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WEEKLY REPORT

OVERBERG MARKET REPORT

Tuesday 21st September 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- A recent newspaper headline reads: "Godongwana recoils from R73.5 billion ANC spree." Do we really need another spending spree? Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Mining production lost some momentum, rising by 10.3% in July, following a 19.1% increase in June. The increase was mainly driven by iron ore output, which soared by 42% year-on-year, followed by PGMs increasing 10.3% year-on-year. On a monthly, seasonally adjusted basis, total production was up 4.1% in July, after dropping by 1.6% in June. As with production, the annual growth in mineral sales was softer in July, coming in at 32.6% after increasing by 94% in June. Activity in the mining sector rebounded from the various disruptions in May and June. Although sales slumped in July, the return to normal operations at the local ports will support volumes during the rest of the year. The recovery in global industrial activity and high commodity prices remain supportive of the sector's overall recovery, but the Delta variant, associated lockdowns, global supply disruptions, planned load-shedding and a slowdown in economic growth in China pose downside risks to the pace of recovery.

- The July retail trade sales data came in weaker-than-expected, caused by the impact of the civil unrest and stricter lockdown restrictions. Retail trade sales decreased by 0.8% year-on-year in July. The largest negative annual growth rates were recorded for retailers in household furniture, appliances and equipment (-10.2%), hardware, paint and glass (-6.2%), and food, beverages and tobacco products in specialised stores. Seasonally adjusted retail trade sales decreased by 11.2% in July compared with June. The data underscores the battle facing the sector as it claws its way back from harder lockdown restrictions and the damage done after protests over the imprisonment of former president Jacob Zuma. Significant improvements on the jobs front and the ability to limit strict restrictions on economic activity will be vital in rebuilding demand in the economy. Looking ahead, progress on vaccinations and a favourable interest rate environment will offer support to the sector's recovery.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Composite Leading Business Cycle Indicator, due Tuesday 21 September. 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 likely to have continued disappointing in July. The consensus forecast is that it fell 6% from a month earlier, following a 2.3% fall in July, attributed to the unrest that disrupted business activity.

- Consumer Inflation Rate, due Wednesday 22 September. The consumer price inflation (CPI) rate is expected to have edged up slightly to 4.9% year-on-year and 0.4% month-on-month from 4.6% and 1.1% in July. This expected increase is attributed to the large fuel price increase along with some pressure from food prices. Core CPI is expected to have remained unchanged from the previous month at 3% year-on-year.

- SACCI Business Confidence Index, due Wednesday 22 September. The South African Chamber of Commerce and Industry (SACCI) business confidence index (BCI) is expected to have recovered slightly to 95 in August after recording the lowest reading since October 2020 in July (93.2). A slight improvement is anticipated as August was not negatively influenced by the looting that occurred during July, nor as heavily impacted by lockdown restrictions. Moreover, an improving vaccination process during August will have brought a further sense of normality to the economic environment.

- Interest Rate Decision, due Thursday 23 September. The South African Reserve Bank's Monetary Policy Committee is not expected to move interest rates from their current near-five decade low given the unstable economic recovery and contained consumer inflation. Interest rates are expected to normalise in 2022 from the current low of 7% prime overdraft rate and the 3.5% repo interest rate.

NORTH AMERICA

Contributed by Nick Downing

- Following several months of acceleration, inflation appears to have peaked. Consumer price inflation (CPI) increased in August by just 0.3% month-on-month, down from 0.5% in July and sharply lower than June's 0.9% reading. On a year-on-year basis, CPI decelerated to 5.3% from 5.4% in both July and June. Core CPI, which excludes food and energy prices due to their volatility, increased by just 0.1% on the month its lowest reading since February and dropped from 4.3% to 4.0% on the year. The earlier inflationary culprits appear to be retreating. Used vehicle prices dropped 1.5% on the month, although still up by 32% on the year. Airline fares fell 9.1% on the month, car and truck rentals by 8.5% and hotel tariffs by 2.9%. The data appears to support the Federal Reserve's view that the current inflation spike will be transitory. The bond market agrees with the Fed. The breakeven rate between conventional Treasury bonds and the Treasury's inflation protected securities (TIPS), which measures the market's expected average annual inflation rate over the bond maturity, is currently pegged at a moderate 2.5% over both 5 years and 10 years. However, some economists believe the bond market and Fed are being too complacent. There is a danger that consumers' inflation expectations, already at elevated levels, could become self-fulfilling. The New York Reserve Bank measure of inflation expectations one year out has increased steadily, rising in August for a tenth straight month by 0.3% on the month to 5.2%. Rental costs, which comprise 40% of core CPI, increased in August by 0.3% on the month and 2.5% on the year, in danger of exceeding the TIPS breakeven rate. The longer-term outlook for inflation will ultimately dictate the capacity for the Fed to maintain interest rates close to historic lows, a key prerequisite for buoyant financial markets.

- August's retail sales and industrial production data were stronger than expected, relieving concerns that the economy was losing momentum amid a resurgence in Covid infections. Retail sales grew by 0.7% month-on-month, a welcome recovery from July's 1.8% decline. The consensus had projected a 0.8% fall. While consumer confidence indices had declined sharply due to Covid concerns, actual retail spending remained surprisingly resilient. Despite the short-term boost attributed to the start of the new academic year at schools and universities, the outlook for retail spending is bright, helped by the massive pool of household savings, a buoyant jobs market and strong wage growth. Meanwhile, industrial production increased in August by 0.4% on the month, its sixth straight monthly increase, and especially encouraging on the back of July's 0.8% gain. The increase would have been higher by 0.3 percentage points had it not been for shutdowns inflicted by Hurricane Ida. Nonetheless, capacity utilisation climbed to 76.4%, its highest since December 2019, indicating a steady easing in supply chain bottlenecks. Although economic recovery will inevitably slow from the breakneck speed set in the first half of the year, growth is expected to remain well above its pre-pandemic pace over the next 12-18 months.

CHINA

Contributed by Nick Downing

- China's economy is reeling from a combination of regulatory crackdowns, especially in the property sector, a slowdown in export demand, extreme weather conditions, and a resurgence in Covid infections. China's zero tolerance approach to Covid means a dramatic, albeit short-lived, effect on both production and consumption. In August, retail sales growth slowed to just 2.5% year-on-year compared with 8.5% in July. Industrial production growth slowed from 6.4% to 5.3%. Fixed asset investment slowed from 10.3% in the January-July period to 8.9% in January-August, compared with the same period in 2020. Restrictions on property developers and curbs on property buying caused new construction starts to fall by

3.2% on the year in the January-August period, accelerating from the 0.9% decline in January-July. Home sales plummeted in the month of August by 19.7% on the year, the biggest decline since April 2020 at the peak of the pandemic. Including its indirect economic impact, the property market accounts for close to 30% of China's GDP. The dismal economic data will inevitably prompt economists to lower their GDP growth forecasts for the full year from the current consensus of 8.5%. Recent data indicates a growth rate closer to 7-7.5%, although much depends on the scope of expected fiscal and monetary stimulus response.

- Shares in China Evergrande Group, the most indebted property developer worldwide, with an estimated $300 billion in outstanding debt, slumped on Monday by as much as 18% as solvency fears mounted. Sizeable bond repayments are due this Thursday. The share price has collapsed by 90% since the start of the year and its international bonds are trading at 20 cents on the dollar. Authorities have clamped down on the ability of highly indebted developers to increase borrowing, which combined with purchase restrictions, has created the perfect storm for Evergrande and the property development industry generally. Developers have so far this year defaulted on $6.2 billion in debt obligations, more than the previous 12 years combined. There are fears that the government, which has long held the view that property sector leverage poses the biggest financial risk to the country, will let Evergrande fail. However, the fallout would be tremendous, spreading beyond the vast numbers of private investors and unfinished homes. The fall in Evergrande shares was felt globally on Monday with equity markets dropping worldwide due to the risk of contagion. The US VIX volatility index spiked to its highest level since May. In a possible rescue scenario for Evergrande, local governments and state-owned enterprises could assume portions of the business on a region-by-region basis, but its equity and bond investors are bound to share the pain.

JAPAN

Contributed by Carel la Cock

- Reminiscent of ancient samurai warriors performing "suppuku", the act of suicide by falling on one's own sword, Yoshihide Suga indicated earlier this month that he will not stand for re-election at this month's Liberal Democratic party's leadership race. Approval ratings for Mr Suga have plummeted to below 30% after failing to successfully curb the spread of covid-19 infections and overseeing a largely unpopular summer Olympic games. His resignation is seen as a selfless act, boosting his party's chances of remaining in power after this year's general election that must be held before the end of November. The Japanese stock market rallied on the news, hitting a 30-year high as traders bet on the likelihood of additional stimulus accompanying new leadership. Some analysts fear that there will be a break in the continuity of Japanese politics. After Shinzo Abe resigned just over a year ago, Mr Suga was backed by the party to maintain Mr Abe's economic policies and to signal to the markets that it is business as usual in Japan. One of the frontrunners to take up the leadership position at the party is Fumio Kishida who formerly served as foreign minister. Mr Kishida has signalled he would launch fresh stimulus and is likely to take a different approach to the Abenomics both his predecessors backed. During this time Japan saw easing monetary and fiscal policies and in the early years of Mr Abe's term, he was lauded for taking bold steps to review an economy that has battled with low inflation for decades. However, in recent years his Abenomics policies have drawn criticism and failed to break the trend of low growth and low inflation. With new leadership comes new hope and the markets have seen this as a catalyst for unlocking the potential in Japan.

EUROPE

Contributed by Carel la Cock

- The European Central Bank (ECB) announced that it will move to "a moderately lower pace" in its pandemic emergency purchase programme (PEPP) from the €80bn a month level it implemented in March. It is important to note that this is not equivalent to tapering as the bond purchases are not set to end. The ECB still has €500bn left in its PEPP fund and ECB president, Christine Lagarde, assured the markets that the programme will run at least until March 2022. Ms Lagarde noted that the eurozone has made a strong recovery and inflation has peaked at 3% in August saying the "rebound phase in the recovery of the euro area economy is increasingly advanced." However, she warned that "we are not out of the woods" as there are 2m unemployed people following the pandemic and many still on furlough schemes. She added that "there remains some way to go before the damage to the economy by the pandemic is undone." The ECB revised its growth expectations for this year to 5%, tapering off to 4.6% next year and 2.1% in 2023 while inflation will end the year above the 2% target at 2.2%, easing to 1.7% and 1.5% in the next two years.

UNITED KINGDOM

Contributed by Carel la Cock

- Energy prices in Europe and the United Kingdom have been hit by the perfect calm. Unusually calm weather in the North Sea where most of Europe's wind farms are located has caused a spike in demand for natural gas to meet the increasing energy demand as economies in the region recover from the pandemic. However, Europe is still replenishing natural gas stocks following a cold and prolonged winter, leading to a supply crunch and rocketing gas prices hitting 13-year highs. In the UK gas prices have risen by 70% since the start of August and are nearly three times higher than at the start of the year. The situation has been exacerbated by a supply constraint from Russia, which some analysts accuse of political meddling by pressuring Europe to approve the controversial Nord Stream 2 pipeline. Supply from Gazprom, the state-backed monopoly, has dropped by nearly 20% this year compared to pre-pandemic levels. The UK is particularly vulnerable to a spike in gas prices because it has been more reliant on renewables and replaced coal-powered generation in favour of generation by natural gas. Lower wind speeds mean it has had to rely more heavily on natural gas at a time when supply is being constrained. The UK also have less storage capacity and essentially operates a "just-in-time" system with much of the gas coming via pipelines from Europe. Some fear that Europe will start to prioritise its own needs using Brexit as a justification. While a mild winter could alleviate the situation, analysts fear that another cold winter could mean that prices rise even further, putting nearly 4m people that can't afford a higher energy bill at risk in the UK. Higher energy prices have also squeezed profit margins at the more than 70 energy suppliers in the UK. Following regulatory reforms more than a decade ago the grip of the six largest energy suppliers was broken, paving the way for independent energy suppliers to enter the market. But fierce competition has left the industry with thin margins and has forced companies to build scale to be profitable. The latest pressure on margins has caused many suppliers to go under. Industry experts predict as many as 40 more suppliers could fold by the end of the winter leaving customers and the industry in a precarious position, casting a spotlight on the UK's energy security.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 3.44	61453
JSE Fini 15	+ 14.01	13750
JSE Indi 25	+ 1.67	79201
JSE Resi 20	- 4.24	55132
USD/ZAR	+ 0.24	14.73
EUR/ZAR	- 3.88	17.28
GBR/ZAR	+ 0.28	20.15
S&P 500	+ 16.02	4357
Nikkei	+ 9.14	29952
Hang Seng	- 11.78	24022
Shanghai	+ 4.06	3613
FTSE 100	+ 6.86	6903
Gold	- 7.20	1761

Platinum	- 14.02	921
Brent oil	+ 43.92	74.55

BOTTOM LINE

Contributed by Gielie Fourie

- A recent newspaper headline reads: "Godongwana recoils from R73.5 billion ANC spree." Why a spending spree? The ANC offers very little to voters in the upcoming municipal elections on 1 November 2021. The ANC is even battling to get itself onto the ballot paper. To lure back voters, the ANC wants to "buy" votes. To "buy" votes the ANC has prepared a wish list of projects with a total value of R73.5 billion (bn). For this it needs the help of our new finance minister, Enoch Godongwana. He was not impressed.

- The projects on the ANCs wish list are: (1) R10 bn for a state bank. (2) R19.6 bn for wage increases for state employees. (3) R4.6 bn to forgive (in other words, write off) unpaid highway tolls in Gauteng. (4) R8.2 bn to bailout Denel and the Land Bank. (5) R15 bn to forgive student debt. (6) R16.1 bn to bailout provinces that have not paid their debts. Total, R73.5 bn. We have much more pressing needs. Not one item refers to the needs of unemployed and poor people. Not one. Why start a state bank when the Land Bank must be bailed out? The ANC has never been good at managing State-Owned Enterprises (SOEs) and municipalities. It cannot even pay its own staff on time. Godongwana cautioned against forgiving road toll debt, saying the "request has serious long-term consequences if the user-pay principle is rejected".

- In addition, government has already committed to spend R38.5 bn to respond to the ongoing impact of Covid-19 and the recent spate of riots and rampant looting. This is money that was not budgeted for. One wonders whether SASRIA, the state-owned insurance company (another SOE), will be able to pay out all the insurance claims. SASRIA is the only short-term insurer in South Africa that provides cover against special risks such as civil unrest, public disorder, strikes, riots and terrorism.

- Godongwana surprised with a wish list of his own. He called for significant economic reforms to be implemented before President Ramaphosa presents his State of the Nation Address in February 2022. These include: (1) Resolving a legal dispute delaying the allocation of additional spectrum to telecommunications companies. (2) Announcing an overhaul of the way work permits are processed to address a skills shortage. (3) Ensuring state ports company, Transnet SOC, issues a request for proposals to encourage private investment in port infrastructure. (4) Accelerating the award of contracts from an already held tender to generate renewable power and hold another bid round. (5) Establish state power utility, Eskom's transmission unit as a separate legal entity. (6) Submit the National Water Resources Infrastructure Agency Bill to Parliament to boost confidence that the country's water supply problems are being tackled. These reforms are strategically very important and must be addressed as a matter of urgency.

- At a cabinet meeting last week to discuss ways to boost our economic recovery, the potential implementation of a Basic Income Grant (BIG) was also discussed. This grant is nothing more than a tactic of the ANC to attract more votes in the coming elections. It is understood that Pres Ramaphosa is pushing hard for the grant, despite sobering warnings from Godongwana. Godongwana made it clear that the country simply cannot afford a BIG, nor could it fund the various other projects on the wish list.

- With its wish list, the ANC is throwing money at a crisis it created itself – its mismanagement of the economy and its inability to stimulate growth and create jobs. The ANC's demands for a wish list and a BIG mark a key test for Godongwana, who is new to the cabinet. Will he be able to withstand the pressures and demands? Government needs to spend less, not more. Government cannot give to anybody anything that government does not first take from somebody else. It is not rocket science. "The inherent vice of capitalism is the unequal sharing of blessings. The inherent virtue of socialism is the equal sharing of miseries." - Winston Churchill.

- Government needs a paradigm shift in its thinking – a shift away from socialism to capitalism. It should foster, not hinder, the conditions for businesses to create employment. Government cannot be the employer to all the unemployed masses. Creating an environment that makes it easy for businesses to operate in, will do a much better job of absorbing unemployed people. It will grow the tax base. There is absolutely no doubt – government (Godongwana) will have to raise taxes to fund any shortfall. With our shrinking tax base, mainly caused by emigration, and a growing resistance amongst taxpayers to pay tax, it is unlikely government will meet its income targets. The ANC dug themselves into a hole. The first Law of Holes states: "If you find yourself in a hole, stop digging".