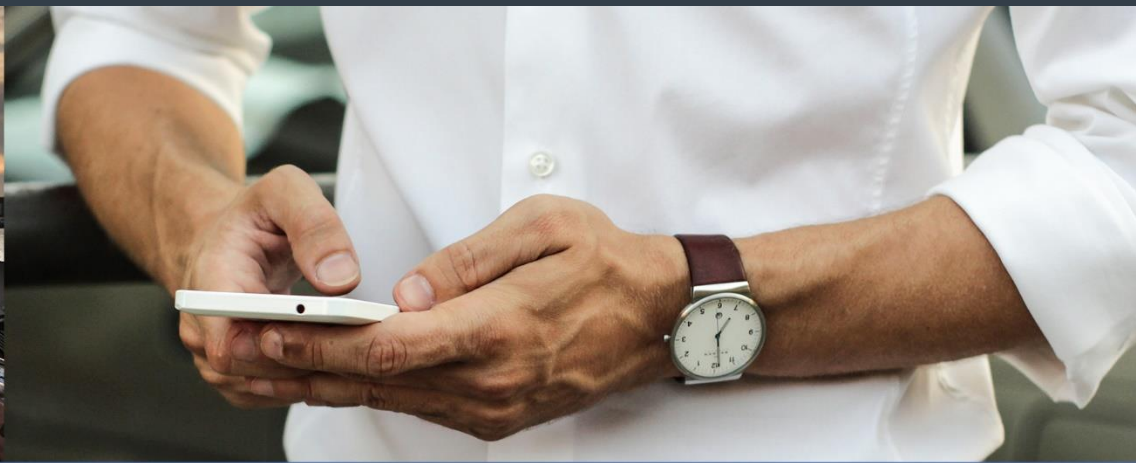
# ECONOMIC REPORT

by Glacier Research

glacier by Sanlam



**24 July 2020**

**Review period: June 2020**

## Domestic Overview

The risk-on environment continued in June with equity markets fast approaching their pre-COVID 19 levels. The equity rally was largely driven by the partial reopening of the domestic economy with manufacturing activity showing a welcomed improvement. The bleak fiscal picture painted by the Finance Minister (in his supplementary budget) was not sufficient to derail the market as local property led the gains followed by small-cap counters. On the global front, emerging market equities showed notable strength, outperforming developed market equities. Global equity markets continue to be driven by sentiment rather than fundamentals, while fixed income remains unattractive given the negligible yields.

## Domestic Highlights in June 2020

- Supplementary budget

## Supplementary budget

South Africa entered 2020 in recession, followed by a sovereign credit rating downgrade to junk status, COVID-19 and the nationwide lockdown. Against this backdrop, Finance Minister Tito Mboweni delivered a supplementary budget in order to re-adjust the country’s fiscal outlook given the impact of the spread of the Coronavirus on the economy.



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It sought to provide a roadmap to stabilise the elevated debt level, improve spending patterns and create fertile conditions for an economic rebound. Some of the key highlights of the budget are as follows:

- The South African economy is expected to suffer a contraction of 7.2% in 2020 – the largest contraction in almost a century
- Consolidated spending (including debt service cost) is estimated to exceed R2 trillion – the highest figure in history
- The consolidated budget deficit is estimated to widen to R761.7 billion, or 15.7% of the GDP in 2020/2021 – a sharp increase from the 6.8% estimated in the February budget
- Gross national debt is projected to be near R4 trillion, or 81.8% of GDP by the end of this fiscal year – a sharp increase from the February estimate of 65.6% of GDP
- The government is set to borrow approximately $7 billion from international finance institutions

Other aspects highlighted include the projected tax revenue short falls and the allocation of funds to various initiatives including the Land Bank default, COVID-19 relief, job creation and infrastructure. Market commentators, however, have criticised the supplementary budget for its lack of sufficient detail of achieving fiscal stabilisation, particularly pertaining to debt.

## South Africa: Economy

Following the announcement of the country's move to alert level 3 (effective from 1 June 2020), President Ramaphosa addressed the nation once more, further relaxing more restrictions in sectors such as restaurants, hotels, cinemas, casinos, personal care services and non-contact sports. Notwithstanding the health risks, this has been supportive of an economic recovery. Accordingly, manufacturing PMI climbed from 50.2 in May to 53.9 in June, signalling an expansion in the manufacturing sector.

However, business confidence plummeted further, from 18 in May to 5 In June as domestic business conditions remain plagued by an ailing economy amid the COVID-19 pandemic. GDP declined by 2% in Q1 20202, after contracting 1.4% in the previous quarter. This contraction was largely driven by slow activity in mining (-21.5%) and manufacturing (-8.5%), which were hard hit by load shedding. On the upside, agriculture (+27.8%) and finance (+3.7%) were the largest contributors. The unemployment rate, during Q1, increased by 1% to reach a record high of 30.1% as the number of unemployed people rose by 344 000 to 7.1 million.

| | Jan'20 | Feb'20 | Mar'20 | Apr'20 | May'20 | Jun'20 |
|---|---|---|---|---|---|---|
| CPI (y/y) | 4.5% | 4.6% | 4.1% | 3.0% | 2.1% | - |
| PPI (y/y) | 4.6% | 4.5% | 3.3% | 1.2% | 0.4% | - |

*Sources: Trading Economics*

| | 30 June 2018 | 30 June 2019 | 30 June 2020 |
|---|---|---|---|
| USD/ZAR | 13.73 | 14.09 | 17.35 |
| GBP/ZAR | 18.12 | 17.88 | 21.52 |
| EUR/ZAR | 16.04 | 16.02 | 19.49 |

*Source: IRESS*

## South Africa: Markets

Following the fixed income rally in May, markets turned risk-on as equity markets booked notable gains with local property leading the gains, returning 12.94%. While the All Share advanced 7.74%, the rally was led by small caps, which returned 11.33%. This was followed by large- and mid-caps, which returned 7.85% and 6.06%. While Industrials returned -1.48%, SA Industrials gained 8.31%. On the fixed income side, bonds had a challenging month with the All Bond Index (ALBI) giving up 1.18%. The longer end of the yield curve came under pressure as the 7-12year maturities booked a return of -1.69% and the 12+ year maturities returned -2.03%. The front-end of the curve offered positive returns as 1-3year maturities were up 0.93%, while cash delivered 0.44%. Foreigners were net sellers of R11.47 billion worth of SA equities and net buyers of R2.98 billion worth in SA bonds.

**LOCAL RETURNS IN ZAR**

| 2019 | April 2020 | May 2020 | June 2020 | Year-to-date |
|---|---|---|---|---|
| SA MID CAPS 15.58% | SA TOP 40 14.65% | SA BONDS 7.06% | SA PROPERTY 12.94% | SA CASH 3.18% |
| SA TOP 40 12.41% | SA EQUITY 13.98% | SA CASH 0.50% | SA SMALL CAPS 11.33% | SA TOP 40 0.37% |
| SA EQUITY 12.05% | SA SMALL CAPS 8.77% | SA TOP 40 0.42% | SA TOP 40 7.85% | SA BONDS 0.36% |
| SA BONDS 10.32% | SA MID CAPS 8.53% | SA EQUITY 0.31% | SA EQUITY 7.74% | SA EQUITY -3.16% |
| SA CASH 7.29% | SA PROPERTY 5.68% | SA MID CAPS 0.23% | SA MID CAPS 6.06% | SA SMALL CAPS -20.95% |
| SA PROPERTY -0.40% | SA BONDS 3.92% | SA PROPERTY -0.53% | SA CASH 0.44% | SA MID CAPS -25.67% |
| SA SMALL CAPS -4.10% | SA CASH 0.52% | SA SMALL CAPS -3.20% | SA BONDS -1.18% | SA PROPERTY -38.35% |

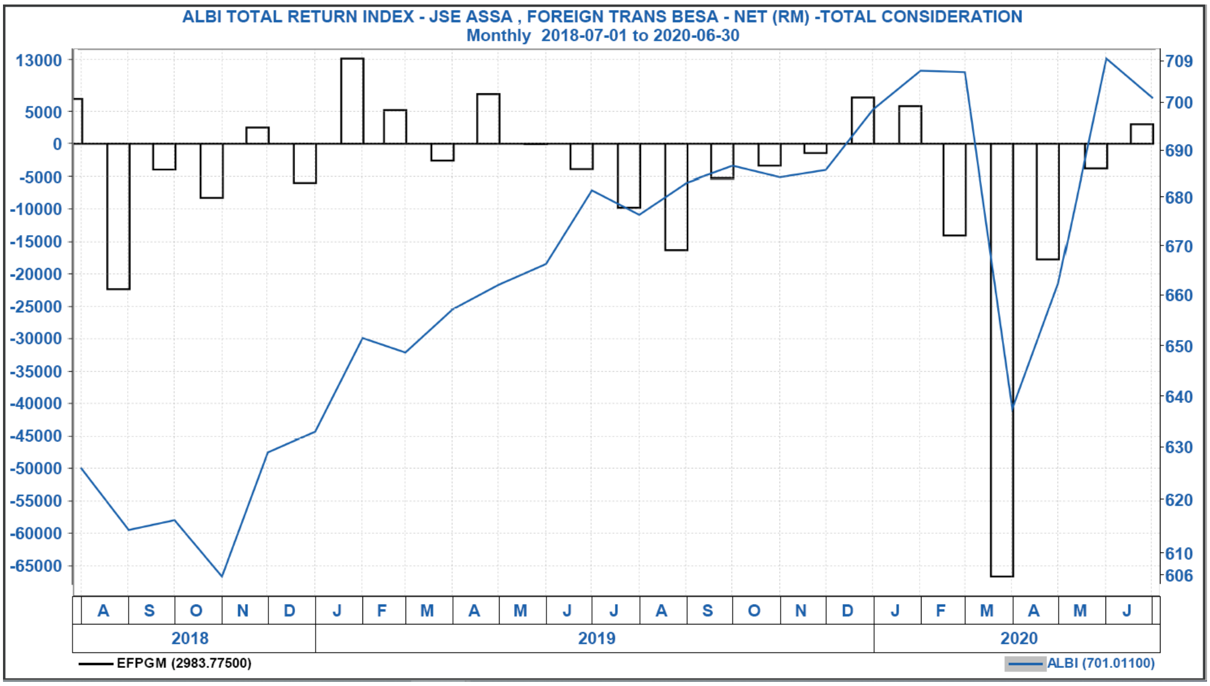
*Source: Morningstar*

In terms of sectors, Resources (8.77%) led the gains once more, with Gold mining stocks rallying 20% for the month. Financials returned 4.17%. Industrials posted a negative return with healthcare stocks pulling back (-1.46%) as Technology gained 13.28%.

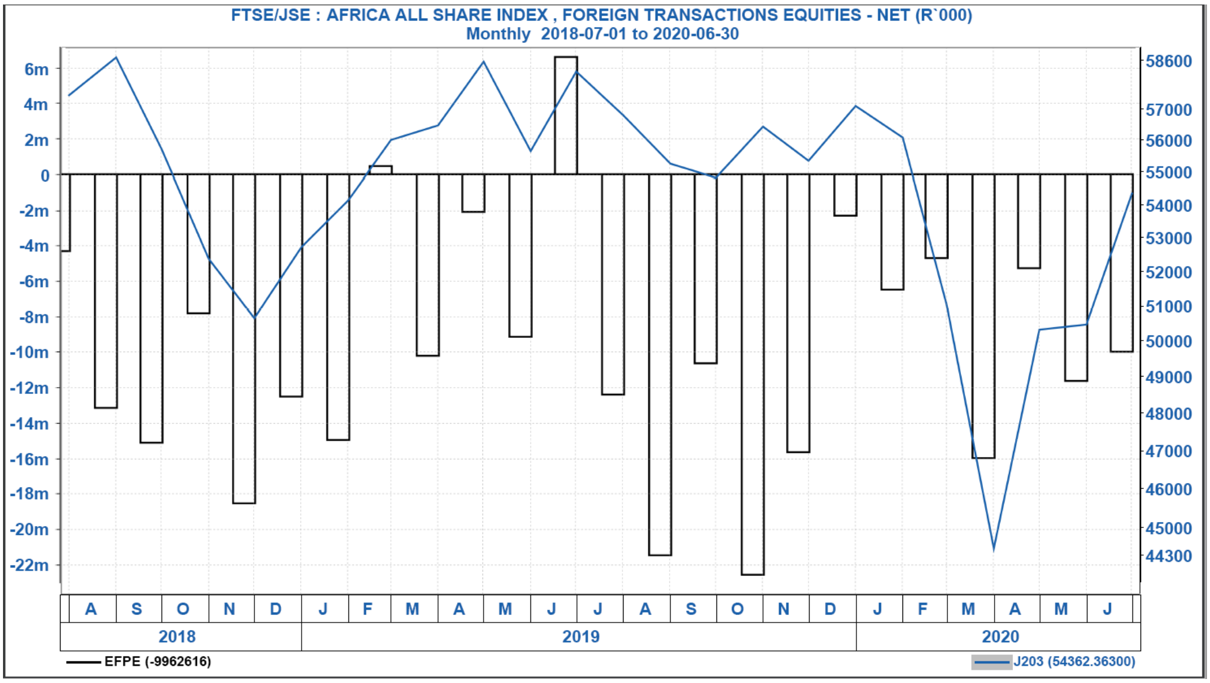
**LOCAL SECTOR RETURNS IN ZAR**

| 2019 | April 2020 | May 2020 | June 2020 | Year-to-date |
|---|---|---|---|---|
| RESOURCES 28.53% | RESOURCES 22.99% | RESOURCES 5.55% | GENERAL RETAILERS 9.11% | SA INDUSTRIALS 6.75% |
| CONSUMER GOODS 18.31% | FINANCIALS 11.92% | INDUSTRIALS 1.95% | RESOURCES 8.77% | RESOURCES 5.52% |
| SA INDUSTRIALS 8.90% | GENERAL RETAILERS 10.69% | SA INDUSTRIALS -1.76% | SA INDUSTRIALS 8.31% | CONSUMER GOODS 0.94% |
| CONSUMER SERVICES 2.60% | SA INDUSTRIALS 9.57% | CONSUMER GOODS -2.70% | CONSUMER SERVICES 7.11% | CONSUMER SERVICES -23.45% |
| FINANCIALS 0.63% | CONSUMER GOODS 9.54% | CONSUMER SERVICES -2.99% | CONSUMER GOODS 4.97% | FINANCIALS -31.68% |
| INDUSTRIALS -8.91% | INDUSTRIALS 5.65% | FINANCIALS -3.18% | FINANCIALS 4.17% | INDUSTRIALS -33.54% |
| GENERAL RETAILERS -18.37% | CONSUMER SERVICES 1.05% | GENERAL RETAILERS -5.86% | INDUSTRIALS -1.48% | GENERAL RETAILERS -36.23% |

*Source: Morningstar*




*Source: IRESS June 2020*




*Source: IRESS June 2020*

## Global Overview

June proved to be another good month for risky assets, as global economies slowly started to reopen. Markets took comfort from the fact that governments and central banks appear to be working together to alleviate the impact of the Coronavirus-inspired recession and to support the economy. Emerging markets meaningfully outperformed developed markets, as the MSCI Emerging Markets Index rallied 6.96% in US dollar (5.82% in ZAR) and the MSCI World firmed 2.65% in US dollar (1.16% in ZAR). From an equity style perspective, momentum was the top-performing investment style, advancing 4.63% in US dollar (3.11% in ZAR), while value remains the laggard, being the worst-performing investment style, firming 0.70% in US dollar (-0.76% in ZAR).

Despite the rally in risky assets, global bonds and gold held up relatively well. The Barclays Global Aggregate Bond Index added 0.89% in US dollar (-0.18% in ZAR) and the Bloomberg Gold Index gained 2.80% in US dollar (1.32% in ZAR). The oil price clawed back some of its losses, gaining 8.14% in US dollar (6.58% in ZAR) using the Bloomberg Brent Crude Oil Index. The better-than-expected supply cuts delivered by OPEC+ were supportive of this rally.

The market seems to be driven by sentiment as opposed to fundamentals as there is a disconnect between economic reality and the optimism seen in the market. There are other risks looming as well. Concerns about a 'second wave' of the pandemic are likely to persist over the coming months. There are also geopolitical, trade and US election risks over the short term. Furthermore, there is th e potential that fiscal fatigue may set in, especially in less developed or less well-funded countries. Emerging market countries are already dealing with high levels of debt, whereby they do not have the fiscal firepower that some of their developed counterparties have.

### United States

US The US market had another strong month, with technology stocks leading the gains once again as the S&P 500 added 1.84% in US dollar (0.76% in ZAR). Encouraging signs that the US economy is finding its footing provided support for the market. America's labour market rebounded in May as nonfarm payrolls rose by 2.5 million and the jobless rate fell to 13.3% from 14.7%. Meanwhile, retail sales surged by 17.7% from the previous month. The US Federal Reserve maintained interest rates at near zero and indicated that it would be targeting monthly purchases of $80 billion worth of treasuries and $40 billion worth of mortgage-backed securities. In addition, it will begin buying individual corporate bonds. The extent of support provided by the US Federal Reserve is unmatched and unrivalled, especially when considering they are willing to buy ETFs and corporate bonds to support the market.

### Eurozone

European equites rallied strongly in June driven by improving economic data and continued monetary and fiscal support from policymakers. As a result, the Euro Stoxx 50 advanced 5.87% in euro terms (5.95% in ZAR). The rally was led by more cyclical parts of the market, with financials leading the charge. The ECB maintained interest rates at previous lows and increased its bond purchases by €600 billion, thereby bringing its purchases to €1.35 trillion. Additionally, it also announced that this bond purchasing program will continue until June 2021. In Germany, the coalition government agreed on a second fiscal stimulus package worth €130 billion, taking the total direct fiscal Covid-19 response to 12% of gross domestic product. In other economic news, the ZEW Indicator of

Economic Sentiment for Germany (where participants are asked about their six-month expectations concerning the economy, inflation, stock markets and exchange rates) rose to 63.4 in June, from 51 in May.

## United Kingdom

The UK market firmed 1.53% in pound sterling (0.85% in ZAR) on the back of optimism of an impending recovery in corporate profitability. The market proved to be resilient despite the UK economy shrinking in April at its fastest pace on record. The gross domestic product fell by 20% in April, the biggest monthly fall since 1997. Over the 3 months to April, the economy contracted by 10.4%. To support households and corporates, the Bank of England has been buying government bonds to inject money directly into the economy. It maintained interest rates at 0.1% while increasing its UK government bond purchases by a further £100 billion. The expectation is that this program will end at the end of 2020, with the total asset purchases reaching £745 billion.

| Spot Rates | 30 June 2018 | 30 June 2019 | 30 June 2020 |
|---|---|---|---|
| EUR/USD | 1.16 | 1.13 | 1.12 |
| GBP/USD | 1.32 | 1.26 | 1.24 |
| USD/JPY | 110.69 | 107.89 | 107.93 |

*Source: IRESS*

## Emerging Markets

Emerging markets turned in a 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 and signaled to market 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 and the Caixin manufacturing purchasing managers’ index rose to 50.9 in June.

| GLOBAL RETURNS IN ZAR | | | | |
|---|---|---|---|---|
| **2019** | **April 2020** | **May 2020** | **June 2020** | **Year-to-date** |
| S&P 500 27.82% | S&P 500 16.01% | EURO STOXX 50 2.11% | EURO STOXX 50 5.88% | GLOBAL BONDS 27.96% |
| MSCI WORLD 24.11% | MSCI WORLD 14.06% | MSCI WORLD 0.63% | MSCI EM 5.80% | SHANGHAI STOCK EXCHANGE 21.80% |
| EURO STOXX 50 22.37% | MSCI EM 12.24% | S&P 500 0.57% | SHANGHAI STOCK EXCHANGE 4.94% | S&P 500 20.43% |
| SHANGHAI STOCK EXCHANGE 21.81% | GLOBAL PROPERTY 9.96% | FTSE 100 -2.77% | MSCI WORLD 1.16% | MSCI WORLD 17.09% |
| GLOBAL PROPERTY 20.64% | FTSE 100 8.68% | MSCI EM -3.27% | GLOBAL PROPERTY 1.15% | MSCI EM 12.10% |
| FTSE 100 18.63% | SHANGHAI STOCK EXCHANGE 8.28% | GLOBAL PROPERTY -3.34% | S&P 500 0.52% | EURO STOXX 50 8.94% |
| MSCI EM 15.12% | EURO STOXX 50 8.11% | GLOBAL BONDS -3.58% | FTSE 100 0.14% | GLOBAL PROPERTY -1.76% |
| GLOBAL BONDS 3.86% | GLOBAL BONDS 4.85% | SHANGHAI STOCK EXCHANGE -5.72% | GLOBAL BONDS -0.57% | FTSE 100 -3.66% |

*Source: Morningstar*