postponing the full opening of the economy could "save many thousands of lives by vaccinating millions more people". The news will be especially hard for the hospitality sector with many events now set to be cancelled. Although the extended lockdown measures will be a drag on economic growth at the tail end of the second quarter, economists do not expect it to have a major impact on second quarter figures and that solid growth expectations for the year remain on track.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel La Cock

- The global shortage in semiconductors was exacerbated by a breakout of Covid-19 cases in Taiwan, threatening the closure of one of the testing and packaging sites for some of the world's leading chip manufacturers. Migrant workers employed at these factories often reside in dormitories which provide a hotbed for the spread of Covid-19 infections. The outbreak will add to the already long lead time of four months for delivery of chips from Taiwan and will have a negative impact on supply chains and manufacturing input costs. The global pandemic last year caused many car manufacturers to scale back chip orders in anticipation of a drop in demand, but the reopening of the global economy and a surge in demand for new vehicles and consumer electronics has caused a shortage in semiconductors across the globe. Taiwan and South Korea are the leading manufacturers of semiconductors used in everyday consumer electronics and cars, but many of the chip designs are licenced to US companies. Following the cooling in trade relations between the US and China, many Chinese manufacturers have started to stockpile chips in anticipation of further restrictions on technology exports to China and have throttled supply to the rest of the word. Production methods relying on "just in time" inputs have left many car manufacturers unable to source chips and some factories have stood idle while suppliers try to catch up with demand. Western governments are investing in manufacturing capacity, but due to the complexity of factories it will take some time before production comes online. The semiconductor industry remains vulnerable to supply side shocks and will continue to have a direct impact on electronics manufacturers across the globe until supply can catch up with the surge in demand.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 14.36	167941
JSE Fini 15	+ 13.77	13720
JSE Indi 25	+ 13.26	88227
JSE Resi 20	+ 13.91	65583
R/$	+ 6.64	13.78
R/€	+ 7.48	16.70
R/£	+ 3.29	19.44
Dow Jones	+ 12.37	34393
Nikkei	+ 6.26	29161
Hang Seng	+ 5.92	28842
FTSE 100	+ 10.62	7146
Gold	- 1.52	1865
Platinum	+ 8.81	1164
Brent oil	+ 41.36	72.86

BOTTOM LINE

Contributed by Gielie Fourie

- GROSS DOMESTIC PRODUCT - FIRST QUARTER 2021 (1Q21): The 4.6% seasonally adjusted and annualised rate (SAAR) expansion in 1Q21 exceeded analysts' consensus of 3.2%. The overshoot was underpinned from both the production side and the expenditure side. The data confirms expectations for a strong growth rebound in 2021 following last year's sharp pandemic-induced contraction. Recent events indicate that the upswing will continue into the second quarter. For example, in the second quarter new vehicle sales and exports remained strong. Mining production and exports are still benefitting from strong economic growth in our export markets. The Reserve Bank's Leading Business Indicator has turned positive after a negative reading in January 2021. Our Foreign Exchange Reserves are a healthy R54 billion.

- THE PRODUCTION SIDE: Production growth was broad-based. The mining sector was the star performer. Growth was by far the strongest in 1Q21 with growth of 18.1% QoQ (Quarter on Quarter) SAAR. Only the agricultural and utilities sectors contracted, each around 3% QoQ. In the finance, real estate, and business services sector, the 7.4% QoQ growth was a pleasant surprise. THE EXPENDITURE SIDE: On the expenditure side consumers were a key recovery driver of expenditure. Consumer spending was even stronger than fixed investment spending. Below are the sectoral growth performances of each of the ten sectors for 1Q21 (% QoQ, SAAR). The first eight sectors achieved positive growth figures. Unfortunately, two sectors, utilities and agriculture, posted negative growth figures.

- #1. The mining sector grew by a healthy 18.1%. The sector grew marginally faster than forecasts, although the growth in the preceding quarter was revised downwards, which could explain this overshoot. According to Stats SA, this strong performance was driven by PGMs (Platinum Group Metals), iron ore and gold production. We expect the mining sector to play a critical role in the economic recovery this year, supported by strong global growth and a spike in some key commodity prices. # 2. The finance, business and services sector grew by 7.4%. Stats SA did not provide much further data on this strong growth, apart from reporting a broad-based rise in economic activity in all the major sub-sectors.

- #3. The trade, catering and accommodation sector grew by 6.2%. This strong growth was supported by a rise in economic activity in both wholesale and retail trade and supported by strong momentum in real consumer spending, which we expect to persist for the rest of this year. This is despite the decline in direct fiscal support for households. #4. The transport and communication sector grew by 4.8%. This performance was in line with analysts' forecasts, supported by the recoveries in the rest of the economy, particularly the main goods-producing sectors during the lockdown. There are also signs in the import data of increased purchases of telecommunication equipment.

- The following sectors lagged in their performance. #5. The personal services sector grew by only 1.7%. Stats SA reported increased economic activity for community and other producers. We expect further growth in the sector in 2021, supported by strong consumer spending. Despite the lagging performance, the sector's real GDP was only 0.6% lower than a year earlier. #6. The Manufacturing sector grew by a mere 1.6%. Growth was driven largely by the automotive sector, as well as by manufacturers in wood, paper, and publishing, according to Stats SA. The sector's performance was broadly in line with forecasts. We expect an ongoing recovery going forward, though tempered by electricity constraints.

- #7. The Government sector grew by a modest 0.9%. This was supported by increased employment in provincial and government departments, which presumably includes the jobs created as part of the presidential employment programme. #8. The Construction sector grew by an uninspiring 0.8%. We were disappointed by the lackluster growth in construction – we expected more. Stats SA attributes the modest growth to increased activity in non-residential buildings and construction works. The sector is still by far the furthest below pre-pandemic levels, with a contraction of 17.5% YoY (Year on Year) compared to 1Q20, which largely preceded the national lockdown introduced at the end of March 2020).

- Unfortunately, two sectors returned negative growth. #9. The Utilities sector was down by 2.6%. Both electricity usage and water consumption decreased in 1Q21. #10. Agriculture dropped the most – it was down by 3.2%. Stats SA attributes this contraction to decreased animal product and crop production. This was a disappointing performance, though the sector's real YoY GDP was a lofty 7.5% more than a year ago.

- SUMMARY: Two of our main economic constraints are Covid-19 lock downs and electricity blackouts. In this regard, pres. Ramaphosa showed much needed leadership last week. Ramaphosa normally consults widely and moves slowly but last week this changed. First, he put the Minister of Health, Dr. Zweli Mkhize, on special leave. By taking action against allegations of misconduct by Dr. Mkhize, the president showed that he can move swiftly. Our economic recovery is vaccine dependent – we need strong leadership from our Minister of Health. Second, after a protracted saga, lasting decades, South African Airways is finally going to be privatized. Third, the threshold for the private sector to produce its own electricity, without a license, will be increased from the current 1 megawatt to 100 megawatts. Like a racing driver, Ramaphosa moved from 1 to 100 in 2 seconds. These structural reforms are encouraging. Although perhaps coincidental that they were announced while Ramaphosa was attending the G7 meeting in the UK, let us hope we will not have to wait until the next G7 meeting for additional structural reforms to be unveiled.