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WEEKLY REPORT

OVERBERG MARKET REPORT

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Global Report

Carel La Cock

The rise of protectionism

The US government passed the landmark Inflation Reduction Act (IRA) in August this year. Although the name is somewhat ambiguous, the act aims to encourage investment in local manufacturing and energy production while also reducing carbon emission by 40% by 2030. The act is seen as a breakthrough by climate activists and will go some way in achieving the country's goal of cutting emissions by half, as per its commitment under the Paris agreement. However, the act has caused tension in transatlantic trade.

The IRA will be spread over 10 years and will be funded by corporate taxes. A minimum rate of 15% for companies with net income greater than $1bn will raise more than $300bn and is estimated to only impact on 150 companies. Furthermore, a 1% levy on share buybacks will come into effect from 2023 while significant savings will come from Medicare due to the insurer being able to negotiate drug pricing directly with pharmaceutical companies. Lastly to improve tax collection, the Internal Revenue Service will be strengthened with extra funding worth $80bn. An estimated $725bn will be raised in this way.

The raised funds will be spent on three broad initiatives. The first two: Affordable Care Act subsidies extension (c.$64bn) and Medicare, low-income drug subsidies and vaccines (c.$34bn) constitute roughly a fifth of the total spend while the lion's share ($369bn) will go towards Energy security and climate change. The latter is the area of most concern to Europe, the UK and other major trading partners. The energy security and climate change initiative will extend tax credits, grants and loans to companies involved in carbon capture and storage, steel and cement plants and those companies involved with producing hydrogen from clean sources, biofuels, and sustainable aviation fuels. Other clean energy producers in solar, wind, geothermal plants and advanced zero-emission nuclear reactors will see nearly $30bn in funding. Investment tax credits to the tune of $10bn will go towards building factories that make electric vehicles and renewable energy technologies. Households will be encouraged to buy clean vehicles "made in the US" with tax credits of $7,500 for those in lower to middle income brackets while further tax credits can be earned by retrofitting homes with energy efficient electric appliances and heating.

Officials from Europe are fretting that the IRA will lead to investment in green technology and manufacturing being lured away from the common currency block and that it will create an uneven playing field for its car manufacturers. The European Commission has highlighted five measures with "clearly discriminatory domestic requirements" which it claims is in breach of World Trade Organisation (WTO) rules. Europe is already at a competitive disadvantage to the US with energy costs soaring this year and major manufacturers have already signalled that further investment in Europe will be reviewed. The act has the potential to cause a trade war at a time when western allies have bound together in support of Ukraine against a common enemy in Russia.

A joint task force was setup to find a solution for the dispute, but it is unlikely that the act will go back to the drawing board as it only passed with the smallest of margins and was seen as a major win for US president Joe Biden prior to the US midterm elections. Although the act comes into effect from the start of 2023, the Biden administration still needs to finalise the rules to implement the new measures and there is hope that some of the more contentious issues around electric vehicles subsidies could be tempered. Europe is also seeking to be offered the same preferential treatment on electric vehicles that was extended to Canada and Mexico. Europe could approach the WTO for relief if talks fail, but this would be seen as a first step in a trade war and has the potential to undo progress made in other areas, most notably aircraft subsidies and steel and aluminium tariffs instituted by the Trump administration.

Although not at the same scale, Europe has its own initiatives to address climate change. The €800bn NextGeneration EU programme requires member states to allocate just over a third of their national recovery spending on climate-related investment and reforms while regional aid schemes are also focussing on green projects. Repower EU, which aims to diversify energy away from Russian oil and gas will also go some way in helping European industries compete internationally. French president, Emmanuel Macron wants to go even further and has called for a “buy European act” to support domestic companies while German economy minister, Robert Habeck, wants a “strong European response” which might include subsidies.

European Commission president, Ursula von der Leyen, recently said that the EU will match the US and that she is willing to relax rules on the level of support from member states, but the sheer size of the IRA will mean that Europe needs to open the taps at a time when member states are still reeling from Covid-19 support. Euro area debt currently stands at 93% of GDP. For now, at least, the US remains firmly on top in the race to attract investment in the green economy.

Local Report

Gielie Fourie

GDP figures: Quarter 3 of 2022

GROWTH SURPRISED IN QUARTER 3 of 2022: Year on Year (YoY) Gross Domestic Product (GDP) growth for the third quarter of 2022 (Q3 2022) was a sturdy 1.6% QoQ (seasonally adjusted). This figure exceeded the consensus forecast for an expansion of around 0.4%, after a 0.7% contraction in Q3 2022. The strong GDP momentum in Q3 2022 should be seen in the context of the contraction in the previous quarter, during the disruptive floods in KZN as well as a sharp worsening of electricity loadshedding and ongoing logistical (port and railway) constraints. An unexpectedly strong 19.2% QoQ (seasonally adjusted) jump in agricultural sector GDP was one of the reasons for the Q3 2022 GDP overshoot.

GDP is computed from data gathered from ten industries. The ten industries are grouped into three sectors. The three-sector model consists of the Primary Sector, the Secondary Sector, and the Tertiary Sector. Eight industries recorded growth in Q3 2022, while two industries contracted. We look at the three sectors and at each of the ten industries. Also see the graph at the bottom.

THE PRIMARY SECTOR: This sector represents companies that are involved in extracting natural resources, like mining, and agriculture. (1) Agriculture - QoQ growth seasonally adjusted was 19.2%. Field crops and horticulture products were responsible for this expansion in Q3 2022, which significantly exceeded analysts' forecasts. Analysts expect reasonable agricultural crops in the near term, supported by favourable weather conditions. (2) Mining - QoQ growth seasonally adjusted was 2.1%. This expansion was mainly driven by higher gold, diamond, coal, and manganese ore production. While the result was consistent with Standard Bank's final forecast for the sector and Stats SA's monthly mining production data, Standard Bank's initial forecasts were more cautious given that this is one of the sectors that is bearing the brunt of Transnet's and Eskom's problems. Standard Bank's forecasts for the mining and other goods-producing sectors remain cautious over the short to medium term.

THE SECONDARY SECTOR: This sector covers all those activities consisting of the processing of raw materials, like manufacturing and construction industries. (3) Manufacturing - QoQ growth seasonally adjusted was 1.5%. According to Stats SA, this growth was mainly supported by the automotive sector as well as food and beverages production. As in the case of the mining sector, this performance is a relief given the severe constraints from electricity availability as well as railway and port infrastructure bottlenecks. (4) Utilities - QoQ growth seasonally adjusted was -2.1%. This is one of only two sectors recording a contraction in Q3 2022. The decline is unsurprising given the reduction in electricity availability in Q3 2022, although Stats SA asserts that decreased water consumption also played a role.

(5) Construction - QoQ growth seasonally adjusted was 3.1%. This sector remains by far the furthest from a recovery to its pre-pandemic real GDP level – it was 19% below its Q1 2022 real (seasonally adjusted) GDP level in Q3 2022, notwithstanding this quarter-on-quarter expansion. Stats SA reports increased activities in residential and non-residential buildings as well as construction works. While the sector's business confidence was still rather weak in Q3 2022, it has generally improved from its weakness in 2020-2021, and the recovery is consistent with the gradual improvement in perceived activity levels recorded in the BER's (Bureau for Economic Research at the University of Stellenbosch) quarterly surveys of the sector.

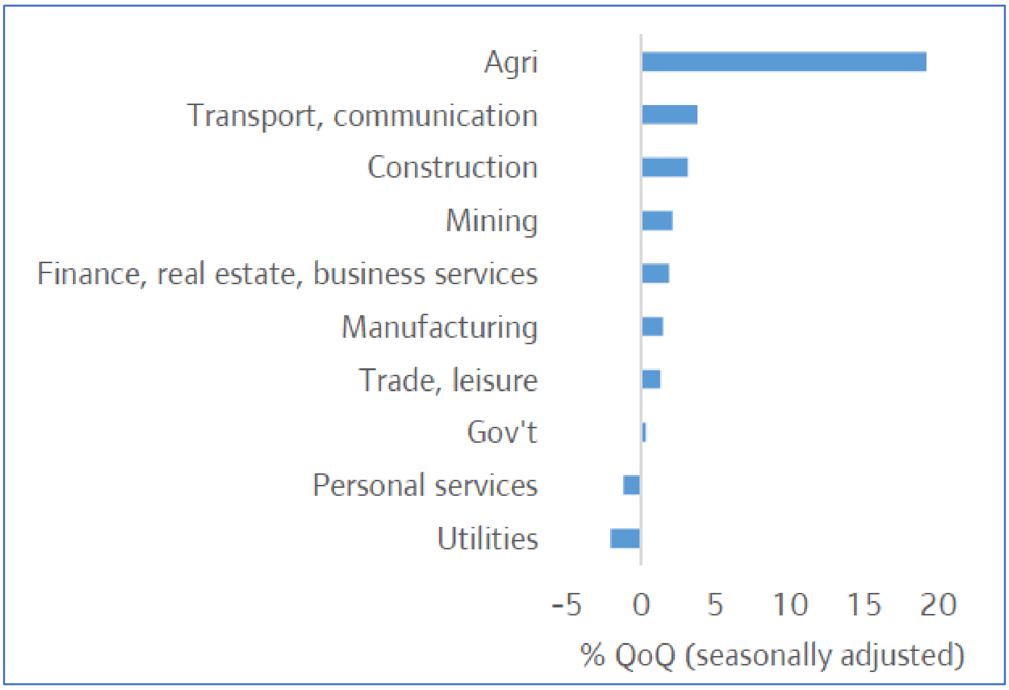
THE TERTIARY SECTOR: This sector consists of the provision of services instead of end products. (6) Trade, catering, and accommodation - QoQ growth seasonally adjusted was 1.3%. The wholesale, motor trade and catering and accommodation industries were responsible for the rise in this sector's economic activity in Q3 2022. The intensifying impact of aggressive monetary tightening will increasingly weigh on the tertiary sector's performance, but it continues to be counteracted by the ongoing recovery in tourism spending and the backdated wage increase awarded to civil servants in November. The wholesale sector has been remarkably resilient amid severe electricity loadshedding. (7) Transport and communication - QoQ growth seasonally adjusted was 3.7%. According to Stats SA, this sector's output was boosted by land transport and transport support services as well as communication services in Q3 2022. It again outpaced analysts forecast.

(8) Finance and business services - QoQ growth seasonally adjusted was 1.9%. Finance is our largest industry. This sector's growth was driven by financial intermediation, insurance and pension funding, auxiliary activities, real estate, and business services, according to Stats SA. This sector's GDP is now nearly 5% higher than it was prior to the pandemic, which makes it one of the best performing sectors on this basis (after only the agricultural and personal services sectors). (9) Personal services - QoQ growth seasonally adjusted was -1.2%. This sector's surprising contraction was, according to Stats SA, owing to decreased economic activity for community and other producers. (10) Government - QoQ growth seasonally adjusted was 0.3%. This expansion was owing to an increase in employment numbers in national government and extra budgetary institutions, according to Stats SA.

BOTTOM LINE – GROWTH WILL BE INTERRUPTED IN 2023: The stronger than expected economic growth in the third quarter was encouraging, but headwinds abound - growth will be interrupted. The macroeconomic forecast is that our GDP is expected to grow by 2.2% in 2022, 1.5% in 2023 and 1.9% in 2024. The latest International Monetary Fund (IMF) World Economic Outlook (WEO) shows that the global economy will grow by 2.7% in 2023, versus SA's 1.5%. Global inflation is expected to average 6.5% in 2023. In SA, the long-drawn-out impact of worsened load-shedding, inflation, and the impact of rising interest rates on household consumption remain a concern. Household consumption contributes more than 60% to our economic consumption. When consumers are hit with higher inflation and interest rates, their 60% contribution to consumption will shrink. Economic growth will drop in 2023 to an estimated 1.5%. 2023 will be a tough year.

Source: Stats SA, Standard Bank Research

Performance of ten industry sectors in Q3 2022 (QoQ, seasonally adjusted)



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