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WEEKLY REPORT

OVERBERG MARKET REPORT

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Global Report

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IMF World Economic Outlook April 2024

The global economy exhibited surprising resilience amidst the disinflationary phase from 2022 to 2023, with economic activity holding steady despite rising central bank interest rates. This resilience was supported by favourable demand and supply dynamics in major economies, although challenges such as high government debt levels and geopolitical tensions persisted.

As inflation approached pre-pandemic levels by late 2023, some developed and emerging market economies still struggled to reach target levels. Despite these inflationary challenges, global economic growth remained robust, surpassing earlier forecasts. The United States and several emerging market economies notably outperformed expectations, driven by strong private consumption and government spending.

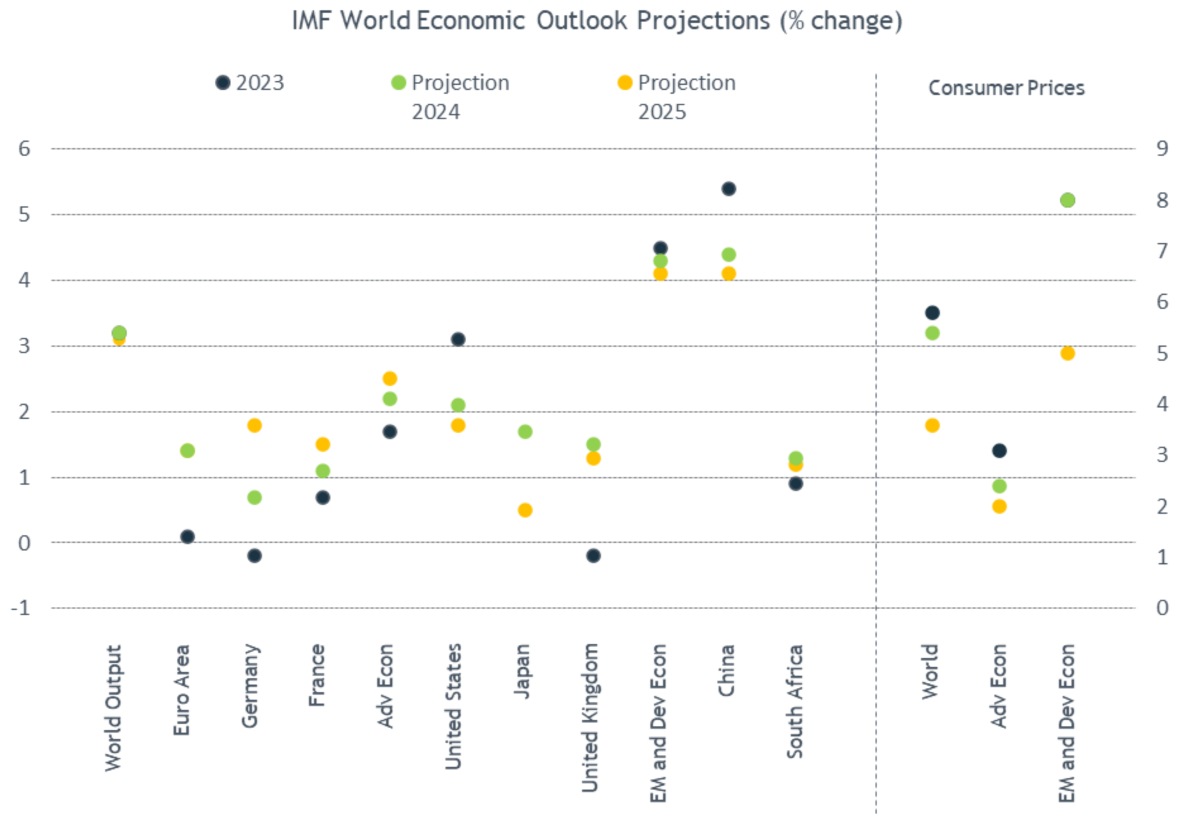
However, disparities existed among regions, with the euro area displaying weaker growth due to subdued consumer sentiment and high energy prices. Additionally, lower-income countries faced higher-than-expected inflation and slower growth, attributed to factors like currency depreciation which filtered into the real economy via higher costs for imported goods such as fuel, food and fertilizers.

The global economy's resilience was supported by post-pandemic supply-side expansions, including a rise in the labour force and increased business investment in response to growing demand. Notably, some economies saw a surge in migrant labour force participation, while others, like China, faced broader labour market weakness.

Furthermore, improvements in supply chain logistics and a decline in transportation costs contributed to economic stability, despite disruptions from events like attacks on commercial shipping and climate-related challenges in key trade routes. Energy prices also fell faster than anticipated, driven by increased oil and natural gas production, particularly in non-OPEC countries like the United States, as well as expanded Russian oil exports.

Since 2022, the decrease in headline inflation primarily stems from diminishing relative price shocks, notably in energy, and reduced core inflation. This decline in energy prices is attributed to increased global supply and tight monetary policies, synchronously implemented by major central banks. Core inflation has decreased due to the waning effects of past headline inflation shocks and easing labour market pressures. Near-term inflation expectations have approached target levels globally, yet financial-market-based measures in the US show a slight increase.

Despite tight labour markets, nominal wage growth has been contained, particularly in the euro area, leading to stagnant or slightly decreased real wages. Wage-price spirals have not materialized, though wages at the lower end of the distribution have risen faster, compressing wage differentials. Factors reducing core inflation differ across major economies, with the US experiencing upward pressure due to labour market tightness and strong macroeconomic conditions. Conversely, the euro area and UK have seen larger roles played by the rapid fading of past relative price movements and pre-pandemic labour market tightness, respectively. IMF estimates reveal positive output gaps in the US and negative gaps in the euro area and UK for 2023.



Source: IMF WEO report April 2024

To combat rising inflation, major central banks have raised policy interest rates to restrictive levels. This has led to increased mortgage costs and tighter credit availability, impacting firms' ability to refinance debt, causing corporate bankruptcies, and dampening business and residential investment. The commercial real estate sector, particularly office markets, is facing significant pressure due to higher borrowing costs and the shift to remote work. Despite these challenges, a global economic downturn resulting from the rate hikes has not materialized for several reasons. Some central banks adjusted nominal interest rates after inflation expectations rose, resulting in lower real rates initially supporting economic activity. Additionally, households in major advanced economies could rely on pandemic savings to mitigate the impact of higher borrowing costs. Changes in mortgage and housing markets over the pre-pandemic decade, such as increased fixed-rate mortgages, have also moderated the immediate impact of rate hikes on household consumption. However, the cooling effects of high policy rates are becoming more pronounced, leading to mortgage resets and declining pandemic savings availability. Nonetheless, with inflation nearing targets, expectations of lower interest rates in advanced economies have eased financial conditions globally, prompting increased asset appetite in emerging markets and reduced sovereign spreads on government debt. As a result, more governments are accessing international debt markets to alleviate funding shortages.

Looking ahead, the pace of economic expansion is expected to remain modest by historical standards, influenced by several factors such as the long-term impacts of the COVID-19 pandemic, geopolitical tensions like Russia's invasion of Ukraine, weak productivity growth, and increasing geoeconomic fragmentation. Additionally, the tightening of fiscal policies to address high government debt levels, including higher taxes and reduced government spending, is anticipated to dampen growth prospects.

The latest projections indicate continued global economic growth at a pace similar to that of 2023, expected to persist throughout 2024–25. Although the global growth forecast remains largely unchanged since the January 2024 World Economic Outlook (WEO) Update, there have been some adjustments for major economies.

The United States is projected to experience a further strengthening, with growth expected to increase to 2.7% in 2024 before slowing to 1.9% in 2025 due to gradual fiscal tightening and labour market softening. This represents an upward revision of 0.6 percentage points from the January 2024 WEO Update.

Conversely, the euro area is forecasted to recover from a low growth rate of 0.4% in 2023 to 0.8% in 2024 and 1.5% in 2025, driven by stronger household consumption as energy price shocks subside. However, Germany's growth outlook has been revised downward by 0.3 percentage points for both 2024 and 2025 due to persistently weak consumer sentiment.

In the United Kingdom, growth is projected to rise from 0.1% in 2023 to 0.5% in 2024 and 1.5% in 2025, supported by easing financial conditions and recovering real incomes as disinflation occurs. Japan's output is expected to slow from 1.9% in 2023 to 0.9% in 2024 and 1% in 2025 due to the fading of one-off factors that supported growth in 2023.

These projections reflect a global economic landscape characterized by restrictive monetary policies, withdrawal of fiscal support, and low underlying productivity growth, contributing to growth rates below historical averages. Despite these challenges, the forecast for global growth in 2024 and 2025 remains higher than that of the October 2023 WEO, with emerging market and developing economies expected to experience stable growth, albeit with regional differences.

Local Report

Francois Louw and Sean Fitzpatrick

Navigating uncertainty: South African election through an investor's lens

In the ever-changing environment of South Africa's political landscape, one thing is certain: uncertainty. As the nation gears up for its upcoming election, the air is thick with anticipation and speculation. Amidst the buzz of campaign promises and political manoeuvres, a feeling of unease looms over the market. Investors, typically skilled at navigating fluctuating landscapes, find themselves treading cautiously and asking the question: Where do I allocate my funds?

Overview of election outcomes

From an investor's perspective, the least desirable scenario would be an ANC coalition with either the EFF or the newly established Umkhonto we Sizwe Party (MKP). These coalition governments would bring about substantial volatility given their divergent stances on key issues like land expropriation, the nationalisation of mines, and their positions on institutions like the SARB, NPA and SARS. While some media polls suggest these two outcomes are likely to materialise, a recent report by Simon Freemantle from SBG indicates it is less probable.

In Freemantle's election report, he discusses the following three outcomes to this year's national election:

Outcome 1 (Probability: 20%) – Should the ANC secure 48% or more of the votes, they might partner with smaller parties like GOOD, Al Jamah-ah, or the AIC. In this scenario, President Ramaphosa's authority is anticipated to strengthen, providing a semblance of stability amidst potential coalition negotiations.

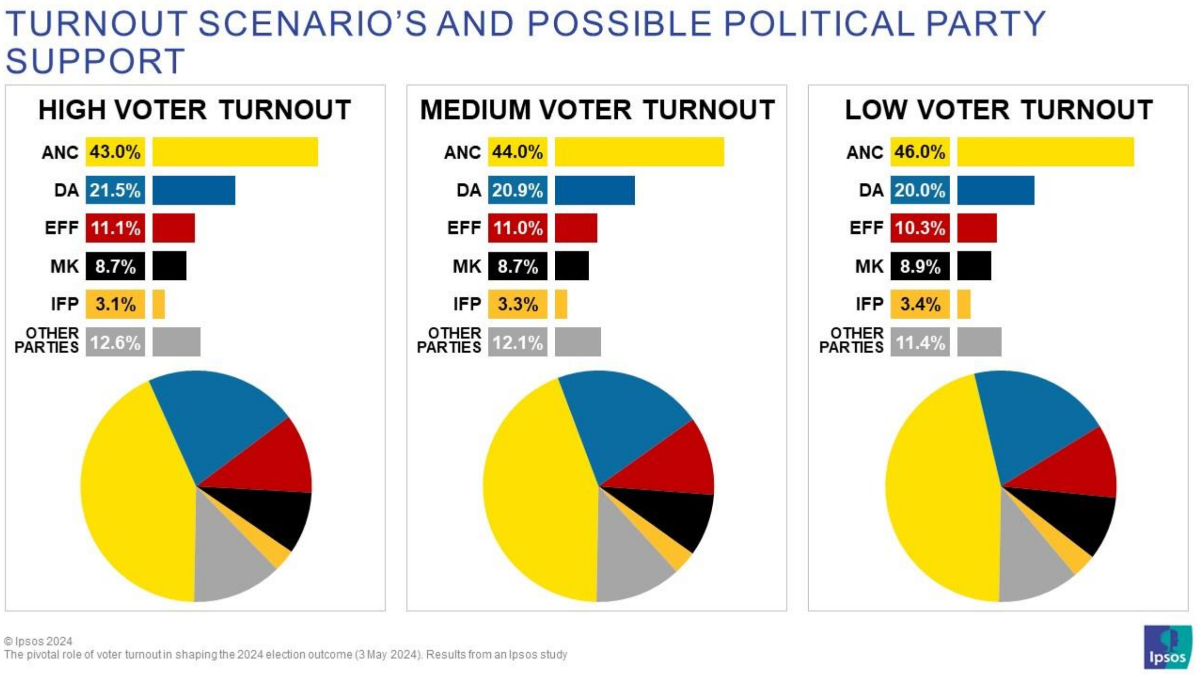
Outcome 2 (Probability: 60%) - In this base-case scenario, the ANC receives between 43% and 47% of the votes, likely necessitating a coalition partnership with at least one mid-sized party. The most probable coalition partner here would be the Inkatha Freedom Party (IFP), potentially altering the political landscape. Despite the uncertainty, President Ramaphosa is expected to retain power.

Outcome 3 (Probability: 20%) - The ANC's vote share dips to 42% or less, forcing them into coalition talks with a larger rival party such as the DA or EFF. This would be unchartered waters for South Africa as these scenarios could result in significant political upheaval, jeopardizing President Ramaphosa's position and introducing considerable market volatility.

Based on the above outcomes, there is only a 20% likelihood of the ANC receiving less than 42% of the national vote. Even if this occurs, there is no guarantee that the ANC would choose to form a coalition with the EFF or the MKP, given their conflicting viewpoints mentioned earlier. This implies a very high probability that the ANC will retain power by forming a coalition with a smaller or medium-sized party, with Mr Ramaphosa remaining president of South Africa.

Voter Turnout

Voter turnout is defined as the percentage of registered voters who show up on the day and vote, and it is an influential factor in terms of election results. Turnout is predicted to be around 62% for this year's election, down from 66% in 2019. A lower turnout may favour the ANC, assuming less-engaged voters abstain. A recent Ipsos study (Chart 1) supports this point. In this model, high voter turnout refers to 74-76%, medium to 57%-59%, and low turnout to 41-43% turnout. There also lies potential for an unexpected increase in voter turnout from 2019, due to the unique opportunities and threats that this election presents.



Source: Ipsos, 2024

Provincial Coalitions

With coalitions at the national level appearing increasingly inevitable, attention must also be directed towards the potential configurations of provincial coalition governments. Each province presents a unique political landscape, where parties may need to collaborate to secure governance.

According to the report, coalition governments are anticipated to govern five out of the nine provinces in South Africa. These provinces include Gauteng, KZN, the Western Cape, the Northern Cape, and the Free State. In the Western Cape, there's a possibility that the DA could lose its majority vote, with both the ANC and the Patriotic Alliance (PA) emerging as contenders in the region. Should this scenario unfold, the margin is projected to be narrow, potentially leading the DA to form a coalition with a smaller party in the area.

Recent polls also indicate a decline in support for the ANC in KZN and Gauteng, with figures expected to dip below 40%. In Gauteng, the ANC may find itself deliberating between coalition partnerships with either the DA or EFF. Similarly, in KZN, the ANC's options may include forming a coalition with either the Inkatha Freedom Party (IFP) or the newly established Umkhonto we Sizwe Party (MKP), though the latter scenario is deemed highly unlikely.

Navigating Market Volatility

The election results' impact on investments hinges on the stability and policy direction of the incoming government. A clear, investor-friendly outcome could bolster market confidence, driving increased investment and potentially higher stock prices for JSE listings. Conversely, uncertainty may lead to investor caution, precipitating market volatility and fluctuations.

Amidst anticipated market volatility, it's prudent to maintain a long-term strategy emphasizing diversification. Should the election yield a favourable outcome, positioning oneself to capitalize on potential gains in the JSE Top 40 holdings through exposure to local equities is essential. Currently, local stocks are trading at significant discounts due to recent selloffs, presenting substantial upside potential. A favourable scenario could trigger a JSE Top 40 rally of 10-15%, accompanied by the Rand appreciating to approximately R17 against the USD.

In the event of an unfavourable outcome, like our least desirable outcome mentioned above, safeguarding against downside volatility becomes paramount. Diversification across geographical regions and asset classes offers protection. Holding assets with exposure to offshore markets acts as a hedge against the Rand, while reducing exposure to local equities (whose earnings are predominantly linked to the South African economy) helps mitigate potential further declines in local stock prices.

Conclusion

As South Africa stands at the forefront of a new chapter, the stakes have never been higher, and the choices never more consequential. There exists no silver bullet in this complex investment landscape, but a diversified and strategic asset allocation is the sustainable solution. Overberg Asset Management strives to provide exactly that for all clients on a consistent basis. We have been making strategic changes to our local portfolios since the end of 2023 with this year's elections in mind. By combining exposure to both offshore markets (through ETFs) and local companies, clients can partake in potential rallies of the JSE, while simultaneously hedging against adverse outcomes on the local front.