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WEEKLY REPORT

OVERBERG MARKET REPORT

Tuesday 25th January 2022

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- GLOBAL ECONOMICS UPDATE – We look at expectations for the global economy in 2022. Most notably, analysts expect interest rates to rise and economic growth to slow. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Gielie Fourie

- Mining production: Mining production in South Africa grew by 5.2% year-on-year (YoY) in November of 2021, after an upwardly revised 2.2% rise in October and better than market estimates of a 4.25% increase. The largest positive contributors were PGMs (38.1% vs 24% in October) and iron ore (9.3% vs 11.7%). At the same time, production rebounded for diamonds (4.3% vs -11.5%) and manganese ore (1% vs -6%). On a seasonally adjusted monthly basis, mining production shrank 2.2% but this followed a 3.1% rise in the prior month. Mining exports, although a small part of our GDP, are a big contributor to our fiscus, and trade balance. Mines are labour intensive and big job providers. The improvement from 2.2% in October to 5.2% in November (YoY), may seem small, but it is a big green flag.

- Consumer Price Inflation (CPI): The annual inflation rate in South Africa accelerated further to 5.9% in December of 2021, from 5.5% in November, above market expectations of 5.7% and moving closer to the top of the South African Reserve Bank's (SARB) target range of 3-6%. That was the steepest inflation rate since March 2017. Inflation was not pushed higher by demand-pull forces. On the contrary, inflation was mainly pushed up by prices of transport (16.8% vs 15% in November), amid a record rise in fuels (40.5%); food & non-alcoholic beverages (5.5%, the same as in November), such as meat and oils & fats; housing & utilities (4.2% vs 3.9%), namely electricity and other fuels and miscellaneous goods & services (4.3% vs 4.2%). The annual core inflation rate, which excludes volatile items such as food and non-alcoholic beverages, fuel and energy, was at a much lower 3.4% in December, albeit the highest since October of 2020, up from 3.3% in the prior month and market estimates of 3.3%. On a monthly basis, consumer prices were up by 0.6%, the most in five months and above market estimates of a 0.4% rise.

- Retail Sales: South Africa's retail trade surged by 3.3% from a year earlier in November of 2021, up from an upwardly revised 1.9% rise in the previous month and well above market estimates of a 1.9% gain. It was the third consecutive month of growth in retail activity and the strongest since June, mainly boosted by sales of textiles, clothing, footwear and leather goods (10.3% vs 6.2% in October) and at general dealers (3.6% vs 0.3%). On a monthly basis, retail trade increased 1.9%, after shrinking 1.3% in the previous month. The 3.3% rise was a good figure – we expected only 1.9%. It is a welcome green flag. Retailers are important job providers.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Gielie Fourie

- Leading Business Cycle Indicator: Due Tuesday January 25, 2022. The composite leading business cycle indicator in South Africa edged up 0.1% Month-on-Month (MoM) from a month earlier in October of 2021, rebounding slightly from a 2.3% fall in the previous month. Five of the ten available component time series increased, while four decreased and one remained unchanged. The largest contributors to the increase were a widening in the interest rate spread and an increase in the US dollar denominated export commodity price index. The largest detractors were a deceleration in the six-month smoothed growth rate in new passenger vehicle sales and a decrease in the composite leading business cycle for South Africa's main trading partner countries.

- Producer Price Inflation: Due Thursday January 27, 2022. Producer prices in South Africa climbed by 9.6% from a year earlier in November of 2021, up from its 8.1% rise in October and above market expectations of an 8.9% jump. That was the highest producer inflation rate since 2013. The largest contributors to the rise in producer prices were coke, petroleum, chemical, rubber and plastic products (22.8%); food products, beverages & tobacco products (5.4%); and metal, machinery, equipment and computing equipment (12.6%). On a monthly basis, producer prices were up 1.4%, following a 0.7% rise in October and above market estimates of 0.65%.

- Interest Rate Decision: Due Thursday January 27, 2022. The SARB raised its benchmark repo rate by 25 basis points (bps) to 3.75% at its November 2021 meeting, against market expectations of 3.5%. This was the first interest rate hike in three years. Is another rate hike likely this week with inflation now at 5.9% at the SARBs inflation ceiling of 6%? The SARBs Monetary Policy Committee (MPC) believes a gradual rise in the repo rate will be sufficient to keep inflation expectations well anchored and moderate the future path of interest rates. At the last policy meeting, the SARDs headline CPI forecast was revised slightly higher to 4.5% in 2021 (from 4.4% in September), 4.3% in 2022 (vs 4.2%) and 4.6% in 2023 (vs 4.5%). Meanwhile, the GDP growth projections were lowered to 5.2% in 2021 (from 5.3%) but kept unchanged at 1.7% in 2022 and 1.8% in 2023. The SARBs model indicated rate increases of 25 bps in Q4 of 2021 and further increases in each quarter of 2022, 2023 and 2024 – that is 1% (100 bps) for every year. Rising CPI normally precedes rising interest rates. The SARBs MPC has five voting members – how will the votes be split? In the November 2021 meeting the vote was split 3-2 – three members in favour of a rate hike (hawkish), and two in favour of an unchanged repo rate (dovish). They cannot be too hawkish or aggressive. Our economic recovery is still fragile, and unemployment remains high. Crucially, the US Fed will have its meeting the previous day, on Wednesday. Its interest rate announcement will be on Wednesday night (SA time). Its interest rate is expected to remain the same. The Bank of England and the Bank of Canada will also announce interest rate decisions on Wednesday.

- Private Sector Credit Extension (PSCE): Due Monday January 31, 2022. South Africa's private sector credit grew by 2.46% YoY in November 2021, faster than its 1.29% gain a month earlier and beating market expectations of 1.7%. This marked the fifth straight month of increase in private sector credit and the strongest rise since February 2021. However, PSCE is expected to have dipped to 2.1% YoY in December 2021. The general upward trend is expected to endure, but at a slower pace. Household and corporate credit will remain subdued.

- Balance of Trade: Due Monday January 31, 2022. South Africa's trade surplus widened to R35.83 billion in November 2021, from an upwardly revised R27.68 billion in the previous month and well above market expectations of R16.8 billion. December's trade surplus is normally large, due to seasonal factors. However, 2021 will be an exception – the forecast is for a surplus of only R15 billion – the result of bigger imports. This trend is expected to continue as imports start to increase from a very low base set in 2020 - 2021.

NORTH AMERICA

Contributed by Nick Downing

- At one stage yesterday, the day before the Federal Reserve's policy meeting, the S&P 500 index was down by almost 4%, compounding its year-to-date loss to over 11%. What is spooking Wall Street? Russia's aggression against the Ukraine is partly blamed but the key culprit is the increased hawkishness of the Fed. Minutes from the last policy meeting in December reveal a determination to act "sooner or at a faster pace" to beat inflation, which Fed Chair Jay Powell has recently described as a "severe threat" to a sustained economic expansion. Interest rate futures are discounting four 25 basis-point fed funds rate hikes in 2022, starting in March, but the Fed may move more aggressively, potentially hiking rates at each successive policy meeting. There are 8 meetings in a year. The Fed could even hike rates by 50 rather than 25 basis points. Its quantitative easing programme of Treasury bond and mortgage-backed security purchases is due to end by March, but it might be terminated immediately. However, the biggest scare for the markets is the expected shrinking of the Fed's balance sheets, which after the central bank's dramatic asset purchase programme has more than doubled since the pandemic to just under $9 trillion. When the Fed shrinks its balance sheet by selling the assets it holds, these will have to be bought in the market which will necessitate other institutions to free up cash by selling assets. The Fed's liquidity withdrawal could be damaging to all asset classes. Markets are anxiously awaiting the Fed's decision and its press release on Wednesday 26th January. The Fed is under tremendous pressure to put the inflation genie back in its bottle and restore credibility. The fear is that this could entail more extreme policy measures than currently anticipated and the risk then is that the Fed's monetary policy pendulum swings too suddenly and endangers the economic recovery even more than inflation. Elevated uncertainty over the inflation trajectory suggests the Fed will provide less forward guidance than usual, allowing it the flexibility to tailor policy to evolving conditions.

CHINA

Contributed by Nick Downing

- While the Federal Reserve and most major central banks in the developed world are tightening monetary policy, the People's Bank of China (PBOC) is moving in the opposite direction cutting its benchmark for mortgage lending for the first time since April 2020. The PBOC cut the 5-year loan prime rate from 4.65% to 4.60% and its 1-year equivalent from 3.80% to 3.70%, the second in two months. The rate cuts are modest but signal the start of a concerted monetary easing cycle. Further easing is expected, in line with the PBOC's stance that it will act to stabilise the economy. Stability is the government's new mantra for 2022, taking over from last year's drive for "common prosperity" and regulatory crackdowns of the internet, private education and property sectors. Running alongside monetary stimulus, the National Development and Reform Commission, the country's top economic planning agency, is pushing an increase in infrastructure projects. Policy easing has already resulted in a pick-up in mortgage lending and household credit expansion, but economic threats remain, most crucially continued weakness in the property sector and expected softening in export demand. Beijing's Covid Zero policy is probably the biggest threat, which will continue to impact consumer spending no matter how much policy easing is implemented by the PBOC.

JAPAN

Contributed by Carel la Cock

- The Bank of Japan (BoJ) has lifted its forecast for inflation from 0.9% to 1.1% for the new fiscal year starting in April. It is the first time in eight years that the central bank has changed its view on price risk from "skewed to the downside". However, the BoJ has kept its loose monetary policy unchanged, including its negative interest rate and asset purchases. In a country that has battled deflation for decades, last month's inflation figure of 0.5% year-on-year came as a surprise. It was the fastest rise in prices in nearly two years, equalling the jump in November, and was largely driven by rising energy costs, rising 16.4%. Some analysts predict that Japan's inflation can rise to the target rate of 2% on the back of higher oil prices and companies passing on their higher input costs, but that there needs to be a significant shift in higher inflation expectations and wages for inflation to maintain its trajectory higher. The probability of energy costs trending lower in the coming months will also impact inflation expectations and ultimately keep inflation below the 2% target. The yen has come under renewed pressure following the BoJ's inflation forecast, falling to a five-year low against the dollar. A weaker yen will be beneficial to Japanese exporters, especially in the auto industry.

EUROPE

Contributed by Carel la Cock

- Europe's economic powerhouse, Germany, faltered in the fourth quarter, slumping to a 1% quarter-on-quarter economic contraction. The economy felt the impact of restrictions to curb the spread of Omicron whilst still battling supply chain bottlenecks and semiconductor shortages in its auto manufacturing sector. The German economy grew 2.7% in 2021, despite the headwinds in the final quarter of the year but is lagging other developed nations which have now all recovered to pre-pandemic levels of output. German exporters, the traditional driving force behind economic growth, have been hampered by the global shortage in raw materials and supply chain bottlenecks and have struggled to build momentum. The economy remains 2% smaller than before the onset of the pandemic. It would have been even worse, if not for the windfall from the licensing fees earned by BioNTech, the developer of vaccines, which boosted the economy by as much as 0.5 percentage points. Economists agree however that the German economy is well placed to rebound sharply once pandemic restrictions are lifted and supply chain difficulties ease further during the year. The Bundesbank forecasts that the economy will surpass pre-pandemic levels this year and will expand by 4.2%, driven by a "boom in private consumption" coupled with increasing export volumes and business investment.

UNITED KINGDOM

Contributed by Carel la Cock

- UK retail sales slumped in December as restrictive measures and waning consumer confidence impacted festive period spending. Retail sales were down 3.7% in December compared to the previous month, surprising economists expecting a drop of 0.6%. The data shows that most consumers shifted their Christmas shopping to November last year and anecdotal evidence from retailers point to lower footfall during December as restrictive measures and a shift to internet shopping hurt high street shops. Sales were down across the board including fashion and sports (-8%), department stores (-6%), furniture (-3%) and petrol (-4.7%) as more people worked from home and avoided travelling. Retail sales were also impacted by a fall in consumer confidence with the latest survey by GfK showing sentiment has fallen to the lowest level in almost a year. The index reading was 4 points lower in January and below expectations. Consumers are fretting about the rising cost of living and higher interest rates as the Bank of England embarks on a rate hiking cycle. There was a sharp decline in survey respondents who think it's a good time to make major purchases, which will impact on the continuation of a consumer led recovery. Household consumption contributed to the bulk of economic growth in the third quarter of last year, but consumers are coming under pressure and may tighten their belts in anticipation of higher energy costs and interest rates in the coming months.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 2.10	72164
JSE Fini 15	- 0.58	14713
JSE Indi 25	- 4.71	90959
JSE Resi 20	+ 0.71	71479
USD/ZAR	- 4.22	15.29
EUR/ZAR	- 4.79	17.30
GBR/ZAR	- 4.72	20.61
S&P 500	- 7.47	4410
Nikkei	- 6.02	27058
Hang Seng	+ 4.08	24351
Shanghai	- 4.26	3484
FTSE 100	- 1.18	7297
Gold	+ 0.75	1842
Platinum	+ 5.61	1023
Brent oil	+ 11.57	86.78

BOTTOM LINE

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- THE GLOBAL ECONOMY: Capital Economics, an independent economic research consultancy based in London, expects growth in almost every major economy to slow in 2022, with the US and China in particular falling some way short of current expectations. Year-to-Date the Nasdaq is already down 12.51%, firmly in technical correction territory. At the same time, while headline inflation is expected to drop sharply, core inflation will remain higher than most anticipate in a number of countries. This will pose a dilemma for policymakers. Capital Economics expects most central banks to tighten policy in 2022, but in some cases (though notably not the US) the pace of tightening will be a bit slower than investors currently anticipate. China is likely to be one of the few countries in which interest rates are cut. China's first interest rate cut for 2022 occurred last week.

- COVID-19 – EXPECT NEW VARIANTS: Capital Economics expects that the evolution of the covid-19 pandemic will continue to be the most important driver of economic and market outcomes in 2022. Its forecast assumes that the virus will continue to ebb and flow, with new variants emerging and governments responding by tightening (and then loosening) restrictions. In most countries they assume that these will be targeted and less economically disruptive than in the initial phase of the pandemic, but stricter measures are clearly possible if more dangerous strains emerge and/or healthcare systems become overwhelmed.

- ZERO-COVID: Those economies that continue to follow "zero-COVID" strategies (notably China) will respond with localised lockdowns and tighter restrictions on regional travel as outbreaks emerge. This will make for a more volatile path of output in these countries. The uncertainty surrounding the pandemic means that the risks around their central forecasts will continue to be unusually large. Indeed, while there is a tendency to focus on the downside risks from new variants of the virus, it's possible that in 2022 it could mutate into a less deadly form that is ultimately positive for economic growth.

- ECONOMIC GROWTH WILL DISAPPOINT: Capital Economics thinks 2022 will be a year in which economic growth disappoints. In the US, it expects demand to remain strong but thinks that supply constraints will put a firmer brake on output than most analysts currently anticipate. In China, it expects the construction-led slowdown to intensify. In Emerging Markets (EMs), it expects a combination of tighter policy, lower commodity prices and continuing virus disruption to weigh on growth. It is more upbeat than the consensus in a handful of economies, including Australia. But overall, GDP forecasts sit below most expectations. While the IMF expects global GDP to expand by nearly 5% in 2022, Capital Economics expects growth to be closer to 4% (compared to 6% in 2021).

- INFLATION WILL DROP: While Capital Economics expects headline inflation to fall back everywhere, it expects that core inflation will remain uncomfortably high in a number of countries. The sharp increase in energy inflation, which contributed to last year's surge in inflation, will unwind in 2022. But in most advanced economies a combination of strong demand and lingering supply shortages means that core inflation is unlikely to ease as quickly as policymakers expect. Some of the heat will come out of the inflation debate, but it will continue to be the key issue for policymakers and markets.

- INTEREST RATES WILL INCREASE: Capital Economics expects most central banks to tighten policy in 2022. The Federal Reserve's fed funds rate is expected to increase at a similar pace to bond markets in 2022 (and at a faster pace in 2023). But in several other countries, including the UK, Australia, Brazil and South Africa, the pace of tightening will be slower than investors currently anticipate. Expect interest rates to remain at current record lows in the euro-zone and Japan. As mentioned above, the People's Bank of China has already started to cut policy rates. Bloomberg expects the South African economy to grow 1.6% in 2022 and that the SA Reserve Bank will continue to hike interest rates.

- SUMMARY – 2022 WILL BE CHALLENGING: Although the combination of a strong economic recovery and accommodative monetary policy has fuelled healthy returns for many investors over the past 18 months or so, Capital Economics argues that the macroeconomic backdrop is now becoming more challenging. A combination of monetary tightening and stubbornly high inflation will mean returns on US Treasuries are likely to be negative and that those from government bonds in other Developed Markets (DMs) will be only slightly positive. Returns from equities and commercial property will be higher, but high valuations and weaker growth will cause them to fall well short of returns in 2021. And while many analysts are forecasting the start of a new commodities super cycle, Capital Economics expects most commodity prices to fall in 2022. In currency markets, it expects the dollar to strengthen a bit further against other majors, but by less than its ~7% rise in 2021. We will revisit these forecasts at the end of the year – it will be interesting to see the divergence between the forecasts and actual performance. A Black Swan or Gray Rhino event, like a Russian invasion of the Ukraine, or a Chinese invasion of Taiwan, will radically affect the above scenarios. The VIX (fear index) is already standing at 29.90, up 80.12% Year-to-Date.

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