## OVERBERG MARKET REPORT

Tuesday 18th January 2022

### IN THIS WEEK'S BOTTOM LINE

*Contributed by Nick Downing*

- JSE valuations are still compelling, despite last year's 24% return in the All-Share index. The index trades on a price-earnings multiple of 12.7x cheaper than its 5-year average of 14.1x. The price-to-book ratio is also undemanding at 2.17 well below the 2007 peak of 3.07. The 3.72% dividend yield is attractive when compared with current money market rates.

### SOUTH AFRICA ECONOMIC REVIEW

*Contributed by Gielie Fourie*

- Manufacturing production shrank by 0.7% year-on-year in November of 2021, following a downwardly revised 8.5% decline in October. Output fell at a softer pace for petroleum, chemical products, rubber and plastic products (-13.6% vs -15.2% in October), in particular coke, petroleum products and nuclear fuel (-11.6 % vs -18%); and furnishings (-7.9% vs -12.8%). Additionally, production rebounded for basic iron and steel, non-ferrous metal products, metal products and machinery (4.4% vs -14.6%); electrical machinery (15.7% vs -2.4%) and food & beverages (1.9% vs -3.2%). On a seasonally adjusted monthly basis, manufacturing output rose 3.7%, recovering significantly from a downwardly revised 5.2% slump in the preceding month. There are several headwinds faced by manufacturers, including higher input costs, an unresolved electricity crisis and problematic but improving global supply chain disruptions. Manufacturing output also faces weak domestic demand, constrained by further interest rate hikes and a rising unemployment rate. The December 2021 data will be closely watched. It will indicate whether the latest SA Reserve Bank and Treasury estimates for GDP growth of above 5% are achievable or overly optimistic. With an official unemployment rate of almost 35%, it is vital that manufacturing, which in South Africa remains relatively labour-intensive, picks up momentum.

### SOUTH AFRICA: THE WEEK AHEAD

*Contributed by Gielie Fourie*

- Overall mining production: Due Tuesday 18 January 2022. The median estimate of Bloomberg's survey of economists shows mining output is expected to have risen in November by 3.3% year-on-year, up from 2.1% the previous month. Overall mining production as well as specific data on gold and platinum output should continue to show expansion ahead of the country's traditional year-end holiday period.

- Consumer Price Inflation (CPI): Due Wednesday 19 January 2022. CPI is expected to have accelerated to 5.7% in December 2021, up from 5.5% the previous month, according to the median estimate of Bloomberg's survey. That would propel SA inflation further above the 4.5% midpoint of the SA Reserve Bank's 3% to 6% target range, adding to the likelihood that local policymakers will continue hiking rates while the US Federal Reserve is expected to start lifting borrowing costs from March 2022.

- Retail Sales: Due Wednesday 19 January 2022. November 2021 retail sales are expected to have grown by a modest 2% year-on-year, up from 1.8% in October, according to Bloomberg's median estimate. Though one would normally expect retail sales to be supported by early festive season shopping and the usual Black Friday revenue bump, the underlying weakness in the economy and the lingering effect of the pandemic are likely to have undermined retailers' performance.

## GLOBAL

*Contributed by Nick Downing*

- The World Bank, in its bi-annual Global Economic Prospects report, forecasts a slowdown in world economic growth in 2022, from an estimated 5.5% in 2021 to 4.1% in 2022, due to new Covid variants, rising inflation, reduced stimulus measures, labour market shortages and supply chain disruptions. Growth is expected to slow again in 2023 to 3.2%. The two largest economies, the US and China, are expected to slow from 5.6% to 3.7% and from 8% to 5.1%, respectively. Some economies, however, are likely to exhibit stronger growth this year, in particular the Far East economies including Japan, Thailand and Indonesia, which were relative laggards in 2021. However, the report cautioned against growing inequality between developed and less developed economies, exacerbated by varying stimulus support, vulnerabilities to rising inflation and interest rates and the imbalance in vaccine access. While global growth is projected to slow in 2022, the World Bank predicts an easing in labour shortages and supply chain disruptions during the year, leading to reduced inflationary pressures in the second half of the year. The view is echoed by research from the Federal Reserve Bank of New York on global supply chain constraints. Its index, measuring 27 global variables, has eased for two consecutive months since peaking in October.

## NORTH AMERICA

*Contributed by Nick Downing*

- Consumer price inflation (CPI) accelerated again in December from 6.8% to 7.0% year-on-year, its highest since 1982, although the month-on-month rate dipped slightly from 0.8% to 0.5%. Core CPI, which excludes food and energy prices, also rose sharply from 4.9% to 5.5%, its highest since 1991, with the monthly increase constant at 0.6%. While most economists predict the pace of inflation will abate in 2022 with an easing in supply chain disruptions and labour shortages, and as demand pulls back once households run through their savings, there is a growing unease that inflation expectations may ratchet higher. US household inflation expectations are still anchored at a manageable 3% but if they ratchet higher, for instance if the Fed loses credibility in its ability to tame inflation, price pressures may enter a vicious cycle of rising wage demands and company price increases. The surge in inflation together with the sharp drop in unemployment to 3.9, has prompted the Fed to pivot towards a more rapid normalisation in monetary policy. In his Senate confirmation hearing to serve for a second term, Fed chair Jay Powell said the highly accommodative monetary policy that had been in place since the pandemic was no longer required and warned that inflation was a "severe threat" to a long economic expansion. Fed policy makers are increasingly unanimous in their calls for at least three 25 basis point interest rate hikes this year, with more "hawkish" members calling for four or even more rate hikes, if required. The four-or-more prediction has been adopted by a growing number of investment bank analysts but so far, no calls have been made for larger 50 basis point rate hikes. In a rare bright spot in the current inflation panic, producer price inflation (PPI), which after a time lag tends to feed through to CPI, slowed to a monthly increase of just 0.2% in December, from 1.0% in November, its smallest gain since November 2020. The PPI data suggests supply chain constraints have already begun easing, a scenario backed by December's ISM manufacturing purchasing managers' report, which revealed an easing in prices and delivery times.

- The latest Wall Street Journal economists' survey, taken in the second week of January, signalled a sharp drop in economic growth forecasts compared with the last survey taken in October. The average annualised GDP growth forecast for the first quarter (Q1) 2022 fell from 4.2% to 3% and for the full year, from 3.6% to 3.3%. This marks a steep decline from 5.2% estimated growth in 2021. The chief culprits include the Covid Omicron variant, supply chain constraints and rising inflation. Survey respondents expressed concern that the inflation spike increases the risk of an overshoot in the interest rate hiking cycle, resulting in a potential recession. Two-thirds of respondents expect the Fed to begin lifting interest rates in March and continue with quarterly increases over the course of the year, a significant turnaround from the October forecast when almost half the respondents predicted no rate hikes at all throughout the year. On average, respondents forecast consumer price inflation will ease from the current rate of 7% year-on-year to 5% by June and to 3.1% by December. The predicted Q1 growth slowdown is foreshadowed by disappointing year-end retail and industrial production data. Retail sales dropped in December by a sharper than expected 1.9% month-on-month and industrial production by 0.1%, led by a 0.3% fall in manufacturing output. The University of Michigan US consumer sentiment index fell from 70.6 in December to 68.8 in January, with consumers citing inflation as their top concern. The percentage of consumers worse off financially than a year ago is the highest since 2014, with savings running lower following the expiry of pandemic relief programmes and inflation eroding household purchasing power.

**CHINA**

***Contributed by Nick Downing***

- China's GDP grew in the fourth quarter (Q4) by 4% year-on-year culminating in overall growth in 2021 of 8.1%, beating the 6% government target. Growth slowed sequentially each quarter last year on a year-on-year basis after the distortion from the low base in early 2020 washed out. However, in Q4 2021, quarter-on-quarter growth improved from 0.7% to 1.6%, signalling a potential turning point from the recent slowdown. Industrial production appears to be improving, with year-on-year growth of 4.3% in December, up from 3.8% in November. Exports also adding substantially to GDP, with China's trade surplus rising to a record $676 billion in 2021, 26% higher than the previous record set in 2020. However, other sectors of the economy continued to disappoint, held back by the government's crackdown on property developers and the impact of strict Covid restrictions on consumer spending. Retail sales grew in December by just 1.7% on the year, down from 3.9% in November. Property developers' construction starts fell in 2021 by 11.4%. Fixed asset investment grew in 2021 by 4.9% down from 5.2% in the 11 months to end November. However, authorities have pledged in recent weeks to stabilise growth through a mix of fiscal support measures and monetary easing. President Xi Jinping will be anxious to restore the country's solid growth trajectory ahead of his planned inauguration in November for an unprecedented 3rd successive term. In contrast with the tightening bias of other central banks around the world, the People's Bank of China accelerated its pace of monetary easing, cutting its key one-year policy loan rate on 17th January for the first time since April 2020, reducing it from 2.95% to 2.85%.

**JAPAN**

***Contributed by Carel la Cock***

- Japanese manufacturing had a strong finish to the year, registering expansions in both November and December according to the Jibun Bank Japan Manufacturing PMI figures. At 54.3 in December, the rate of expansion eased only slightly from 54.5 in November but was handsomely above the 52.7 average for the year. Demand continued to improve leading to growth in both production and new orders with firms reporting the strongest rise in staff levels in nearly four years. However, the outlook for the year ahead dimmed slightly as firms are still concerned about ongoing supply chain disruptions and material shortages. Supplier delivery times continue to lengthen in December to new record highs, which manufacturers are trying to counter by building both pre- and postproduction inventory. Furthermore, rising cost of raw materials added to average cost pressures while output prices also increased for a thirteen month in a row. Encouragingly car production recovered well in November, increasing by an eye popping 43.1% from the month before and leading to overall industrial production rising by 7.2% from October. Japanese car producers have successfully managed to resolve some supply chain issues that have plagued the auto industry, especially the shortage in semiconductors. The Japanese government has upgraded its outlook for the sector to "showing signs of recovery" from its previous "at a standstill". Analysts caution that the Omicron variant could still have an impact on both supply chains and demand from South Korea and the rest of the region.

## EUROPE

*Contributed by Carel la Cock*

- Private sector business activity in Europe lost momentum at the end of the year amid a resurgence in covid-19. The Omicron variant, which is more virulent, has especially impacted the service sectors as parts of Europe implemented restrictive measures to curb the rapid spread. The drag on activity and new business in the service sector saw it underperform the manufacturing sector for the first time in four months. This despite manufacturers still battling with sourcing inputs. Overall, the IHS Markit Eurozone PMI Composite Output Index fell from 55.4 in November to 53.5 in December, marking the weakest private sector expansion since March. Across the region, all countries reported slower rates of expansion except Germany (49.9) which saw a slight contraction. France (55.8), Spain (55.4) and Italy (54.7) all had multi-month lows, but well within +50 expansionary territory. Optimism for activity in the year ahead picked up from November which also led to a solid increase in employment, now trending at well above the historic average. Firms expanded capacity to deal with backlogs of work which have increased for ten consecutive months. Inflationary pressures remained during December with input costs increasing at the second fastest rate on record, only marginally down from the record in November. Joe Hayes, Senior Economist at IHS warns: "As euro area nations deal with the latest developments in the pandemic, it's clear that risks to the economy are now greater as tighter restrictions to curb the spread of COVID-19 are more likely than they have been recently."

## UNITED KINGDOM

*Contributed by Carel la Cock*

- The UK manufacturing sector ended the year with a further expansion, registering 57.9 on the IHS Markit/CIPS Purchasing Managers' Index (PMI) and marking a $19^{th}$ consecutive monthly expansion. Growth of production and new orders were coupled with higher employment figures as supply chain bottlenecks started to ease. However, new export business was down for a fourth month especially at consumer goods producers while demand for UK capital goods for export rose to the highest levels since August. Firms also reported sustained optimism for the year ahead and hiring of more staff to meet higher demand and rising backlogs. Inflation remains a concern, but firms were again successful in passing on rising input costs. Factory gate selling prices rose to a new record high. Duncan Brock, Group Director at the Chartered Institute of Procurement & Supply remarks: “We can’t lose sight of the fact that the UK economy took a significant hit, and new variants and potential lockdowns threaten to impede much needed progress but at least the sector ended the last quarter of 2021 on a surer footing.”

## FAR EAST & EMERGING MARKETS

*Contributed by Carel la Cock*

- Manufacturing conditions in the ASEAN group of countries improved markedly according to the latest IHS Markit Purchasing Managers’ Index, driven by an acceleration in new orders and further expansion in output. While ongoing supply chain disruptions added to rising input costs, firms were largely successful in passing higher costs on to customers. The headline PMI figure of 52.7 for December has only once been eclipsed since records began. Of the constituent countries, only Thailand (49.5) and Myanmar reported deteriorating sub-50 conditions while Singapore reported the strongest growth with an all-time high reading of 58.0. Indonesia (53.5), Malaysia (52.8) and Vietnam (52.5) all saw multi-month highs. Sentiment across the region improved to the highest levels since mid-2019 as the region’s manufacturing sector ended the year on a high. Lewis Cooper, Economist at IHS Markit, remarks with a sense of hope: “Indeed, the ASEAN manufacturing sector remains in a strong position as we enter 2022, with the latest rebound showing little signs of slowing."

## KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

| | | |
|---|---|---|
| JSE All Share | + 2.56 | 75593 |
| JSE Fini 15 | + 4.72 | 15497 |
| JSE Indi 25 | + 0.12 | 95568 |
| JSE Resi 20 | + 5.24 | 74695 |
| USD/ZAR | - 3.26 | 15.43 |
| EUR/ZAR | - 3.06 | 17.59 |

| | | |
|---|---|---|
| GBR/ZAR | - 2.57 | 21.04 |
| S&P 500 | - 2.17 | 4662 |
| Nikkei | - 1.15 | 28459 |
| Hang Seng | + 3.36 | 24183 |
| Shanghai | - 1.78 | 3575 |
| FTSE 100 | + 3.07 | 7611 |
| Gold | - 0.64 | 1817 |
| Platinum | + 0.27 | 971 |
| Brent oil | + 12.06 | 87.16 |

**BOTTOM LINE**

*Contributed by Nick Downing*

- Helped by a strong finish to the year, the JSE produced exceptional returns in 2021. As confidence grows in the strength of the global economic recovery, investment appetite appears to be veering towards more cyclical markets and equity sectors. This trend benefits emerging markets. South Africa, a major commodity producer with the added attraction of low valuations, is a key beneficiary and outperformed the emerging market average. The JSE All Share index surged by 14.67% in the fourth quarter (Q4), capping a 24.07% return for the full year. Commodity stocks shone in the final quarter lifting the Resources 20 index by 22.19% and 23.27% for the year. The industrial 25 index gained 16.45% in the quarter and 22.71% over the year, while the Financial 15 index gained a similar 22.71% over the year but returns were spaced differently with a relatively modest Q4 return of just 1.20%. Equity market returns were even impressive in hard currency terms despite the rand's 9.32% depreciation versus the dollar over the year from R/$14.59 to 15.95. However, this meant that the 8.35% annual return in the All-Bond Total return Index was entirely eroded in dollar terms. The dollar gold price gained in the final quarter by 4.24% but over the year drifted by 3.49% from $1894 per ounce to $1827.

- Equity markets are forward looking. In typical fashion they looked past the effect of July's riots, Covid lockdowns, NUMSA strike activity and energy outages, which all conspired to cut economic activity. GDP contracted in Q3 by 1.5% quarter-on-quarter and the unemployment rate recorded a new high of 34.9%. However, forward-looking confidence measures appear to be recovering. The Absa manufacturing purchasing managers' index (PMI) climbed sharply in November from 53.6 to 57.2, well above the expansionary 50-level. The survey suggests businesses are looking towards an improving environment in 2022. The IHS Markit PMI, which measures conditions across the entire private sector, regained the key 50-level in November, rising from 48.6 to 51.7. However, the outlook is clouded by a weak reading in the RMB/BER Business Confidence index, which after dropping from 50 to 43 in Q3, remained at that level in Q4, which is discouragingly below the neutral 50 mark. Business confidence is an important ingredient for much needed fixed investment, which helps spur job creation and economic growth.

- The South African Reserve Bank, in its latest policy meeting in November, estimates GDP growth in 2021 will register a robust 5.2% but its forecasts for 2022 and 2023 are comparatively modest at 1.7% and 1.8% due primarily to continued structural headwinds, including persistent energy outages, fiscal imbalances and insufficient structural economic reforms. Despite record high unemployment and sluggish economic growth, the Reserve Bank hiked the repo rate by 25 basis points from 3.50% to 3.75%, citing increased inflation risk. Consumer price inflation (CPI) has risen above the mid-point of the SARB's 3-6% target and accelerated again in November from 5.0% to 5.5% year-on-year. Supply chain bottlenecks and rising commodity prices caused producer price inflation to accelerate from 7.2% to 8.1%, which could spill over into consumer inflation if companies pass on their cost increases. The SARB projects the repo rate will rise steadily in quarterly increments of 25 basis points throughout 2022, 2023 and 2024, which would result in a terminal rate of 6.75%. This would not exceed the recent 2016 peak of 7.0%, an unlikely eventuality given the considerable slack in the local economy. Moreover, the unprecedented current account surplus, measuring 3.6% of GDP in Q3, and likely capital flows into emerging markets, should protect the rand from the volatility that typically raises the SARB's inflation anxieties. As base effects flush out of the system, inflation is likely to ease back over coming months, allowing the Reserve Bank to adopt a more gradual monetary policy normalisation and maintain easy settings for longer.

- The fourth quarter contained numerous political and macro-economic developments, mostly positive. The ANC lost considerable support in the local government elections held on 1st November, with its share of the vote dropping to 47% compared with 54% in 2016 and 63% in 2011, indicating political and patronage losses for the ruling party. The election resulted in a record 66 hung councils, now run by coalition, including 5 metropoles, 3 of which are run by the Democratic Alliance. Encouragingly, the ANC refused to enter coalition discussions with the EFF, signalling President Ramaphosa's growing authority over the party's more radical factions. A similar refusal to compromise with the EFF on the proposed amendment to Section 25 of the Constitution caused it to be rejected by parliament, putting to rest remaining concerns over expropriation without compensation.

- Finance Minister Enoch Godongwana impressed financial markets in his maiden Budget on 11th November. The Medium-Term Budget Policy Statement (MTBPS) confirmed a R120 billion revenue overrun due to high commodity prices, which together with the beneficial restatement of GDP resulted in a reduction of the projected FY2022 budget deficit from 9.3% to 7.8% of GDP. The debt-to-GDP projection also improved, peaking at 78.1% in FY2026. The MTBPS is committed to fiscal consolidation and debt stabilisation but controlling expenditure will not be easy amid public sector wage negotiations, financial support for state owned enterprises and demand for social support measures. Pressure will mount for a permanent extension of the R350 per month Social Relief of Distress Grant. Social grants are paid to 27.8 million people, 46% of the population. Godongwana said, "A fast-growing economy will allow for greater revenue collection, making it possible for more comprehensive responses to the challenges we face."

- Amongst the positive policy developments over the final quarter, the government announced the preferred bidders for the fifth round of the Renewable Independent Power Producer Procurement Programme, which will add 2500MW of capacity. The Independent Communications Authority of South Africa issued its final invitation to apply for high-demand mobile spectrum, in an auction valued at an estimated R8 billion and expected to bring numerous efficiency and cost savings to consumers and businesses. South Africa also secured R130 billion in concessionary financing at COP 26 towards accelerated decarbonisation. These incremental developments and improving fiscal outlook caught the attention of Fitch credit rating agency, which moved South Africa's sovereign risk outlook from "negative" to "stable".

- Some concern has been voiced over a repeat of the 2013 "taper tantrum". When the Federal Reserve reduced its asset purchases that year, financial markets rioted, and emerging market currencies were particularly badly affected. The taper this time round has been much better telegraphed. Financial markets have already discounted the event. Moreover, emerging market currencies are now largely undervalued compared with being overvalued 8 years ago. At that point there had been excessive capital transfers into emerging markets. The reverse is true today. In 2021, the JSE suffered net foreign selling of R140 billion. Also, in contrast to 2013, emerging markets are supported by stronger terms of trade. In the 11 months to end November 2021, South Africa chalked up a massive R412.7 billion trade surplus. The current account surplus will strengthen the rand's resilience.

- Following a dismal year in 2021, China's economy is expected to recover its momentum in 2022, as regulatory constraints ease and authorities step up policy stimulus. An upgrade to China's forecasts is positive for commodity prices and emerging markets generally. As the global recovery extends beyond the US, which enjoyed exceptional growth last year, capital flows will gravitate towards more cyclical markets. South Africa, which is a "high beta" cyclical economy, with an outsized stake in commodities, will benefit in this expected scenario. JSE valuations are still compelling, despite last year's 24% return in the All-Share index. The index trades on a price-earnings multiple of 12.7x cheaper than its 5-year average of 14.1x. The price-to-book ratio is also undemanding at 2.17 well below the 2007 peak of 3.07. The 3.72% dividend yield is attractive when compared with current money market rates. Money market rates will rise in line with the Reserve Bank's monetary tightening cycle. However, a stable rand, backed by capital inflows, buoyant commodity prices, and robust trade and current accounts, should enable the Reserve Bank to lag its rate hike projection, providing an added tailwind for the economy and its markets.

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