OVERBERG MARKET REPORT
Tuesday 3rd December 2019

IN THIS WEEK’S BOTTOM LINE

Contributed by Kirk Swart

• Previous bottom lines pointed to the fact that South Africa needs structural reforms, not more initiatives.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

• The South African Reserve Bank (SARB) composite leading business cycle indicator, a measurement of expected economic conditions 6-9 months ahead, continued to trend lower in September. The September index measurement came in at 103.2, down 0.6 points, from 103.8 in August. Year-on-year the index is down 1.6% from the September 2018 reading. Of the nine components measured, four had positive contributions with the other five weighing down the index. The largest negative contributions came from a deceleration in the twelve-month percentage change in job advertisement space and a decrease in the number of residential building plans approved. The largest positive contributions came from an increase in the volume of orders in manufacturing and the US dollar-based South African export commodity price index. Overall, the reading continues to be indicative of our subdued full-year GDP growth.

• Business confidence, as measured by the RMB/BER Business Confidence Index (BCI) was up marginally in the fourth quarter. Business confidence for the fourth quarter came in at 26, up 5 points from its twenty year low of 21, recorded in the third quarter of 2019. Albeit the recovery in business confidence, RMB/BER report warns that one needs to view the recovery with some realism: the improvement was marginal and was not broadly-based across sectors, reflecting tough trading conditions for firms in an economy battling to grow. The reading of 26 is still deep in negative territory and a long way off from the 50-mark separating net negative and net positive business confidence. Of the five sectors making up the BCI, three recovered from the previous quarter namely; building, manufacturing and retail trade. New vehicles sales and wholesale both recorded drops in business confidence during the quarter, dropping from 22 to 17, and 29 to 28 respectively. “For us to convincingly conclude that the long and persistent downturn in the RMB/BER BCI has bottomed out will take, not one, but several quarters of improvement in sentiment driven by a consistent recovery in underlying activity. Further signs that the worst point of the...
slowdown in global trade is behind us, coupled with a confidence-inspiring National Budget and the successful implementation of the government’s new Economic Transformation, Inclusive Growth and Competitiveness Strategy will certainly go a long way to help make this happen”, said Ettienne Le Roux, chief economist at RMB.

- **Producer Price Inflation (PPI)** for final manufactured goods slowed to 3% in October down from 4.1% recorded in September. The October reading is the lowest reading for the year and the sixth consecutive monthly drop since April’s high of 6.5%. The largest contribution to PPI came from food products, beverages and tobacco products, which increased by 3.7% year-on-year and contributed 1.2 percentage points (ppt). This was followed by producer prices for metals, machinery, equipment and computing equipment which rose by 3.7% year-on-year and added 0.5 ppt to final PPI. The latest PPI figures complement the slowdown measured in consumer price inflation in October and point to very subdued domestic demand conditions. Looking ahead, producer prices are likely to remain volatile with some potential for upside, as weaknesses in the rand exchange rate continues to drive the costs of imported goods. This presents a challenge for companies, especially in an environment where weak domestic demand presents very little scope for pass-through to selling prices.

- **Private Sector Credit Extension (PSCE)** growth surprised to the upside, increasing to 7.3% year-on-year in October. This was a notable increase from the 6.2% year-on-year growth recorded in September and also above the consensus forecast of 6.5%. Corporate sector’s loans and advances accelerated to 7.5% year-on-year in October from 5.2% year-on-year in September. This indicates a gradual upward trend in the corporate sector’s credit cycle. Albeit positive, the prospect of a corporate sector expansion is minimal given the weakness in the recent business confidence figure and the continued decline in the SARB composite leading business cycle indicator. Households’ credit growth remained at 6.7% year-on-year in October, with unsecured lending continuing to outpace asset-backed loans.

- **South Africa** recorded a trade surplus of R 3.09 billion in October, down R 1.44 billion from its September reading of R 4.53 billion. Exports surged 11.9% month-on-month led by precious metals and stone sales. However, imports grew at a faster 13.7% month-on-month amid notably higher purchases of mineral products. The cumulative year-to-date surplus currently stands at R 5.32 billion, an improvement over the cumulative R 3.7 billion deficit recorded in the first 10 months of 2018. Exports increased by 5.1% year-to-date relative to the same period in 2018, while imports expanded by a more modest 4.2%.

- **The ABSA Purchasing Managers’ Index (PMI)**, which measures the health of the manufacturing sector, dropped again in November, adding further to the evidence that the economy remained weak in the fourth quarter. The PMI dropped to 47.7 in November, from 48.1 in the previous month. This is the fourth consecutive month where the PMI is below
the 50-level which separates expansion from contraction. The decline was broad-based as four of the five subcomponents of the headline PMI ticked down compared to the previous month. Despite the decline, the average level of the PMI in October and November is still slightly above that recorded in the third quarter. The drop in the November PMI was mainly due to the decline in the business activity measure, which fell from 45.6 to a 28-month low of 39.4. The weak readings in the business activity index seen in the fourth quarter so far argue against a strong, if any, recovery in manufacturing output. Demand remained under pressure with the new sales orders index not being able to hold on to the previous month’s gains. Respondents saw a decline in export demand during the month. The only major subcomponent to record an improvement was purchasing inventories, which picked up from the ten-year low reached in October. Notwithstanding the increase, the index remained well below the neutral 50-point mark. The only subcomponent to come in above 50, which generally points to improving conditions, was the supplier deliveries index. On a more positive note, the sub index that tracks expected business conditions in the next six months rose to 47.4 index points in November. Though this was the first increase after five consecutive decreases, the latest reading means that conditions are still expected to worsen in six months’ time, albeit less so than before. November’s PMI adds to evidence that the economy remained weak in the fourth quarter. Given that economic activity contracted in the third quarter anything less than a dramatic rebound in the final months of the year would lock in very poor GDP growth for 2019 as a whole.

- The new vehicle market declined further in November. Overall new vehicle sales declined month-on-month in November to 47 478 units, down 2 740 units (5%), from 44 738 units in September. The new passenger vehicle market recorded a modest 1.3% year-on-year increase in November, with sales supported by the rental car industry. Domestic sales of new light commercial vehicles, bakkies and minibuses disappointed in November recording a decline of 22.1% month-on-month. The decline in the overall market was mainly due to this substantial drop in the sales of light commercial vehicles — mainly bakkies and minibus taxis. Sales in the medium and heavy truck segments also performed weaker during November, with medium commercial vehicles declining by 60 units (down 7.6%) and heavy trucks and buses declining by 34 units (down 1.8%) compared to the corresponding month last year. November export sales declined marginally to 35 27, down 306 units (0.9%), compared to the 35 577 vehicles exported in the same month last year. However, of significance is that vehicle exports for the first eleven months of 2019, surpassed the previous annual record of 351 139 recorded in 2018. The overall declining trend in the new vehicle market has continued into November 2019 affected by numerous constraining factors. The current low economic growth environment and enduring pressure on household disposable income due to rising costs of living are not supportive of business and consumer confidence. As a result, conditions in the domestic new vehicle market are expected to remain under pressure over the short to medium term.
SOUTH AFRICA: THE WEEK AHEAD

Contributed by Werner Erasmus

• Standard Bank Manufacturing Purchasing Managers Index: Due Wednesday 4th December. Although the fourth quarter started with a slight recovery from the 49.1 average in the previous quarter, the Standard Bank Manufacturing Purchasing Managers Index (PMI) is expected to have fallen from 49.4 in October to 49.1 in November. The index is expected to mirror the continuation of a subdued environment for the private sector economy.

• Current Account Deficit: Due Thursday 5th December. The current account deficit is expected to have narrowed slightly in the third quarter to a deficit of R 160.8 billion, down from a deficit of R 204.1 billion recorded in the second quarter. The current account deficit as a percentage of Gross Domestic Product (GDP) is expected to have improved slightly in the third quarter to -3.10% of GDP compared with -4% of GDP in the second quarter.

• South African Chamber of Commerce and Industry Business Confidence Index (Nov): Due Friday 6th December. The South African Chamber of Commerce and Industry Business Confidence Index (SACCI BCI) is forecast to have decreased slightly from 91.7 recorded in October to 91 in November. Slow economic reforms, low GDP growth and ongoing uncertainty surrounding a credit downgrade continue to impact business confidence.

GLOBAL

Contributed by Nick Downing

• Equity strategists have begun staking their reputations on market forecasts for 2020. As usual there is a wide variation in forecasts. At one end of the spectrum, Credit Suisse forecasts the S&P 500 index will rise around 9% from current levels, building on this year's 20%-plus gains. Gains will be boosted by continued share buybacks and increased company earnings growth, alongside a cyclical recovery in the economy. At the other end of the spectrum, Morgan Stanley forecasts a sharp decline in the S&P 500 index of almost 20%, driven by a significant economic slowdown and potential recession. Famed bond investor Bill Gross, sides with the bears, calling for a decline of up to 10% in US stocks next year, as fiscal and monetary policy lose their impetus. Much depends on a resolution of the US/China trade war. 2020 will be the Year of the Rat according to the Chinese zodiac which, if it lives up to its characteristic of flexibility, may bode well for a constructive trade agreement and restore global investment confidence.
NORTH AMERICA

Contributed by Nick Downing

- In a speech last week, Fed chairman Jay Powell stressed that the central bank needed to prevent a continued decline in inflation expectations as “the experience of Japan, and now the euro area, suggests that this dynamic is very difficult to reverse.” Consumer price inflation has remained stubbornly below the Fed’s 2% target over the last ten years, which is a source of concern for policy makers. As a remedy, the Fed is considering a “make-up strategy” whereby inflation would be measured on an average basis which means it could be higher than 2% at times to make up for the years when it is lower than 2%. An alternative to a make-up strategy would be to change the official target to a new range, of say 2-2.5%. The Fed is expected to announce the outcome of its policy review during 2020, which is likely to allow for higher inflation and have consequences for increased monetary policy stimulus.

- Third quarter (Q3) GDP growth was revised upwards from its initial estimate of 1.9% to 2.1%, exceeding Q2 growth of 2.0%. Once again, strong personal consumption expenditure made up for declines in fixed investment spending. Personal consumption expenditure began Q4 on a solid footing, rising in October by 0.3% month-on-month, helped by solid growth in wages and salaries, which increased 0.4% on the month compared with a 0.1% increase in September. Meanwhile, the personal savings rate, which tends to fall as confidence rises, declined to 7.8% from 8.1% in September. Although the Conference Board consumer confidence index fell in November for a fourth straight month from 126.1 to 125.1 it remains at historically elevated levels amid strong jobs growth and record low interest rates. Moreover, while the consumer confidence index measuring current conditions fell from 173.5 to 166.9, the forward-looking measure actually improved from 94.5 to 97.9, signalling rising consumer spending over coming months and the festive season.

- Durable goods orders partly recovered September’s steep 1.4% month-on-month decline with growth of 0.6% in October, despite the strike at General Motors which caused motor vehicle orders to drop 1.9% on the month. Excluding the volatile transport category, so-called core durable goods orders increased a solid 0.6% on the month. Following months of declines, non-defence capital goods orders excluding aircraft, a proxy for business investment spending, unexpectedly surged higher in October, by 1.2% on the month. The data indicate a recovery in capital spending, which together with the broad-based improvement in durable goods orders, should prompt analysts to upgrade their forecasts for fourth quarter (Q4) GDP growth, to around 1.5-2.0%. This would compare favourably with 2.1% growth achieved in Q3.

- The Institute for Supply Management (ISM) manufacturing index unexpectedly fell in November from 48.3 to 48.1, cutting short its improvement from the ten-year low of 47.8 plumbed in September. The index remains below the critical 50-threshold which
demarcates expansion from contraction. Among the ISM sub-indices, the production index gained from 46.1 to 49.1 and the inventory index fell from 48.9 to 45.5 a point from which inventories will likely need replenishing, providing a boost to production. However, both the new orders index and new export orders index fell from 49.1 to 47.2 and from 50.4 to 47.9, respectively. As forward-looking indicators, the decline in new orders indices is especially disappointing. Fortunately, it is not all bad news. In contrast with the ISM measure, the IHS Markit manufacturing purchasing managers’ index climbed to 52.2 in November, its highest since April. Meanwhile, China’s manufacturing PMI is showing strong signs of recovery, which may signal a bottoming-out in the global manufacturing cycle, and a subsequent boost in US manufacturing activity, especially if a phase-one trade deal with China is ratified.

CHINA

Contributed by Nick Downing

• China’s manufacturing survey data was surprisingly strong in November at both the official purchasing managers’ (PMI) level, which focuses on larger state-owned enterprises, and the private sector Caixin PMI level, which focuses on smaller private sector companies. The official manufacturing PMI gained from 49.3 to 50.2, breaking above the expansionary 50-level for the first time since April. The forward-looking new orders and new export orders sub-indices gained from 49.6 to 51.3 and from 47.0 to 48.8, indicating continued improvement in activity levels over coming months. The Caixin manufacturing PMI built on October’s increase, rising in November from 51.7 to 51.8 its highest level since December 2016, led by strengthening employment. Meanwhile, the official non-manufacturing PMI, which measures conditions in the services sector of the economy, surged higher from 52.8 to 54.4 its highest since March. November’s PMI data are consistent with an improvement in GDP growth in the fourth quarter (Q4) to around 6.2%, up from 6.0% recorded in Q3. The stronger economic survey data is attributed to reduced trade war uncertainty and the effect of monetary easing and fiscal stimulus. China’s government boosted its fiscal stimulus programme last week by fast-tracking the allocation to local government special-purpose bonds, which is used to finance infrastructure projects. The allocation of 1 trillion yuan was made ahead of the usual cut-off date in March.

JAPAN

Contributed by Carel la Cock

• Japan’s capital investment by non-financial firms rose by 7.1% year on year in Q3 and was up from 1.9% year on year growth in Q2, according to the latest Ministry of Finance (MoF) quarterly survey of leading companies. Whilst capital expenditure plans for the current year remained sufficiently buoyed, some firms indicated a postponement of further
investments this year until there is more clarity around the ongoing US-China trade war, which has caused a slump in global demand. Amongst the various sectors, capital investment in manufacturing rose by a healthy 6.4% year on year in Q3 following a drop of 6.9% in Q2. Non-manufacturing saw an equally impressive jump, growing 7.6% year on year in Q3 following a gain of 7% in Q2. The MoF’s survey is based on the demand side and forms a key part of the calculations in revising the quarterly GDP figures. GDP revision estimates after the latest survey data suggest that GDP in Q3 could be revised to as high as 1.8% quarter on quarter annualised, compared to the initial 0.2% growth. This means Japan’s economy is perhaps in better shape than previously thought.

EUROPE

Contributed by Carel la Cock

- Eurozone flash estimate consumer price inflation of 1% year on year in November beat expectations of a 0.9% rise and has rebounded from 0.7% in October and 0.8% in September. The news will come as a relief for the European Central Bank, which many economists fear is fast running out of ammunition to reach its inflation target of just below 2%. Falling inflation was the main reason the ECB decided to cut interest rates and restart its bond purchasing programme at its last monetary policy meeting in November. Record low unemployment of 7.5% in October has filtered through to higher wages, but companies have been slow to pass the higher costs on to consumers. In Germany, wages grew by a robust 4.2% in Q3, yet economists expect consumer price inflation to remained anchored at around 1.3% to 1.4% in 2020 and 2021.

UNITED KINGDOM

Contributed by Carel la Cock

- UK manufacturing activity contracted further in November according to the IHS Markit/CIPS Purchasing Manager’s Index (PMI). The index was down 0.7 points to 48.9 in November and below the key 50-point mark which indicates falling output. The PMI has been in contraction territory for nine consecutive months and the falling output has led to job cuts. The employment sub index has fallen to 46.8 in November, the lowest level in more than seven years. A possible further delay in Brexit and subdued global demand together with an unwinding of stocks previously piled up prior to the second Brexit deadline has had a pronounced impact on new orders and manufacturers are trying to reduce output and overheads accordingly. The UK is falling behind other developed nations which recently reported a slight turnaround in industrial production. Due to Brexit uncertainty and the ongoing trade wars, most purchasing managers have adopted a “wait and see” approach before restocking. The outlook for manufacturing remains bleak for the remainder of the
year and into early next year until there is more certainty around Brexit and the terms of any new trade deals with the EU.

FAR EAST AND EMERGING MARKETS

Contributed by Carel la Cock

- India’s GDP grew 4.5% year on year in Q3 down from 5% growth in Q2. It also marked the sixth consecutive quarterly slowdown in growth from the 8% achieved in Q1 of 2018. The economy has struggled since the demise of IL&SF, a leading lender in the shadow banking sector. It has highlighted the crisis within the shadow banking sector, which has steadily filtered down into the wider economy. Investment and manufacturing output each grew by a pedestrian 1% year on year, while private consumption was up 5% year on year compared to 3.1% in Q2. However, the main driver came from government spending which grew by 15.1%. Many economists believe that prime minister, Narendra Modi has reached the ceiling of further fiscal stimulus following corporate tax cuts, aimed at attracting foreign investors. The fiscal deficit is expected to breach the targeted 3.3% of gross domestic product, with both fiscal and monetary policy measures failing to turn the ailing economy around. Economists forecast that India’s economy will remain at these subdued growth levels until there are further structural changes, especially within the shadow banking sector and efforts are made to arrest the contagion into the rest of the economy.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

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CAC 40  + 22.32   5786
MSCI Emerging  + 7.72   1040
MSCI World  + 20.83   2276
Gold  + 13.61   1455
Platinum  + 12.83   895
Brent oil  + 14.77   62.48

BOTTOM LINE

Contributed by Kirk Swart

- The enormous public sector wage bill and wasteful expenditure at municipalities, departments and state-owned enterprises (SOEs) needs to be reformed to ensure economic growth going forward. The biggest elephant in the room is Eskom. Andre de Ruyter, the previous CEO of Nampak, was tasked to turn around Eskom’s fortunes. His appointment at the helm of Eskom has been received with mixed reactions. Although Mr de Ruyter might not have been the first choice, he has an impressive CV having been the CEO of Nampak for the last five years as well as working for Sasol in senior management positions for more than 20 years. Mr de Ruyter will oversee the process of splitting Eskom into the three divisions of Generation, Transmission and Distributions.

- The crippling strike at South African Airways (SAA) was resolved. While Numsa and the SA Cabin Crew Association might feel they won the negotiation battle, they will only receive the 5.9% wage increase SAA initially offered. This is a massive victory for South Africa as both SAA and the government effectively drew a line in the sand regarding union demands. It seems as if the Ramaphosa slow poison is kicking in. SAA will now have to find the cash. This week sees SAA and its lenders in discussions to secure funding for the embattled airline. Minister of Public Enterprises, Pravin Gordhan issued a statement that the airline needs “radical restructuring”. It will be disappointing if government comes to the rescue of SAA with a loan. This will nullify the hard work that has been done to date. Sizwe Pamla, Cosatu’s spokesperson mentioned that the union will support partial privatisation of SAA and other SOEs.
• Regarding monetary policy, the SARB must aim to loosen monetary policy in order to kickstart the economy. South Africa’s inflation rate declined to 3.7% in October 2019. This was below market expectations of 3.9%. Although the SARB kept rates on hold, a further weakening in the inflation outlook will force the SARB to cut interest rates going into 2020. The reluctance to cut rates could be an attempt to protect the currency. Protecting the currency via monetary policy might work over the short term but the relationship breaks down over the long term. If the benign inflationary environment continues into 2020, the SARB can lower the Repo rate from its current level of 6.5% to below 6%.

• A further indication of the Ramaphosa slow poison is the arrest of former state security minister Bongani Bongo. Bongo, a Zuma loyalist, has been arrested on charges of disrupting the parliamentary enquiry into Eskom in 2017 by bribing an advocate. This high-profile arrest is what South Africans have been calling for. We can expect more corrupt individuals to have their day in court as Hermione Cronje, head of the NPA’s Investigating Directorate, assured South Africans that we “will see the work that has gone on in the background”. South Africans will need to show patience.

• Recently South Africa dropped to 84 out of 190 countries when it comes to ease of doing business, according to the World Bank. For a country that desperately needs foreign direct investment, this is one area that the government should and can improve on. The World Bank cites “access to financing, corruption, inadequate infrastructure and weak governance” as the main culprits. The good news is that all these areas can be fixed and Ramaphosa knows it. These areas, along with stringent B-BBEE legislation, makes it very hard for South African businesses to flourish. It is advised that government award good B-BBEE practices, rather than punish those who do not comply.

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