OVERBERG MARKET REPORT

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Global: US Inflation Highest in 40 years

Contributed by Nick Downing

US consumer price inflation accelerated again in February, from 7.5% to 7.9% year-on-year, its highest since January 1982 when it registered 8.4%. Oil and energy prices were the main culprit. Gasoline prices gained 6.6% on the month but the data was collected before Russia's invasion of Ukraine. Gasoline prices are expected to rise by a further 20% in March. Core CPI, excluding food and energy prices, also accelerated, indicating a much-feared broadening in inflationary pressure. Core CPI accelerated on the year from 6% to 6.4%, although the month-on-month increase in core CPI slowed to 0.4%, down from 1% in January and 1.2% in December. This may offer some comfort, but the inflation outlook is clouded by the Ukraine crisis.

The Russia/ Ukraine crisis has created a significant supply shock in commodity markets, including oil, gas, wheat and metals. Russia is the world's second largest exporter of oil and wheat. Ukraine is the fifth largest exporter of wheat. **The invasion sent the oil price to $139 per barrel, a 64% increase since the start of the year. On 7th March, the wheat price recorded a peak of $12.94 per bushel, marking a 70% year-to-date increase. Gains in European natural gas prices are even more extraordinary.**

Fortunately, the inflationary pass-through from higher food and energy prices is less today than it was in the past due to rising living standards and better energy efficiency**. According to research from TS Lombard, cars were getting about 13.5 miles/gallon at the time of the first OPEC oil embargo in 1973 compared to today's 25.4 miles/gallon. The percentage of household budgets spent on food and energy has halved since the 1970s.** This implies less inflationary pass-through from the current commodity price shock.

When the Federal Reserve concludes its upcoming monetary policy meeting on 15/16th March, it is likely to lift its inflation forecasts, while at the same time reducing its economic growth forecasts. The Ukraine crisis will undermine growth. Higher food and energy costs will reduce the disposable cash of both consumers and businesses. Sentiment will also be affected. Despite the added inflationary impulse, the Fed will likely be more cautious in reversing its policy stimulus. Instead of lifting the fed funds rate by 50 basis points on the 16th March, as had been expected, the Fed will opt for a 25 basis point hike and signal afterwards that it will be prepared to adjust its plans depending on the war's impact on economic prospects. This may be good news for financial markets. **Share prices have become so attuned to low interest rates and policy stimulus, that they are probably less susceptible to changes in the Ukraine conflict than they are to changes in monetary policy.**

Stagflation is the new buzzword. Stagflation is defined as rising inflation at the same time as falling economic activity. This is an unenviable situation, and a toxic scenario for equity markets. Some economists are comparing the current scenario with the 1970s, as there are many similarities. Following a decade of policy stimulus, inflation started rising sharply in the early 70s. Policy makers said it was transitory but then inflation was exacerbated further by the 1973 Arab oil embargo on the US. However, most economists believe it is unlikely that we will get a repeat of the "Stagflation" of the 1970s.

According to Dario Perkins of TS Lombard: "While there are certain superficial similarities, there are much more important differences**. Back in the 1970s, product markets were generally domestically focused and 'closed', while the workforce was young, militant and typically part of a trade union. Wages were often indexed to inflation……. Today we are in a totally different world**……Our best guess – and it is only a guess at this point – is that US inflation will settle in the 2-3% range in 2023…... There will be 'no repeat of the 1970s' and there is no danger of wages and prices suddenly 'spiralling out of control'".

Local: South Africa's Energy Revolution

Contributed by Gielie Fourie

INTRODUCTION: Eskom, formed in 1923, was a reliable electricity supplier until 2007, a period of 84 years. The last sixty years of power generation can be split into two vastly different periods of 30 years each. **Over the first 30 years, between 1961 and 1991, Eskom completed 14 new power stations with a capacity of 35,804 MW. Over the next 30 years, between 1991 and 2021, Eskom only completed one new power station, Majuba, with a capacity of 4,110 MW.** To put it into context: 14 Power stations over 30 years vs. one power station over the next 30 years. Eskom simply failed to build sufficient new power stations to keep up with economic growth and to replace ageing generation plants and maintain ageing transmission lines. We experienced our first loadshedding in 2007. Loadshedding is expensive. The cost of loadshedding in 2019 alone amounted to between R60 bn (billion) and R120 bn.

MEDUPI AND KUSILE: **The construction of these two mega power stations turned into mega disasters.** Construction of Medupi (Limpopo) and Kusile (Mpumalanga), with a combined capacity of 9,564 MW, began in 2007. Unfortunately, design faults, corruption, and mismanagement delayed the completion of these two important stations. Eskom's new management is addressing these challenges, but it is taking much longer than expected. Medupi was scheduled for completion in 2015 - it only came on stream in August 2021. However, energy analyst, Chris Yelland, called the announcement a ". . . premature paperwork exercise". Yelland mentioned rework that needs to be done to address boiler design defects. On 9 August 2021, Eskom confirmed that an explosion at unit 4 of Medupi power station caused extensive damage to that unit's generator due to non-compliance with procedures. Damage was extensive - repairs will take three years. Costs escalated from a budget of R80 bn to R135 bn.

Kusile, scheduled to be fully on stream in 2014, will be completed by 2023. The total estimated cost will be R161 bn from a budget of R81 bn. **It was within this context that former pres. Zuma opened the door for IPPs (Independent Power Producers) to produce renewable energy.**

THE REVOLUTION: A big switch, some people even describe it as a revolution, is taking place in the power generation industry. Fossil fuels are now increasingly being replaced with solar and wind to generate energy. Furthermore the "revolution" is driven, financed, and operated by IPPs. **With a few exceptions every renewable energy plant built by IPPs has been constructed on time and within**

budget. From 2011 to 2020 the cost of Eskom's power went up by 112% from 52.30c to 110.93c/kWh, while the cost of renewable energy dropped by 85% from 312c to 47c/kWh. In the first round of bidding in 2011 the cost of renewables was 312c/kWh. This was higher than Eskom's price of 52.3c/kWh. Renewable energy prices dropped to just 47c/kWh in the fifth round of bidding in 2021 - Bid Window 5 attracted 102 bids – it was four times oversubscribed. 47c/kWh was the average price – the cheapest bids came in at 34.4c/kWh for wind and 37.5c/kWh for solar. This compared very well with Eskom's price of 110.93c/kWh in 2020. Successful bids come with a sweetener of a 20-year Eskom contract. Thus far, the renewable energy programme has injected nearly R260 bn into the economy – more than R40 bn of that from offshore. Bid Window 6 is now open. The model was so successful that it was emulated globally.

CORRUPTION AND POLITICS: **Corruption and politics have impeded our capability to generate power.** Brian Molefe and the Guptas have all but bankrupted Eskom. In addition, Gwede Mantashe, Minister of Mineral Resources and Energy, and former chairperson of the South African Communist Party, still favours coal for power generation. Mantashe was, and still is, a staunch supporter of procuring excessively costly emergency energy via a multibillion-rand deal with Karpowership, the Turkish owner of a fleet of 25 powerships. A powership is a fully self-contained floating power station.

CLOSING REMARKS: **As indicated above, our renewable energy program has thus far attracted R40 bn from international investors and the fifth bid window was four times oversubscribed. These two facts are an indication of the attractiveness of our renewable energy program as an investment.** We are indeed experiencing a renewable energy revolution. It started almost unnoticed and far away from urban areas, predominantly in the Cape provinces. In the Northern Cape the sunny areas are ideal for solar power generation – in the Western Cape the windy coastal areas are ideal for wind power generation. We are indeed fortunate that we have both abundant wind and sun available for energy generation. On top of it, it is free.