OVERBERG MARKET REPORT

Tuesday 27th July 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Why do some CEOs with brilliant track records prior to their appointment as CEO, succeed, and why do some fail? Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The South African Reserve Bank's (SARB) composite leading business cycle indicator rose by 2.3% in May to 128.8 from 125.8 in April. The leading indicator leads economic activity by around six months and provides insight into expected future economic and business conditions. The recent improvement reflects, among other factors, the impact of the low base established a year earlier during the initial severe Covid-19 lockdown restrictions. Seven of the ten available component time series increased while the remaining three component time series decreased. The largest contributors to the increase in the composite leading business cycle indicator were gains in the average hours worked per factory worker and the volume of orders in manufacturing. The largest detractors were decelerations in the percentage change over 12 months in the composite leading business cycle indicator for South Africa's main trading-partner countries and the six-month smoothed growth rate in the number of new passenger vehicles sold.

- Consumer inflation, as measured by the Consumer Price Index (CPI), dropped noticeably in June, to 4.9% year-on-year from 5.2% year-on-year in May. The May reading was slightly higher than the consensus forecast of 4.8%. Core inflation, which excludes volatile food and non-alcoholic beverages and fuel, was 3.2% year-on-year in June. This is well below the 4.9% headline rate, indicating the importance of these products as inflation drivers. Fuel prices increased by 27.5% in June compared with the same month last year. These relatively high rates come off a low base recorded during the second quarter of 2020 when fuel prices were depressed. The Bureau for Economic Research (BER) reported that inflation expectations increased slightly in the second quarter. The survey respondents, on average, expect inflation to be 4.2% in 2021, compared to a forecast of 3.9% in the first quarter. Households expect inflation to be 5.1% in the next 12 months, slightly up from 5.0% before. Inflation is assessed to have peaked in June, with diminishing base effects expected going forward. Looking ahead, inflation is expected to moderate towards the 4.5% midpoint of the SARB's 3%-6%

target range. Risks to the outlook would come from a weaker rand that could drive fuel inflation higher, but oil inventories should lift following the higher OPEC+ production agreement.

- The South African Reserve Bank (SARB) left the repo interest rate unchanged at 3.5% (prime lending rate 7%), as expected by the market. The SARB revised its consumer price inflation target for 2021 slightly higher to 4.3% (up from 4.2%) and further expects inflation to be 4.2% (down from 4.4%) in 2022 and 4.5% in 2023. This benign inflation outlook is well within the SARB's 3-6% target range, proving room for the bank to take on a more accommodative monetary stance. Given the medium and long-term projections set out above, a weaker currency, higher domestic import tariffs, and escalating wage demands present longer-term upside risks to the inflation forecast. The implied policy rate path of the SARB's Quarterly Projection Model (QPM) indicates an increase of 25 basis points in the fourth quarter of 2021 and each quarter of 2022. Regardless, the consensus view is for the SARB to maintain an accommodative monetary policy for as long as possible and to only start increasing interest rates in the first quarter of 2022. The SARB expects GDP growth of 4.2% for 2021, 2.3% in 2022, and 2.4% in 2023. The recent unrest and economic damage could have lasting effects on investor confidence and job creation. The SARB estimates the unrest will have fully negated the better-than-expected growth results from the first quarter, resulting in an unchanged estimate of 4.2% for growth in 2021.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Private Sector Credit Extension, due Tuesday 27 July. Private sector credit extension (PSCE), a measure of credit extended by the South African Reserve Bank to domestic borrowers, is expected to have increased in June following three months of contraction. An increase is anticipated as consumer spending continues rising amid growth in household income, the low interest rate environment, and the subdued prices of most consumer goods. The consensus forecast is for PSCE to have increased 0.3% year-on-year in June from the 0.42% contraction recorded in May.

- Producer Price Inflation, due Tuesday 27 July. Producer inflation, as measured by the Producer Price Index (PPI), is expected to have edged down marginally in June. The consensus forecast is that June recorded a 7.3% year-on-year increase from 7.4% recorded in May. Despite the marginal pullback, PPI remains considerably higher than current CPI levels but with continued weakness in domestic demand. there is little risk of inflationary pressures at the producer level being passed on.

- Balance of Trade, due Friday 30 July. The balance of trade, which is the value of exported goods minus the value of imported goods, is expected to reflect another encouraging figure in June with the consensus forecast expecting a R55 billion surplus. This would be South Africa's widest monthly trade surplus since January 2010, up from the R54.6 billion surplus recorded in May. The June surplus is expected to have been constrained slightly by the stronger rand, global lockdown restrictions and slowing growth in commodity prices.

- Total New Vehicle Sales, due Monday 2 August. New vehicles sales are likely to have maintained the gradual recovery seen in the first half of the year, although affected slightly by the Covid-19 third wave and corresponding lockdowns. A full recovery in new vehicle sales is only projected in 2023.

NORTH AMERICA

Contributed by Nick Downing

- There is great anticipation ahead of the Federal Reserve's policy meeting, which concludes on Wednesday 28th July. The Fed is widely expected to provide further guidance on the eventual tapering of its $120 billion per month asset purchase programme. The start of any interest rate hiking cycle will probably only occur after asset purchases have ended, hence any decision on tapering will be closely followed, not just the initiation date but also the speed of incremental cuts to the programme. The Fed is likely to adopt a flexible approach, allowing it to adjust the tapering speed according to changing economic variables. The hawks within the Fed are anxious that the process starts soon, probably as early as September, due to rising inflation and an increased risk of financial instability, stemming from an overheated equity and residential property market. The dove camp, which is more powerful as it is represented by Fed chairman Jay Powell and vice-chair Richard Clarida, is more circumspect, believing that the inflation spike will fade and that the twin objective of full employment is still a long way off. Moreover, the Covid Delta variant is creating uncertainty over global economic growth. Economic surveys are signalling a decline in inflation expectations, which supports the Fed's dovish camp. The yield difference between fixed rate and inflation adjusted 10-year Treasury bonds, which measures the market's expected annual inflation rate over the next decade has retracted over the past three months. The so-called Breakeven rate has declined to 2.25% from 2.55% as recently as May. The conventional 10-year Treasury bond yield has declined from its peak of 1.75% in March to 1.28%, having dropped to a low of 1.13% last week. The greater risk according to the bond market appears to be disappointing growth rather than excessive inflation, which the Fed is bound to take note of in its policy deliberations.

- The boom in the residential property market continued into June. Existing home sales gained by 1.4% month-on-month, lifting the year-on-year increase to 22.9%, while the median home price surged to a new record high of $363,000 up a massive 23.4% on the year. Demand is being fuelled by historically low mortgage interest rates, sizeable household savings and rising demand for larger properties to accommodate working from home. With a limited supply of homes for sale, property prices are likely to keep rising. At the current sales rate, there is only 2.6 months' supply of homes for sale, creating a squeeze on the market. Homes are typically selling above their asking price and on average spending a record low 17 days on the market. Meanwhile, building activity and the supply of new homes is restricted by supply chain disruptions, surging material and labour costs. Although the National Association of Home Builders reported a 6.3% month-on-month increase in housing starts in June, the outlook is less certain. New building permits, a forward-looking barometer of building activity, lost 5.1% on the month. Some economists, including officials at the Federal Reserve, are concerned that the property boom is not sustainable and if it busts could spark financial instability in the broader economy.

CHINA

Contributed by Nick Downing

- China's equity markets have suffered steep declines over the past three trading days, taking the Shanghai & Shenzhen CSI 300 index down by 7.74%. The index has lost 9.80% since the start of the year, in stark contrast with the US S&P 500 index, which has rallied by 19.5%. The catalyst for the latest sell-off is a crackdown by regulatory authorities on the private tutoring industry. There is enormous demand from school learners for private tutoring to assist in university entrance exams. Heightened competition means an estimated 70% of learners attend private tutoring. New regulations forbid tutoring companies from making profit, from raising capital or seeking a foreign equity listing. Tutoring prices will be regulated. The measures are aimed at reducing education inequality and at reducing the cost of raising families. Surging educations costs are blamed in part for the country's falling birth rate, which has continued to decline despite a complete relaxation of the one-child policy. Authorities are concerned by the falling fertility rate and its implications for an ageing population, especially in a nation which has little immigration. The shares of private tutoring companies collapsed, losing around 90% of their market capitalisation over just three days, as new regulations upended their business models. New Oriental Education, a benchmark in the peer group and listed on the New York stock exchange, lost 65% over two trading days. The regulatory interference has amplified concerns among investors that other industrial and service sectors may also be targeted. However, others see the market sell-off as an opportunity to gain access to China's market at bargain prices. Regulatory restrictions and anti-trust legislation will in time nurture rather than constrain competition and innovation. From a longer-term perspective, the process of "disrupting the disrupters" is viewed positively by some investors.

JAPAN

Contributed by Carel la Cock

- Japan's private sector business activity declined at the fastest pace in six months as a rise in covid-19 cases impacted activity and dampened demand. The latest Jibun Bank Flash Japan Composite Purchasing Manager's Index (PMI) reading of 47.7 in July was down 1.2 points from June's final reading. The data indicates a steepening deterioration in private sector business activity. The Jibun Bank Japan Manufacturing Purchasing Manager's Index showed that the sector expanded at a marginally slower rate with a reading of 52.2 in July, slipping from 52.4.0 in June. Output and new order growth slumped to a six-month low as the rise in covid-19 cases and delays in acquiring raw materials impacted on activity. The services sector saw another monthly decline, although at a faster pace. The Jibun Bank Flash Japan Services Business Activity Index eased to 46.4 in July from 48.0 in June, while new business declined for an 18th consecutive month. Employment levels continued to expand but at a slower pace. Manufacturers reported weaker demand for staff while the services sector shed jobs for the first time this year. Overall optimism for business conditions in the year ahead remains positive although slightly less so than in June with hopes that future rises in infections will be suppressed by the expanding vaccination programme.

EUROPE

Contributed by Carel la Cock

- In Europe, private sector business activity surged ahead, expanding at a rate not seen in 21 years. The IHS Markit Flash Eurozone Composite PMI rose to 60.6 in July from 59.5 in June, marking the fourth consecutive month of accelerating business activity, helped by continued easing of covid-19 restrictions across the region. Service sector activity rebounded at the fastest pace in 15 years as the easing in travel restrictions led to the fastest rise in services exports since records began. Manufacturing output grew for a thirteenth consecutive month but was held back by deteriorating access to inputs. The Flash Eurozone Manufacturing PMI eased to a 5-month low while the Output Index softened to a 4-month low, hampered by the lengthening in supplier delivery times. Manufacturers also reported higher input costs leading to selling prices rising at unprecedented levels. Furthermore, firms indicated that staff complements increased for a sixth consecutive month as companies try to meet increasing demand. Amongst the larger nations, Germany powered ahead leading the region with a record monthly expansion as both services and manufacturing reported solid growth. Business activity in France eased to a 3-month low, held back by its services sector. Across the region optimism waned despite the current expansion with many respondents worried about the rise of the delta variant of the virus and the efficacy of vaccines for future variants. Overall demand for both manufacturing and services remained robust indicating that the current recovery will be sustained well into the third quarter.

UNITED KINGDOM

Contributed by Carel la Cock

- UK private sector output growth expanded at the slowest pace in four months, hampered by staff shortages in the services sector and access to raw materials in manufacturing. The IHS Markit/CIPS Flash UK Composite Output Index at 57.7 dropped sharply from 62.2 reported in June. Firms in both the services sector and in manufacturing indicated a loss in momentum. While the easing in covid-19 restrictions improved consumer demand for business services and strengthened new order books for manufacturers, the inability to fill vacancies, the shortage of raw materials and export complications brought on by Brexit, detracted from growth in the month. Input costs rose because of wage inflation, higher transport costs and price hikes by suppliers as demand outstripped supply, causing a further deterioration in suppliers' delivery times. As a result, output charges rose at the fastest pace since records began. Although private firms remain optimistic about the next twelve months, optimism waned to its lowest level in nine months as employers fret about filling vacancies and manufacturers are concerned that demand for products will slow following a period of stockpiling. The Bank of England will be keeping a close eye on rising output prices and commensurate inflationary pressures as it decides on hiking interest rates at the next policy meeting in August.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 14.55	68051
JSE Fini 15	+ 5.35	12704
JSE Indi 25	+ 11.97	87227
JSE Resi 20	+ 20.48	69364
R/$	- 0.67	14.79
R/€	+ 2.76	17.47
R/£	+ 3.50	20.45
Dow Jones	+ 14.56	35061
Nikkei	+ 1.42	27833

Hang Seng	- 3.81	26192
FTSE 100	+ 8.74	7025
Gold	- 4.62	1806
Platinum	+ 2.37	1095
Brent oil	+ 45.19	74.77

BOTTOM LINE

Contributed by Gielie Fourie

- Why do some CEOs with brilliant track records prior to their appointment as CEO, succeed, and why do some fail? David Fubini, senior lecturer at Harvard Business School, shares his research on why leaders succeed or fail in his new book, "Hidden Truths: What Leaders Need to Hear but Are Rarely Told" published in December 2020. People strive for years to develop special skills and knowledge and a track record of success, to reach a point where they can be promoted to the CEO of a company. Unfortunately, what is shocking for most new CEOs, is that the experience that prepared them for the role as CEO, is not helpful once they get there. In his book Fubini identifies four key pieces of advice for business leaders.

- AVOID HALF-TRUTHS AND MISPERCEPTIONS: Fubini quotes a former admiral who said he knew two things with certainty when he came onto a battleship: He was never going to get handed a cold cup of coffee, and he was never going to hear the whole truth. People coming into a new role will struggle because they get told only a portion of what they need to know. You have to be open and candid and say: "Look, tell me what you are not telling me". Some CEOs will perform a double-check on what they have been told. They will go back and have confirmative conversations with others. Some CEOs will go a few layers below the senior management level and engage middle management, who are often willing to be absolutely candid and have a deeper understanding of what is really going on. Peter Drucker once remarked: "The most important thing in communication is hearing what isn't said".

- START CHANGE MANAGEMENT BY CHANGING THE MANAGEMENT: There is enormous value to changing management because it unleashes frozen organizations and brings a change of perspective. The broader body of the company often welcomes the change. There are lots of examples where people come in and get told: "We cannot do this. Let me tell you why this did not work". People get stuck in a status quo mindset. But you do not have time for that - change is often a matter of speed. There is also sometimes a belief that you do not want to change management because you will lose the institutional knowledge that exists there. But the truth is, the institutional knowledge does not rest with the people who are directly reporting to the senior management team. It rests with the people below it.

- USE PSYCHIC REWARDS, NOT JUST MONETARY ONES: For the employee money is critically important only up to a point. Real motivation comes from an emotional connection that you feel - either that you are more highly valued than someone else, or the ego enhancement of being told how great a performer you are. If I tell you that you are highly respected and that your colleagues appreciate what you are doing, you will break down walls to be successful. Or it could be more informal, by giving you recognition in a speech in front of your peers, or in an all-staff email. Those are the little things that leaders should do, but do not do enough. “The worst mistake a boss can make is not to say, 'well done'.” John Ashcroft.

- KNOW WHEN TO LEAVE: People always feel they have one more act. In reality, very, very few people are wildly successful for an extended length of time. So, you want to find an inflection point, where you can leave while you are at the apex, not past it. One clue is if you are starting to have trouble retaining really high-performing people, who are your natural successors. They might feel their way is blocked by you hanging around. That is a true warning sign that maybe it’s time for you to move on and do something new.

- HAVE THE “BEST EARS IN THE COMPANY”: In another book, “Five Ways to Keep Connected” Fubini tells the story of Bill Russell, one of the greatest players in National Basketball Association history when he played for the Boston Celtics. His coach was the legendary Red Auerbach. Russell recalled that Auerbach would have conversations with each player, but that he tailored his style of communication to the needs of each player. His goal was to hear what each player needed and adjust his coaching accordingly. Russell said that Auerbach had “the best ears in the NBA”. Ask yourself: “Do I have the best ears in my company?” If not, you need to try harder to develop this ability. It will also help you to fight the sense of isolationism that comes with leadership roles. It gets lonely at the top, but the view is splendid.

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