FG ASSET MANAGEMENT

ECONOMIC EXPRESS

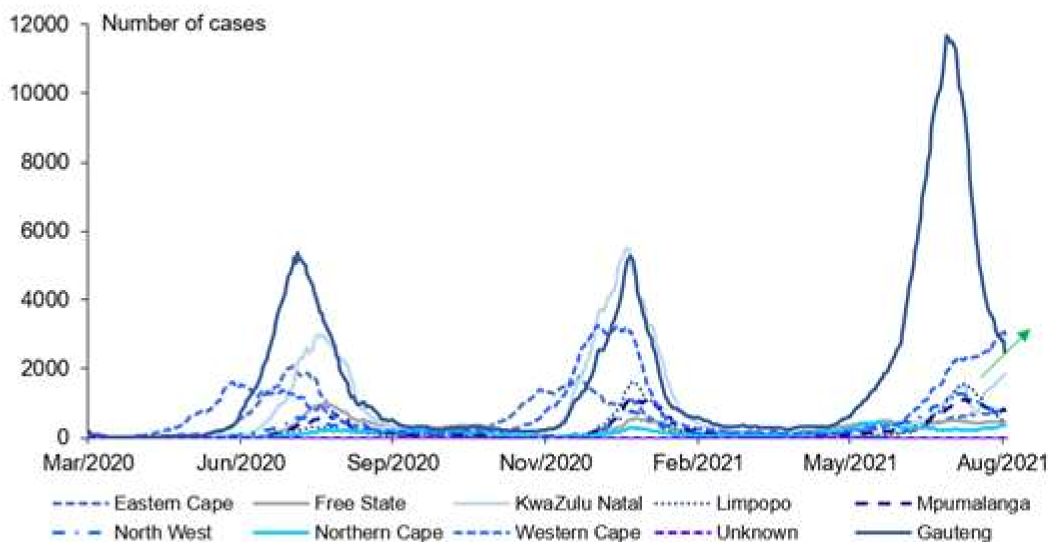
JULY 2021

Early July saw the former South African president, Jacob Zuma, start serving a 15-month jail sentence for failing to appear before the Zondo Commission. In the week that followed, public unrest and looting escalated within KwaZulu-Natal and Gauteng. The unrest lasted for more than a week which saw hundreds of businesses being destroyed and significant damage was done to key infrastructure. The relative underperformance of domestically focused bank and retail sectors reflected investor concerns, however these sectors recovered somewhat in the second half of the month as the violence subsided and order was restored.

The costs of the damages from the unrest is estimated to total around R5.5bn for the two provinces. In addition, the national Treasury's extension of the COVID-19 grant to March 2022 is expected to cost a further R27bn. The grant extension will be funded from the overrun in tax revenues from the commodity sector. The longer-term implications of the unrest however will have a much more meaningful impact, as the shock to investor confidence will put future planned fixed investments at risk.

In addition to the social unrest, South Africa was under level four lockdown for the most part of July as the third wave of infections grew. By the end of the month the active cases in most provinces were declining from their peaks, with the exception of the Western Cape and KwaZulu-Natal (figure 1) which were still rising. Certain sectors, which had been forced to close under level 4 will be a further drag on July's economic activity and therefor the expectations for the third quarter growth have seen downward revisions.

Figure 1: Daily COVID-19 cases – 7 day rolling average:



Source: Investec, National Department of Health

The South African Reserve Bank's Monetary Policy Committee (MPC) kept interest rates unchanged at 3.5% at their July meeting. Growth forecasts were left unchanged, without any downward adjustments being made to account for the previous week's unrest. The Quarterly Projection Model (QPM)'s implied policy path was lowered from two rate hikes this year to only one 25bp hike in the fourth quarter. It was again reiterated that the QPM is only a guide and that the repo rate should be consistent with growth. The MPC also noted that upside risks still remain for domestic inflation as a result of higher food, petrol and electricity prices. June's inflation rate that was released the day before the MPC meeting reflected the annual inflation rate easing from 5.2% to 4.9%, mainly driven by lower fuel inflation.

Globally, investors remained focused on global inflation and by implication global monetary policy. Mid-month, the US inflation was released coming in at 5.4% year-on year, much stronger than the expected 4.9%. The surprise increase was driven by used car sales (+45.2% YoY) and fuel prices (+45.1% YoY) which made up 3% of the 5.4% headline inflation.

The US Federal Open Market Committee (FOMC) held its fifth meeting of this year at the end of the month, where we saw the committee keep interest rates and asset purchases unchanged. The accompanying statement and press conference did however give the indication that given the progress in the employment and inflation goals, they were looking into the best way to approach reducing the asset purchases (tapering). The market reaction was fairly muted, suggesting that the change in tone was in line with expectations.

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The US second quarter's growth release showed that the US grew by 6.5% from the first quarter on an annualised basis, increasing from the first quarter's 6.3% q/q. Despite it coming in significantly below market expectations of 8.5%, the report was still seen as reflecting robust growth. Consumer spending was the biggest positive contributor growing by 11.8%, while inventory declines driven by supply chain distributions detracted from growth.

At the end of July the Chinese government introduced regulation on afterschool tutoring which saw the share prices within this sector dropping around 90%. They also introduced further regulations within internet businesses (anti-trust, anti- competitive behavior, privacy control and treatment of employees) which was seen to be in line with recent regulations within Western markets. The market took fright and concerns increased with regards to what this tough regulatory stance could mean for other large cap Chinese technology stocks in the future.

The local equity market rebounded from June's weakness to return +4.2% (FTSE/JSE ALSI) as the strong run in resources offset the weakness in domestic counters and Naspers. Developed market equities performed in line with local equities in rand terms, returning +4.3% (MSCI World), while emerging markets peers lagged, returning -4.4% (MSCI EM) in rand terms driven by concerns around China.

Index	Asset Class	JULY 2021
STEFI Composite Index	Local Cash	0.31%
FTSE/JSE All Bond (Total Return)	Local Bonds	0.83%
FTSE/JSE SA Listed Property (Total Return)	Local Property	-0.64%
FTSE/JSE Africa All Share (Total Return)	Local Equities	4.18%
JP Morgan World Govt Bond index (USD)	Global Bonds	0.80%
EPRA/NAREIT Global Index (USD)	Global Property	4.19%
MSCI AC World (USD)	Global Equities	0.72%

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