IN THIS WEEK’S BOTTOM LINE

- The Reserve Bank is likely to adopt a cautious outlook given the potential for rand reversals during the first quarter. In February, the Budget speech and State of the Nation Address and in March a potential credit rating downgrade from Moody’s, each have the potential to disrupt the rand’s recent trajectory.

SOUTH AFRICA ECONOMIC REVIEW

- Total new vehicle sales contracted in December by 2.4% year-on-year marking the first decline in seven months. Passenger vehicle sales fell 6.4% after rising 16.3% in November. Export sales fell 7.1% following a 13.6% decline the previous month. More encouragingly, light commercial and extra heavy vehicle sales increased by 7.0% and 13.4% respectively, showing a strong improvement from November’s figures. In the full year 2017, total vehicle sales increased 1.5%. In 2017, passenger vehicle sales increased 1.6% compared with a contraction of 12.4% in 2016. Sales were boosted by the car rental sector and significant sales incentives from manufacturers. Total exports dropped in 2017 by 4.6% due to port disruptions in Durban and production shifts to new models. The vehicle sales outlook for 2018 should benefit from buoyant export demand and a normalization in export operating conditions. Moreover, domestic demand will likely improve following the boost to business and consumer confidence post the ANC elective conference.

- Manufacturing production increased in November by a stronger than expected 1.7% year-on-year well ahead of the 0.5% consensus forecast. On a month-on-month basis manufacturing production grew by a robust 0.9%. In the three months to end November compared with the prior three months manufacturing production grew by 0.5% indicating a positive contribution to GDP growth in the fourth quarter. Among the manufacturing categories “food and beverages”, which comprises 25.15% of the total, grew 6.0% on the year contributing the bulk (1.5 percentage points) of the total increase. “Basic iron and steel, non-ferrous metals, metal products and machinery” grew 4.6% on the year contributing 0.8 percentage points of the total increase. The outlook for manufacturing should improve as domestic consumer and business confidence show signs of recovery following the change in ANC leadership. At the same time export demand is expected to maintain its upward momentum.
Growth in private sector credit extension (PSCE) unexpectedly accelerated from 5.4% in October to 6.5% in November more than making up for the decline from 5.5% in September. On a month-on-month basis PSCE increased by a solid 1.1%. Encouragingly, credit growth improved across households and corporates. Credit extension to companies improved on a year-on-year basis from 7.2% to 7.8% and to households from 3.5% to 3.7%. While credit growth is subdued there are early signs of recovery in the credit cycle. Credit growth is likely to recover during 2018, helped by a gradual pick-up in consumer and business confidence and the potential for further easing in monetary policy.

The trade balance registered a surplus for the ninth consecutive month growing substantially from R4.3 billion in October to R13.0 billion in November. While imports increased by 3.3% year-on-year exports increased by 11.5%. The growth in exports is due largely to the precious metals and stones category while the slight rise in imports is attributed to increased shipments of machinery and electronics. In the 11 months to end November the trade surplus measured R64.7 billion up considerably from a trade deficit of R11.2 billion in the equivalent period in 2016. While imports remain subdued by weak domestic demand a buoyant global economy is lifting export demand across the board. The World Trade Organisation lifted its growth forecast for world merchandise trade volumes in 2017 to 3.6% from a previous 2.4%. This compares with 1.3% growth in 2016. The positive trend in South Africa’s trade balance signals a narrowing in the country’s current account deficit and a reduced reliance on capital inflows.

The South African Chamber of Commerce and Industry (SACCI) business confidence index increased in December for a second straight month rising from 95.1 in November to 96.4 in December. This compares with 92.9 in October and marks the highest reading since January 2017. The improvement is attributed primarily to positive political developments. In its accompanying statement SACCI said: “The anticipation for more policy certainty and sustainable growth-oriented domestic economic policy, global economic growth, and a probable fresh approach towards business and investor challenges should further augment the business mood.” However, SACCI cautioned that: “For the momentum in the business mood to continue, it should be met and augmented by urgent economic policy action.” Business confidence could slip back if no real changes are implemented by the new leadership of the ANC. There tends to be a two-quarter lag between a rise in business confidence and actual investment.

Following four straight months of improvement the Absa purchasing managers’ index (PMI) fell sharply from 48.6 in November to 44.9 in December well below the key 50-level which separates expansion from contraction. The decline was broad-based across the sub-indices with the business activity and new sales orders indices showing the biggest declines. In mitigation, the December PMI reading tends to be weak due to seasonal factors. Moreover, there has been a poor correlation between the PMI readings and actual manufacturing data,
which means that following strong manufacturing production figures in both October and November the sector is still likely to make a positive contribution to fourth quarter GDP growth. Encouragingly, the expected business conditions index increased from 50 to 61.9, indicating a recovery in manufacturing activity towards mid-2018.

- Shares in Aspen tumbled on the 9th January by as much as 10% at one point following rumors that Viceroy Research was compiling a report on the company. Viceroy rose to prominence in South Africa after bringing out a hard-hitting report on Steinhoff on the day its shares tumbled following the announcement of accounting irregularities. A selection of real estate investment trusts, including Resilient, Greenbay, NepiRockcastle and Fortress also suffered severe share price losses on the 9th January amid market perceptions that they could become victims of Viceroy research recommendations.

SOUTH AFRICA: THE WEEK AHEAD

- Mining production: Due Tuesday 16th January. According to consensus forecast mining production is expected to maintain its run of strong growth following on from October’s 5.1% year-on-year increase with a gain of 4.8% in November. Commodity demand and prices are gaining in line with rising global growth momentum.

- Retail sales: Due Wednesday 17th January. Despite the weak labour market, tight credit conditions and poor consumer confidence retail sales are expected, according to consensus forecast, to follow-on from October’s 3.2% year-on-year growth with a slight acceleration to 3.8% in November, boosted by strong Black Friday sales.

- South African Reserve Bank monetary policy decision: Due Thursday 18th January. The South African Reserve Bank Monetary Policy Committee will conclude its first meeting of the year on Thursday 18th January. The consensus forecast is that there will be no change in the repo rate on Thursday despite the surge in the rand over the past month and the benefit the stronger currency has on inflation. The Reserve Bank made a start to its interest rate cutting cycle on 20th July but since then rates have been kept on hold. (See Bottom Line for further analysis).

GLOBAL

- The oil price hit its highest level since December 2014 propelling Brent crude to the $70 per barrel level. Prices are rallying in response to a combination of dollar weakness, OPEC-led production curbs and a sharper than expected fall in US inventories. Iraq echoed a statement from the UAE and other producers that OPEC-led production cuts should continue despite the recent price rise. Meanwhile, US crude stockpiles declined for an eighth straight week. Global demand, buoyed by rising economic growth momentum, has
exceeded expectations. Bank of America Merrill Lynch forecasts a global oil market deficit of 430,000 barrels per day (bpd) in 2018 revised upwards from a previous forecast of 100,000 bpd, reporting that: “We have updated our supply/demand balances to reflect a faster-than-expected tightening in the global oil market due to improving cyclical conditions, cold winter weather, and tighter than expected OPEC compliance.”

NORTH AMERICA

- US equity indices maintained their winning streak into 2018, powering to new record highs. The latest rally is attributed to strong fourth quarter (Q4) earnings forecasts. A Thomson-Reuters survey forecasts S&P 500 earnings will increase in Q4 by 11.8%. If the consensus forecast is exceeded by 3-5 percentage points as has been the trend over the past few quarters, Q4 earnings will beat the 15% earnings growth achieved in Q1 2017. Encouragingly, earnings are being powered by revenue growth rather than cost-cutting which had been the case between 2011-2014. So far there is no indication of margin erosion, which was one of the chief concerns during 2017. The financial and energy sectors are enjoying the greatest upward forecast revisions. The Q1 2018 consensus earnings forecast for the financial sector has increased to 18.4% up sharply from 10% in October. The equivalent earnings forecast for the energy sector has increased from 27% to 53%.

- Core consumer price inflation (CPI), excluding food and energy, increased in December by 0.3% month-on-month the strongest reading in almost a year and beating the 0.2% consensus forecast. Shelter costs increased by 0.4% and prices of medical care increased 0.3%. On a year-on-year basis core CPI accelerated from 1.7% to 1.8% moving closer to the Fed’s target of 2%. The Fed’s “dot plot” is predicting three 25 basis point rate hikes during 2018 as in 2017 although the Fed has stressed that more may be in store if needed. However, Fed officials differ in their outlook on interest rates. This week Raphael Bostic, a voting member of the Federal Open Market Committee, said only two rate hikes might be needed in 2018 due to soft inflation. Meanwhile, producer price inflation (PPI) eased in December to 2.6% on the year from 3.1% in November. A declining PPI may exert downward pressure on consumer prices.

- Retail sales growth increased in December by 0.4% month-on-month, which although down from November’s upwardly revised 0.9% growth marks the fourth straight monthly increase. On a month-on-month basis, sales of motor vehicles, furniture and food posted solid gains while sales of electronics, clothing and miscellaneous goods contracted. The December retail sales numbers provide a solid finish to a strong year. In 2017, retail sales increased 4.2% year-on-year the highest reading since 2014. The so-called “retail-control sales group”, which excludes food services, auto dealers, building materials stores and gasoline stations, and used to calculate GDP, increased in the fourth quarter (Q4) by 8.9% quarter-
on-quarter annualised up from 3.4% in Q3. Retail sales likely made a strong contribution to Q4 GDP growth.

CHINA

- Citing tightening liquidity conditions due to a peak in the tax season and the reserve requirements of financial institutions, the People’s Bank of China (PBOC) injected 398 billion yuan into the banking system through its medium-term lending facility. This marks the first liquidity injection in three weeks and coincides with a sharp appreciation in the yuan. The yuan strengthened to its strongest level against the US dollar since December 2015 rising a further 0.5% on the day. Economists are expecting the yuan to strengthen further amid the government’s continued deleveraging initiatives.

JAPAN

- The Bank of Japan (BOJ) decided by an 8-1 majority to keep its benchmark interest rate unchanged at -0.1% and maintain its asset purchase programme to keep the 10-year government bond yield at around 0%. Without giving time guidance BOJ Governor Haruhiko Kuroda said: “The year-on-year rate of change in the CPI is likely to continue on an uptrend towards 2%, due mainly to an improvement in the output gap and a rise in medium- to long-term inflation expectations.” Kuroda added that: “The BOJ will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI exceeds 2% and stays above the target in a stable manner.” The BOJ cited risks to its constructive economic outlook as being US economic policies and their impact on global financial markets, the impact of Brexit, the European debt problem, the prospects of emerging and commodity exporting countries, and geopolitical risks.

EUROPE

- Eurozone industrial production increased sharply in November by 1.0% month-on-month up from 0.4% in October and well above the 0.7% consensus forecast. On a year-on-year basis industrial production grew by 3.2% although down slightly from 3.9% in October due to adverse base effects. Among industrial sectors, capital goods production led the way increasing 6.2% on the year followed by the production of intermediate and durable consumer goods at 4.6%. By contrast, energy production contracted by 3.4% on the year and non-durable goods by 0.1%. Industrial production is likely to maintain its positive trend over coming months, helped by a combination of buoyant domestic and global demand.

- Eurozone unemployment fell from 8.8% in October to 8.7% in November the lowest since January 2009. The unemployment rate has fallen steadily since hitting 12.1% in 2013 at the
peak of the Eurozone sovereign debt crisis. Among individual countries, Germany, France and Italy experienced declines in unemployment from 3.7% to 3.6%, from 9.3% to 9.2%, and from 11.1% to 11.0%. Even Greece has experienced a substantial improvement in recent months with its unemployment falling to 20.5% compared with 23.2% in November 2016. Encouragingly, youth unemployment was sharply lower across the board, aiding social stability. Employment growth is key to restoring consumer price inflation to the ECB’s target of under but close to 2%.

- The European Commission economic sentiment indicator increased from 114.6 in November to 116.0 in December its highest since October 2000 and well above the 114.8 consensus forecast. The EC business climate indicator, which tends to be a reliable indicator of the business cycle, surged higher from 1.49 in November to 1.66 in December, its highest since the data series began in 1985 and substantially above the 1.50 consensus forecast. Confidence increased across the board with gains in industry, services, retail, construction and service sectors. However, the index measuring consumers’ inflation expectations for the next 12 months fell from 16.0 to 13.6 a four-month low, indicating further challenges ahead in the ECB’s quest to restore inflation to its target level.

- Eurozone retail sales increased in November by a stronger than expected 1.5% month-on-month its fastest growth in just over a year, more than making-up for the 1.1% decline in October. Non-food retail sales led the way with an increase of 2.3% while food, drinks and tobacco sales gained 1.2%. Among individual Eurozone countries Portugal recorded the fastest growth in retail sales at 3.9%. Germany recorded strong growth at 2.3%. Robust retail sales data suggest the Eurozone, which grew its GDP in the third quarter (Q3) by 0.6% quarter-on-quarter, will likely maintain its elevated GDP growth rate in Q4.

UNITED KINGDOM

- Manufacturing production increased in November by 0.4% month-on-month, growing for an eighth straight month the longest winning streak since May 1994. In the three months to end November manufacturing production increased by a solid 1.4% compared to the preceding quarter. The strong rise in manufacturing output is attributed to rising global demand and the boost to UK export competitiveness from a weaker pound. The stronger than expected manufacturing data contributed to the National Institute of Economic and Social Research (NIESR) raising its forecast for UK GDP growth in the fourth quarter (Q4). The NIESR is forecasting Q4 GDP growth of 0.6% quarter-on-quarter, which would reflect a strong improvement on the 0.4% growth recorded in Q3. Amit Kara, NIESR’s head of UK macroeconomic forecasting said: “The recovery has been driven by both the manufacturing and the service sectors, supported by the weaker pound and a buoyant global economy.”
FAR EAST AND EMERGING MARKETS

- India’s industrial output increased in November by 8.4% year-on-year up strongly from a downwardly revised 2% gain in October and well ahead of the 4.4% consensus forecast. It marked the strongest growth rate since June 2016. Manufacturing production, which comprises around 77% of industrial production, grew by an impressive 10.2% on the year compared with growth of 2.2% in October. Encouragingly, much of the increase in industrial production growth is attributed to capital goods and infrastructure spending, which bodes well for productivity improvements and the sustainability of the economic recovery. The upbeat economic data confirms that the economy has adapted to the disruptive effects of last year’s removal of high denomination bank notes from circulation and this year’s implementation of the Goods and Services Tax.

KEY MARKET INDICATORS (YEAR TO DATE %)

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Gold + 3.47
Platinum + 7.38
Brent oil + 5.58

TECHNICAL ANALYSIS

- Having broken key resistance levels at R/$13.50 and R/$12.50, the rand has returned to its appreciating trend, targeting a break below R/$12.00 over coming months.

- The US dollar index has tried but failed to break through a major 30-year resistance line suggesting the three-year bull run in the dollar may be over.

- The British pound has broken above key resistance at £/$1.35 promoting further near-term currency gains to a target range of £/$1.40-1.50.

- The JPMorgan global bond index is testing the support line from the bull market stemming back to 1989, which if broken will project further sharp increases in bond yields.

- The US 10-year Treasury yield has failed to break below key resistance at 2.0% raising the probability that the multi-year bull trend in US bonds is over.

- The benchmark R186 2025 SA Gilt yield has broken below key resistance at 9.0% indicating the potential for a new target trading range of 8.0-8.5%.


- The Brent oil price has broken above key resistance at $60 and likely to remain in a trading range of $60-70 over the foreseeable future. Base metal prices are in a bull trend confirmed by copper’s increase above key resistance at $7000 per ton.

- Gold has developed an inverse “head and shoulders” pattern, which indicates further upward momentum and a test of the $1400 target level.

- The break in the JSE All Share index above key resistance levels at 56,000 and 60,000 signal the early stages of a new bull market.
BOTTOM LINE

- The South African Reserve Bank Monetary Policy Committee will conclude its first meeting of the year on Thursday 18th January. The consensus forecast is that there will be no change in the repo rate on Thursday despite the surge in the rand over the past month and the benefit the stronger currency has on inflation. The Reserve Bank made a start to its interest rate cutting cycle on 20th July but since then rates have been kept on hold.

- The outlook for the rand is critical in determining the path for interest rates. The level of the rand will affect consumer price inflation, which is the key factor guiding monetary policy.

- The rand has surged since the ANC national conference elected Cyril Ramaphosa as the new leader of the ruling party. The rand has strengthened by 8.3% against the US dollar over the past month, appreciating from R/$13.47 to R/$12.35 between 14th December and 14th January.

- The global economy has also helped. Global synchronised growth and the resultant surge in commodity prices has been positive for the rand via a rapidly growing trade surplus and dramatically narrowed current account deficit.

- Given the recent strength in the rand the Reserve Bank is likely to lower its forecasts for consumer price inflation (CPI) from the current levels of 5.2% for 2018 and 5.5% for 2019. A stronger rand benefits inflation by reducing the cost of imported goods, enabling lower prices for consumers. The appreciating rand has already helped counter the rise in international oil prices. Despite the oil price rising over the past month by almost 12% in US dollar terms, South Africa’s petrol and diesel prices have dropped since the start of the year by 34 cents and 22 cents per litre. Also helpful to the inflation outlook is the low electricity tariff increase of 5.23% awarded by Nersa in contrast to the 19.9% increase requested by Eskom.

- The economy badly needs lower interest rates. Third quarter GDP growth of 2.0% quarter-on-quarter annualised was down from 2.8% in the prior quarter and remains far too low to make any impact on the country’s 27% unemployment rate. Economic surveys including purchasing managers’ indices, confidence measures and the Reserve Bank leading economic indicator, all point to lacklustre conditions.

- Despite economic weakness and tame inflation, the Reserve Bank is unlikely to cut the repo rate on Thursday. The surge in market optimism, which followed Ramaphosa’s election as head of the ANC, has succumbed to a new realism over the past week. There is a growing realisation that Zuma is unlikely to be recalled as swiftly as initially expected.
Furthermore, the Reserve Bank is likely to adopt a cautious outlook given the potential for rand reversals during the first quarter. In February, the Budget speech and State of the Nation Address and in March a potential credit rating downgrade from Moody’s, each have the potential to disrupt the rand’s recent trajectory.

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