OVERBERG MARKET REPORT

Tuesday 20th July 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Nick Downing

- A tempus horribilis. From the 10-17th July we witnessed the horrifying spectacle of arson, looting and destruction, the loss of human life and erosion of the remaining goodwill towards our country from foreign investors. We have witnessed in all its glory, the full splendor of expropriation without compensation. Read more in Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Mining production increased by 21.9% year-on-year in May after a 117.4% spike in April. The largest positive contributors were platinum group metals (up 27.0%), gold (up 44.5%), iron ore (up 48.4%) and manganese ore (up 39.7%). It was the third straight month of rising mining activity, reflecting the gradual recovery from the Covid-19 shock a year before. Mining is a key sector for South Africa's economy, employing 450,000 people and contributing 8.2% to Gross Domestic Products (GDP) in 2020. Annual numbers still offer limited insight into economic activity, as the data remains clouded by base effects. However, on a monthly basis, seasonally adjusted total production was down by 3.5% in May, the first drop in output levels since December 2020. Mining sector output was potentially hampered by an unstable power supply in May. On the positive side, mineral sales increased by 88.2% year-on-year in May, supported by overall strong commodity prices. Looking ahead, high commodity prices and the recovery in industrial activity will remain supportive of the sector's recovery. However, the third wave of infections and associated lockdowns, combined with planned load-shedding in the months ahead, pose significant downside risks to the pace of the recovery.

- Retail sales volumes growth moderated from the lockdown-induced spike of 95.7% in April to 15.8% year-on-year in May, in line with the diminishing base effects. The retail sector benefited from looser lockdown restrictions in May. The main contributors to the increase were 'other' retailers (up 87.7%) and retailers of food, beverages, and tobacco products in specialised stores (up 54.2%). Retail sales expanded by 2% month-on-month, while wholesale trade sales rose by a solid 6.3%. The outlook for the sector is bright, although, the recent surge in Covid-19 infections, associated lockdowns and the slowdown in vaccinations will have a significant negative impact on the pace of the recovery. The retail sector will be further impacted by the recent riots in some parts of the country that resulted in the interruption of supply chains, damage to retail outlets and properties, and the loss of inventory and trading time. While the slight improvement in consumption credit uptake (credit cards and general loans) is encouraging, these factors, combined with declining consumer sentiment and the slow re-adjustments in the labour market, pose a downside risk to consumption expenditure.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Leading Business Cycle Indicator, due Tuesday 20 July. The composite leading business cycle indicator, which leads economic activity by around six months and provides insight into expected future economic and business conditions, is expected to have increased 3.4% month-on-month in May 2021, almost equal to April's 3.7% gain.

- Consumer Price Inflation, due Wednesday 21 July. Consumer Price Inflation (CPI) is expected to have moderated in June towards the middle of the 3%-6% target band set by the South African Reserve Bank (SARB). The consensus forecast is that inflation retreated to 4.8% year-on-year and 0.2% month-on-month from 5.2% and 0.1% in May. The main anticipated contributors to inflation are food and non-alcoholic beverages, transport and housing and utilities. Core inflation, which excludes volatile energy and fuel components, is expected to remain steady at about 3.1% year-on-year.

- Interest Rate Decision, due Thursday 22 July. The Reserve Bank is expected to keep the interest rate unchanged at 3.5%, the lowest it has been in five decades. The Bank's commentary on the impact of last week's developments and the third wave of Covid-19 on the economy and inflation will be closely followed. The Monetary Policy Committee (MPC) is expected to convey that its contribution to the economic recovery will be to keep the policy interest rate accommodating for the time being. It will likely only hike interest rates this year if there is a significant increase in its inflation forecasts or if it sees a high risk that material upside inflation risks might materialise. Despite the recent unrest, which could affect inflation and growth forecasts, the impact is expected to be temporary and therefore should not require changes to monetary policy.

GLOBAL

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- The OPEC+ group of oil producing nations finalised their long-awaited deal after Saudi Arabia and the UAE put aside their differences on quota increases. From 1st August, the cartel will increase output by 400,000 per month until end December 2022, gradually restoring production to pre-pandemic levels. The deal brings greater price stability for consumers, reducing the inflationary risk of a potential oil price spike. Oil price concerns have been felt especially in the US, where demand is recovering rapidly amid mass vaccination and the reopening of the economy. US oil stockpiles have been falling at their fastest pace since 1982, exacerbated by a sharp decline in domestic shale oil production, which is still 15% below peak levels. Shale producers are wary of increasing production as the collapse in the oil price last year to less than zero is still fresh in the collective memory. The oil price collapsed last year after OPEC+ entered a price war and Saudi Arabia increased production by 11.6 million barrels per day. The latest deal should bring added security for producers, encouraging the US shale industry to raise production while also restoring price visibility for consumers.

NORTH AMERICA

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- Inflation data again exceeded expectations. Consumer price inflation (CPI) accelerated in June from 5% to 5.4% year-on-year well above the 4.9% consensus forecast. On a month-on-month basis CPI increased by 0.9%, lifting the rolling three-month annualised rate from 8.4% to 9.7%. Core CPI, which excludes food and oil prices due to their volatility also accelerated from 3.8% to 4.5%. Rising inflation concerns are becoming increasingly widespread, which raises the risk that inflation expectations will start to increase. The Federal Reserve's Beige Book summary of anecdotal reports on business conditions reported rising expectations of higher input costs and selling prices over coming months. The University of Michigan consumer sentiment index fell in June to its lowest level since February, attributed primarily to rising inflationary pressures and their effect on living standards. Fed Chairman Jay Powell faced interrogations over the rising inflation threat at his semi-annual testimonies to Congress, which came shortly after the latest CPI data release. Powell was more circumspect about forecasts that the inflation spike would prove transitory, saying that the inflation numbers were "bigger than many expected and bigger certainly than I expected, and we are trying to understand whether it is something that will pass through fairly quickly or whether if in fact we need to act." The next Fed policy meeting is on 27-28th July. Transitory price increases may give way to more permanent increases in wages, rents and inflation expectations, but on the other hand the deflationary effects of globalisation and technology adoption remain as relevant as ever. The worst-case scenario would be stagflation, with inflation rising while growth slows, the opposite of the Goldilocks economy, which is characterised by above-trend growth, low inflation and low interest rates.

- Retail sales and industrial production data remained strong in June, rising from already elevated levels. While spending patterns shifted from durable goods towards services as Covid restriction were lifted, aggregate retail spending increased in June by 0.6% month-on-month. If the 2% decline in vehicle sales is excluded, the increase in retail sales would have been even stronger at 1.3%. Compared with February 2020, just prior to the pandemic, retail sales grew by a massive 18%. Retail sales, which comprise the bulk of consumer spending, are likely to maintain their positive trend in the second half of the year. While the $300 per week enhanced unemployment benefit is set to expire in September, the Republican states have already discontinued the fiscal support programme. Meanwhile, rising jobs growth and wages should compensate for the drop-off in fiscal support. Jobless benefit claims fell in the week to 10th July from 386,000 to 360,000 the lowest since the start of the post-pandemic recovery. Industrial production also increased in June, rising by 0.4% on the month. Manufacturing, its biggest component, fell 0.1% but after excluding vehicle and parts production, which declined by 6.6% due to supply chain disruptions, manufacturing increased by a robust 0.4% on the month.

- According to the Wall Street Journal's monthly economists' survey, the pace of US economic growth has passed its peak, although it will remain well above trend into next year. The average survey forecast predicts annualised quarter-on-quarter GDP growth of 9.1% in the second quarter (Q2), dipping to 7% in Q3 and slowing to 3.3% by Q2 2022. In Q4 this year, year-on-year GDP growth will measure 6.9%, moderating to 3.2% in the same period in 2022 and to 2.3% in 2023. Inflation is also expected to moderate, with consumer price inflation predicted to slow from its current year-on-year rate of 5.4% to 4.1% by December and to 2.5% by December 2022. The latest Bank of America monthly fund managers' survey indicates a similar easing in global economic forecasts. The portion of survey respondents who believe the world economy would continue to improve slipped to 47%, down sharply from the March peak of 91% and the lowest reading since last November when vaccines were approved, and President Joe Biden won the US election with a clean Democrat sweep of Congress. The survey highlighted the main risks to the world economy as inflation, a disorderly response to the Fed's asset purchase programme taper, the danger of asset bubbles, a slowdown in China and the effects of the Covid Delta variant.

CHINA

Contributed by Nick Downing

- China's GDP grew in the second quarter (Q2) by a robust 7.9% year-on-year. Although significantly slower than the 18.3% growth posted in Q1, those numbers were boosted by the Covid base effect. On a quarter-on-quarter basis, GDP growth picked up from 0.4% in Q1 to 1.3% in Q2. Among the key GDP components, industrial output and retail sales grew in Q2 by 8.9% and 13.9% year-on-year and fixed asset investment by 12.6% in the first half of the year. However, the higher frequency data signal a loss in momentum. Year-on-year growth in industrial production slowed in June to 8.3% from 8.8% in May, while retail sales growth slowed to 12.1% from 12.4% in May and 17.7% in April. While export growth confounded expectations of a slowdown, with a 32.2% year-on-year increase in June, lifting the monthly trade surplus from $45.5 billion to $51.5 billion, the demand for China's goods is likely to lessen as global consumer demand shifts from goods to services amid a continued easing in Covid restrictions. The People's Bank of China appears to be aware of the need to shore up growth momentum after cutting the reserves banks are required to hold for the first time since April 2020. Despite China being on track to achieve 8% GDP growth in 2021, additional monetary stimulus is expected over coming months.

JAPAN

Contributed by Carel la Cock

- Japanese private sector business confidence has hit a 12-year series record. The June IHS Markit Japan Business Outlook survey reported that a net balance of +26% of firms expects business activity to improve in the next twelve months, a 1%-point improvement from the February survey. Service providers showed the highest level of optimism buoyed by the reopening of the economy as the vaccination program gathers pace and the potential boost from the Olympic Games. However, survey respondents highlighted ongoing concerns around the pandemic and more resistant strains of the virus while manufacturers also fretted about the rising cost of raw materials and supply chain disruptions. Other potential headwinds include weaker demand after the Olympics and renewed trade frictions between the United States and China. The outlook for hiring staff improved marginally from February and was in line with pre-pandemic levels. A net balance of +15% of firms expects to hire more staff in the next year. Manufacturers expect a stronger rise in employment levels and capital expenditure compared to the service sector while overall wage costs are expected to increase. Furthermore, private sector firms expect profits to improve in the next twelve months with an unchanged net balance of +16%. Usamah Bhatti, Economist at IHS Markit has warned that “Japan’s economy remains precariously placed, as policymakers battle to balance risk from further waves of the virus with a successful Olympics and economic recovery.”

EUROPE

Contributed by Carel la Cock

- The IHS Markit Europe Business Outlook survey revealed record levels of optimism in the private sector for both manufacturing and service providers, supported by successful vaccination programs and stronger global demand. The IHS Europe Business Activity Net Balance in June was +50%, significantly up from the +40% recorded in the February survey and has set a new series record. Importantly it was also significantly higher than the global average of +38%. Optimism was shared equally amongst manufacturers and service providers while both reported higher optimism than their respective global averages. Spain (+59%) and Ireland (+60%) reported the greatest levels of optimism amongst service providers while German service companies came in at +41%, but German manufacturers (+57) led the charge followed closely by Dutch manufacturers (+56%) suggesting that demand for industrial exports will recover significantly in coming months as the global economy emerges from the grips of the pandemic. Following the improved optimism in business activity, private sector companies are expecting to increase their staff levels with the net balance of +31% surging to a series record. Firms also expect to increase capital expenditure in the next twelve months, especially amongst manufacturers (+28%). On the inflation front, concerns remain around an increase in non-labour costs, highlighting the recent supply chain disruptions and shortage in raw materials while higher demand for staff is also expected to raise the cost of labour in the year ahead. Both manufacturers and service providers indicated that they would try and pass the higher input costs on to consumers, leading the net balance on output prices to a series record of +33%. Companies expect profitability to improve, while service providers (+29%) were more optimistic than manufacturers (+14).

UNITED KINGDOM

Contributed by Carel la Cock

- The UK jobs market is in rude health following the successful vaccination program and the easing of lockdown measures. The latest KPMG and REC UK jobs report shows that recruitment activity hit record levels in June and vacancies grew at a record pace. Permanent appointments have also recorded a new series record as confidence in the economy returns and billings for temporary workers has grown at the fastest pace in the survey history. The result is that the availability of workers has deteriorated substantially leading to higher starting pay rates for both permanent and temporary staff. Recruiters noted that the dwindling availability of suitable candidates was exacerbated by the surge in hiring, Brexit, furlough schemes and the uncertainty around the pandemic. The increase in staffing costs will be a concern for the Bank of England (BoE) which has until now maintained that inflation pressure would fade towards the end of the year and thus hiking rates too soon would detract from the economic recovery. However rising wages are less transitory and could mean that the BoE will start hiking rates sooner than anticipated. Committee members have in recent weeks made their opposing views public, setting the scene for a heated debate at next month's rate setting meeting.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 9.08	64804
JSE Fini 15	+ 3.04	12427
JSE Indi 25	+ 9.75	85495

JSE Resi 20	+ 8.45	62441
R/$	+ 0.84	14.57
R/€	+ 4.41	17.19
R/£	+ 0.77	19.93
Dow Jones	+ 13.33	34687
Nikkei	+ 0.76	27652
Hang Seng	+ 0.95	27489
FTSE 100	+ 5.94	6844
Gold	- 3.41	1829
Platinum	+ 6.77	1142
Brent oil	+ 32.47	68.62

BOTTOM LINE

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- A tempus horribilis. From the 10-17th July we witnessed the horrifying spectacle of arson, looting and destruction, the loss of human life and erosion of the remaining goodwill towards our country from foreign investors. We have witnessed in all its glory, the full splendor of expropriation without compensation.

- The television footage and the multitude of videos doing the rounds on social media were distressing. Few could have expected the speed and thoroughness of the destruction, and yet none of it should really come as a surprise. Studies have shown that historically there is a very high chance of civil unrest within 14 months of a pandemic, especially in poor countries which cannot afford the luxury of generous furlough schemes, as in the UK, or the $300 per week enhanced unemployment benefits granted in the US.

- In true form, the government is already doing its level best to search for a scapegoat. There were supposedly dark forces at play, "spooks" who according to the Minister of Police Bheki Cele (Mr. Hat) have conspired to de-stabilise the country by inciting mass insurrection. There may be some ringleaders but if they really mean to change the political direction of the country why have they not come forward with a visible presence? It is fortunate that they have not, as this reduces the probability of escalation. Revolutions seldom take root without charismatic leadership.

- If this had occurred in the UK or any other developed nation, the entire cabinet would have resigned. Not here. The government is looking for someone to blame. Rather than find a scapegoat, the government needs to take the complete blame. The government needs to finally own up to the failure of its economic policy. Perhaps the crisis of the past week is just the catalyst to make this possible. It might be wishful thinking but once the so-called perpetrators have been rounded up, the government might own up to the root of the problem, its failed policy. It might embark on deep reflection and reinvention.

- The government is hamstrung by its ideology, keeping it on the ruinous path of maximum state intervention, BBBEE regulations and inflexible labour laws. These policies have created the perilous state of corruption, negligence, joblessness, poverty and helplessness which lit the flame of insurrection. It is a surprise that it has taken so long but it is almost a relief that the moment of reckoning has finally arrived.

- While destructive the crisis also showed South Africa's best side. When buildings were looted and destroyed, people from all races and backgrounds rallied together to protect property and begin the tidy-up, filling the gap of essential public sector services. Citizens showed courage and kindness, remarkable decency and restraint in defending property. The crisis has simultaneously shown the country's very worst but also its very best aspects. True Ubuntu.

- The moment of reckoning has arrived. The boiling frog experiment may finally be over. The week marks South Africa's Ground Zero, a potential catalyst to end the failed economic policies of the past 27 years. The government now has the platform from which to embrace the private sector, reduce government interference, reject odious BBBEE regulations and inflexible labour laws. These are handbrakes on investment and employment. If BBBEE must be maintained, it should be simplified and implemented as an incentive rather than on a punitive basis. Disadvantage boils down to education alone, and this is where the government should focus its attention. With world class education and apprenticeships there would be no requirement for affirmative action.

- Since the looting erupted, futurist and scenario planner, Clem Sunter, has increased the probability of the "Low Road" scenario for South Africa, in which the country descends into anarchy, from 30% to 50%. I disagree. Counter intuitively, the looting crisis may have reduced the probability of the Low Road scenario. The chance of effective structural reform and an abandonment of failed government economic policy must surely have increased following the past two weeks. Even a blind man would be able to spot the evidence of policy failure. If after the events of the past week, the government still refuses to admit culpability, then perhaps the following scenarios have increased in probability: A breakup of the ANC alliance and the emergence of a two-party state. This would also be positive for the country's long-term outlook. As with a recovering addict, the first and most important step to recovery is an admission of addiction (failure). The time for our President to do the same has at long last arrived and for this we have the looters to thank. Mr. New Dawn, please refrain from placing the blame on Mr. Hat's spooks. This time, take the blame fairly and squarely on the chin. See how the private citizenry has cleaned up your mess and take heed.

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