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WEEKLY REPORT

OVERBERG MARKET REPORT

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Global

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Is the US headed for recession and an equity bear market?

The US equity market has de-rated sharply since the start of the year despite continued earnings growth. S&P 500 earnings increased in the first quarter (Q1) by a robust 10.4% year-on-year, based on companies that have reported so far, comprising 80% of the index. Yet the S&P 500 index has declined year-to-date by 16.1%, almost enough to put it in “bear” market territory, defined as a drop of 20% or more from the recent high.

Equity bear markets usually do not occur without there being a recession. This scenario appeared absurd as recently as 5 months ago when US GDP grew in Q4 2021 by an astonishing 6.9% quarter-on-quarter annualised. How times have changed, with a war in Europe, surging oil and food prices, accelerating inflation and China’s Covid lockdowns all conspiring to lower the pace of GDP growth. In Q1 2022, US GDP contracted for the first time since 2020, at an annualised rate of 1.4%.

If GDP contracts again in Q2, the US economy will officially be in recession, identified by two straight quarters of economic contraction. However, this scenario is highly unlikely. Recent GDP weakness is attributed to changes in government spending and a deteriorating trade balance. Exports fell 5.9% and imports increased 17.7% in Q1, which stripped 3.2% from GDP but in fact signals strong domestic demand. Personal consumption which accounts for 70% of US GDP, grew by 2.7% in the quarter, up from 2.5% the previous quarter. Business investment grew 9.2% up from 2.9%.

Domestic demand is strong and will continue to be supported by replenished household and company balance sheets. The savings rate has eased back from its pandemic highs but at the current rate of 6.2%, savings are still accumulating and are now a whopping $2.4 trillion above pre-Covid levels. According to research firm BCA, the US private sector financial balance, measuring the difference between what households and firms earn and spend, still stands at a comfortable surplus of 3% of GDP. Recessions usually occur when the balance is negative. Ahead of prior recessions in 2001 and 2008, the private sector balance hit deficits of 5.4% and 3.9% of GDP.

US unemployment has dropped to just 3.6% close to the pre-pandemic low of 3.5%, yet there are about 4 million more job openings than in February 2020. Job openings climbed to a record 11.5 million in March almost twice as many as the 5.9 million Americans looking for a job. It will be a long time before unemployment starts to rise again. In the meantime, a tight labour market support strong wage growth and household spending.

The chief concern is inflation, which is running at its highest in 40 years. Yet, there are signs that inflation has passed its peak. In April, US consumer price inflation dipped from 8.5% to 8.3%. Month-on-month, CPI increased 0.3% compared with 1.2% in March. The shift in spending from goods to services means core goods inflation has started trending lower. Core goods inflation, one of the key culprits in the supply chain inflation shock of the pandemic era, fell in April by 0.4% on the month.

Market based measures indicate a decline in inflation expectations. The closely watched breakeven rate, the yield difference between the 10-year Treasury Inflation Protected Security and conventional Treasury bonds of the same maturity, has dropped over the past month from 3% to 2.6%. The breakeven rate measures the market's expected annual inflation rate over the next 10 years.

A tempering in inflation data and inflation expectations will take pressure off the Federal Reserve, which has becoming increasingly "hawkish" since the start of the year. As it is, the Fed expects it will reach a "neutral" fed funds rate, which neither speeds up or slows down the economy, by the end of the year. The Fed estimates the neutral rate is around 2.75%. Although comprising a further 175 basis points in rate tightening, the projected neutral rate would still be below the expected inflation rate and therefore not austere in monetary policy terms.

The conclusion is that the US economy is likely to escape recession at least for the next 12 months. Research firm TS Lombard's US recession probability model indicates a negligible recession risk. Continued growth coupled with declining inflation should ensure further gains in US equity markets over coming months.

LOCAL

Gielie Fourie

Challenges facing our Mining Industry in creating new jobs.

INTRODUCTION: Last week our production figures were reported. Gold production for March and April was down year-on-year by 9.3% and 25.6%, respectively. Mining production was down by 6% and 9.3%. For a country with an unemployment rate of 35.3% and 7.9 million unemployed people, this is not good news. Mining is labour intensive and a major job creator. Our mines supply jobs to just over 500,000 people. Many more jobs can be created. Why can we not create more jobs? The Mining Indaba last week in Cape Town clearly highlighted what we need to do to create new jobs.

MINING INDABA 2022: Last week, from Monday to Thursday, we had our annual Mining Indaba in Cape Town. It was attended by 6,500 delegates from all over the world. The Mining Indaba is a platform for engagement and collaboration between all stakeholders in the mining industry. Pres. Ramaphosa delivered his keynote address on Tuesday. By all accounts he delivered one of his best speeches ever to woo investors to invest in South Africa. He received a standing ovation. He clearly understands the mining industry. It was an embarrassment that he was introduced to the Indaba by min. Gwede Mantashe as "comrade president", showing off his roots as a communist. Mantashe's own speech was a disappointment. South Africa's mining sector was recently ranked as one of the ten worst mining investment countries in the world, according to the 2021 Canadian Fraser Institute Investment Attractiveness Index. South Africa fell to 75th place out of 84 countries.

BOTTLENECKS: This year mining's surplus contribution to the fiscus is expected to be less than last year's R92 billion. Last year R92 billion of the extra R120 billion in income tax collected, came from the mines. One reason for the expected drop in income tax is the drop in the company tax rate from 28% to 27%. Other reasons include problems with rail transport, bottlenecks at our harbours and loadshedding. Mines can now generate 100 MW power without requiring a licence but after one year there is still red tape holding back the introduction of this option. Another problem at our mines is security. The industry spends more than R2 billion per year on security. The construction mafia and gangs are a big problem. They block access roads to mines to bring mines to a complete standstill and then force mines to allocate contracts to them.

MINING LICENCES: Another major bottleneck is the delay in issuing prospecting rights, mining licences and the renewal of licences. There is a backlog of more than 4,500 prospecting and mining rights licences in the pipeline waiting for approval. Roger Baxter of the Minerals Council says R100 billion is snarled up in red tape. It takes on average one year (352 days) to issue a new license. Zambia, Namibia and Botswana have better systems. In Botswana the waiting period for a mining license is only three months. An investor must jump over several high hurdles before he can start mining in South Africa.

NO CADASTRAL SYSTEM: This may be our biggest problem. Unlike other mining countries, South Africa does not have a cadastral system. What is a cadastral system? The system provides transparent data (open to anybody who needs to view the data) of all prospecting sites and licences. It is vital and essential to support exploration and growth in mining. The system was discussed ten years ago, but nothing has happened yet. The result is that there is no central database where vital mining data can be accessed.

CONCLUSION: All this is happening while there are investors waiting to invest billions and create thousands of jobs. For investors South Africa is at the bottom of the agenda as an investment option. Western Australia is the most attractive destination for investing in mines. Mining has the potential of creating thousands of new jobs and new income streams, but not while Gwede Mantashe is our minister of Mineral Resources and Energy (which includes Eskom), Fikile Mbalula is our minister of Transport and Bheki Cele is our minister of Police. They are creating serious bottlenecks. Conventional wisdom is to ”throw all your resources” at bottlenecks to get them out of the way as quickly as possible. Mantashe, Mbalula and Cele are three of those bottlenecks. The sooner they go, the sooner mining can start creating thousands of jobs.