MARKET MATTERS

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It was a busy week in South Africa, with a worsening third wave of coronavirus infections, a deluge of economic data releases that provide detail on the nature of the recovery, a notable court case and a special birthday.

Starting with Covid-19, the continued increase in daily new infections to record levels and the pressure on hospitals, particularly in Gauteng, suggest the Level 4 lockdown will continue beyond the initial two-week period. This is devastating for the alcohol and hospitality industries, but the exact impact will depend on the duration of the restrictions.

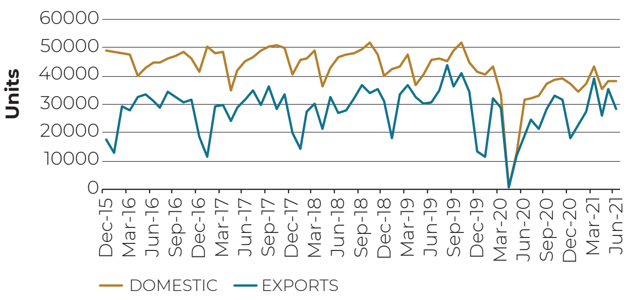
Although this lockdown is clearly less disruptive to the broader economy than last year's hard lockdown, it's more urgent than ever before to vaccinate as many people as possible as quickly as possible. Life cannot return to normal until a substantial proportion of the population is immune. The Delta variant is rapidly becoming the dominant variant in both the UK and US, but with their advanced levels of vaccination, the impact is less severe.

The raft of data releases mostly pre-date the latest restrictions, but still provide an update on the state of most aspects of the local economy. In a nutshell, the picture is mixed, still pointing to a K-shaped recovery in which some sectors and households are doing well, while others struggle.

SOME SALT

Some of these numbers need a pinch of salt. Any comparison from the low base of early last year when the country was in hard lockdown will look impressive. For instance, vehicle sales increased 20% year-on-year in June and 197% in May but that was because new car sales collapsed to only a few hundred units in April last year. Sales recovered to around 38 000 per month from September onwards. June's sales numbers were in line with this trend. However, this is still below the roughly 45 000 units that were sold on average each month in 2019. One factor is that demand from car rental companies, usually a significant portion of total sales, is understandably still muted. On the other hand, vehicle exports are back at pre-pandemic levels in unit terms, and at record levels in value terms, which is good news.

CHART 1: NEW VEHICLE SALES



Source: NAAMSA The Automotive Business Chamber

Similarly, the arrival of tourists from overseas (i.e. not from elsewhere in Africa) surged over the past year, but that is because the borders were closed a year ago. The 19 915 overseas visitors in April reported by StatsSA is still only a fraction of the 217 131 arrivals in April 2019. The tourism industry is still decimated. As a result, it probably has the best recovery prospects but only once the pandemic is under control here and abroad.

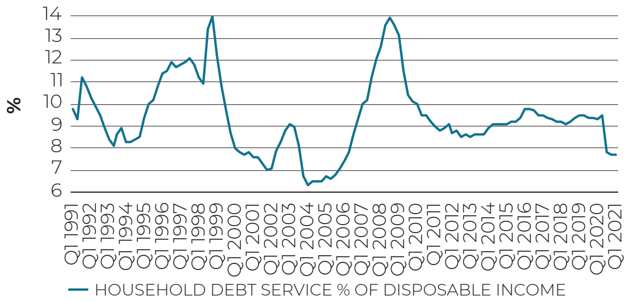
CONSUMER WITH A K

Consumer confidence remains battered, understandably given the widespread job losses and uncertainties associated with the severe third wave of Covid-19 infections and more stringent lockdowns. The long-running FNB/BER Consumer Confidence Index declined in the second quarter to -13 index points, close to all-time lows. Low income households in particular saw a sharp deterioration in confidence levels.

It is in household finances that the unequal K-shaped recovery is most evident. New data from the SA Reserve Bank shows that household net wealth – the difference between total household assets and liabilities – stood at a record high in the first quarter. This is in large part due to the improved performance of the equity market, while the growth in household debt has been muted. Clearly ownership of household assets is very concentrated, which is problematic in its own right, but does imply that more affluent consumers can continue supporting the recovery in overall household spending.

There is also the benefit of lower interest rates. The portion of after-tax income spent on making interest payments (the debt service ratio) was at a 15-year low of 7.7% in the first quarter, unchanged from the prior quarter. For those with existing debt (home loans in particular) it means extra income each month. New borrowing has been slower to increase, but seems to be picking up the pace. Overall household borrowing was 5.6% higher than a year ago in May. Worth noting is that home loan growth is steadily picking up speed, rising to a decent if unspectacular 6% annual pace.

CHART 2: HOUSEHOLD DEBT SERVICE RATIO

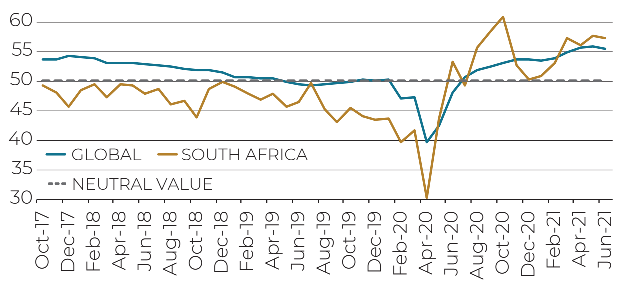


Source: SA Reserve Bank

MANUFACTURING

The global manufacturing boom continues, and South Africa is for once not missing out. The JPMorgan global manufacturing purchasing managers' index (PMI) was at an elevated 55.5 index points level in June (with 50 index points the neutral level). Similarly, the local Absa manufacturing PMI was at a robust 57.4 index points in June 2021, down only slightly from a month before. Local industry is experiencing a growth spurt not seen in several years, and the average PMI reading in the second quarter was also above that of the first, pointing to a positive quarterly contribution to the overall economy.

CHART 3: MANUFACTURING PURCHASING MANAGERS' INDICES



Source: Refinitiv Datastream

However, the big story for the local economy remains the commodity-driven export surge. May saw another massive R54 billion trade surplus, thanks to near record exports of R163 billion. The trade surplus for the first five months of the year was R202 billion, compared to a R10 billion surplus over the same period a year ago.

This is largely due to the substantial improvement in the terms of trade – the ratio of export prices to import prices. Neither the volume of exports nor the volume of mining production is meaningfully above pre-pandemic levels, but commodity prices are to a significant extent. Rhodium and palladium are at near-record levels, while manganese, coal and iron ore prices are at decade-highs.

This helps greatly, of course, but two news items from the past week confirm how much work still needs to be done for South Africa to fully benefit from the global commodity boom before it inevitably peters out. Rio Tinto suspended operations at its mineral sands business in Richards Bay due to ongoing violence directed at its operations. It is not the only mine in South Africa where labour or community violence has recently disrupted production. The other news item was from coal miner Exxaro's results. Despite elevated prices, the company has not been able to ramp up foreign sales volumes, because of Transnet's limited and unreliable rail capacity.

GETTING FISCAL

As the economy recovers, so do government's tax revenues. For the first two months of the new fiscal year (April and May), tax revenue was 41% higher than the depressed base a year ago and 6% compared to the same period two years ago. In other words, total government revenue has recovered to pre-pandemic levels. The improvement is broad-based, with value added tax 19% higher than two years ago and company tax 10% higher. Personal income tax is only 1.5% higher than two years ago, but has increased strongly in recent months. It is the largest source of government revenue by far and expected to bring in R515 billion in the current fiscal year.

Spending growth has also moderated somewhat. While it is still very early in the new fiscal year, the data points to a budget deficit that could be smaller than was projected in February. The deficit will still be uncomfortably large, but the fiscal worst-case scenarios that were spoken about last year – such as debt-to-GDP ratios jumping above 100% – now seem much less likely. The key determinant will be the size of the final public sector wage increase.

INSTITUTIONS

The notable court case and birthday celebration of the past week highlighted two key institutional strengths. When economists talk about institutions, they are referring to the structures that govern and influence economic activity, the 'rules of the game'. Some are formal agencies or organisations, while some are informal arrangements. Good governance and strong and stable institutions are crucial to long-term economic development. The rule of law is right at the top of this list.

It is therefore significant that the Constitutional Court found former president Jacob Zuma guilty of contempt of court and handed him a jail sentence. Whether he goes to prison quietly is another matter. What is important is that no one is above the law. This is the most basic principle of the rule of law, and from it all others flow.

A credible and independent central bank is another key institution. The SA Reserve Bank celebrated its centenary on 30 June. It is among the most respected central banks in the world, and the envy of many emerging markets. Apart from implementing sound monetary policy and acting as the guardian and supervisor of the financial system, the Reserve Bank is also a valuable source of economic data and research.

The debate over nationalising the Reserve Bank seems to have died down, but it is worth emphasising that its private ownership structure, while somewhat unique globally, has no bearing on how it conducts its important functions. Its operational independence is guaranteed by the Constitution.

Alongside our independent judiciary, the Reserve Bank and South Africa's sophisticated financial system, we can also highlight a free and active media and a vocal civil society as important institutions that will prevent the country from falling apart. Competitive elections (though they may be postponed by the pandemic) are another, as is the country's many world-class companies, universities and research institutions. For all the many and obvious problems we have – particularly the negative economic and social consequences of the numerous dysfunctional municipalities – there are mitigating factors as well as checks on the potential abuse of power by political elites.

THE BIG RAND HEDGE

And though it is strictly speaking not an institution, we can also add to this list South Africa's large and diversified global asset base, which offers a natural wealth hedge against any political, economic and social instability that causes the currency to weaken.

South Africa recorded another positive net international investment position in the first quarter, which simply means collectively we have more foreign assets than foreign liabilities. It implies that a weaker currency should increase national wealth (all else being equal) provided that inflation doesn't run away. Historically, inflation rises only 10 basis points for every 1% the rand weakens, and this has been declining over time, so currency weakness is not as destabilising for South Africa as it is for other emerging markets.

For many emerging economies, a weaker currency can be disastrous because of offshore borrowing, but also because most capital goods, sometimes even food, is imported. If you look up north into Africa, most currencies are pegged to create some stability. This works well until it doesn't. Usually, the currency becomes too strong relative to fundamentals and a destabilising and painful devaluation follows. Political elites in these countries tend to favour strong currencies as it lets them borrow cheaply abroad and import luxuries. Since hard currency is scarce, there is profit to be made from allocating it to associates or selling it on the black market. A free-floating currency like the rand therefore somewhat unexpectedly works against corrupt activities.

RETURNING TO RETURNS

In summary then, we know that there are ground rules in place that protect our investments (return of capital) and progress in terms of the economic recovery (leading hopefully to return on capital). South African assets are also still cheap compared to their global counterparts, despite decent returns over the past year. It means that, in the context of a diversified portfolio, we can be more optimistic about return prospects from local investments than has been the case for the past few years.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	3 046.0	0.69%	0.96%	13.23%	36.71%
United States	S&P 500	US$	4 352.0	1.66%	1.26%	15.87%	39.04%
Europe	MSCI Europe	US$	2 040.0	-1.21%	0.69%	10.87%	30.19%
Britain	FTSE 100	US$	9 855.0	-0.52%	1.23%	11.62%	26.67%
Germany	DAX	US$	1 753.0	-0.62%	0.86%	13.92%	32.00%
Japan	Nikkei 225	US$	259.3	-1.18%	0.05%	-2.40%	25.85%
Emerging Markets	MSCI Emerging Markets	US$	1 355.0	-1.81%	-1.45%	4.96%	32.45%
Brazil	MSCI Brazil	US$	2 023.0	-2.08%	-0.10%	7.84%	35.32%
China	MSCI China	US$	106.6	-2.98%	-2.69%	-1.64%	17.94%
India	MSCI India	US$	751.7	-1.42%	-0.44%	11.36%	49.44%
South Africa	MSCI South Africa	US$	489.0	-1.21%	-0.61%	8.67%	32.16%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	66 324.0	0.16%	0.11%	11.64%	21.43%
All Share	All Share (Total Return)	Rand	10 502.0	0.18%	0.11%	13.33%	24.64%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	26 266.0	0.07%	-0.02%	13.29%	26.34%
TOP 40/Large Caps	Top 40	Rand	9 497.0	0.26%	0.22%	12.50%	22.92%
Mid Caps	Mid Cap	Rand	17 519.0	0.01%	-0.28%	15.51%	29.94%
Small Companies	Small Cap	Rand	22 227.0	-1.13%	-1.13%	29.44%	62.04%
Resources	Resource 20	Rand	4 675.2	0.26%	1.57%	14.41%	31.78%
Industrials	Industrial 25	Rand	17 637.0	0.56%	-0.42%	12.04%	15.59%
Financials	Financial 15	Rand	8 268.0	-0.78%	-0.96%	9.55%	29.84%
Listed Property	SA Listed Property	Rand	1 464.9	1.25%	-0.15%	19.09%	19.29%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	541.0	0.02%	0.03%	-3.18%	2.55%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	795.7	0.27%	-0.15%	4.84%	13.47%
Government Bonds	BESA GOVI	Rand	785.7	0.26%	-0.16%	4.76%	13.36%
Inflation Linked Bonds	BESA CILI	Rand	292.2	-0.82%	0.15%	7.84%	15.09%
Cash	STEFI Composite	Rand	473.2	0.07%	0.02%	1.85%	4.00%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	76.2	-0.01%	1.56%	46.48%	77.14%
Gold	Gold Spot	US$	1 777.0	0.11%	0.91%	-6.18%	0.45%
Platinum	Platinum Spot	US$	1 088.0	-1.09%	1.40%	1.68%	31.72%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	14.25	-0.67%	0.20%	3.12%	19.27%
ZAR/Pound	ZAR/GBP	Rand	19.72	-0.41%	0.15%	1.83%	7.40%
ZAR/Euro	ZAR/EUR	Rand	16.91	-0.17%	0.13%	6.16%	12.90%
Dollar/Euro	USD/EUR	US$	1.19	0.00%	-0.34%	2.69%	-5.88%
Dollar/Pound	USD/GBP	US$	1.38	0.35%	-0.25%	-0.98%	-9.65%
Dollar/Yen	USD/JPY	US$	0.01	0.21%	-0.08%	7.46%	3.28%

Source: I-Net, figures as at 2 July 2021

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