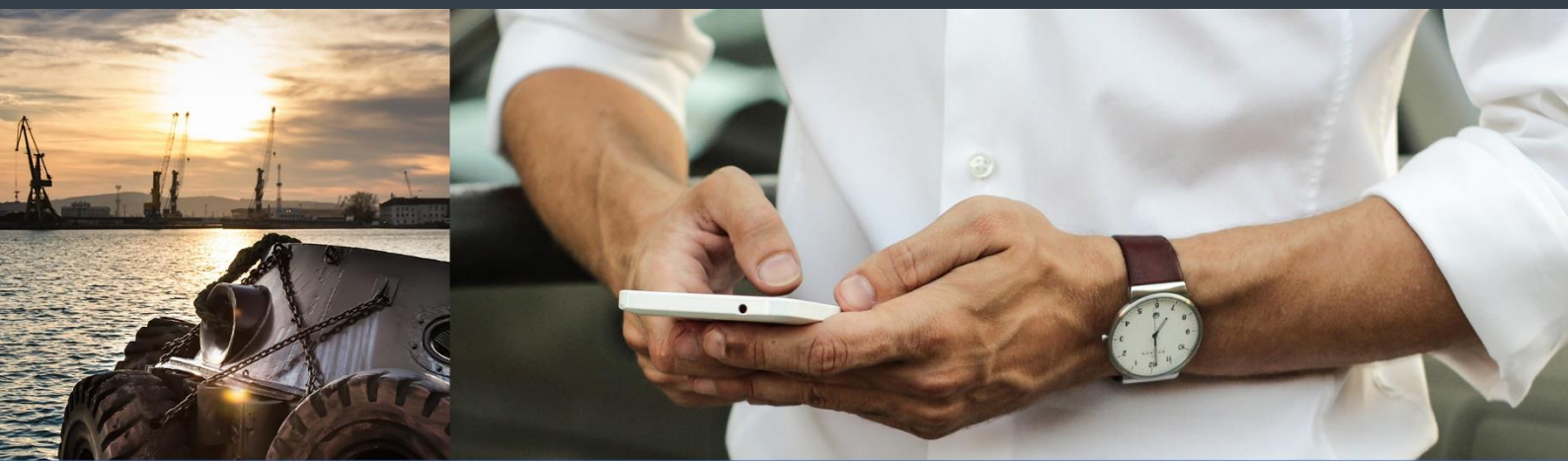
ECONOMIC REPORT

by Glacier Research

glacier by Sanlam



27 August 2020

Review period: July 2020

Domestic Overview

Local equites ended the month of July higher, albeit much lower than the strong gains recorded in June. Gold mining stocks continued to be the leading gainers with the gold price rising to record levels. On the global front, emerging market equities continued to outperform developed market equities as the unprecedented global stimulus found its way to emerging market economies. While global equity markets (particularly the US) continue to be driven by sentiment (and a handful of technology stocks), economic fundamentals are not yet at pre-pandemic levels albeit showing modest signs of recovery.

Domestic Highlights in July 2020

- SARB interest rate cut
- IMF loan

SARB interest rate cut

In its July meeting, the SARB took a decision to further slash short-term interest rates by 25 basis points to 3.50%. Three members voted in favour of an interest rate cut while the other two members preferred to keep rates on hold). This comes after a 50 basis points rate cut in May alongside other monetary policy tools which the SARB effected in its attempt to ease the impact of the coronavirus on the economy.

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Year to date, rates have been cut by 3% as inflation trended well below the mid-point of the target range. In its July meeting, the SARB highlighted the global backdrop of the economic recovery while citing the dire expectations of South Africa's economic growth. As a result, the bank currently expects growth to decline by 7.3% in 2020 (even as lockdown restrictions are lifted) before rebounding by 3.7% in 2021 and 2.8% in 2022. Headline consumer price inflation is forecasted to average 3.4% in 2020 before increasing to 4.3% in 2021 and 2022. Overall risks to the inflation outlook are said to be balanced and the SARB's Quarterly Projection Model is pointing to another 25 basis points cut in the next meeting.

IMF loan

The IMF approved South Africa's request for an emergency financial assistance of $4.3 billion (amounting to R70 billion) under the Rapid Financing Instrument (RFI). This funding is designed to meet SA's fiscal needs stemming from (and worsened by) the outbreak of the pandemic. Contrary to the norm, the interest rate on the loan is reported to be significantly less than current long-term financing rates of comparable maturities in South Africa and conditions of the loan are said to be less stringent as well. This offers much-needed respite for South Africa to deal with its fiscal headwinds, provided that the funds are used for their intended purpose. Important to note is that the loan is not rand-denominated, which therefore brings about currency risks to the borrower should the rand depreciate (as this will result in higher interest costs).

South Africa: Economy

The South African economy is slowly showing signs of recovery albeit at a very slow pace as level 3 lockdown restrictions continue to prevail. The IHS Markit South Africa PMI rose from 42.5 in June to 44.9 in July, pointing to a soft recovery although still in contraction territory. Vehicles sales experienced a muted increase from June to July. Similarly, petrol prices ticked up from 0.78 to 0.90 as the oil price rebounded. Foreign exchange reserves ballooned to a record of $57.88 billion in July, up from $52.32 billion in June. The SARB increased its balance sheet albeit at a slower pace, picking up R2.5 billion of government bonds in an effort to support the functioning of the local bond market (as opposed to implementing QE). President Ramaphosa reintroduced an immediate ban on the sale of alcohol, citing an imminent surge in COVID-19 cases as the country was fast approaching its peak levels. Other restrictions such as curfews, family visits and the mandatory wearing of facial masks were reinforced, however public transport occupancy was increased.

	Feb'20	Mar'20	Apr'20	May'20	Jun'20	Jul'20
CPI (y/y)	4.1%	3.0%	2.1%	2.2%	2.2%	-
PPI (y/y)	3.3%	1.2%	0.4%	0.5%	0.5%	-

Sources: Trading Economics

	31 July 2018	31 July 2019	31 July 2020
USD/ZAR	13.27	14.34	17.06
GBP/ZAR	17.42	17.44	21.33
EUR/ZAR	15.51	15.88	20.10

Source: IRESS

South Africa: Markets

The South African equity markets pulled back from the strong gains of the prior month as local sentiment subsided. The All Share Index (ALSI) gained 2.56%, driven by a rally in resources. Gold mining shares skyrocketed, advancing 23.16%. Investors flocked into this hedge asset, pushing the price to record levels. Large-cap stocks were up 2.43% while mid-caps and small-caps delivered modest gains of 1.71% and 1.29%. Property took a knock, losing 3.36% as the reality of the SA economy dawned on investors with distributions becoming more challenging given rental pressure.

On the fixed income side, bonds rebounded from last month's losses, returning 0.61% as investors sought comfort in the medium to front end of the curve. The longer end of the yield curve was somewhat muted as the 7-12-year maturities gained 0.81% while the 12+ year maturities remained flat. The front-end of the curve offered a relatively sweeter spot in the curve. The 3-7 year maturities gained 1.50% and the 1-3 year maturities were up 1.26%. Cash, however, returned 0.42% as short-term interest rates have trended lower after the SARB's cut.

Foreigners were net sellers of R11.06 billion worth of SA equities and net sellers of R17.06 billion worth in SA bonds

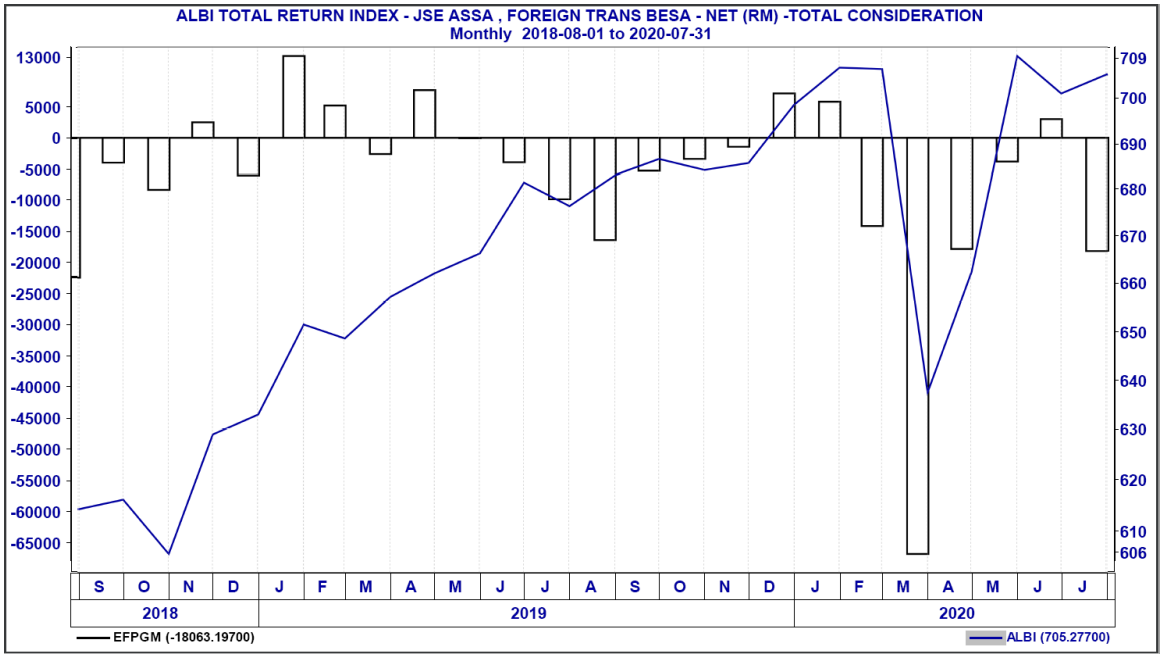
LOCAL RETURNS IN ZAR				
2019	May 2020	June 2020	July 2020	Year-to-date
SA MID CAPS 15.58%	SA BONDS 7.06%	SA PROPERTY 12.94%	SA EQUITY 2.56%	SA CASH 3.62%
SA TOP 40 12.41%	SA CASH 0.50%	SA SMALL CAPS 11.33%	SA TOP 40 2.43%	SA TOP 40 2.81%
SA EQUITY 12.05%	SA TOP 40 0.42%	SA TOP 40 7.85%	SA MID CAPS 1.71%	SA BONDS 0.97%
SA BONDS 10.32%	SA EQUITY 0.31%	SA EQUITY 7.74%	SA SMALL CAPS 1.29%	SA EQUITY -0.68%
SA CASH 7.29%	SA MID CAPS 0.23%	SA MID CAPS 6.06%	SA BONDS 0.61%	SA SMALL CAPS -19.93%
SA PROPERTY -0.40%	SA PROPERTY -0.53%	SA CASH 0.44%	SA CASH 0.42%	SA MID CAPS -24.40%
SA SMALL CAPS -4.10%	SA SMALL CAPS -3.20%	SA BONDS -1.18%	SA PROPERTY -3.36%	SA PROPERTY -40.42%

Source: Morningstar

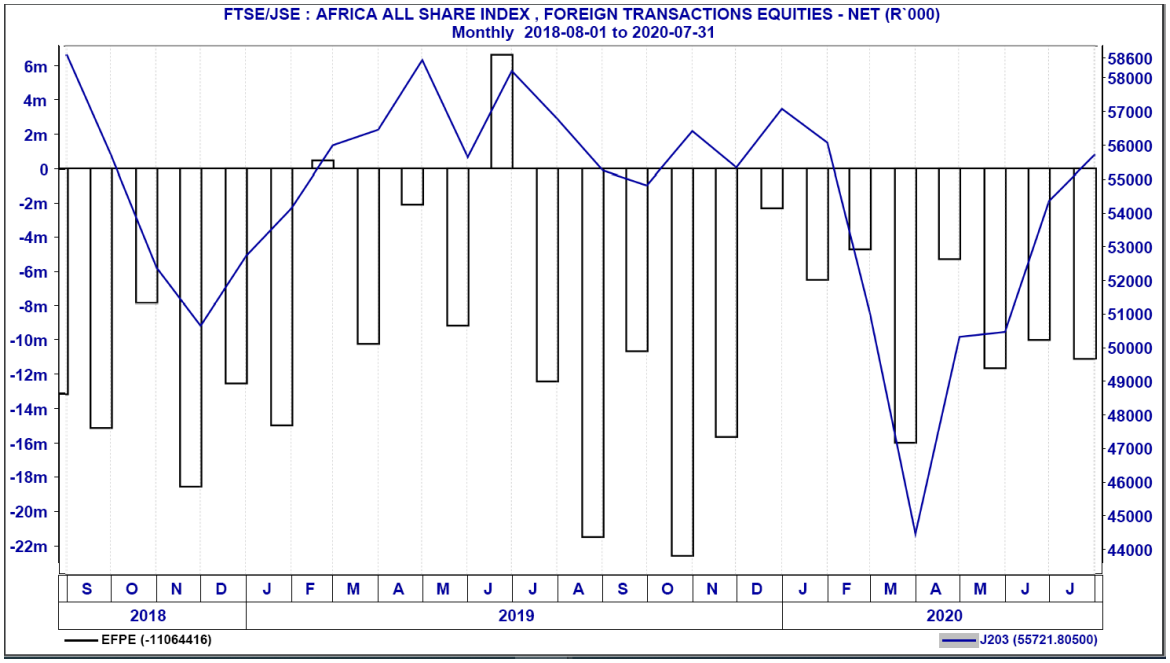
In terms of sectors, resources (+9.04%) continued to lead the gains, once more, with Gold mining stocks rallying 23.16% for the month. SA Industrials were down 1.28% while Financials delivered a muted gain of 0.40%. Industrials (-2.57%), however, continued to fall once again with consumer goods and healthcare stocks driving the sell-off.

LOCAL SECTOR RETURNS IN ZAR				
2019	May 2020	June 2020	July 2020	Year-to-date
RESOURCES 28.53%	RESOURCES 5.55%	GENERAL RETAILERS 9.11%	RESOURCES 9.04%	RESOURCES 15.06%
CONSUMER GOODS 18.31%	INDUSTRIALS 1.95%	RESOURCES 8.77%	FINANCIALS 0.40%	SA INDUSTRIALS 5.38%
SA INDUSTRIALS 8.90%	SA INDUSTRIALS -1.76%	SA INDUSTRIALS 8.31%	SA INDUSTRIALS -1.28%	CONSUMER GOODS -4.04%
CONSUMER SERVICES 2.60%	CONSUMER GOODS -2.70%	CONSUMER SERVICES 7.11%	CONSUMER SERVICES -1.57%	CONSUMER SERVICES -24.65%
FINANCIALS 0.63%	CONSUMER SERVICES -2.99%	CONSUMER GOODS 4.97%	INDUSTRIALS -2.57%	FINANCIALS -31.41%
INDUSTRIALS -8.91%	FINANCIALS -3.18%	FINANCIALS 4.17%	GENERAL RETAILERS -2.93%	INDUSTRIALS -35.25%
GENERAL RETAILERS -18.37%	GENERAL RETAILERS -5.86%	INDUSTRIALS -1.48%	CONSUMER GOODS -4.94%	GENERAL RETAILERS -38.10%

Source: Morningstar



Source: IRESS July 2020



Source: IRESS July 2020

Global Overview

A tale of two halves…This is what comes to mind following the events of the second quarter. The S&P 500 fell by 34% in March, followed by an even more rapid recovery of 40%. In just a few weeks US markets experienced one of the sharpest falls and swiftest recoveries since 1926, solidifying the second quarter as the best performance in more than 20 years. The rebound in global equity markets continued to widen the gap between the real economy and investor behaviour. Equity markets rallied strongly at a time when the global economy plunged into the deepest recession since the Great Depression. This rally was led higher by technology, consumer discretionary and materials stocks.

The MSCI World delivered 5.14% in dollar terms, with the US 10-year treasury yield hitting an all-time low of 0.53% and gold rising by 11%. On the last day of the month, Apple displayed its dominance by posting its biggest one-day gain, adding US$172 billion to its market capitalisation. On a global equity style basis using the MSCI World style indices, growth was the top-performing style (6.86%), followed by momentum (6.67%), quality (4.64%) and value (2.54%). The price of Brent crude oil rose slightly from US$41.27 to close at US$43.52 a barrel. Oil prices have been particularly volatile this year with prices falling from more than US$65 a barrel in January to less than $20 in April after the pandemic impacted demand. However, the oil price has recovered on the back of greater demand, supply cuts and a weaker dollar. Both global bonds and global equity were positive in dollar terms during the month.

United States

US equity markets returned positively for the month, led higher by technology stocks as seen in the performance of the Nasdaq, which advanced 6.82%. Some of the biggest gainers came from Apple, Amazon and Facebook. Overall, the S&P 500 delivered 5.51% in dollar terms. On the macroeconomic front, the US manufacturing purchasing managers' index (PMI) increased to 50.9 in July of 2020 from 49.8 in June, below market expectations. The change pointed to the first expansion in factory activity since February 2020 as growth was driven by the first upturns in both output and new orders for five months. The US Services PMI rose to 50 in July 2020 from 47.9 in the previous month, signalling the service sector is beginning to stabilise.

The US unemployment rate decreased to 10.2% in July 2020 from 11.1% in the previous month. The number of unemployed people decreased by 1.4 million to 16.3 million. However, the jobless rate remains above the Global Financial Crisis peak of 10.0%, and more than double than February's 3.5%, before the spread of the pandemic in the US. The US economy shrank by an annualized 32.9% in the second quarter of 2020. This is the biggest contraction the US has experienced, pushing the economy into a recession. The coronavirus pandemic forced many businesses including restaurants, cafes, stores and factories to close, and people to stay at home, hurting consumer and business spending. While US economic activity is expected to pick up in the third quarter, a resurgence of coronavirus cases has forced many states to pause or roll back reopening plans.

Eurozone

European equity markets retreated during the month on the back of weaker earnings in the second quarter which weighed on sentiment. In addition, rising tension between the US and China coupled with poor GDP data across Europe negatively impacted the market. As a result, the Euro Stoxx finished -2.87% lower in euro terms. Europe appears to have managed the virus better than many other regions. Activity across regions is increasing with heightened activity experienced in Germany as new infections continued to remain low. To combat the

impact of the virus on the economy, the European Union (EU) agreed on a €750 billion recovery fund. €390 billion will be allocated to grants and €360 billion to loans.

The recovery fund will be backed by common bond issuance by the European Commission. On the macroeconomic front, Eurozone Manufacturing PMI increased to 51.8 in July of 2020 from 47.4 in June, beating expectations. The reading pointed to the first increase in factory activity since January of 2019, partly reflecting a technical rebound from recent lockdowns. The Eurozone Services PMI rose to 55.1 in July 2020 from 48.3 in the previous month. The latest reading signaled the steepest month of expansion in the sector since June 2018 as economies continued to reopen after lockdowns. The Eurozone economy shrank by 12.1% in the second quarter of 2020. This is thus far the deepest contraction on record. All major economies in the region posted record declines in GDP: Spain (-18.5%), Italy (-12.4%), France (-13.8%) and Germany (-10.1%).

United Kingdom

UK equity market returns were negative during the month as investors grew concerned about a second wave of the virus. As a result, the government imposed new lockdown restrictions in parts of northern England despite the steady fall in daily new cases of Covid-19. The FTSE 100 finished 4.41% lower in pound terms. The Chancellor put forward a summer recovery plan aimed at introducing measures to get the economy back on its feet. He plans to reduce stamp duty and cut VAT for the food and hospitality sectors. In addition, to offer companies GBP 1000 for each furloughed staff member that's retained until the end of January. On the data front, the Purchasing Manager's Index jumped to 53.3 in July of 2020 from 50.1 in June. The reading pointed to the strongest increase in factory activity since March of 2019, following the easing of lockdown measures. Output growth accelerated to the fastest since November 2017. UK gross domestic product shrank by 20.4% in the second quarter of 2020. This figure highlights the second consecutive quarterly decline in GDP, officially entering a recession, due to the COVID-19 pandemic and the government measures taken to reduce the spread.

Spot Rates	31 July 2018	31 July 2019	31 July 2020
EUR/USD	1.16	1.10	1.17
GBP/USD	1.31	1.21	1.30
USD/JPY	111.88	108.76	105.88

Source: IRESS

Emerging Markets and Asia

Emerging markets turned in stellar performance, with the biggest gains coming from China and Brazil. In addition, US-China tensions continued to bubble under the surface and were brought to the fore as new controversial rules and regulations were imposed on Hong Kong. The Bank of Japan boosted its coronavirus lending program to over $1 trillion while also suggesting that interest rate increases are unlikely to happen through 2021 to 2022. Meanwhile, the People's Bank of China announced that it would purchase up to 400 billion yuan in bank loans made to micro-and-small enterprises in 2020 and that no further stimulus is planned.

Economic data out of China suggests that momentum is picking up. Gross domestic product declined by 6.8% for the first quarter, but industrial output increased by 4.4% in May while the Caixin manufacturing purchasing managers' index rose to 50.9 in June.

GLOBAL RETURNS IN ZAR				
2019	May 2020	June 2020	July 2020	Year-to-date
S&P 500 27.82%	EURO STOXX 50 2.11%	EURO STOXX 50 5.88%	SHANGHAI STOCK EXCHANGE 10.97%	SHANGHAI STOCK EXCHANGE 35.16%
MSCI WORLD 24.11%	MSCI WORLD 0.63%	MSCI EM 5.80%	MSCI EM 6.77%	GLOBAL BONDS 29.41%
EURO STOXX 50 22.37%	S&P 500 0.57%	SHANGHAI STOCK EXCHANGE 4.94%	S&P 500 3.53%	S&P 500 24.68%
SHANGHAI STOCK EXCHANGE 21.81%	FTSE 100 -2.77%	MSCI WORLD 1.16%	MSCI WORLD 2.70%	MSCI WORLD 20.24%
GLOBAL PROPERTY 20.64%	MSCI EM -3.27%	GLOBAL PROPERTY 1.15%	EURO STOXX 50 1.53%	MSCI EM 19.68%
FTSE 100 18.63%	GLOBAL PROPERTY -3.34%	S&P 500 0.52%	GLOBAL PROPERTY 1.49%	EURO STOXX 50 10.61%
MSCI EM 15.12%	GLOBAL BONDS -3.58%	FTSE 100 0.14%	GLOBAL BONDS 1.13%	GLOBAL PROPERTY -0.30%
GLOBAL BONDS 3.86%	SHANGHAI STOCK EXCHANGE -5.72%	GLOBAL BONDS -0.57%	FTSE 100 -0.26%	FTSE 100 -3.91%

Source: Morningstar