ECONOMIC OVERVIEW

QUARTER 3, 2020

MENTENOVA

Contents

EXECUTIVE SUMMARY

The global economy has continued making a gradual recovery from the COVID-19-induced economic shocks. Production levels rebounded from the troughs seen in Q2, lifting business sentiment as business activities picked up and trading conditions improved with the further reopening of economies. Consequently, equities delivered another quarter of resilient performance relative to bonds as risk-on sentiment dominated for most of the time in Q3. Consumer confidence also saw moderate recovery. However, it was much more cautious as the labour market outlook cooled towards the end of the quarter once the low-hanging fruit had been picked as businesses resumed operations post-lockdown. Further payroll growth will depend on the progression of the pandemic going forward and recovery in the aggregate demand. With each passing month, more companies have announced job-cut plans – which were largely paused during the lockdown – as firms have assessed the future business climate and cut costs to retain profit margins.

The overall sentiment is most bullish in China as the country has so far succeeded in preventing a second wave of COVID-19. Also, domestic travel in China has nearly recovered to pre-pandemic levels, local tourism has received a boost, factories are churning and life has almost returned to full normalcy. Thus, the Chinese stock market was one of the best performers in the third quarter. However, the economic future of the world's largest manufacturer is also dependent on how quickly its major trading partners recover from the COVID slump.

What we have seen is that a K-shaped recovery path is expected globally, with countries like China, Switzerland and the US expected to see a stronger rebound due to their fundamental economic strength, stimulus prowess or success in containing the pandemic. For countries like India, Spain, the UK and South Africa, the pandemic has exacerbated existing economic woes. The speed of global economic recovery goes hand in hand with infection rates and the point at which vaccines become widely available.

Most central banks remain accommodative, pulling out all the stops to engineer a more sustainable economic recovery. We have seen persistent positive liquidity injections from the ECB and the Bank of Japan, while the Federal Reserve remains committed to asset purchases and keeping rates near zero to boost recovery in the labour market. Locally, the South African Reserve Bank took more of a cautious stance after slashing the repo rate from 6.5% in 2019 to an all-time low of 3.5% in 2020. The upside inflationary risk looks limited for now as consumer demand remains weak, despite reopening efforts producing some positive inflationary momentum. But deflationary forces are also at play as producers and retailers struggle to pass the rand weakness witnessed so far, into 2020. The domestic economic outlook remains fragile as the country grapples with structural constraints, macro policy uncertainty and a very high unemployment rate.

While the US November presidential election may be one of the most crucial binary risk events in the near term, the outcome may have less impact on the direction of the market than previously thought. The reasons for this are that the global economy may continue to recover from now on as we move closer to having a vaccine and there could also be a further, post-election stimulus from the White House, with Trump's recent termination of relief talks possibly being an electoral tactic.

In all, the business operating environment in emerging markets, excluding China in particular, will continue to face potential challenges in the short term, such as financial market volatility and subdued or uneven demand. As for the developed world, managing the second wave in the upcoming winter season is crucial if the impact of the virus on the nascent growth momentum is to be contained.

MARKET OVERVIEW

Equities delivered another round of decent performance in Q3, with the US and emerging markets leading the rest of the market, while listed properties and REITs lagged.

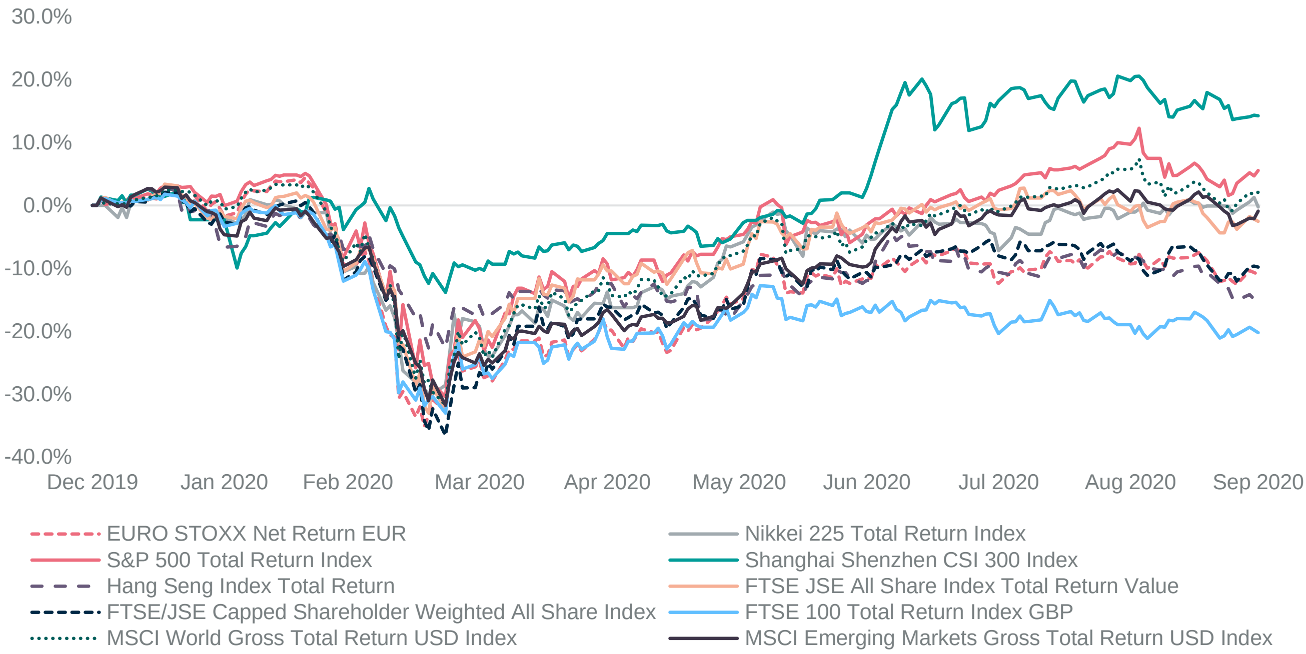
Figure 1: Performance of major indices and asset classes

30 September 2020 (Local Currency)	1M	3M	YTD	1-Year	3-Year (annualised)	5-Year (annualised)	10-Year (annualised)
FTSE/JSE ALSI Total Return	-1.6%	0.7%	-2.5%	2.0%	2.4%	4.8%	9.6%
FTSE/JSE Capped SWIX Total Return	-1.1%	1.0%	-9.8%	-5.0%	-2.4%	1.1%	
S&P 500 Total Return	-3.8%	8.9%	5.6%	15.1%	12.3%	14.1%	13.7%
STOXX 600 Total Return	-1.4%	0.6%	-11.6%	-6.1%	0.2%	3.5%	6.3%
Nikkei 225 Total Return	0.8%	4.7%	-0.2%	8.7%	6.6%	8.0%	11.6%
MSCI World Total Return	-3.4%	8.0%	2.1%	11.0%	8.3%	11.1%	10.0%
MSCI ACWI Total Return	-3.2%	8.3%	1.8%	11.0%	7.7%	10.9%	9.1%
MSCI EM Total Return	-1.6%	9.7%	-0.9%	10.9%	2.8%	9.4%	2.9%
STEFI	0.3%	1.2%	4.4%	6.2%	6.9%	7.1%	6.4%
ALBI	0.0%	1.5%	1.8%	3.6%	7.3%	7.6%	7.6%
IGOV	-1.7%	1.0%	-1.5%	-2.4%	0.7%	2.1%	5.7%
WGBI	-0.2%	2.9%	7.1%	6.8%	4.4%	3.9%	1.9%
SAPY Total Return	-3.0%	-14.1%	-46.4%	-46.1%	-23.8%	-12.9%	1.8%
MSCI US REIT Total Return	-3.2%	1.6%	-17.1%	-17.8%	0.3%	4.0%	7.9%
STOXX 600 Real Estate Total Return	-1.5%	2.1%	-18.2%	-11.6%	-0.4%	-0.4%	6.5%
Crude Oil	-9.6%	-0.5%	-38.0%	-32.6%	-10.7%	-3.3%	-6.7%
Aluminium	-1.9%	9.0%	-2.5%	2.5%	-5.7%	2.3%	-2.8%
Copper	0.1%	10.9%	8.1%	16.5%	1.0%	5.3%	-1.8%
Gold	-4.2%	5.9%	24.3%	28.1%	13.8%	11.1%	3.7%
Platinum	-4.1%	7.7%	-7.6%	1.1%	-0.7%	-0.3%	-6.0%
Nickel	0.0%	0.0%	0.0%	0.0%	6.1%	4.5%	-2.4%
Palladium	2.9%	18.9%	18.8%	37.9%	35.1%	28.8%	15.1%
Iron Ore	-6.3%	20.3%	37.2%	26.8%	22.9%	15.6%	
USDZAR	-1.1%	-3.5%	19.6%	10.7%	7.3%	3.9%	9.2%
GBPZAR	-4.4%	0.6%	16.6%	16.3%	6.0%	0.7%	7.1%
EURZAR	-2.9%	0.7%	25.0%	19.0%	7.0%	4.9%	7.5%
JPYZAR	-0.7%	-1.2%	23.2%	13.5%	9.7%	6.6%	6.7%

Source: Bloomberg

The Chinese stock market posted the best performance in the third quarter (up by 11.2%), largely reflective of the success of President Xi's government's outbreak-containment measures, together with steady, ongoing, industrial-led economic recovery. Foreign direct investment into China, which had been up since April, rebounded by 18.7% year on year in August.

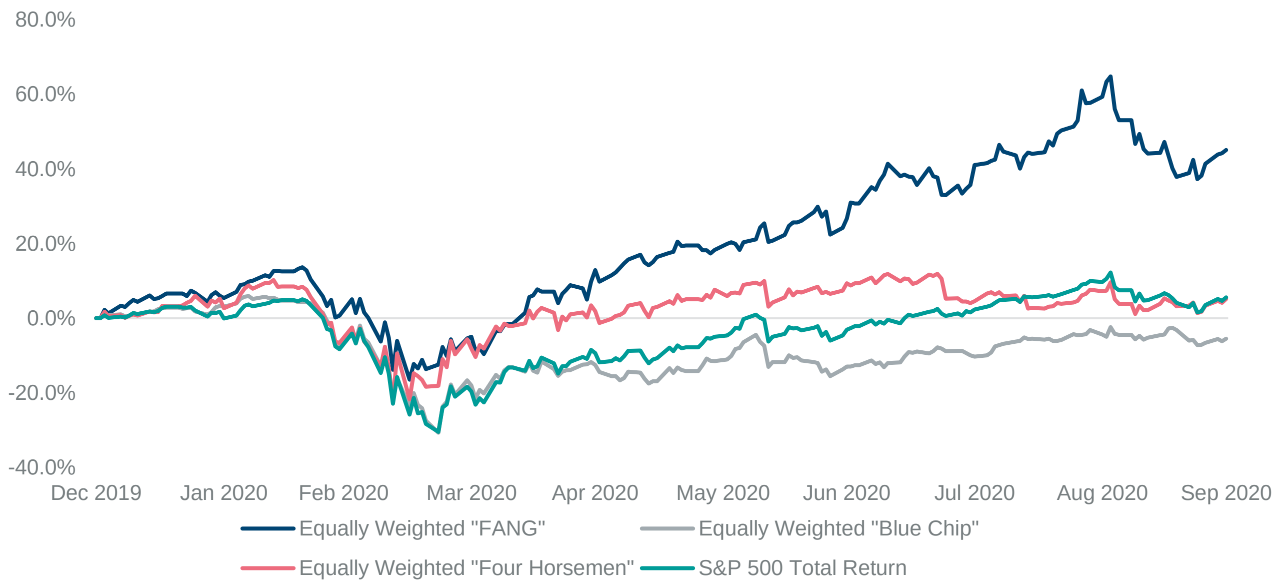
Figure 2: Performance of major equity indices YTD 2020 as at 30 September 2020 (local currencies)



Source: Bloomberg

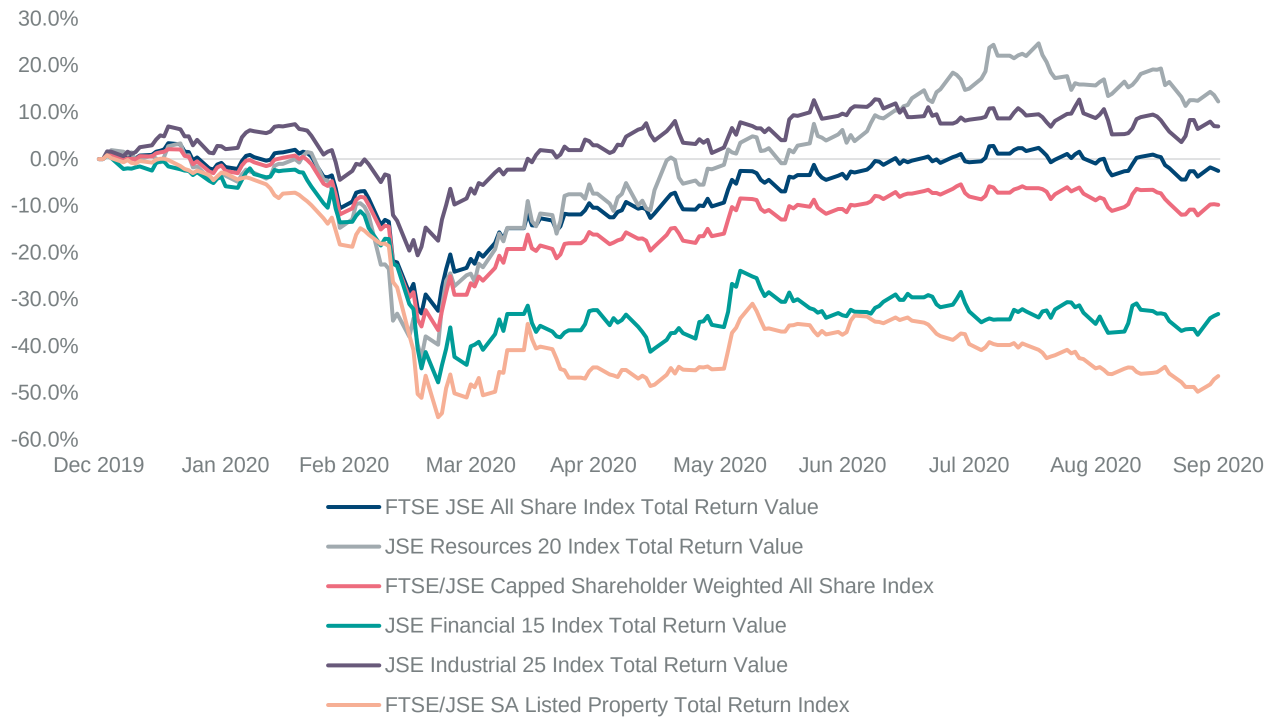
The nature of the equity market recovery remained largely uneven. In the US, the techs that have benefited from the pandemic due to the work-from-home trend and accelerated digitalisation, held onto their lead despite the rout seen in the first few weeks of September. Resource-based companies, in turn, outperformed financials and industrials on the local side for the first three quarters of 2020.

Figure 3: US equity performance in US$ YTD as at 30 September 2020



Sources: Bloomberg, AlpineMacro, FANG stocks (Facebook, Apple, Amazon, Netflix, Alphabet/Google), four horsemen stocks (Microsoft, Cisco, Intel and Oracle), blue-chip stocks (Coca-Cola, Walt Disney, General Electric, IBM, Johnson & Johnson, McDonald's, Merck and Procter & Gamble)

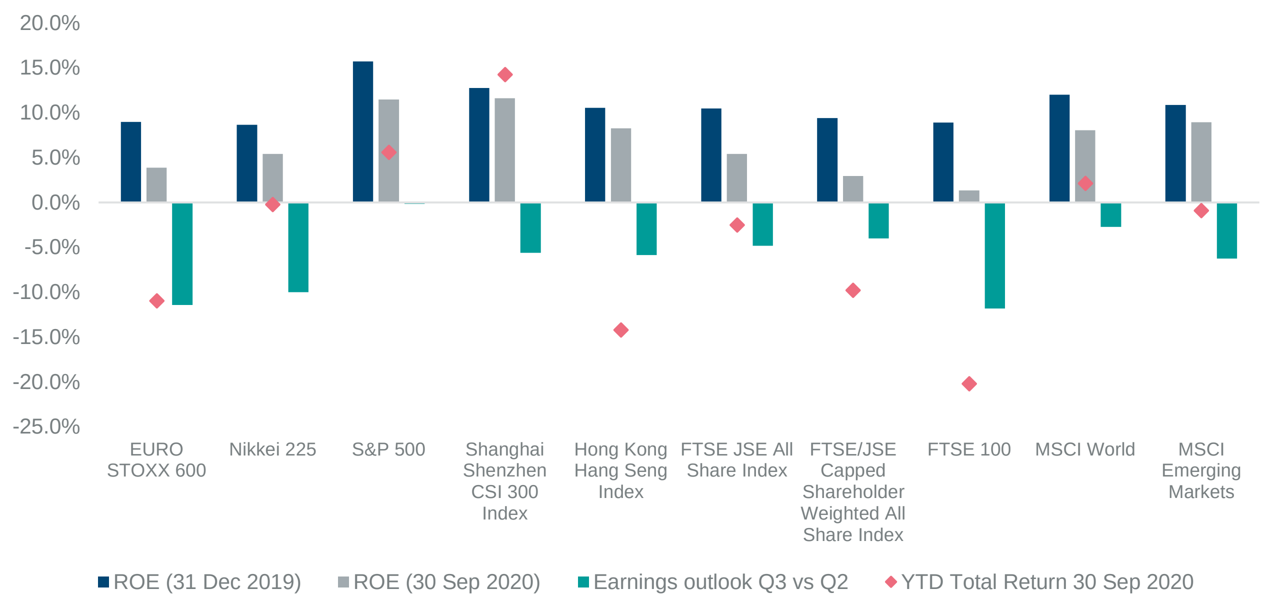
Figure 4: SA equity index performance YTD as at 30 September 2020



Source: Bloomberg

The earnings outlook did not improve much for most of the regions (based on earnings estimates) over the past quarter. The severity of the fundamental deterioration (i.e. impact on ROE) and the sentiment on forward earnings seemed to be correlated with the performance of most equity markets to date.

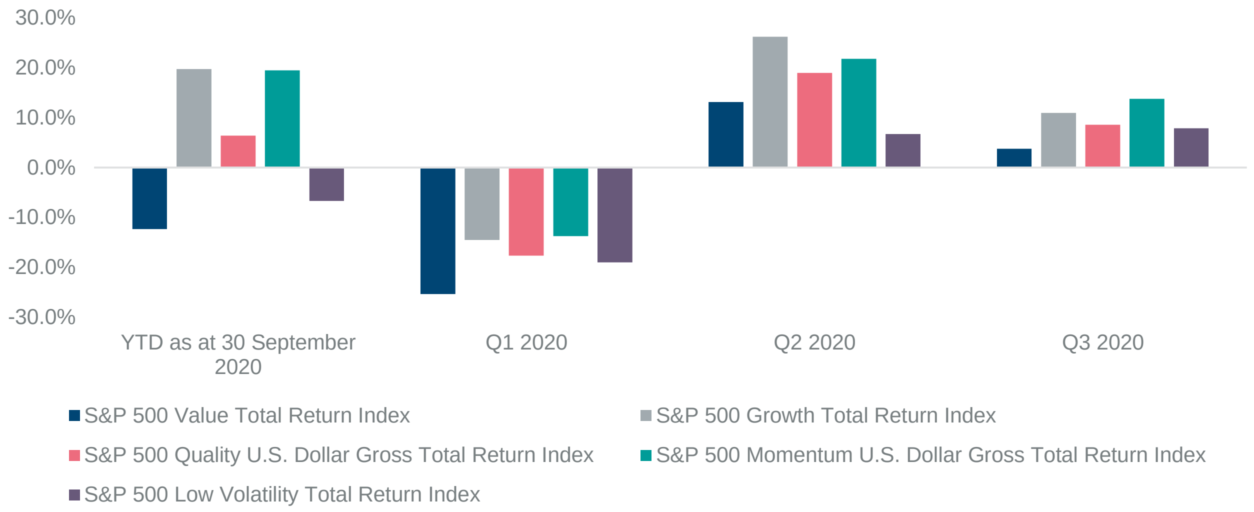
Figure 5: Major equity index performance YTD vs return-on-equity and earnings outlook as at 30 September 2020



Source: Bloomberg

We saw from a style perspective that the S&P 500 Value Index underperformed against other factors for the year to date. The S&P 500 Growth and Momentum indices delivered the strongest rebound in Q2 after the COVID-19-related crash in Q1. Momentum was the best performer in Q3, with value continuing to be the underdog.

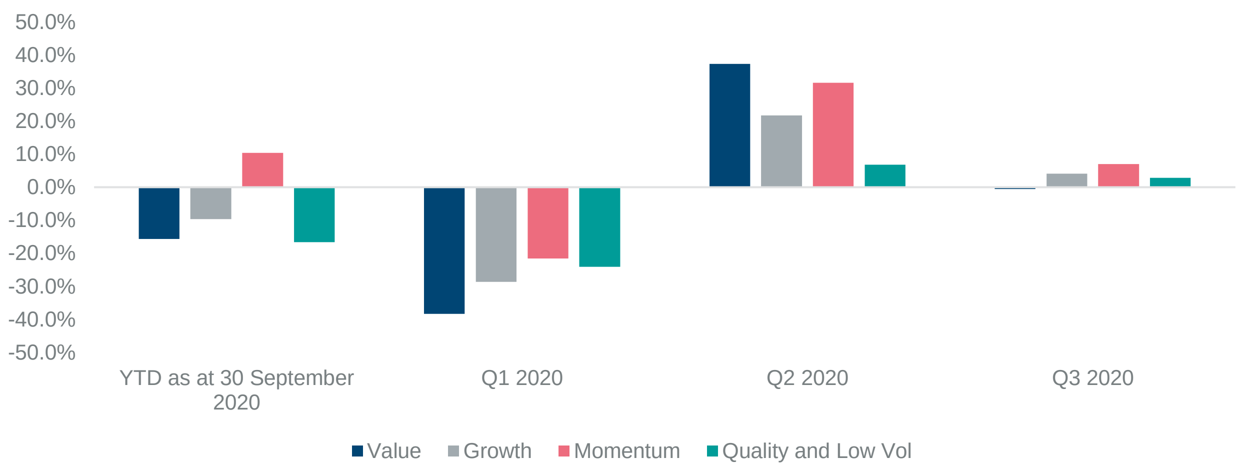
Figure 6: S&P 500 style indices performance YTD as at 30 September 2020



Source: Bloomberg

We saw some similar patterns in South Africa, based on our proprietary-style factor indices, where Momentum fell less during the sell-off in March and then rebounded strongly in the second quarter and led other factors in Q3. What is slightly different from the observations made in the US is that the local value index did show a very strong recovery in Q2 and performed slightly better than the Quality and Low Vol index for the year to date. During the normal contraction phase, we would expect Quality and Low Vol to be more defensive and as the economy gains traction, cyclical strategies such as Value and Momentum would be preferred. COVID-19 is a public health crisis and the shock to the world economy has largely been self-induced, aimed at curbing the spread. Because of this, together with extraordinary government and central bank stimulus efforts, it is not surprising that Momentum has done well both in the US and SA.

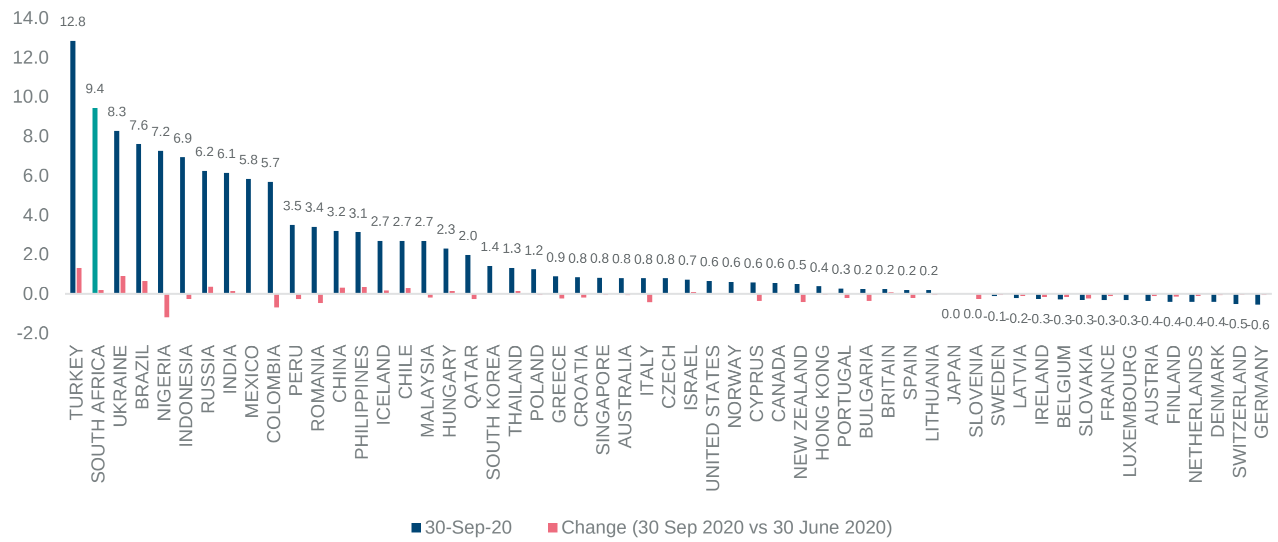
Figure 7: SA style indices performance YTD as of 30 September 2020



Source: Bloomberg

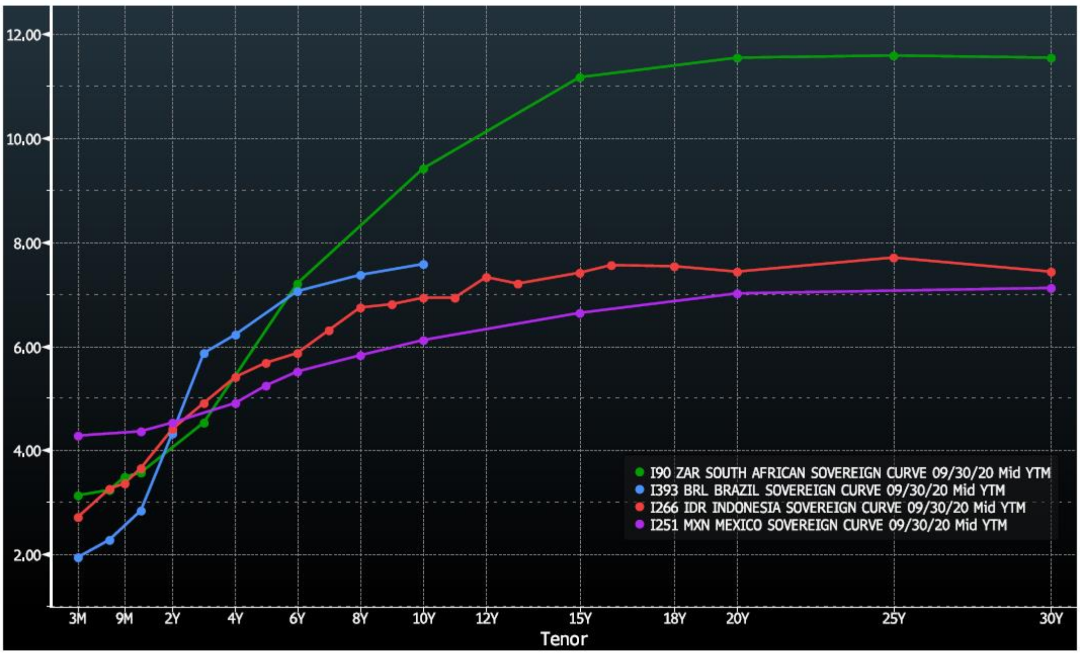
Turning to bonds, most of the developed market yield dipped further into the red, while SA's yield curve steadied over the past quarter, but it was one of the steepest among emerging markets as investors remained concerned about the medium- to long-term sustainability of SA's fiscal debt level and the execution risk associated with the country's economic growth turnaround plan.

Figure 8: 10-year government bond yield as at 30 September 2020



Source: Bloomberg

Figure 9: Sovereign bond yield curve as at 30 September 2020



Source: Bloomberg

The US 10-year vs 2-year and 10-year vs 3-month Treasury spread stayed largely flat at 56pbs and 59bps, respectively, at the end of the third quarter, having increased by 5bps and 7bps over the quarter.

Figure 10: 10-year vs 2-year US Treasury yield spread vs US recession

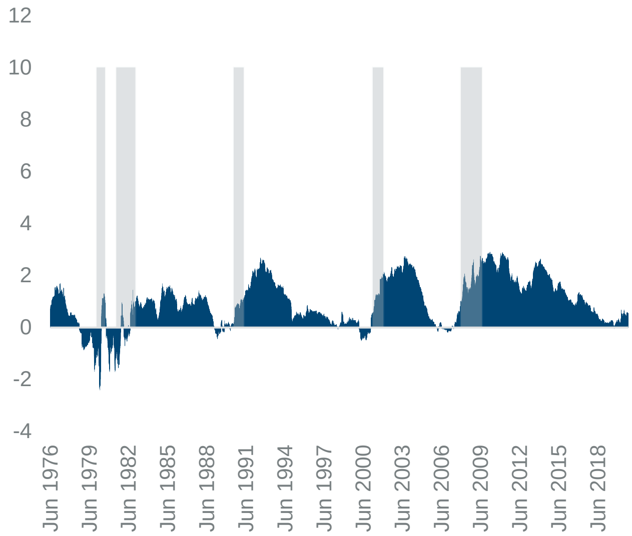
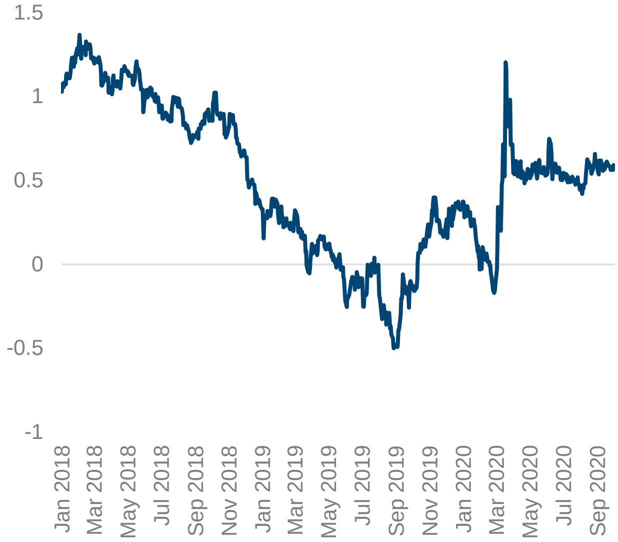


Figure 11: 10-year vs 3-month US Treasury yield spread



Source: Bloomberg

From an ETF net flow perspective, we see that investors have, in general, favoured developed market assets for the year to date as developed markets have more ammunition with which to defend their economies, using fiscal and monetary policies. Yield-thirsty investors also favoured investment-grade emerging market debt in the prevailing low-interest rate environment. South Africa would have benefited from the inflow had it retained its investment-grade status. Unfortunately, for the year to date, as at the end of September, foreign investors had net sold US$3.6 billion and US$6.4 billion worth of local bonds and equities, respectively. This is the fourth consecutive year in which foreign investors have net sold SA equities and the third consecutive year in which the same has occurred for domestic bonds. The non-resident holding of SA government bonds plunged from 37.15% to 29.18% from December 2019 to September 2020, the situation having been significantly worsened by the government increasing its debt issuance to try and lift the economy out of the COVID-19 hole. Banks' holding of local government debt increased from 16.7% to 22.9% over the same period, since holding this asset class has minimal effect on risk-weighted asset ratios. Investors' appetite for emerging market equities has also been showing a slow return in recent months.

Figure 12: Developed and emerging market net ETF flows as at 2 October 2020

View Asset Class | Show Netflow | Market DM | In Millions of USD

Map View | Details | Historical

Asset Class	1D	1W	1M	3M	YTD	1Y	3Y
1) Equity	-4,736	+4,974	+19,840	+40,471	+158,499	+257,859	+755,822
10) Broad Market	+137	+3,041	+8,800	+26,145	+89,378	+112,113	+301,876
11) Large-cap	-4,105	+2,660	+13,280	+17,757	+73,943	+139,350	+386,939
12) Not Declared	+14	+86	+628	+1,257	+3,132	+3,560	+6,292
13) Small-cap	-498	-418	-1,475	-1,371	+340	+6,925	+39,186
2) Fixed Income	+2,634	+5,298	+9,692	+54,851	+159,287	+209,353	+458,255
20) IG BBB or higher	+870	+1,922	+6,044	+35,211	+95,280	+118,440	+215,780
21) IG A or higher	+1,041	+2,129	+8,185	+7,250	+34,307	+47,230	+161,929
22) High Yield	+504	+545	-5,160	+5,054	+16,084	+23,154	+25,883
23) Not Declared	+219	+701	+624	+7,336	+13,616	+20,529	+54,663
3) Currency	+8	-15	+287	+436	+638	+398	-318
30) United States	+8	+4	+298	+292	+621	+450	-186
31) Switzerland	--	--	+5	+72	+113	+96	+91
32) Australia	--	-4	-7	+60	+68	+55	+21
33) Canada	--	--	--	+22	+22	+22	-39
4) Commodity	-14	-114	-134	-1,307	+11,176	+11,133	+8,085
40) Energy	-31	-105	-223	-2,173	+9,213	+9,186	+4,789
41) Broad Based	-8	-42	-55	+383	+1,125	+1,068	+2,288
42) Precious Metals	+26	+25	+73	+345	+634	+693	+783

*Regionally Focused Funds

View Asset Class | Show Netflow | Market EM | In Millions of USD

Map View | Details | Historical

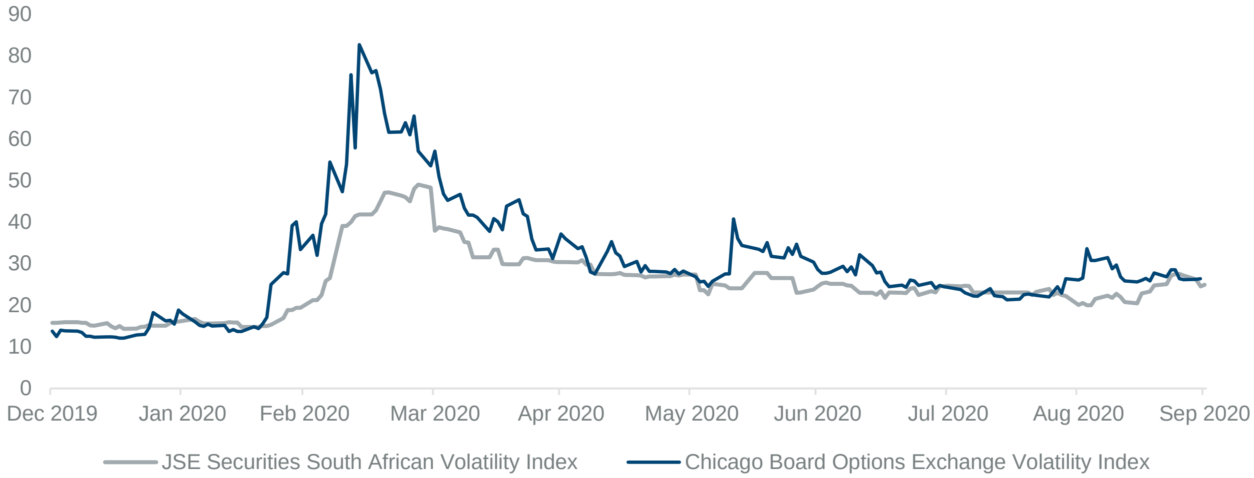
Asset Class	1D	1W	1M	3M	YTD	1Y	3Y
1) Equity	-38	+841	+3,845	+4,179	-25,147	-4,794	+70,779
10) Broad Market	+40	+810	+1,469	+5,010	-20	+4,530	+29,363
11) Small-cap	+1	-38	-126	-346	-544	-309	+1,181
12) Mid-cap	--	+89	+56	-121	-871	-947	+1,004
13) Not Declared	+2	+212	+1,504	-341	-3,820	-5,065	-2,505
2) Fixed Income	+199	+64	+2,009	+5,528	+1,610	+6,784	+28,870
20) IG BBB or higher	+141	+346	+239	+1,904	+1,587	+3,489	+7,064
21) IG A or higher	--	-182	+32	+356	+495	+806	+2,115
22) High Yield	-5	-77	+33	+69	-47	+102	+1,088
23) Not Declared	+62	-22	+1,705	+3,199	-425	+2,386	+18,602
3) Currency	--	--	--	-1	-17	-31	-110
30) Asia Pacific*	--	--	--	--	0	0	0
31) Mexico	--	--	--	--	0	-11	-19
32) China	--	--	--	0	-3	-3	-16
33) International*	--	--	--	0	-7	-9	-37
4) Commodity	--	+56	+116	+1,020	+1,422	+1,140	+2,479
40) Precious Metals	--	+49	+115	+1,096	+1,622	+1,332	+2,671
41) Industrial Metals	--	+4	+2	-14	-18	-10	-10
42) Energy	--	-1	-4	-10	-49	-49	-49

*Regionally Focused Funds

Source: Bloomberg

Both the VIX and SAVI index stayed in the 22 to 25 range for most of the third quarter until late August and early September when both indices increased to 27 and 30 as investors turned their attention to the US November election as the source of major event risk. The Brent crude oil price also recovered from US$41.15 per barrel in June to US$45.58 in August, but pared some gains, decreasing to US$40.94 per barrel by 30 September as concerns about fresh waves of the pandemic in Europe hurt global travel demand.

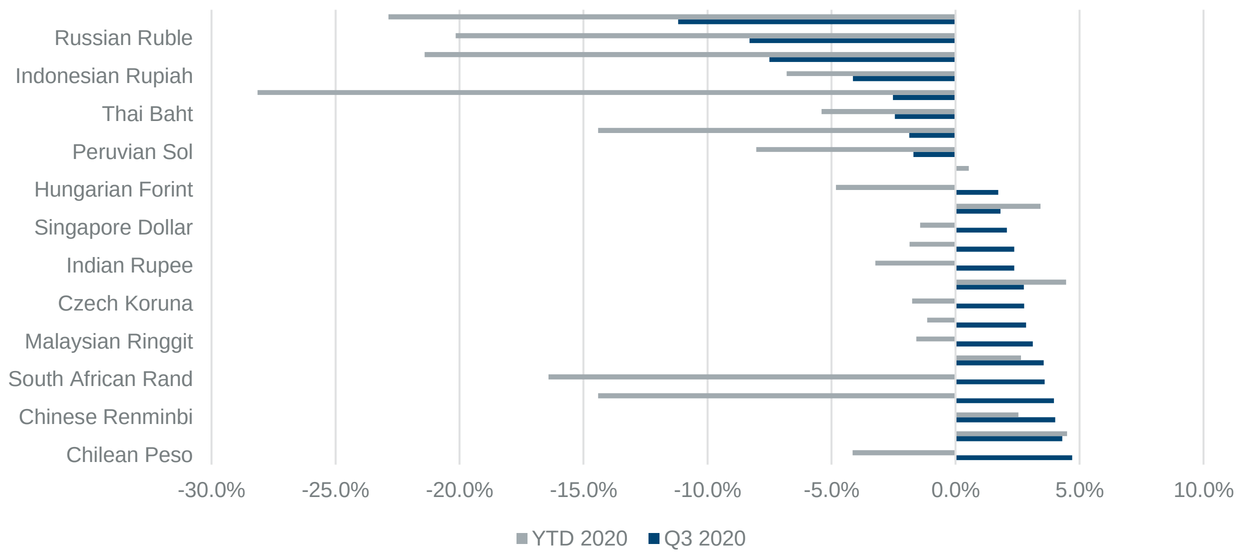
Figure 13: VIX and SAVI index for the year to date as at 30 September 2020



Source: Bloomberg

We saw the rand strengthen from R17.35/$ to R16.75/$ from 30 June to 30 September, briefly touching R16.16/$ on 17 September as risk-on sentiment continued to dominate the market for much of the third quarter. It was the third best-performing emerging market currency vs the US dollar in Q3 but remained the fifth worst-performing EM currency for the year to date, having depreciated by 16.4% against the dollar. The US Dollar Index indicated that the US dollar strengthened by 3.6% against major currencies in the third quarter as investors boosted haven demand in early August. This was as the US–China tech war took a very bad turn when Trump signed executive orders banning WeChat and TikTok and delayed further relief packages in the US, which could dampen the country's tentative economic recovery. The gold price managed to hold on to the 5.9% gain over the quarter, but at US$1886 per ounce on 30 September – which was 8.6% down on the US$2064 per ounce seen on 6 August 2020 – its retreat was mainly driven by the strengthening of the greenback.

Figure 14: Emerging market currency spot return as at 30 September 2020



Source: Bloomberg

Figure 15: Gold spot price in US$ vs the US Dollar Index as at 30 September 2020

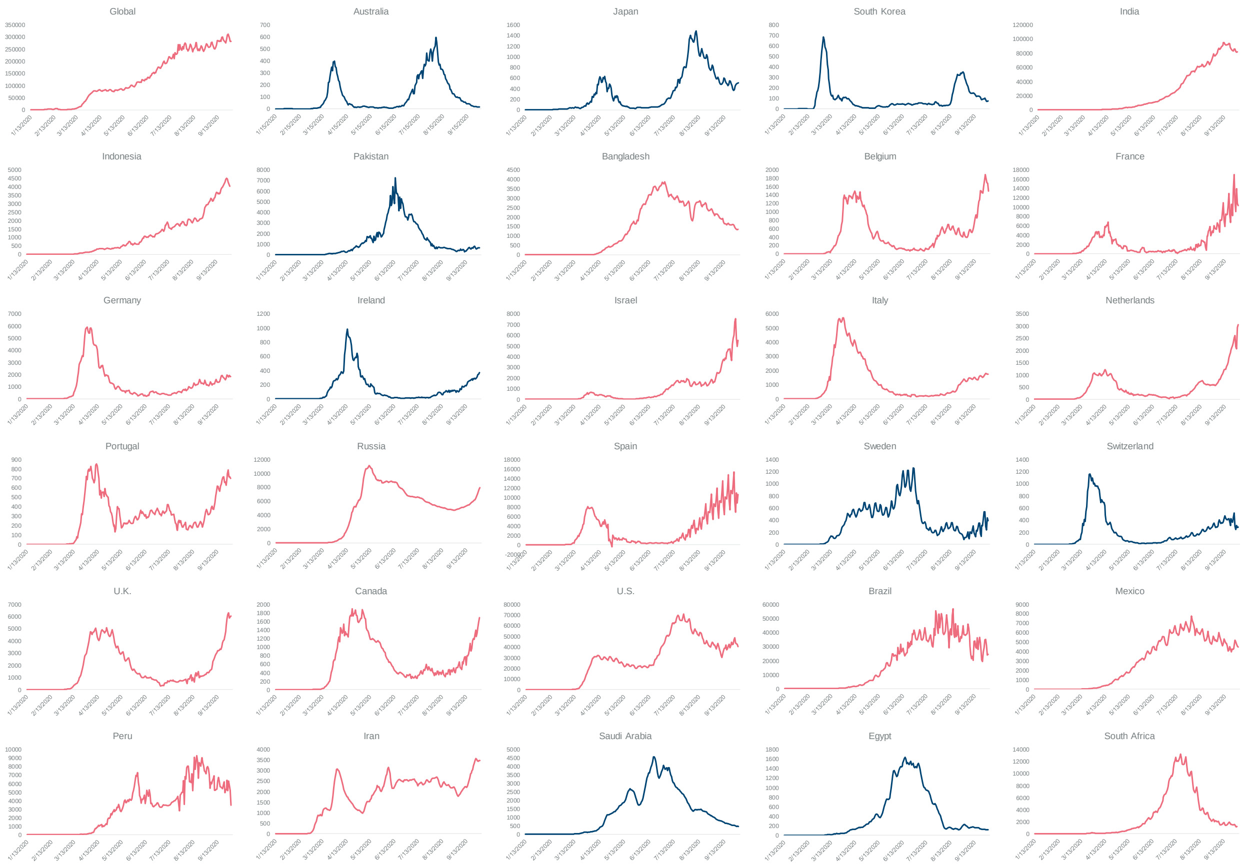
Source: Bloomberg

COVID-19

While the third quarter started off with rising reopening optimism, the number of new daily cases began trending upwards in early August across many European nations, such as France, Spain, Netherlands, Germany and the UK. By late August, signs of a second wave of the COVID-19 pandemic were fairly evident in Europe and Canada. Israel was the first country to re-impose lockdown as its government failed to curb the soaring number of infections. In September, investors and the public also became increasingly concerned about the likelihood of more restrictions in Europe aimed at slowing the spread of the virus as the northern hemisphere approached its flu season. Seasonal influenza on top of COVID-19 could place older adults and individuals with comorbidities at greater risk and also place a heavier burden on hospitals and medical infrastructure. Life in China has largely returned to normal, with face masks remaining an essential, every-day requirement. Most of the new cases tend to be imported. The pandemic also seems to have been contained in most Asia-Pacific nations.

The three-day rolling positivity rate in South Africa dropped from 28% in July to 8% by the end of September, but it has fiercely resisted falling any further. With South Africa having moved to alert level 1, local travel restrictions were lifted from 21 September, while international travel was allowed to resume from 1 October to/from approved, low-risk countries. We expect that numbers of infections may now increase, but the rate of increase and how well the COVID-19 health crisis can be controlled will depend on strict screening at borders and the public continuing to practise social distancing and wear facial masks. The US three-day positivity rate slowed to 3.0% in mid-June and started trending up to 8.0% in early July, after which it has fluctuated between 4.0% and 6.0% for the remainder of the third quarter. However, we are seeing signs of a rise in new cases, with the positivity rate having increased to 7.7% on 29 September.

Figure 16: 5-day rolling average of new COVID-19 cases as at 30 September 2020



Source: Bloomberg

Figure 17: SA 3-day rolling positivity rate as at 30 September 2020

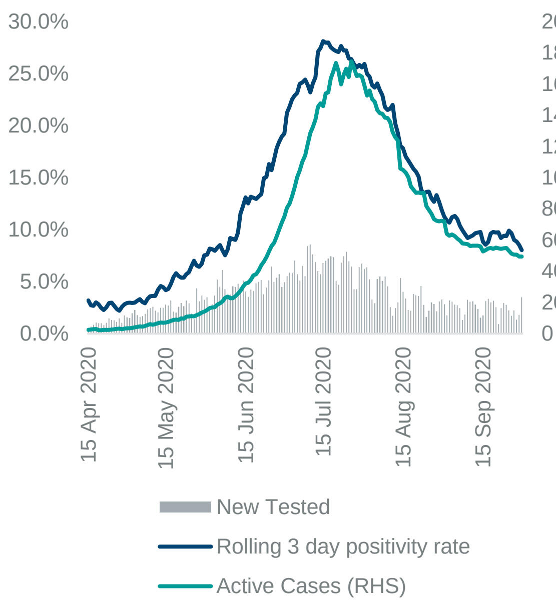
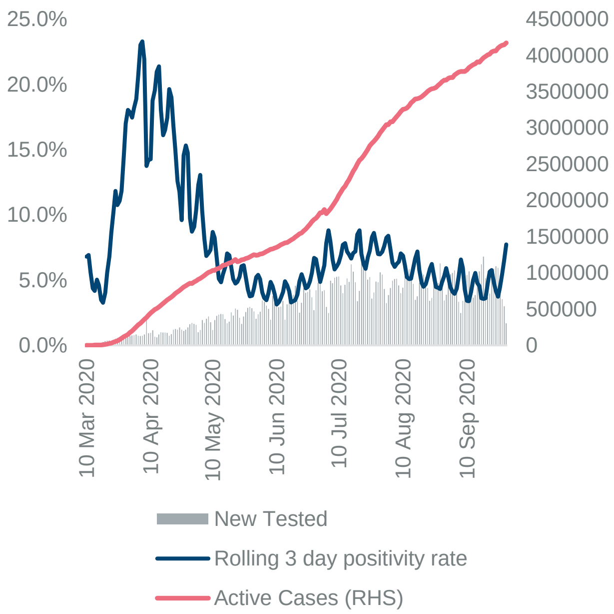


Figure 18: US 3-day rolling positivity rate as at 29 September 2020



Source: Bloomberg, sacoronavirus.co.za, ourworldindata.org

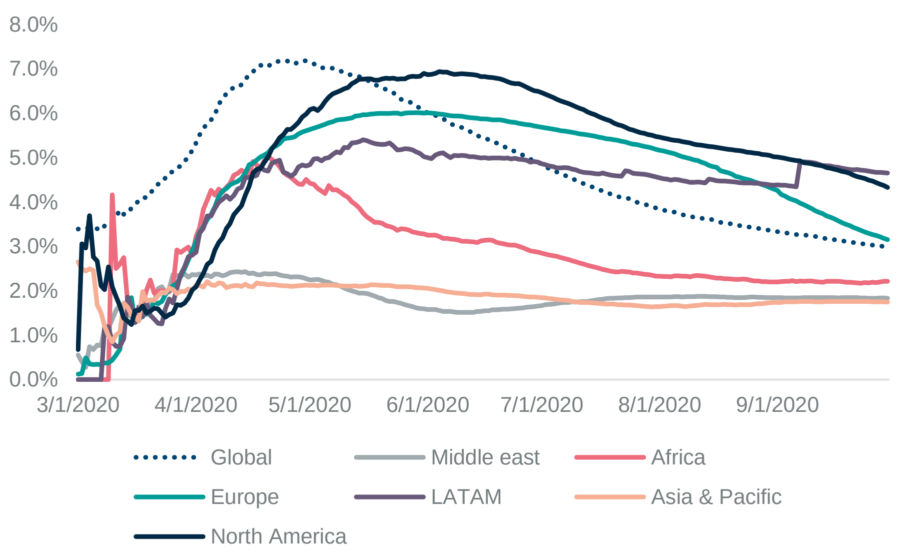
Whether countries re-impose lockdowns and the speed of economic recoveries will largely depend on pandemic-containment strategies and the availability of a COVID-19 vaccine. While pharmaceutical companies race to finish their final trials in the next four months, investors have adopted a more cautious stance as accelerated economic growth requires that vaccines be widely available, and the exact time remains largely unknown. The FDA recently announced further guidelines suggesting that half the participants in trials must be followed for two months after their second dose, making vaccine approval before the November election highly unlikely. However, with some nascent signs that the virus may be mutating into more contagious but less deadly strains, a steady decline in global case-related fatality rates, more medical knowledge of how to treat the symptoms, better prognoses and being a step closer to having a vaccine, we believe that the probability of nationwide lockdowns remains low. More likely are localised restrictions to slow the spread – unless a new outbreak reached a critical and uncontrollable stage, which would result in the risks to public health outweighing the economic costs.

Figure 19: Vaccine timeline

Pfizer (US)			Moderna (US)			AstraZeneca (OUS pooling)		
# of infections to trigger analysis	Projected Timing	Required VE for positive result	# of infections to trigger analysis	Projected Timing	Required VE for positive result	# of infections to trigger analysis	Projected Timing	Required VE for positive result
32	10/8-10/15	>~77%						
62	10/18-10/25	>~68%	53	early-Nov to mid-Nov	>~74%			
92	early-Nov	>~63%	106	late-Nov to early-Dec	>~57%	75	mid-Nov	>~70%
120	mid-Nov	>~59%						
164	late-Nov to early-Dec	>~52%	151	early-Dec to mid-Dec	>~50%	150	early-Jan	>~50%

Source: RMB Morgan Stanley

Figure 20: COVID-19 case-related fatality rate per region as at 30 September 2020



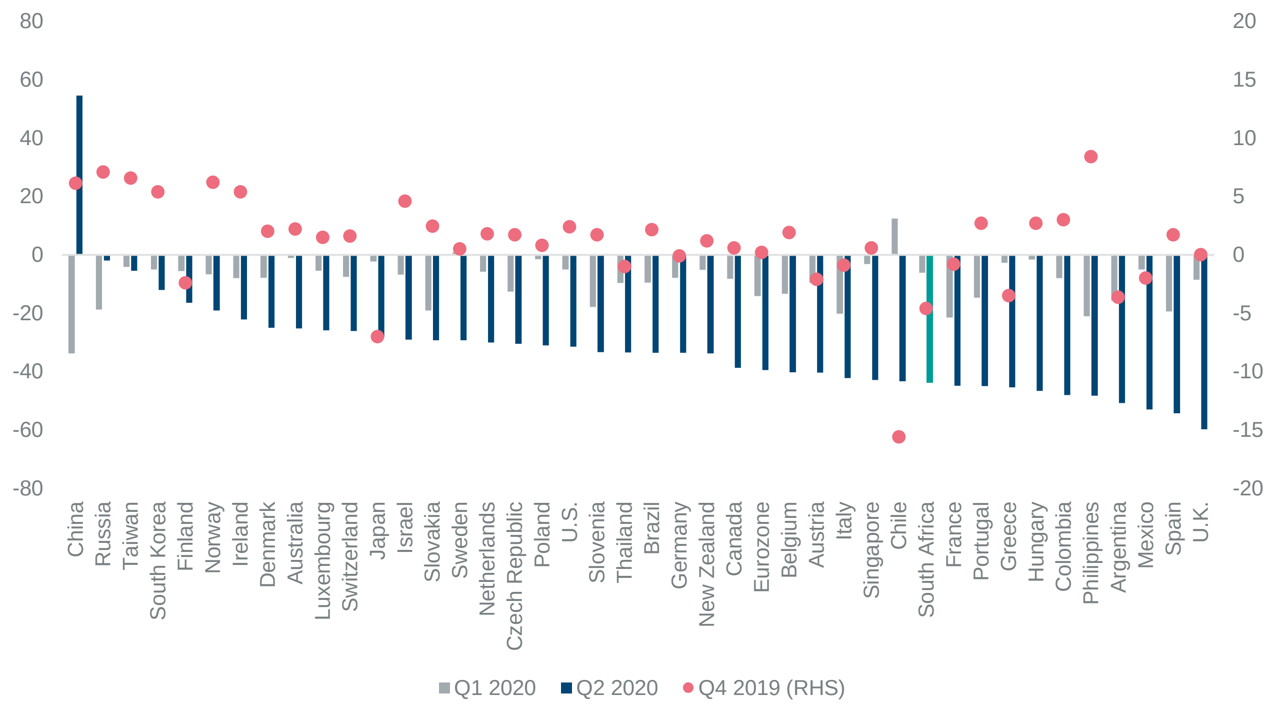
Source: Bloomberg

GRADUAL ECONOMIC RECOVERY UNDER WAY

DIVERGING GDP RECOVERY PATHS

We saw COVID-19-related lockdown measures taking their toll on Q2 GDP figures in most countries. Those countries that were experiencing weak economic growth before the onset of the pandemic typically experienced a sharper contraction in Q2, such as Chile, South Africa and Greece. Those that experienced more severe outbreaks, which were usually accompanied by nationwide lockdowns, such as France, Spain and the UK, also saw their GDP plunge. China implemented lockdown measures in Q1 and has managed to curb the spread since then, with its focus swiftly shifting to economic revival in Q2. Its Q2 GDP managed to rebound. We expect countries that have managed to contain the outbreak and have strong economic fundamentals to recover more quickly and to show a similar pattern in their Q3 GDP growth rate.

Figure 21: Global GDP QoQ% seasonally adjusted annualised



Source: Bloomberg

The outlook for 2020 varies greatly across regions, with China being the only country expected to have a positive GDP growth rate in 2020, according to the latest Global Economic Outlook report by FitchRatings. Data also seem to suggest that the COVID-19 crisis has done less damage to the world economy – thanks to the unprecedented and swift remedial actions taken by governments and central banks.

The recovery path diverges across developed markets and emerging markets, with countries such as Switzerland, China, Brazil and the US gaining some positive momentum, with other countries such as India, Spain, the UK and South Africa going into a deeper slump. According to the latest update from the SARB, the Q3 GDP for South Africa is expected to contract by 9% year on year, which is slightly better than the median forecast of –10.8% by a Bloomberg survey of six economists.

Figure 22: FitchRatings global GDP growth 2020 forecast

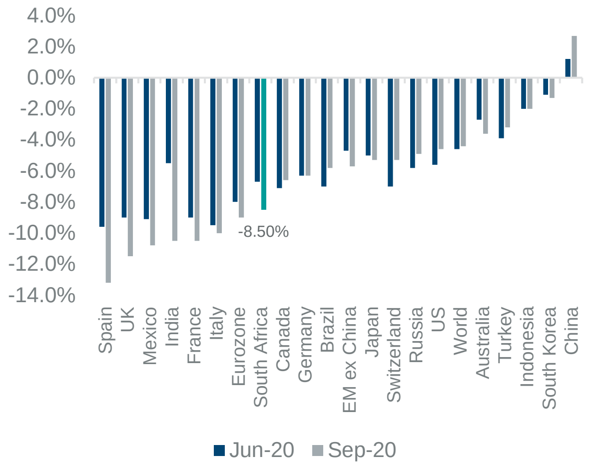
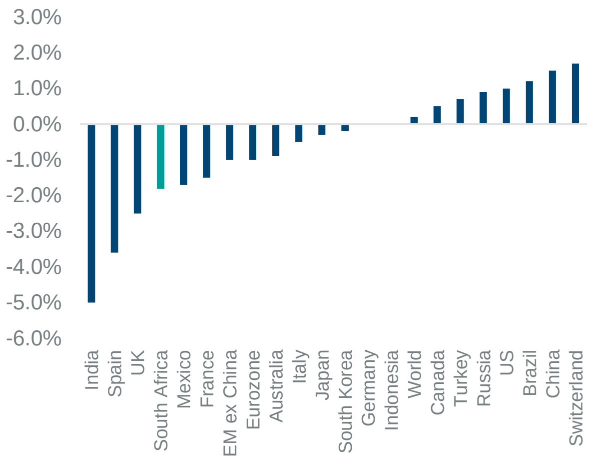


Figure 23: FitchRatings global GDP growth 2020 forecast revision



Source: FitchRatings

The OECD Interim Economic Outlook forecasts have posted slightly more conservative growth expectations for 2020 and the respective outlooks for countries such as South Africa and Italy are much worse than those provided by FitchRatings. The OECD is, however, as bullish about China and the US but have become more pessimistic about India and South Africa. The OECD expects global GDP to return to its Q4 2019 level by the third quarter of 2021 in their base case, or by the first quarter of 2021 in their bull scenario.

Figure 24: OECD global GDP growth 2020 forecast

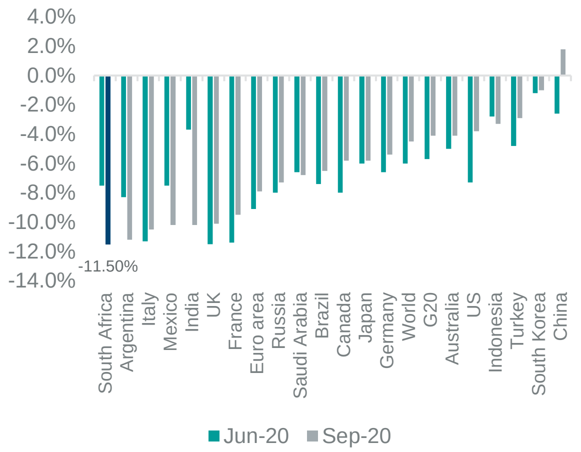


Figure 25: OECD global GDP growth 2020 forecast revision

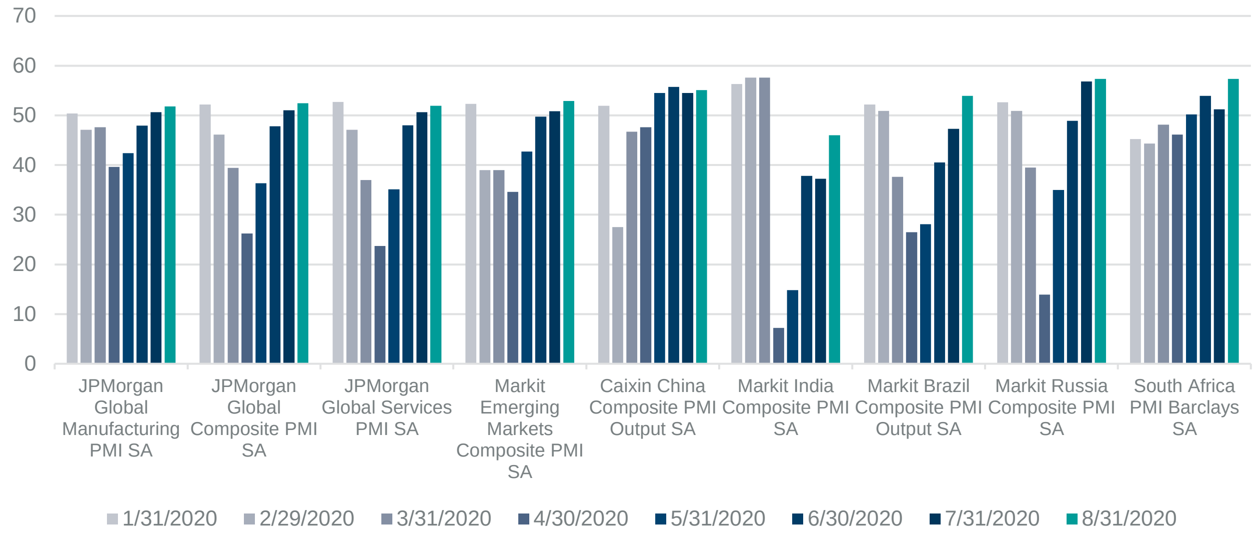
Source: OECD

INDUSTRIAL-LED RECOVERY AND IMPROVING TRADING CONDITIONS

We have observed recovery in PMIs in both developed and emerging markets since April. Most of the countries reported numbers above the neutral level of 50 by August, indicating improving manufacturing and business conditions post-lockdown. However, PMIs for Germany, France, Italy, Spain, Ireland and Australia ticked lower in August. Germany's composite PMI was dragged lower by weaknesses in its services sector as fresh coronavirus restrictions weighed on activities. However, manufacturing remained upbeat. The US non-manufacturing sector PMI continued to be one of the strongest among the developed nations, with September data reported to be 57.8. However, business activities paused to build on the upward trend over the same period. The China non-manufacturing PMI improved further from 55.2 in August to 55.9 in September. The data suggest that sustaining further momentum after early gains may not be as easy in regions that are still exposed to a heightened COVID-19 health risk.

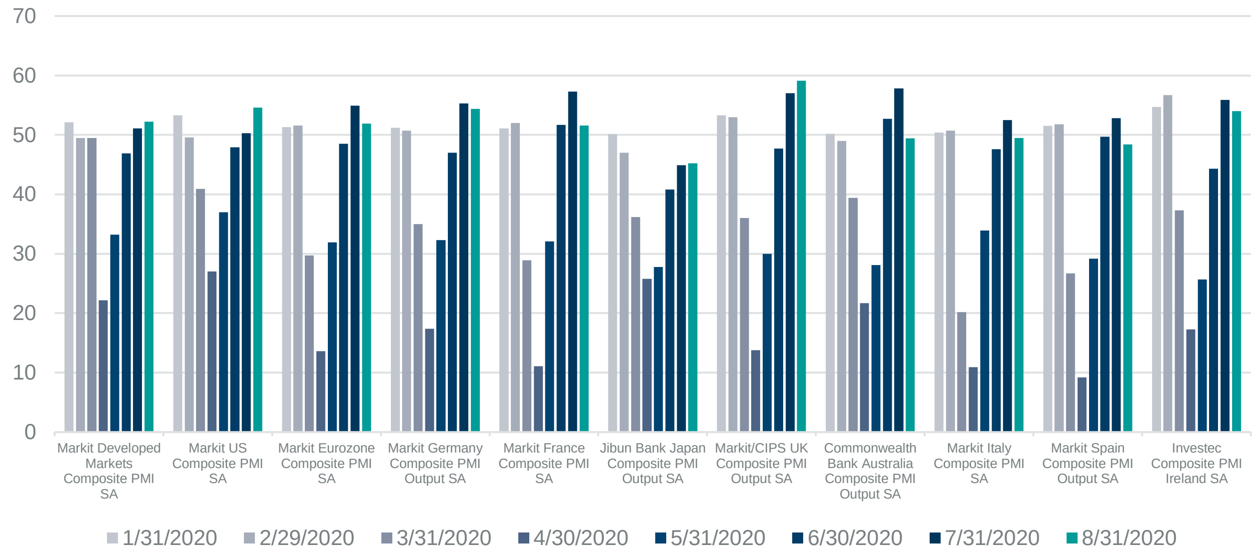
The South Africa PMI jumped from 53.9 in June to 58.3 in September as the local economy recovered from a collapse in output due to the COVID-19-related lockdowns. However, according to the head of the South African Reserve Bank's economic research department, Chris Loewald, getting output back to pre-pandemic levels may take several years.

Figure 26: Global and EM PMIs



Source: Bloomberg

Figure 27: Developed market PMIs



Source: Bloomberg

Figure 28: Germany PMI

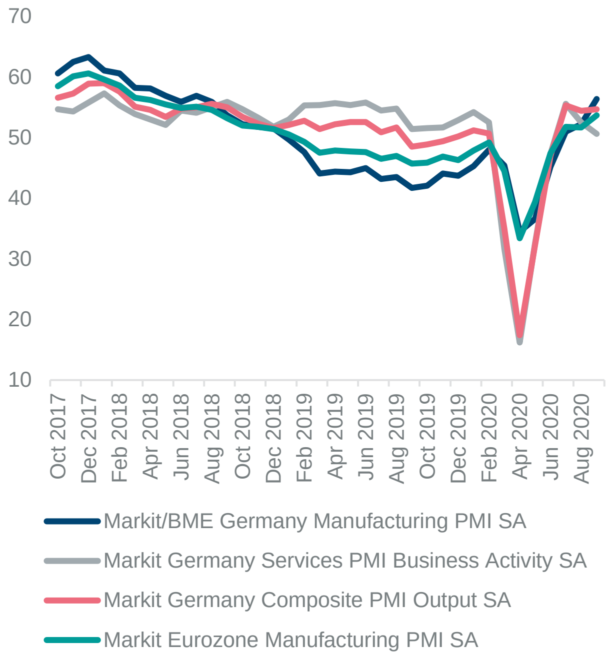
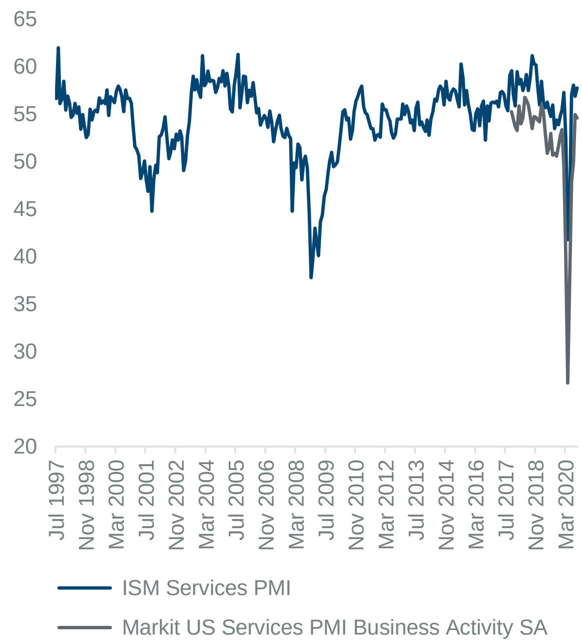


Figure 29: US services PMI



Source: Bloomberg

We have also seen a rebound in industrial production from Q1 or Q2 through most regions of the world, with the actual month differing as COVID-19 has affected each country in turn. However, apart from China, which posted four consecutive months of positive year-on-year growth rates (5.6% in August), the industrial production growth rate year on year remained in the red for the Euro area (–7.6% in July), Japan (–13.3% in August) and the US (–7.73% in August).

Figure 30: Euro area business climate and industrial production

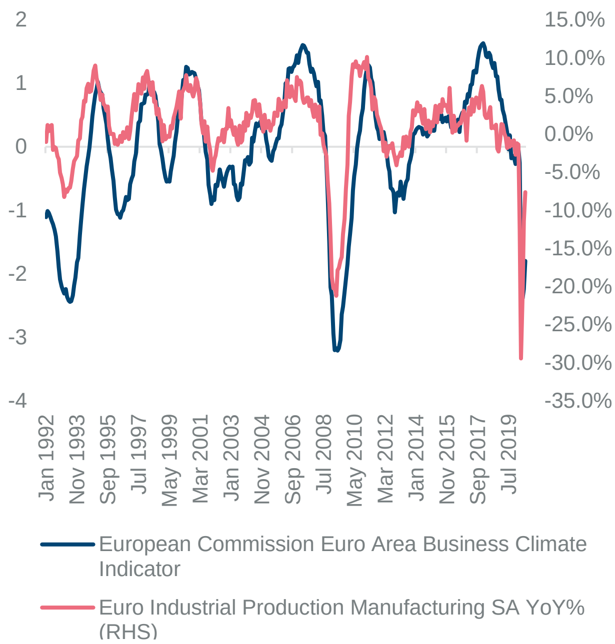
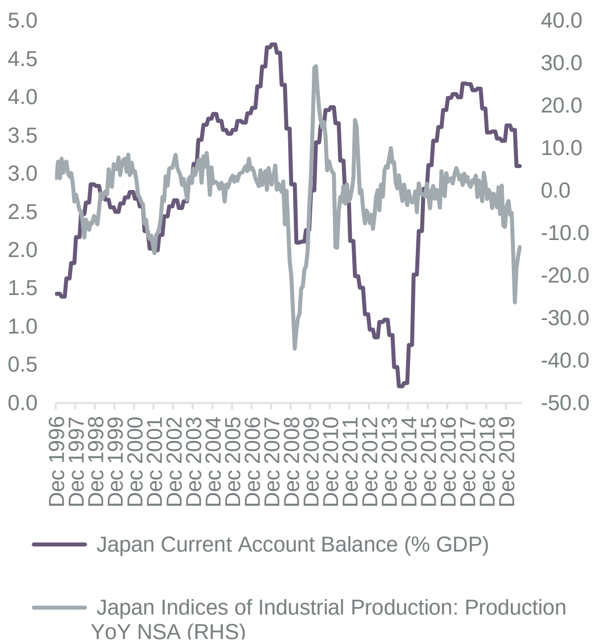


Figure 31: Japan industrial production



Source: Bloomberg

Figure 32: US industrial production

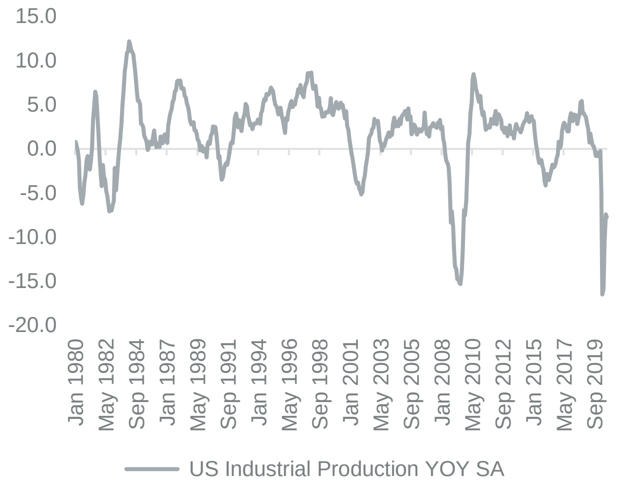


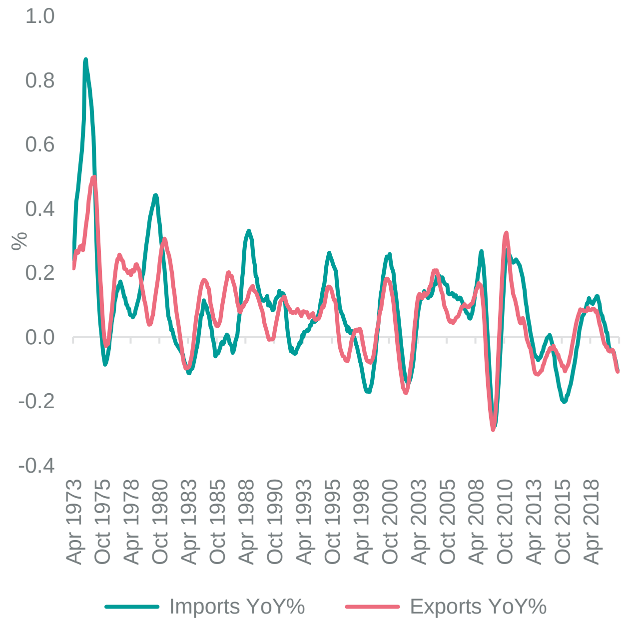
Figure 33: China industrial production

Source: Bloomberg

As economies normalised further in Q3, we also saw trading conditions improve. However, the extent of recovery in each region has been rather mixed. China's year-on-year export growth rallied from 4.3% in June to 11.6% in August, but imports weakened from 6.2% to –0.5% over the same period. Growth in Japanese exports and imports year on year persistently traded lower over the quarter, with the latest figures in August being –10.8% and –10.5%, respectively. South Korea's exports and imports have been relatively weak, with export and import growth struggling to climb above the zero mark from mid-teen negatives. South Korea did, however, post export and import year-on-year growth rates of 7.7% and 1.1%, respectively, after six months of contraction.

Figure 34: China imports and exports

Figure 35: Japan imports and exports



Source: Bloomberg

Euro area aggregate data showed that Q2 exports and imports year on year contracted by –21.5% and –20.7%, respectively. However, we expected that they would slowly recover from that point on, as

Germany’s year-on-year export and import growth rates improved from –14.6% and –13.4% in June to –10.8% and –11.3% in July. France’s exports and imports made similar gains as year-on-year growth rates improved from –22.5% and –14.6% in June to –16.0% and –10.4% in July. The US’s export growth rate year on year was much lower than that of imports, albeit improving from –33.4% in May to –20.1% in July. US imports also made a significant recovery, from –24.4% to –11.4% over the same period. South Africa’s imports remained dismal, nudging from –32.8% in June to –20.7% in August, in the face of weak domestic demand. Export growth year on year jumped from –49.9% in May to 8.7% in August as the easing of restrictions improved logistics and cargo movements.

Figure 36: South Korea imports and exports

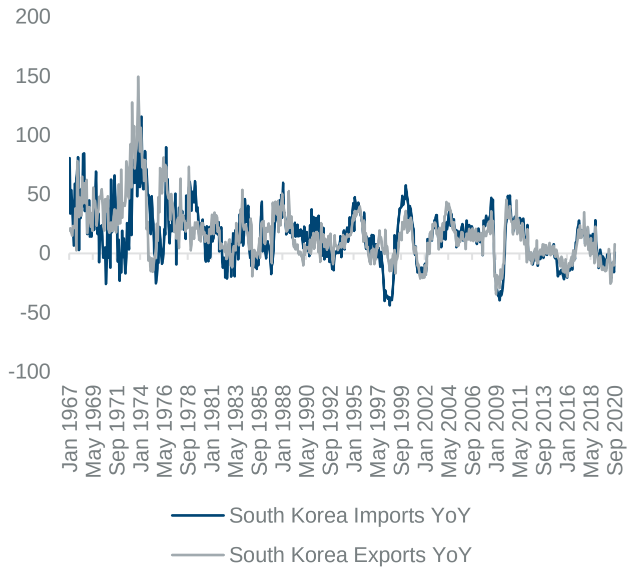


Figure 37: Euro area imports and exports

Source: Bloomberg

Figure 38: US imports and exports

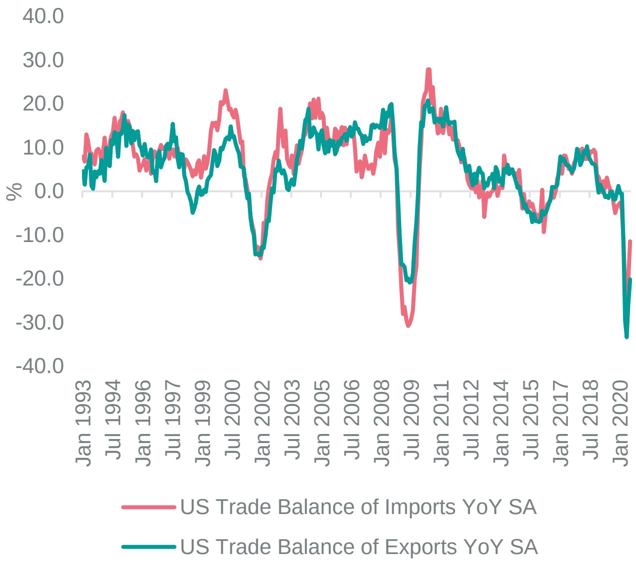
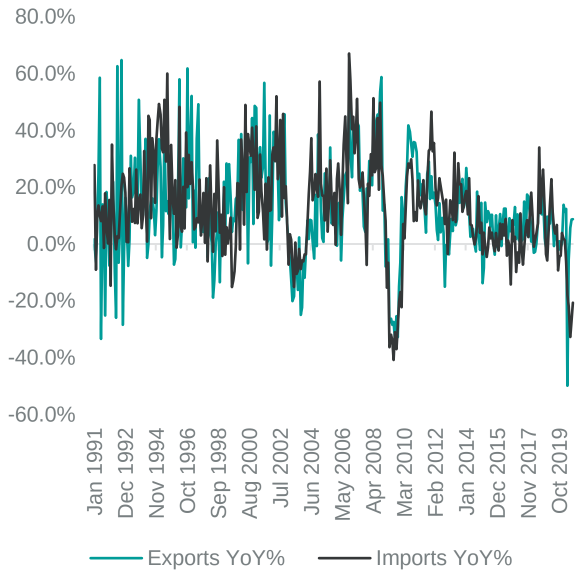


Figure 39: South Africa imports and exports



Source: Bloomberg

CONSUMERS REMAIN CAUTIOUS

What we have seen from the previous import data is that domestic demand remained weak in most regions. This was reflected in suppressed consumer sentiment, whose recovery lagged behind that of businesses, which adopted a more cautious stance against the backdrop of widespread uncertainty and a lack of visible prospects in the near-term job market. US consumer confidence continued to make slow gains. Both the University of Michigan Consumer Sentiment Index and Conference Board Consumer Confidence Index edged higher from 78.1 and 98.3, respectively, in June to 80.4 and 101.8, respectively, in September. The Bloomberg US Weekly Consumer Comfort Index also ticked up from 43.3 to 49.3 over the same period. The European Commission Consumer Confidence Index was largely flat at –14.7 for June and August, still some distance away from its long-term average of –10.

Figure 40: University of Michigan Consumer Sentiment Index

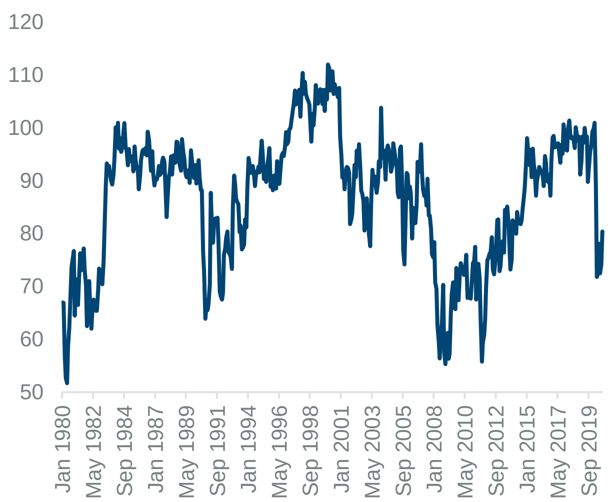
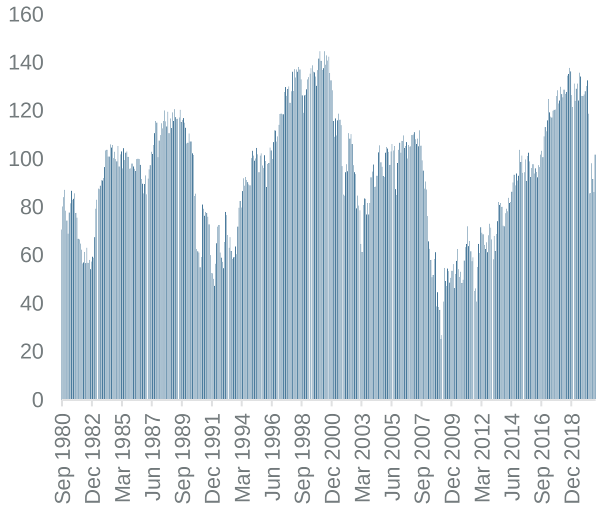


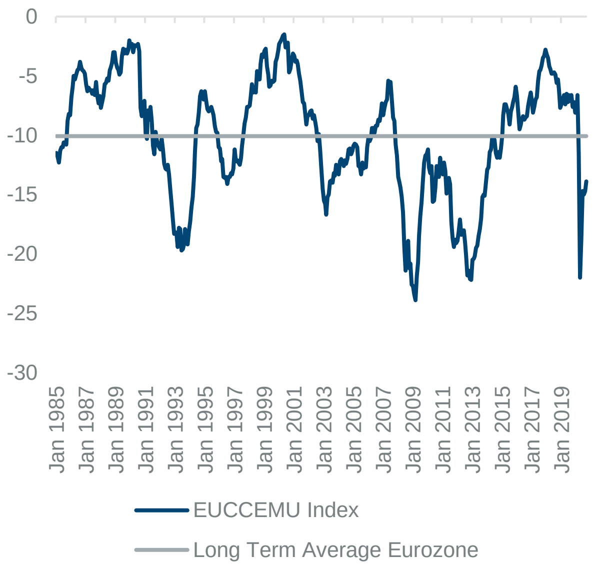
Figure 41: Conference Board Consumer Confidence Index



Source: Bloomberg

Figure 42: Bloomberg US Weekly Consumer Comfort Index

Figure 43: European Commission Consumer Confidence Index

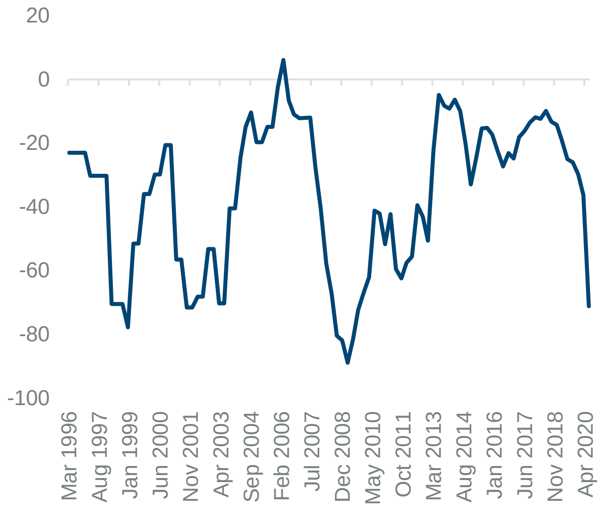


Source: Bloomberg

While the Bank of Japan Consumer Sentiment Index on present economic conditions fell from –36.3 in Q1 to –71.2 in Q2, Japan's Consumer Confidence Overall Index improved from 30.5 in June to 33.8 in September. The Bureau for Economic Research South Africa Consumer Confidence Index also showed some recovery, up from –33 to –23, but relatively more pessimistic than in the developed world.

Figure 44: Japan Consumer Confidence overall nationwide

Figure 45: Bank of Japan Consumer Sentiment Diffusion Index NSA present economic conditions



Source: Bloomberg

If the Consumer Confidence Index indicates consumers' outlook on the economy and their personal financial situation in the short term, retail sales reflect consumers' actual behaviour.

Figure 46: BER SA Consumer Confidence Index

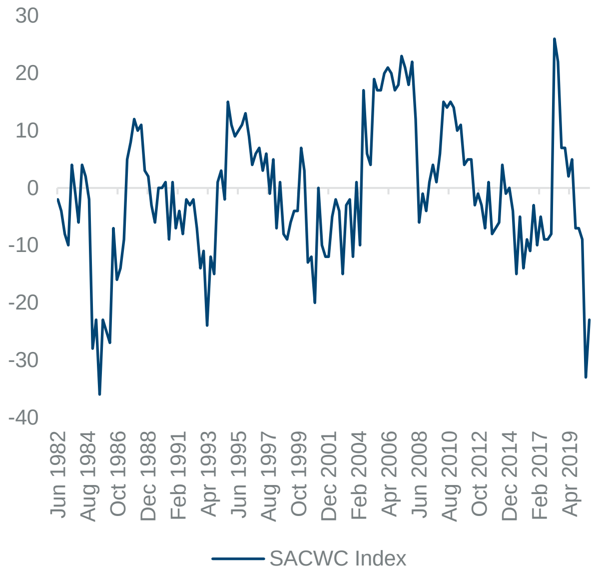
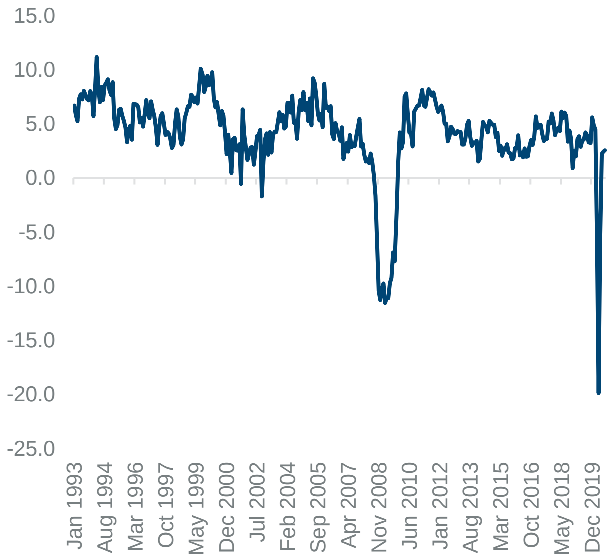


Figure 47: US retail sales less autos and gas stations seasonally adjusted YoY

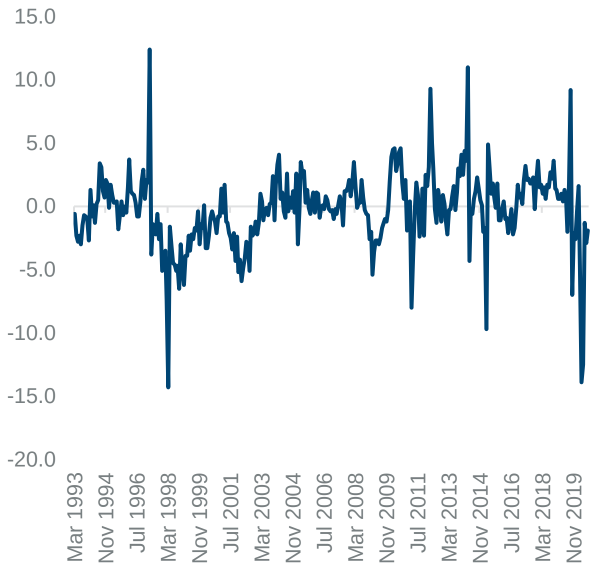


Source: Bloomberg

Retail sales data in the US and Eurozone are much more resilient than those of China, Japan and South Korea, largely due to the scale of unemployment benefits and furlough programmes that plugged the income holes during lockdowns. The growth rate in US retail sales year on year ticked up from 2.23% in June to 2.57% in August. Eurozone retail sales improved sharply from 1.4% in June to 3.7% in August, despite a –0.1% dip in July. Japan's retail sales year on year improved from –13.9% in April to –1.3% in June, but lacked the momentum to go higher, and contracted by 1.9% in August. China's retail sales made slow but steady gains, moving from –1.8% in June to 0.5% in August. SA retail sales suffered the largest blow with –48% in April as the nationwide lockdown brought the economy (already weak before the pandemic) to a standstill. The growth rate in retail sales year on year improved to –8.2% in June but dipped to –8.9% in July as household income came under severe strain and the path to recovery remained highly uncertain.

Figure 48: Eurostat retail sales Eurozone volume YoY WDA

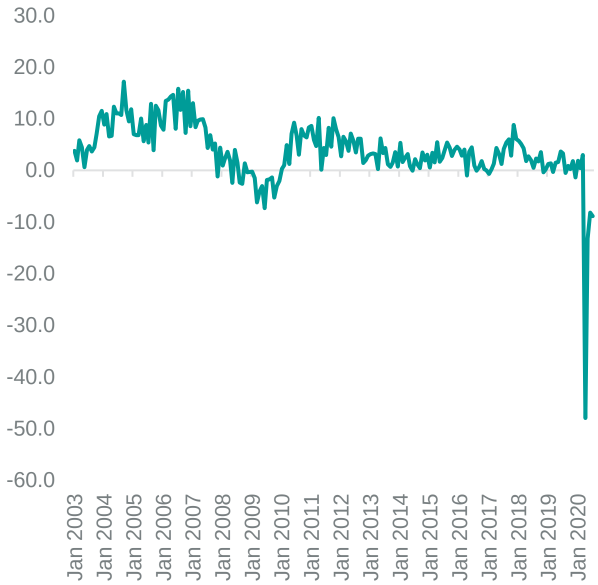
Figure 49: Japan retail trade YoY NSA



Source: Bloomberg

Figure 50: China retail sales value YoY

Figure 51: South Africa retail sales real YoY% SA



Source: Bloomberg

While SA total car sales jumped from –98.8% in April to –23.9% in September as lockdown restriction eased, this was in stark contrast to the data for China, which saw its year-on-year passenger vehicle sales grow by 7.9% and 8.8% in July and August, respectively, driven largely by sales of electric cars.

Figure 52: South Africa total and new car sales YoY%

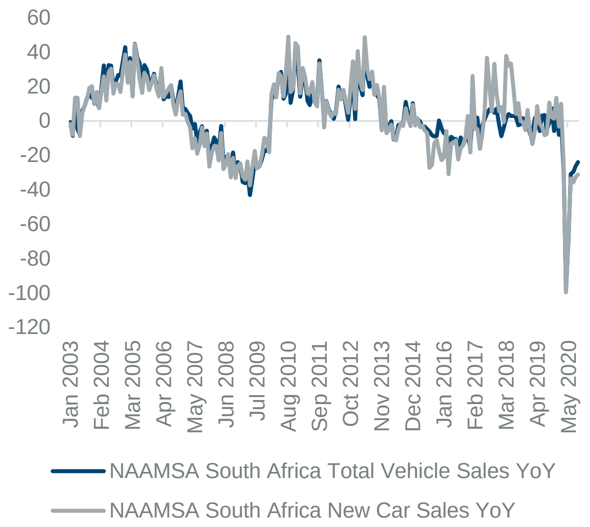


Figure 53: China passenger vehicle sales YoY%

Source: Bloomberg, China Passenger Car Association

Steady US consumer sentiment together with an all-time-low mortgage rate also boosted the US housing market. What came as a surprise were the nascent signs of a rebound in our local housing market. According to FNB Economics, the housing price index increased to 1.4% year on year in July from 0.7% in June, supported by the compression of the demand and supply gap. Low interest rates and lower transfer duties, together with a growing work-from-home trend, also stimulated buyers' interest in picking up bargains and boosted demand for larger homes. The concern is that the weak domestic labour market may put downward pressure on house prices.

Figure 54: US building permits and new home sales

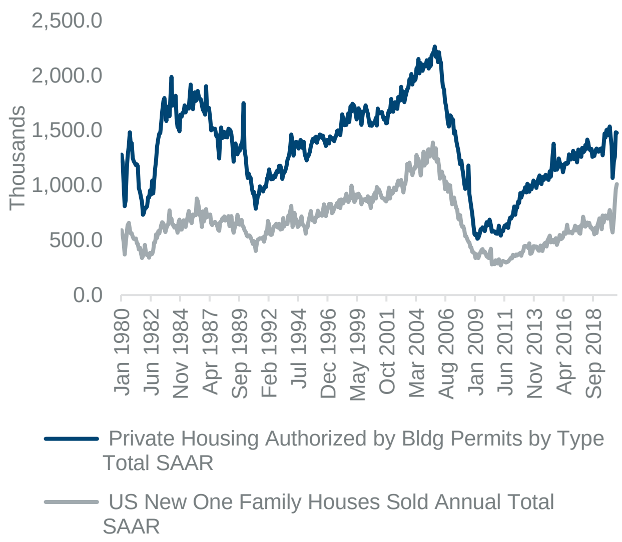
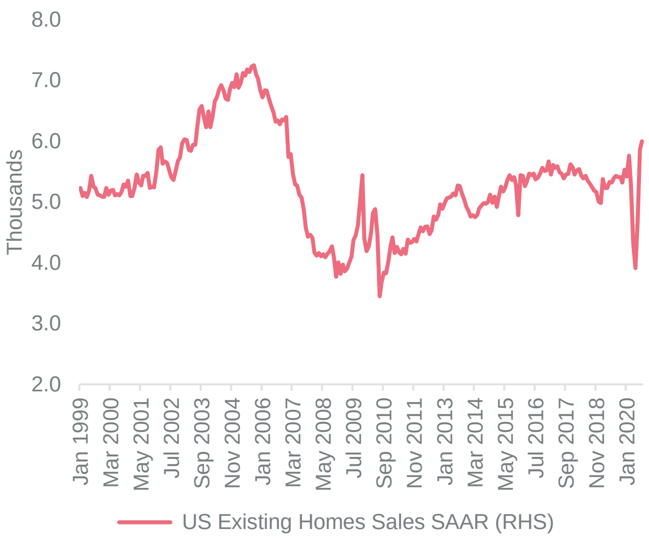
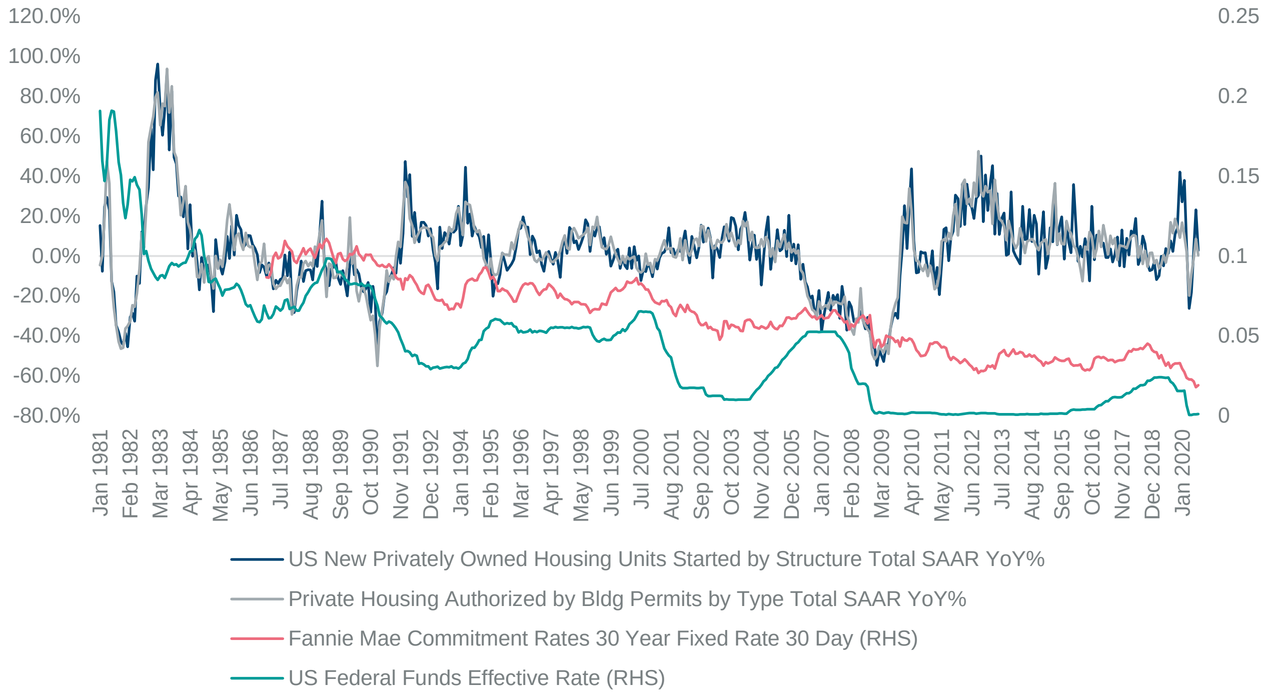


Figure 55: US existing home sales



Source: Bloomberg

Figure 56: US building permits and housing starts YoY% vs mortgage rate



Source: Bloomberg

Figure 57: FNB Housing Price Index

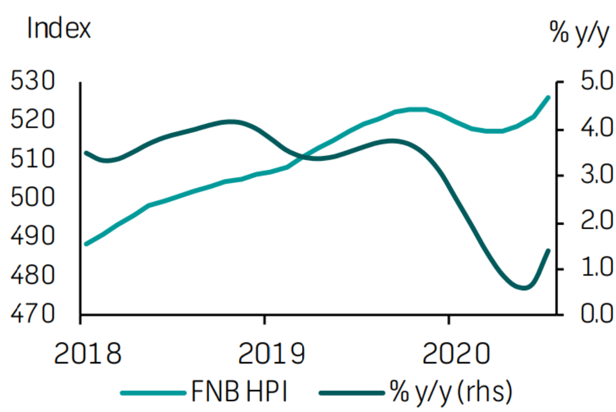
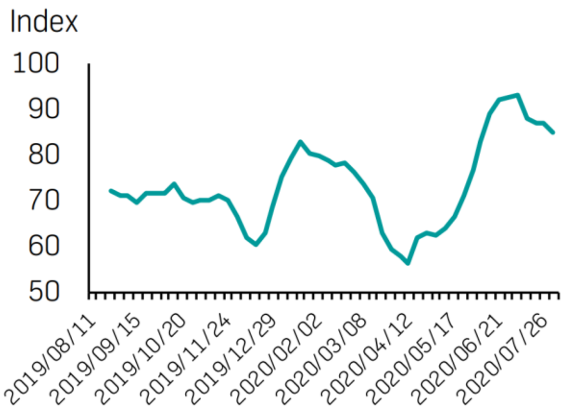


Figure 58: Buyer Interest Index 4-day moving average



Source: FNB Economics

The US unemployment rate saw a steady decline from 14.7% in April to 7.9% in September, albeit still far from the rate of 3.5% prior to the pandemic. Initial jobless claims and continual jobless claims also trended lower, from about 1.3 million and 16 million in June to about 850 000 and 11.7 million in September. Non-farm payrolls have been beating market expectations since May, adding about 2.5 million, 4.8 million, 1.7 million and 1.3 million jobs in the period May to August. However, the latest September figure of 661 000 fell below the market consensus of 859 000. This is a sign that, while reopening brought some jobs back, certain sectors may take longer to recover, while some jobs may not return in the medium term as corporate retrenchment plans are implemented to protect profitability when the initial rounds of government stimulus expire. US ADP employment change data also softened in July and August, with the September figure (749 000) being slightly above market expectations (649 000).

Figure 59: U-3 US unemployment rate total in labour force, seasonally adjusted

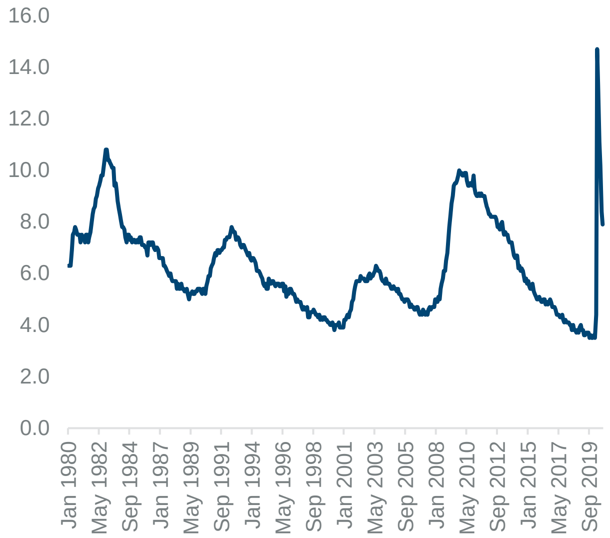
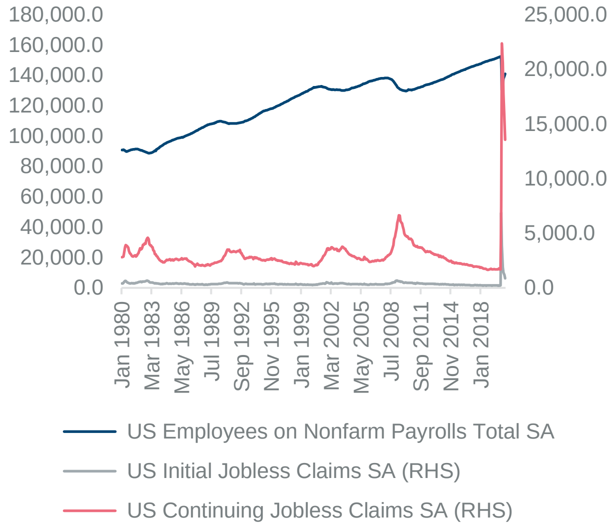


Figure 60: US payrolls and jobless claims



Source: Bloomberg

Owing to the structure of the income subsidy supporting furlough programmes, the unemployment rate in the Eurozone saw a more modest increase compared to the US, with the former increasing from 7.8% in June to 8.1% in August. Germany's unemployment rate increased from 5.0% in March to 6.3% in September. The UK's ILO unemployment rate increased from 3.9% in March to 4.1% in July. Japan, which never went into a nationwide lockdown, saw its jobless rate increase from 2.5% in March to 3.0% in August.

Figure 61: EU unemployment rate

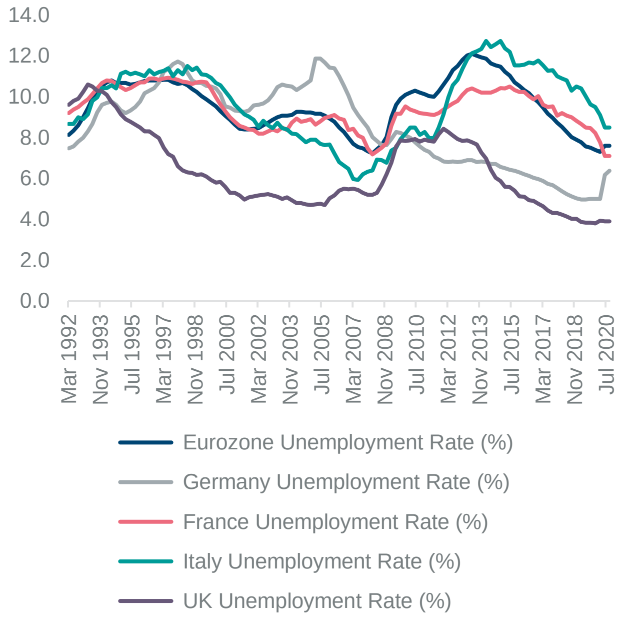


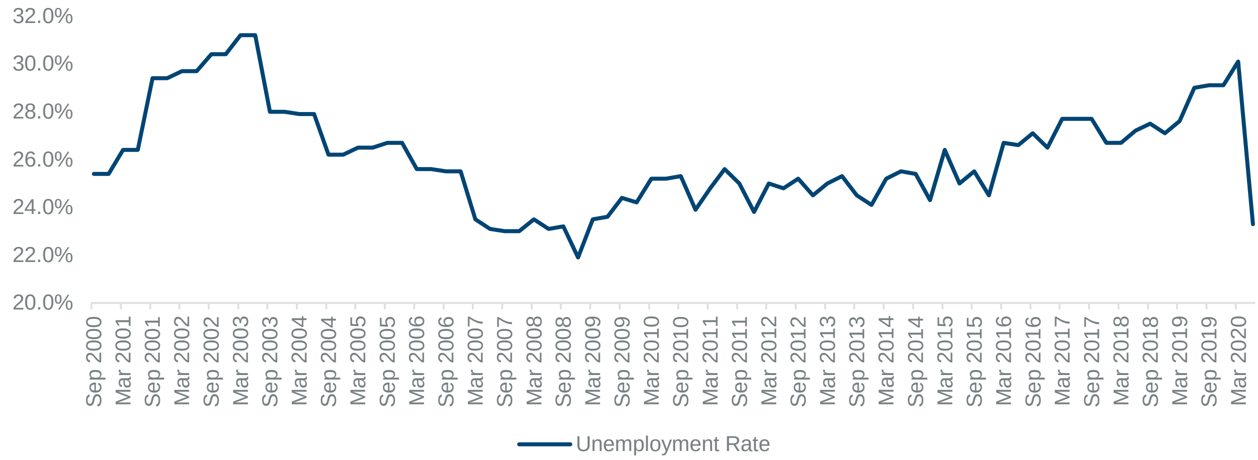
Figure 62: Japan unemployment rate

Source: Bloomberg

Surprisingly, South Africa saw its unemployment rate drop from 30.1% in Q1 to 23.3% in Q2, beating the market consensus of 34.9%. However, this is attributable to an increase of 5.2 million non-economically active individuals whose ability to seek work was impacted by the lockdown. If we use the expanded definition of unemployment, the unemployment rate increased from 39.7% to 42% over the same period.

While the SA PMI number has been in expansionary territory in recent months, the sub-index for employment remained below the neutral level of 50, improving from 32.7 in June to 44.5 in September. This suggests that manufacturing is very optimistic about the level of business activity, new orders and business conditions. However, jobs are still being shed, albeit at a slower rate. What is also worth highlighting is that, according to Stats SA, only 81.3% of those who stayed employed during the lockdown received an income while 21.1% had their salaries cut. The softness in the domestic labour market mirrors the subdued growth in retail sales.

Figure 63: SA unemployment rate



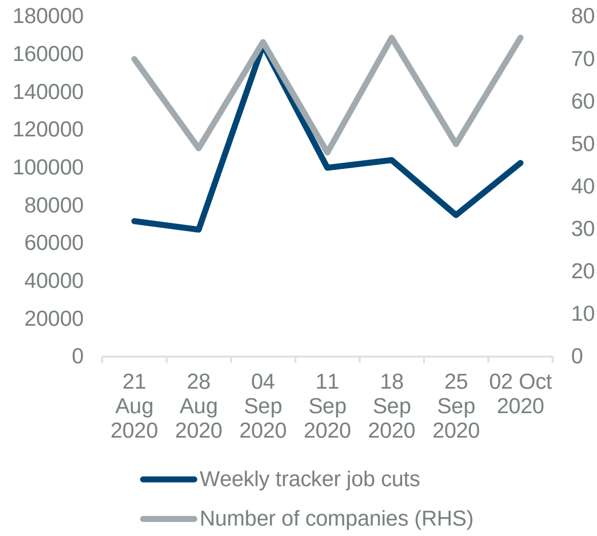
Source: Bloomberg

We have observed an increasing number of companies announcing job-cut plans, not to mention sectors that were severely impacted by the pandemic, such as air transport, oil, automobiles and restaurants. One of the latest victims of COVID-19 is Disney and its theme park business, while a number of banks have resumed job cuts after pausing these during the pandemic. Continental European banks have disclosed the highest number of job losses, with job cuts in the sector totalling 67 800 so far this year, which could well top last year's total of 79 500.

Figure 64: International Trade Union Confederation COVID-19 Job Cuts Tracker for September 2020

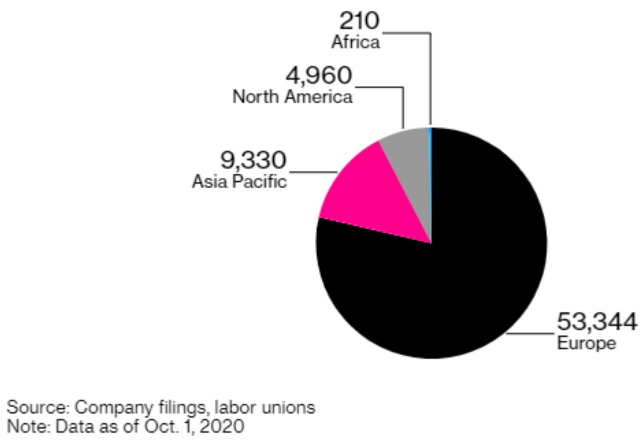
Source: www.ituc-csi.org/jobcutstracker

Figure 65: ITUC Job Cuts Tracker weekly over time



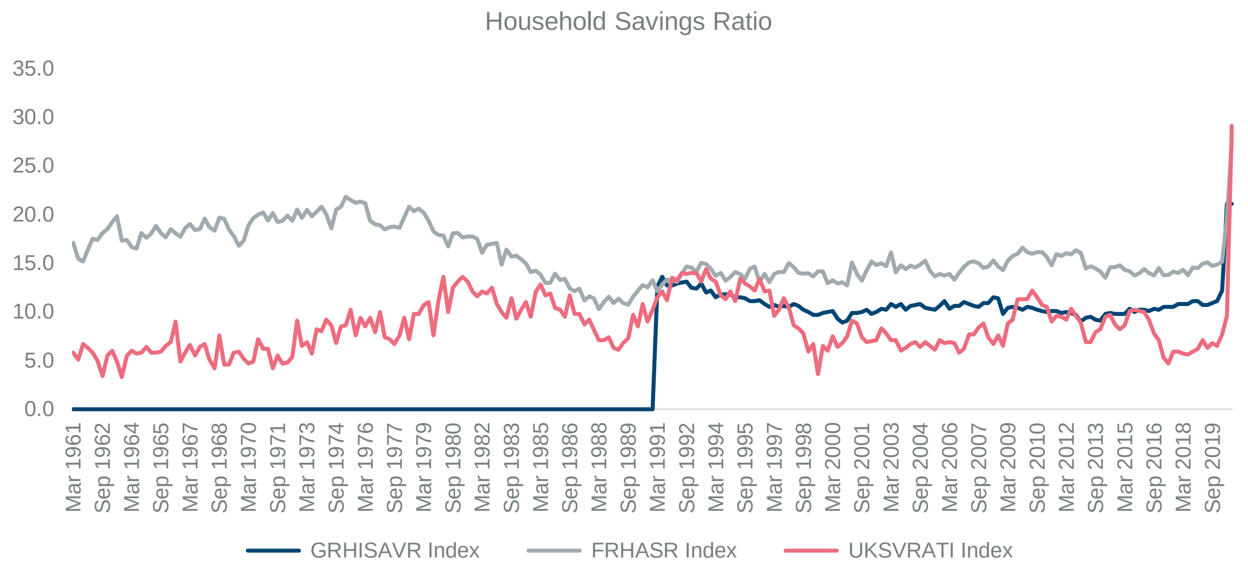
Source: www.ituc-csi.org/jobcutstracker, Bloomberg

Figure 66: Banking job losses in 2020



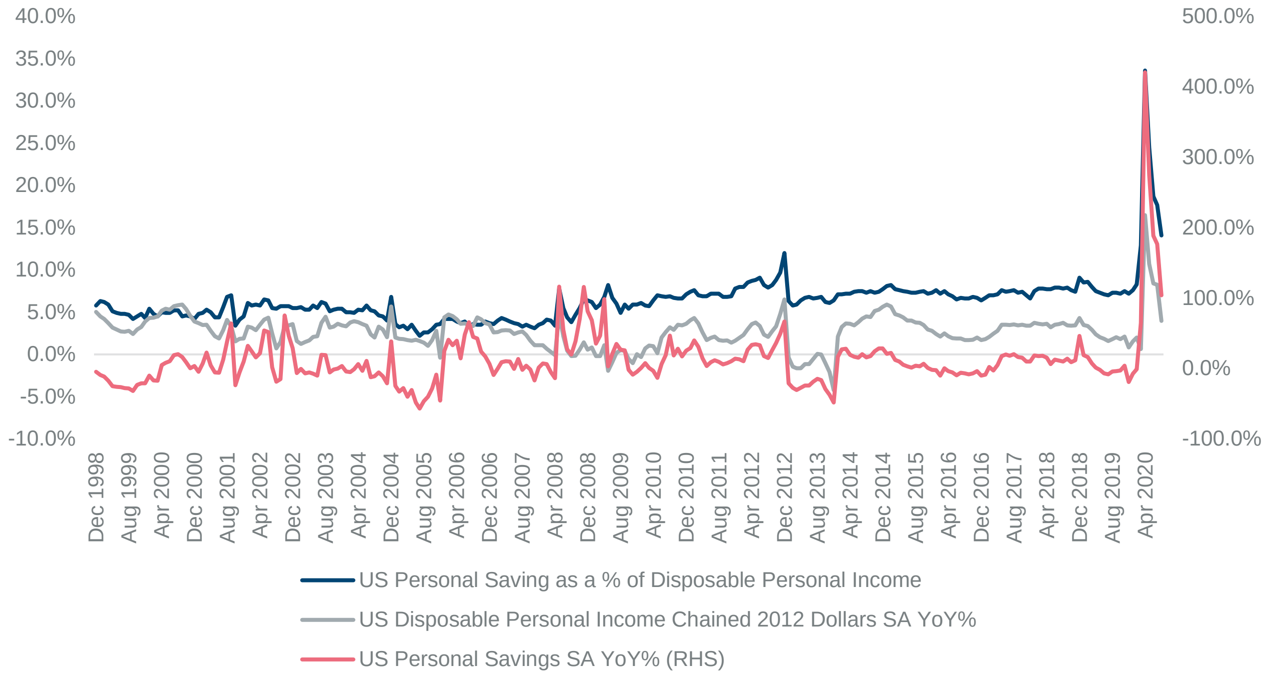
As corporates shed jobs to cut costs in order to support net profit margins and liquidity as COVID-19 government subsidies wane, it raises the notion of consumer spending and saving for rainy days, as shown in Figure 67 below. The chart shows that Germany's household income-savings ratio jumped from 11.1% to 21.1% from the end of 2019 to June 2020. Similarly, France's and the UK's household savings ratios jumped from 15.14% and 7.7%, respectively, to 27.41% and 29.1%, respectively. US personal savings also increased from 7.2% to 14.1% of disposable income from December 2019 to August 2020, after peaking at 33.6% in April, largely driven by extensive unemployment benefits. At the same time, we have seen US household debt-to-disposable income fall from 96.54% in Q1 to 88.18% in Q2, but for the UK, the ratio increased from 134.42% to 139.22% over the same period.

Figure 67: European household savings ratio



Source: Bloomberg

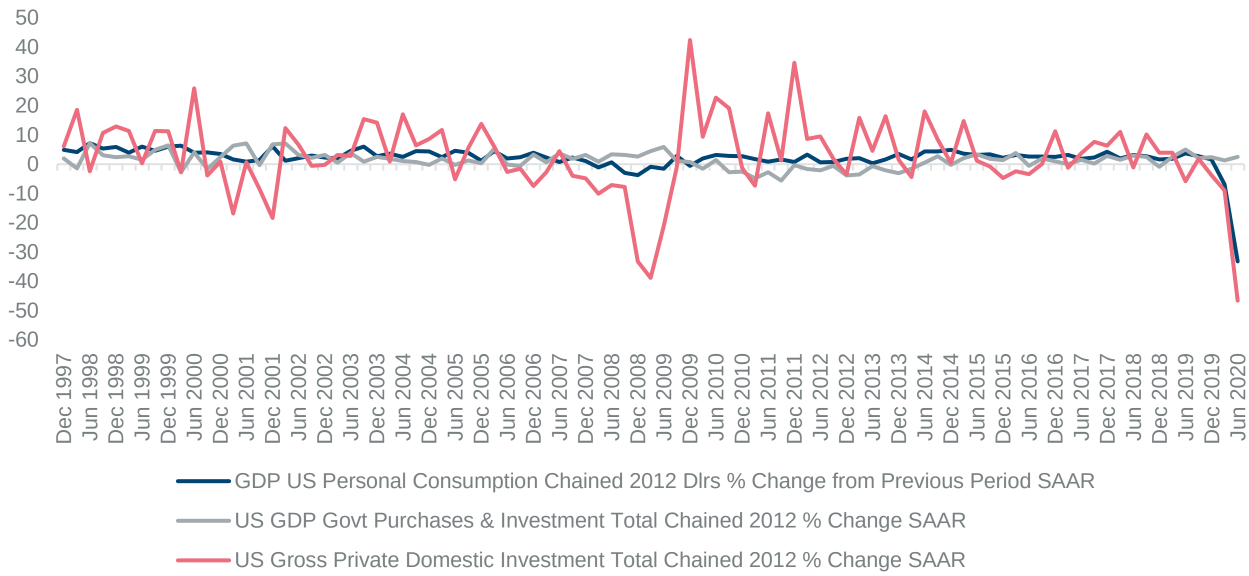
Figure 68: US personal savings-to-disposable income ratio



Source: Bloomberg

Ultimately, consumer spending continues to be the dominant growth engine in many economies. Unless fundamentals improve further and employers hire back workers, spending and saving patterns in the average household will not change.

Figure 69: US personal spending, government spending and private domestic investments YoY



Source: Bloomberg

BUSINESSES AWAKENING FROM COVID-INDUCED COMA

Business sentiment is generally more upbeat than consumer sentiment as the easing of lockdown restrictions immediately improved operating conditions and production levels. We saw the USA Business Tendency Manufacturing Confidence Composite jump from 98.16 in April to 100.74 in August. Both the Dallas Fed Manufacturing Outlook Level of General Business Activity and Dallas Fed Manufacturing Outlook Production improved further from –6.1 and 13.6, respectively, in June to 13.6 and 22.3, respectively, in September, which is certainly very bullish. The US Federal Reserve Bank of New York Weekly Economic Index and the US Federal Reserve Bank of San Francisco Daily News Economic Sentiment have also continued to show a recovery since June, although they are still well off their 2019 levels.

Figure 70: USA Business Tendency Manufacturing Confidence Composite OECD

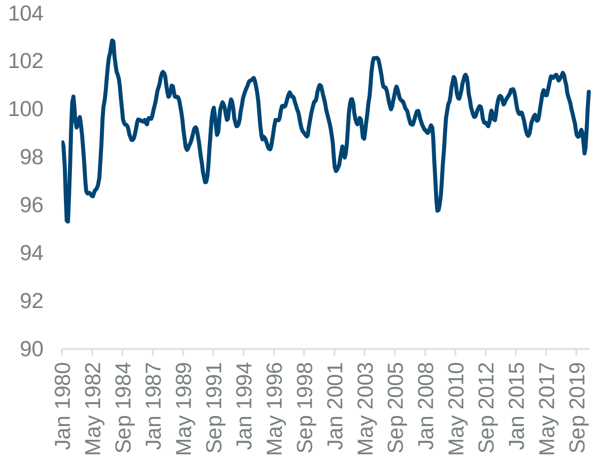
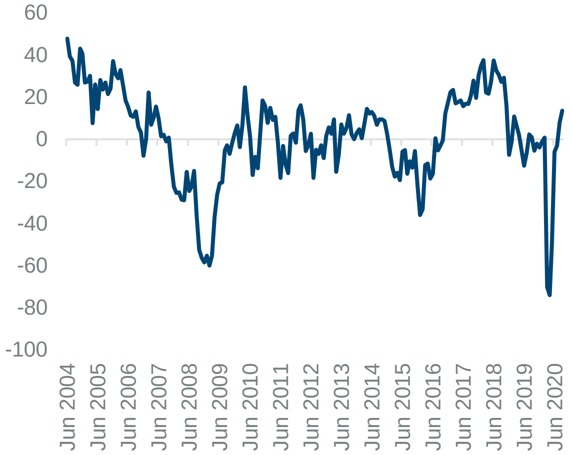


Figure 71: Dallas Fed Manufacturing Outlook Level of General Business Activity



Source: Bloomberg

Figure 72: Dallas Fed Manufacturing Outlook Production

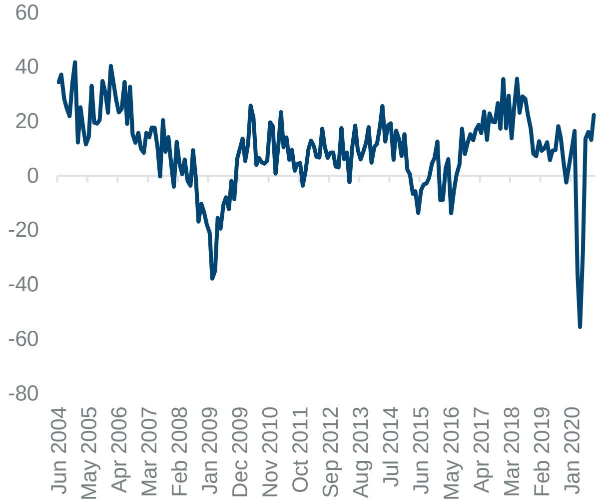
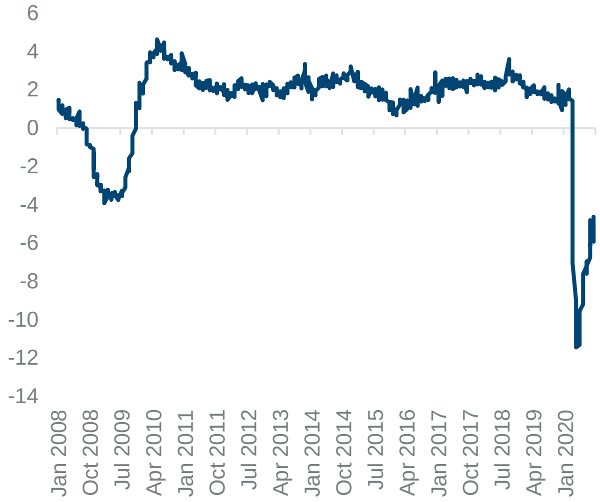


Figure 73: US Federal Reserve Bank of New York Weekly Economic Index



Source: Bloomberg

The Eurozone Economic Sentiment Indicator increased from 75.8 in June to 87.5, narrowing the gap with its long-term average. Japan SME manufacturing and all-industry business confidence both rebounded from –65.9 and –64.1 in Q2 to –40.8 and –34.1 in Q3, suggesting that the operating environment for small and medium enterprises in that country remained challenging. Locally, SA business confidence improved from 5 to 24 between Q2 and Q3, according to the Bureau for Economic Research. In a survey conducted by SACCI, business confidence also rebounded, from 70.1 in May to 82.8 in July, as the lockdown eased.

Figure 74: US Federal Reserve Bank of San Francisco Daily News Economic Sentiment

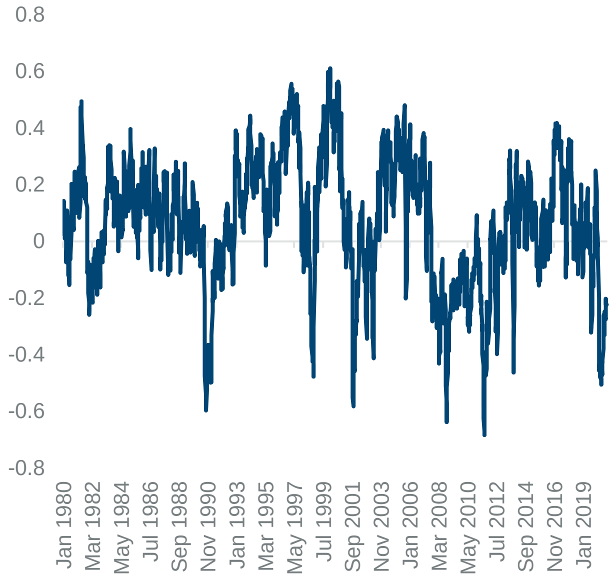
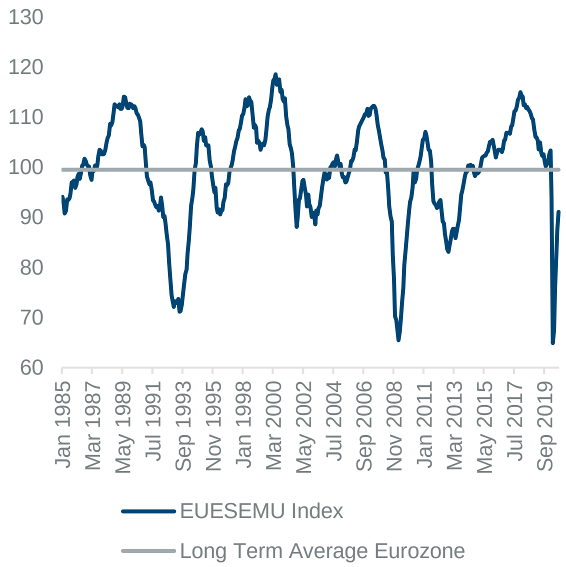


Figure 75: European Commission Economic Sentiment Indicator Eurozone



Source: Bloomberg

Figure 76: Japan SME Business Survey: Business Confidence Manufacture

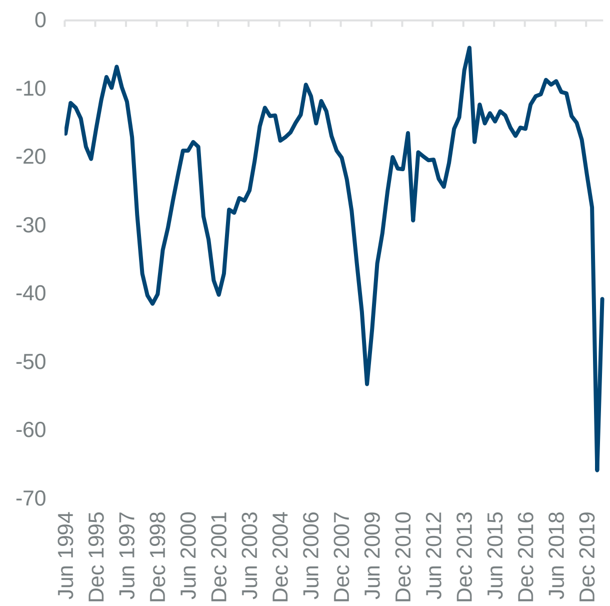


Figure 77: Japan SME Business Survey: Business Confidence All Industry

Source: Bloomberg

Figure 78: BER SA Composite Business Confidence Index

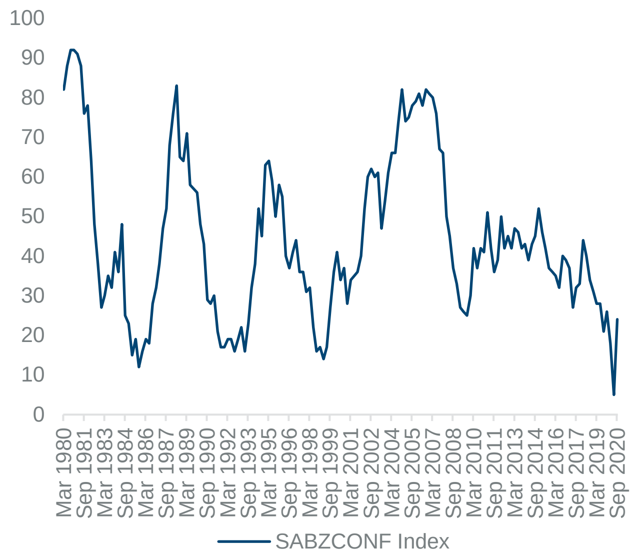
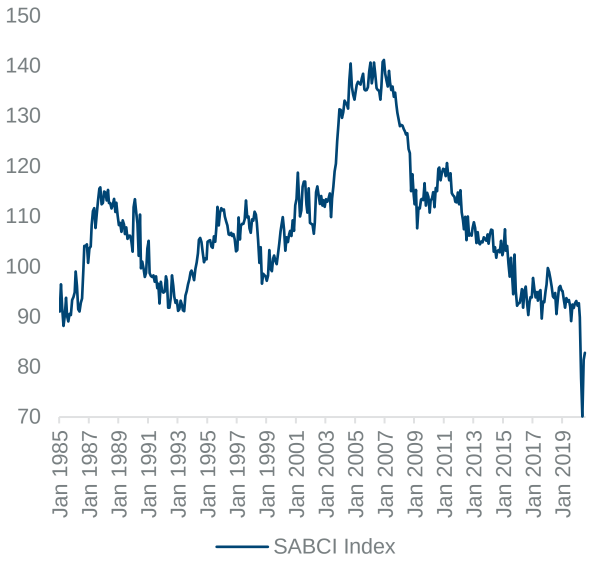


Figure 79: SACCI South Africa Business Confidence



Source: Bloomberg

In the US, the number of new bankruptcy-related Chapter 11 filings ticked up from 1708 in Q4 2019 to 2062 in Q1 and 2145 in Q2. We have not, though, seen the sharp surge witnessed during the GFC, where new filings jumped to 4348 in Q2 2009. The actual number of bankruptcies filed fell from 181 000 to 124 000 from Q4 2019 to Q2 2020, suggesting an increase in restructuring activities. Fewer bankruptcies (as the government stepped up support early on in the pandemic) would help the economy to get back on its feet sooner. In SA, the number of company liquidations in the first half of 2020 was lower than in previous years, with the lockdown resulting in 0 liquidations in April. The number of liquidations filed in July and August totalled 421, which means that the number of liquidations in 2020 will most likely be very similar to that in 2019. However, the number of businesses that actually closed down may be much higher as the data did not take into account sole proprietorships.

Figure 80: US new bankruptcy filings

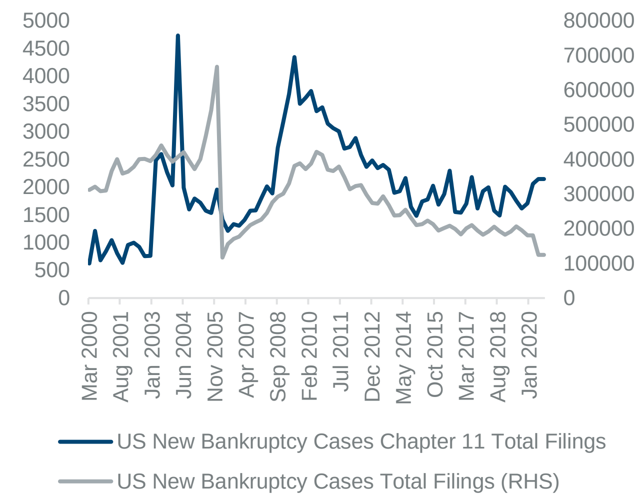
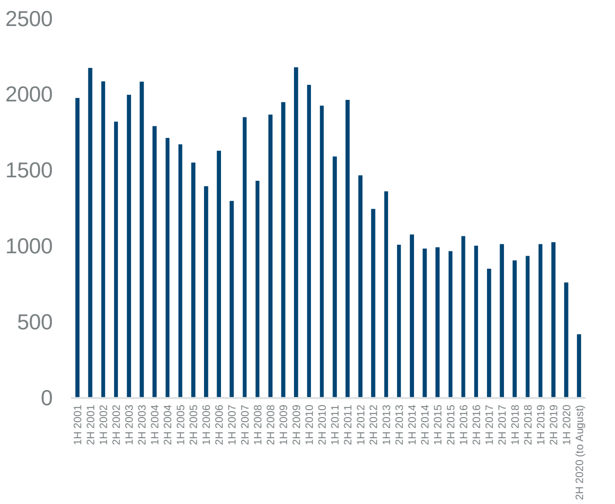


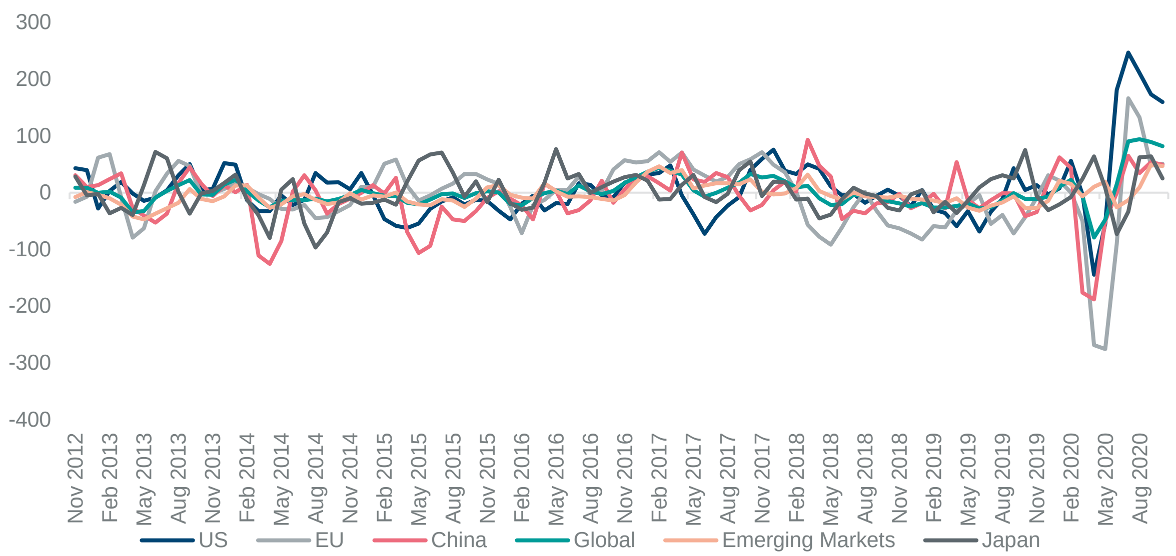
Figure 81: South Africa company and close corporation liquidations



Source: Bloomberg

Economic surprises indices also saw a strong rebound in most regions, with most of the economic releases beating the market consensus in Q3. The only concern is the declining trend, which suggests that the global economy needs catalysts to sustain the revival momentum.

Figure 82: Economic surprises indices



Source: Bloomberg

We have seen a productivity gain in the US, increasing by 2.8% year on year in Q2 compared to 0.9% in Q1. At the same time, we have seen labour costs increase by 4.9% from 2.5% over the same period. While a similar trend has been evident in Euro area labour costs, which has certainly helped to reduce the deflationary risk, we have not seen much of a productivity gain. Japan saw a slight productivity decline and a minimum wage increase over the same period.

Figure 83: US labour productivity output per hour non-farm business sector QoQ SA

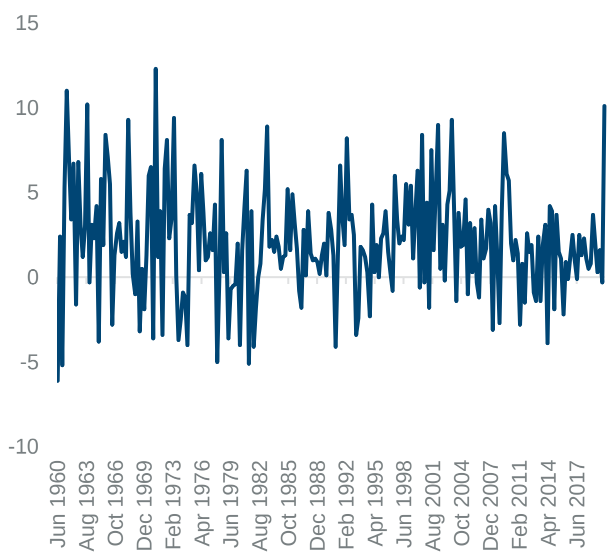
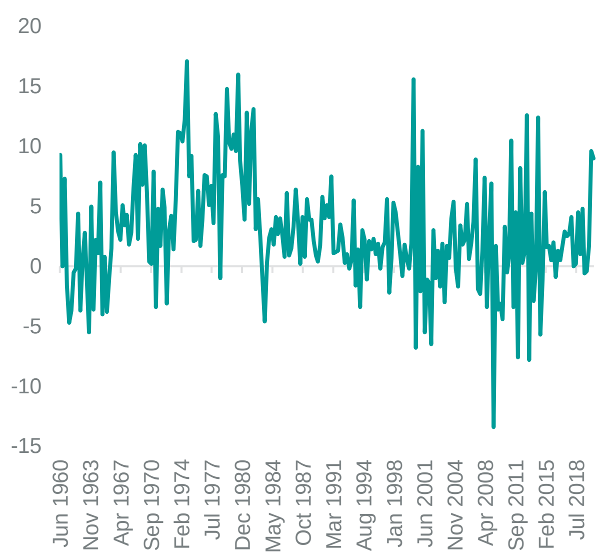


Figure 84: US unit labour costs non-farm business sector QoQ% SAAR



Source: Bloomberg

Figure 85: Labour productivity per hour worked YoY Euro area

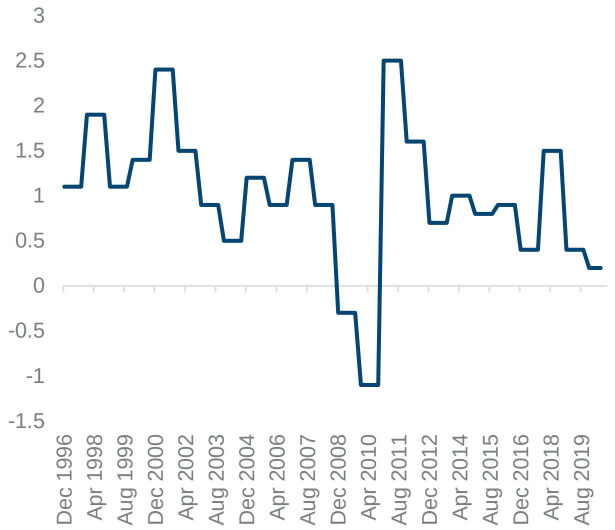
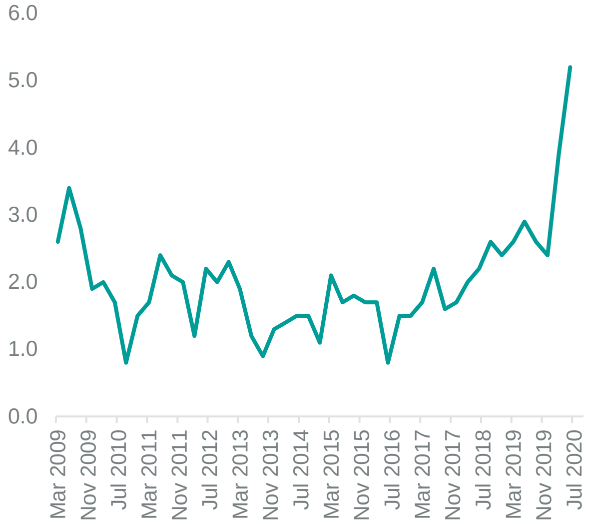


Figure 86: Eurostat labour cost wages and salaries Euro area WDA YoY



Source: Bloomberg

Figure 87: Japan labour productivity

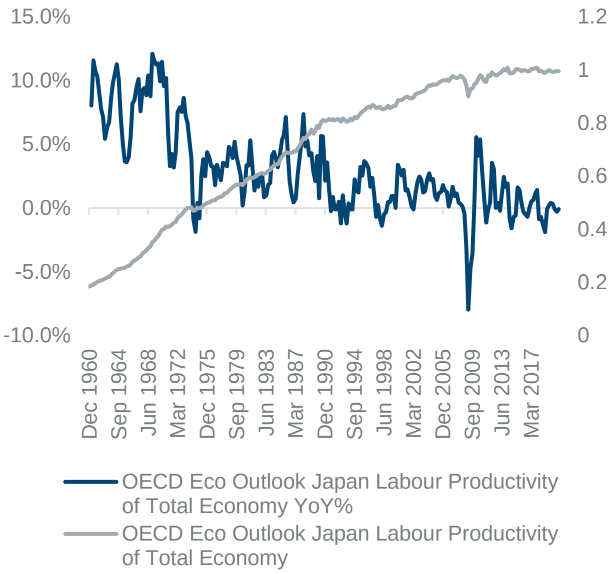
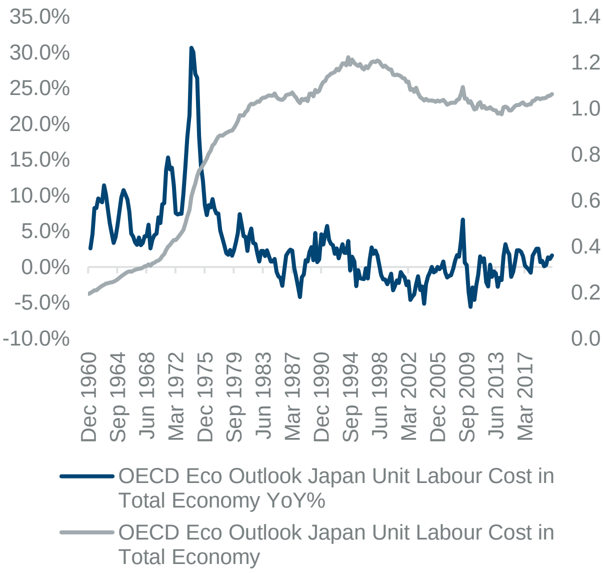


Figure 88: Japan labour cost



Source: Bloomberg

The productivity gains or losses we saw correlate with each region's profitability. S&P 500, which has more tech exposures, saw operating margins rise from 17.8% in March to 26.1% in September. Despite its return on equity plunging from 15.1% in late December to 11.5% in September, it still managed to stay in the double digits. STOXX 600 saw a decline in both its operating margin and return on equity over the same period in the face of higher financial, real estate and consumer discretionary sector exposures. NIKKEI 225, which leans more towards industrials, saw its operating margin rise from 15% in late 2019 to 38% in September, but its return on equity also dropped to a single-digit figure.

Figure 89: S&P 500 operating margin and ROE

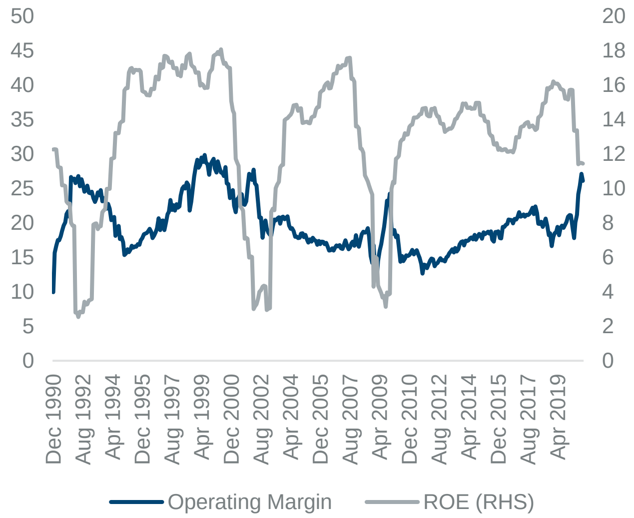
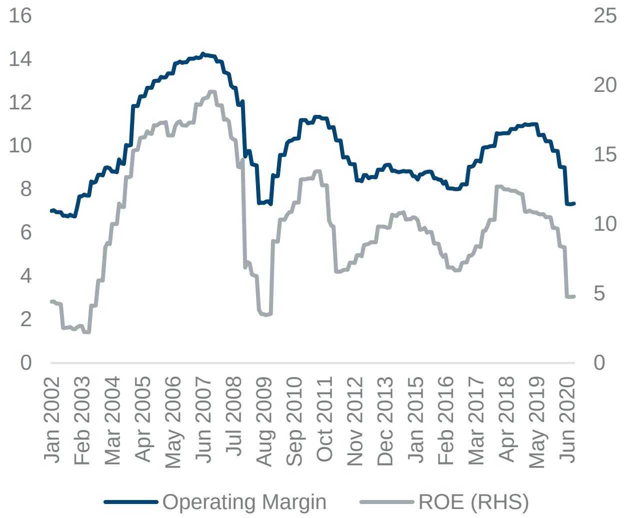


Figure 90: STOXX 600 operating margin and ROE



Source: Bloomberg

Figure 91: NIKKEI 225 operating margin and ROE

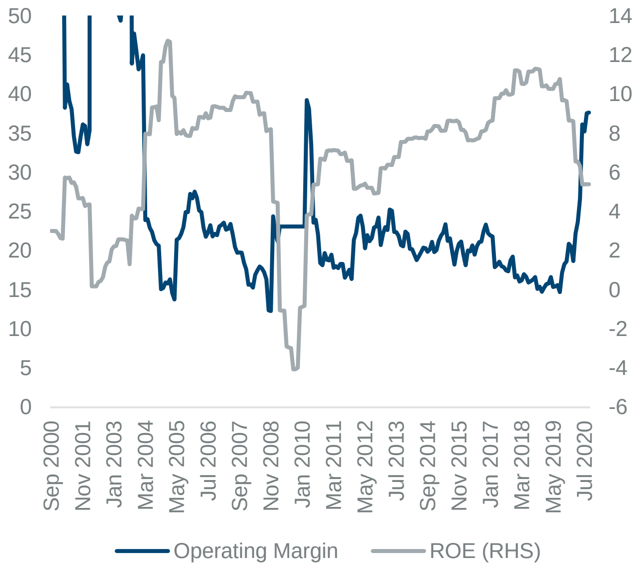
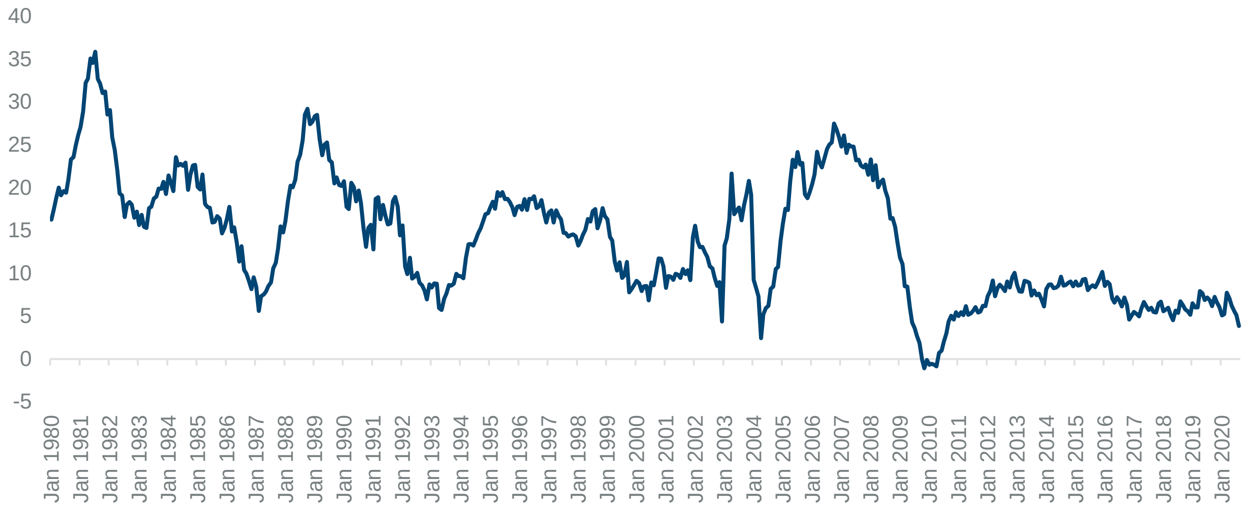


Figure 92: ALSI operating margin and ROE

Source: Bloomberg

South Africa has performed similarly to Europe and Japan in its return on equity, with its operating margin seeing less of a contraction compared to Europe. Debt funding costs are still much higher in emerging markets than in the developed world. We saw that SA private credit extensions ticked lower in August. These have been unable to climb out of the 5%–9% range since 2011, indicating a weak appetite for credit during the country's longest-ever economic downturn.

Figure 93: SA private credit extensions YoY



Source: Bloomberg

It is worth highlighting that R&D and capital expenditure for the US, Europe and Japan have increased since 2010, contrary to the general opinion that share repurchases have hurt corporate investments. What is concerning for South Africa is that local companies have spent the minimum on research and development – 0.1% of revenue vs 2%–3% of revenue by developed country peers. This has been accompanied by declining capital expenditure, which will limit South Africa's growth potential in the long run.

Figure 94: STOXX 600 R&D and capex

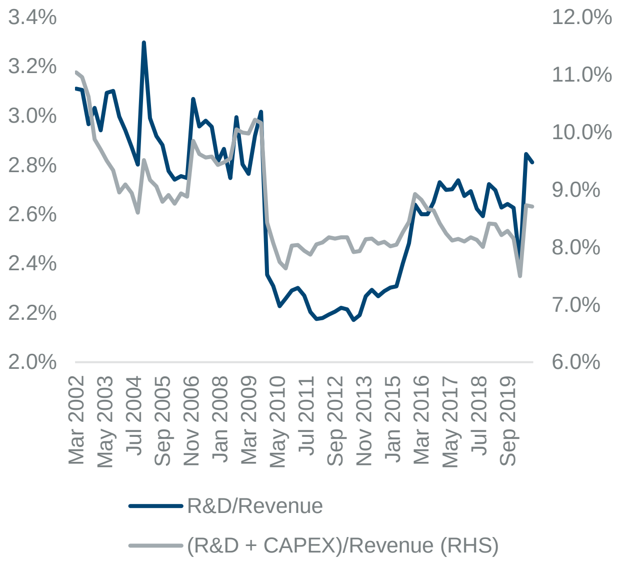
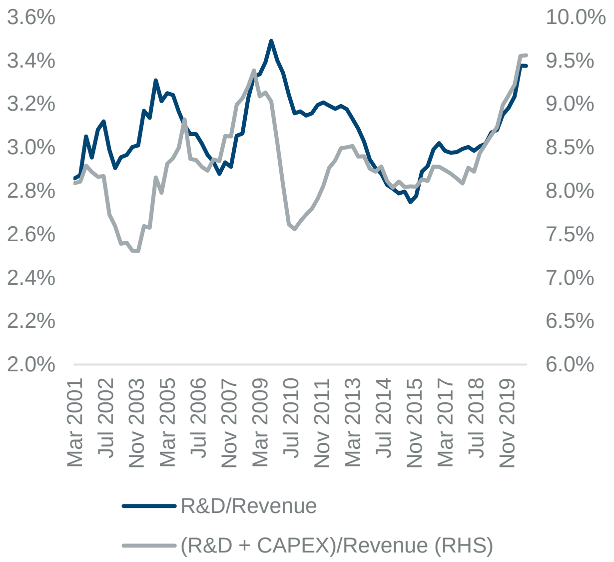


Figure 95: NIKKEI 225 R&D and capex



Source: Bloomberg

Figure 96: S&P 500 R&D and capex

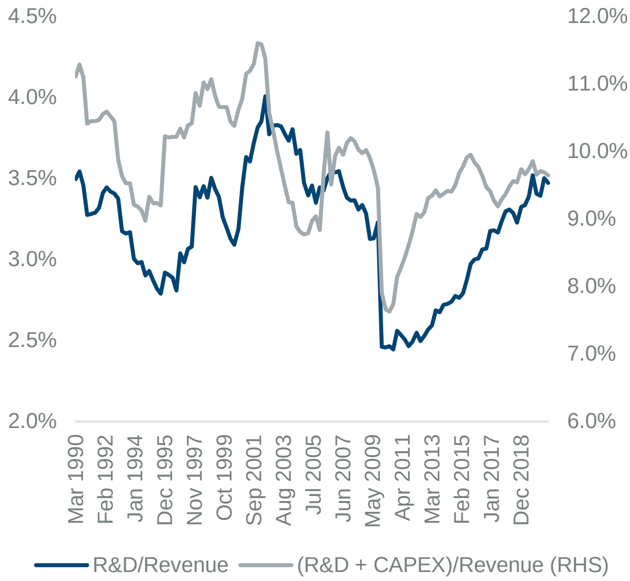
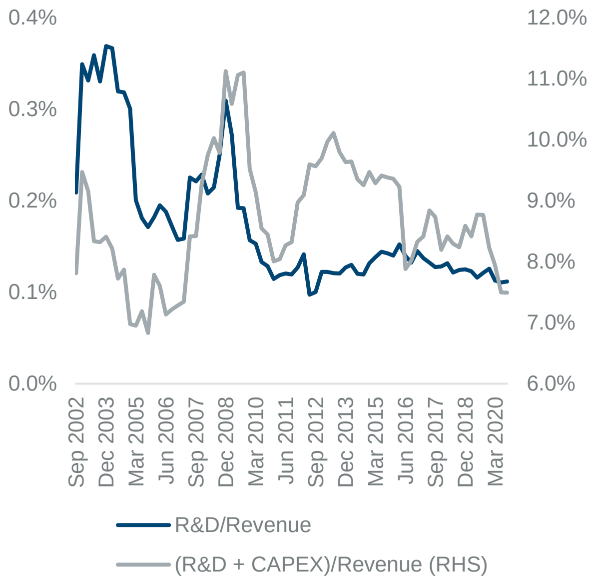


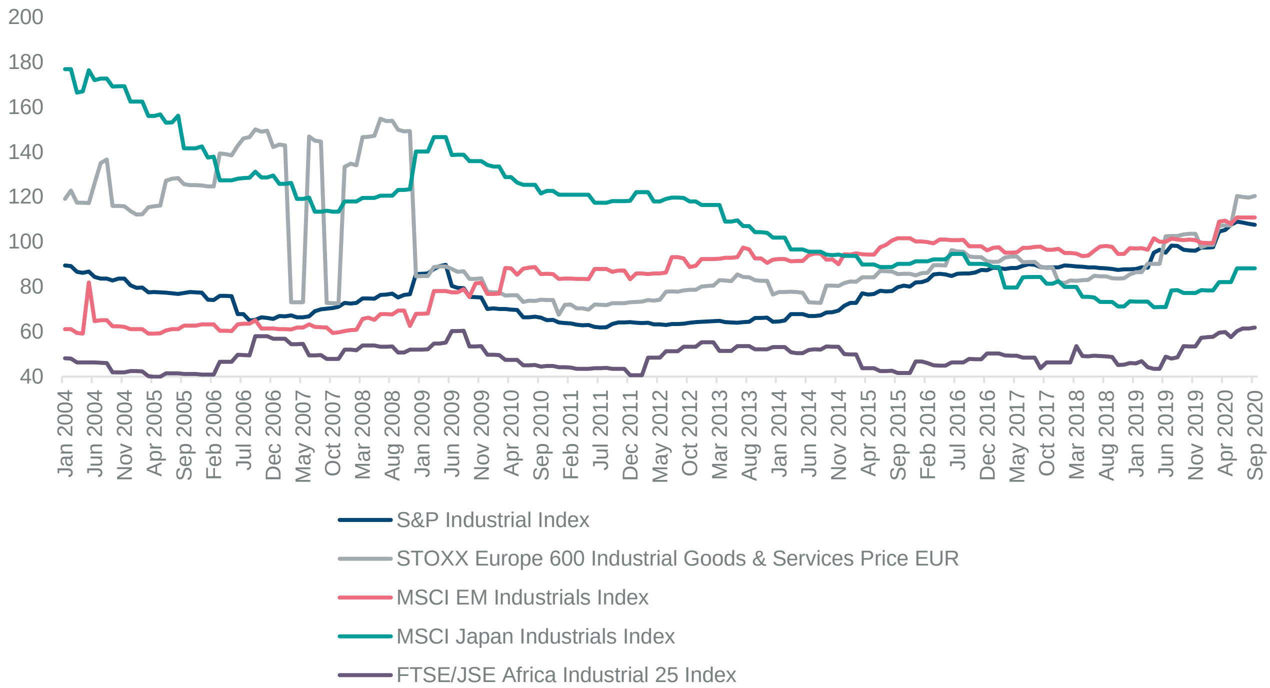
Figure 97: ALSI R&D and capex



Source: Bloomberg

Since late last year, we have also observed the debt-to-equity ratio rising in all four regions, with European industrials seeing the sharpest increase.

Figure 98: Debt-to-equity ratio



Source: Bloomberg

INTEREST RATE OUTLOOK

In general, we expect monetary policies to remain accommodative as, after some initial gains, the economic recovery path remains largely uncertain. While the inflation outlook is hotly debated, so far we have not seen a significant surge in prices as consumer demand has yet to come out of the woods. SA inflation year on year dropped to 2.2% in June but rebounded to 3.2% and 3.1% in July and August, respectively, proving that the breaching of the lower band was only temporary. The MPC lowered the repo rate from 3.75% in June by another 25bps to 3.5% in July, and has since adopted a wait-and-see strategy. The SARB implemented a very aggressive approach, compared to emerging market peers, by slashing rates, as shown in Figure 105. The Reserve Bank's forecasting model, however, does suggest an upward shift towards the end of 2021 when the rate is predicted to increase to 4.0%. The Fed, according to the most recent FOMC members' projections for the 19 September meeting, expects rate increases only by 2023.

Figure 99: US inflation YoY% and Fed funds rate

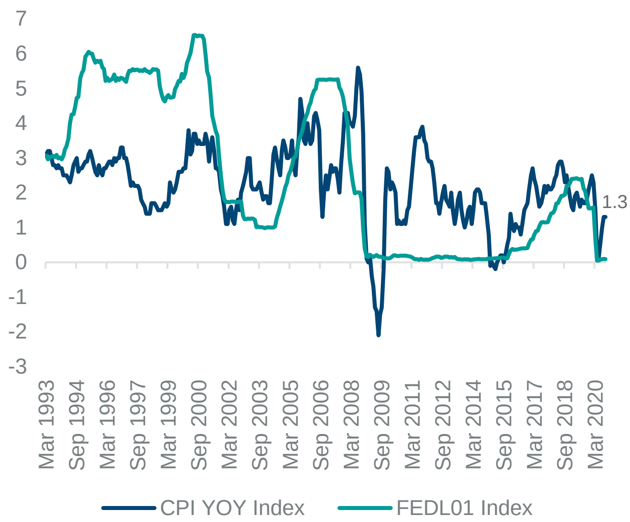
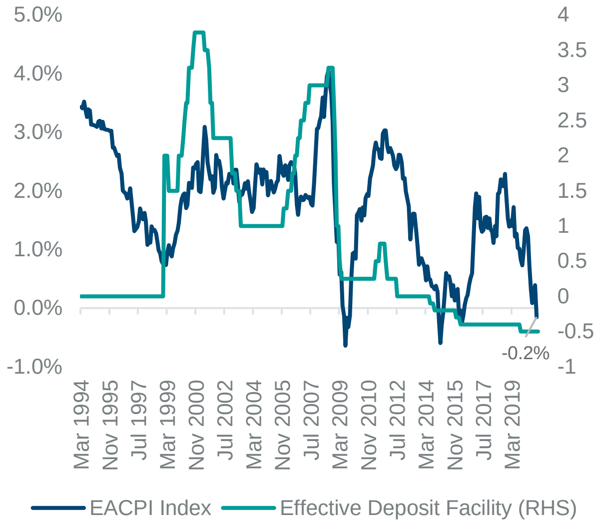


Figure 100: Euro area inflation YoY% and target rate



Source: Bloomberg

Figure 101: Japan inflation YoY% and overnight rate

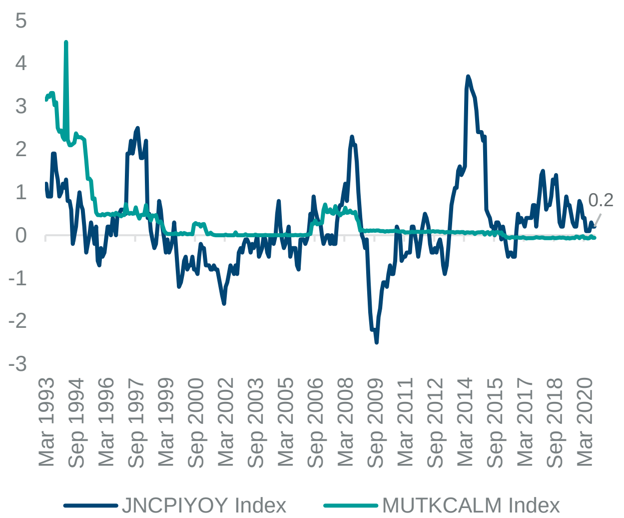
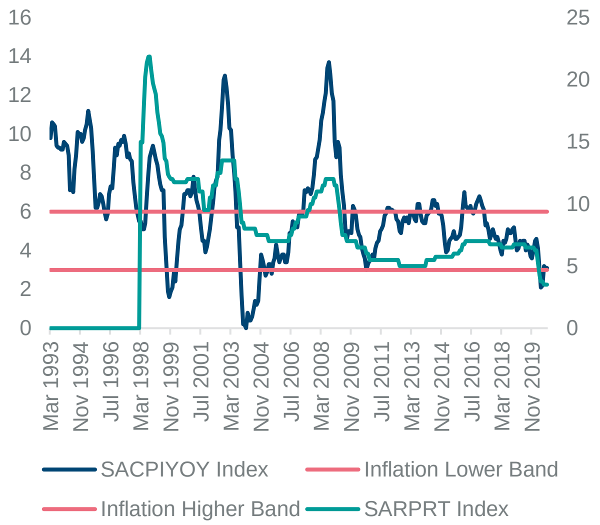


Figure 102: SA inflation YoY% and repo rate



Source: Bloomberg

According to the forward agreement rates, the market is not pricing in any rate cuts in the US or SA in the near term or rate hikes beyond 12 months in South Africa, which is in line with central bank guidance.

Figure 103: Japan inflation YoY% and overnight rate

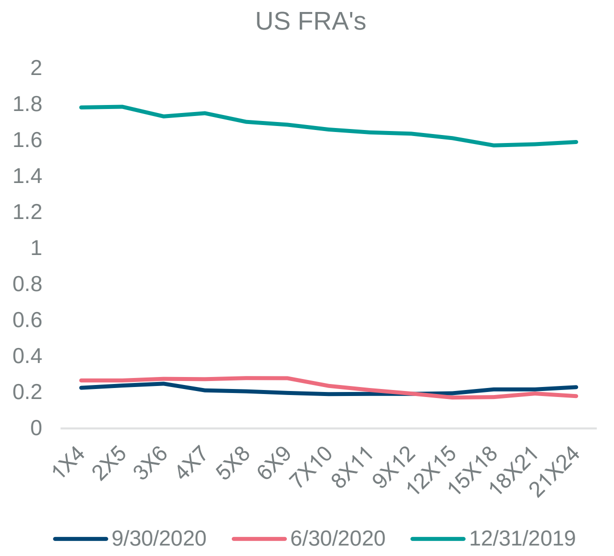
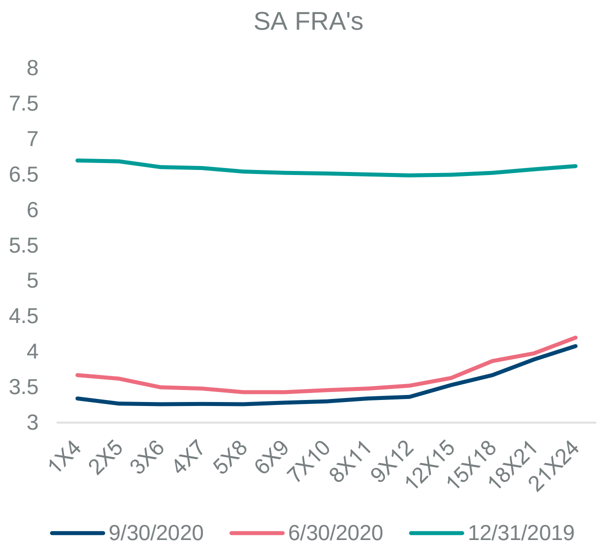
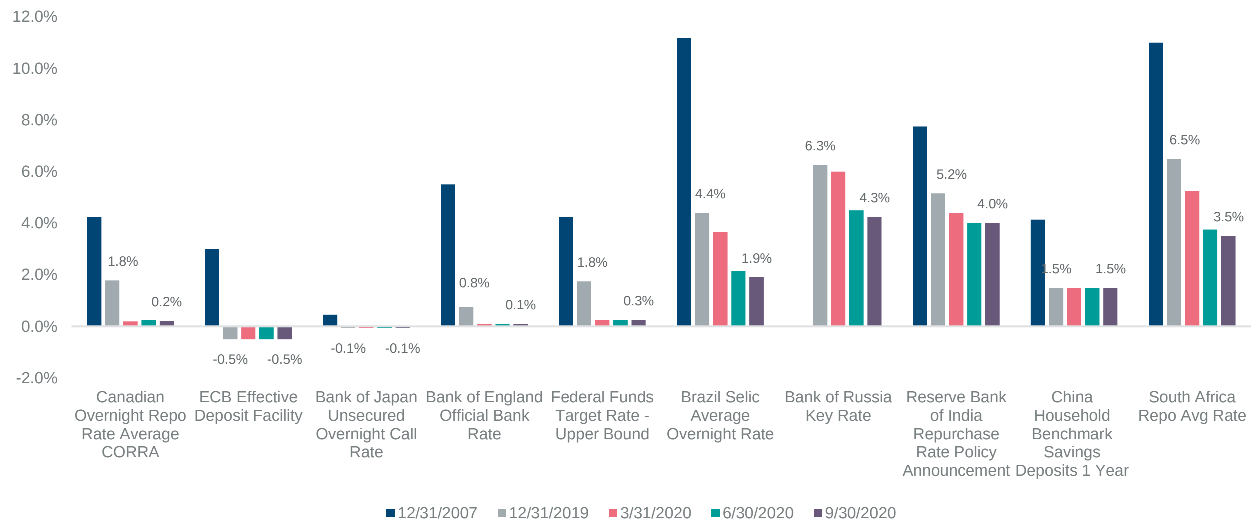


Figure 104: SA inflation YoY% and repo rate



Source: Bloomberg

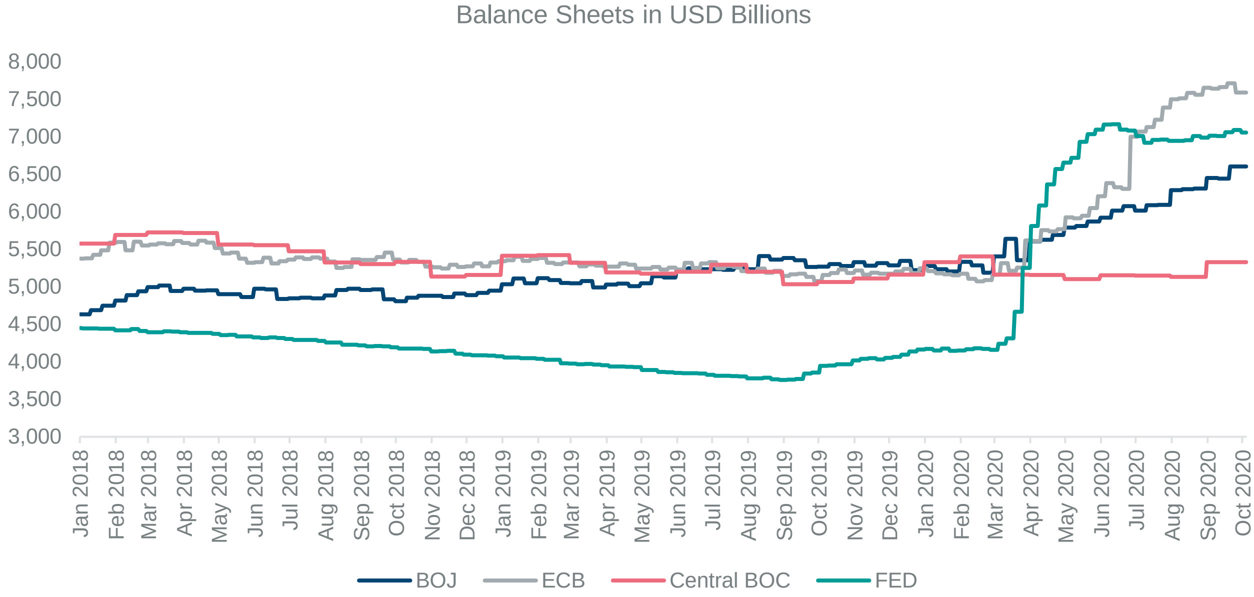
Figure 105: Policy rates for selected countries



Source: Bloomberg

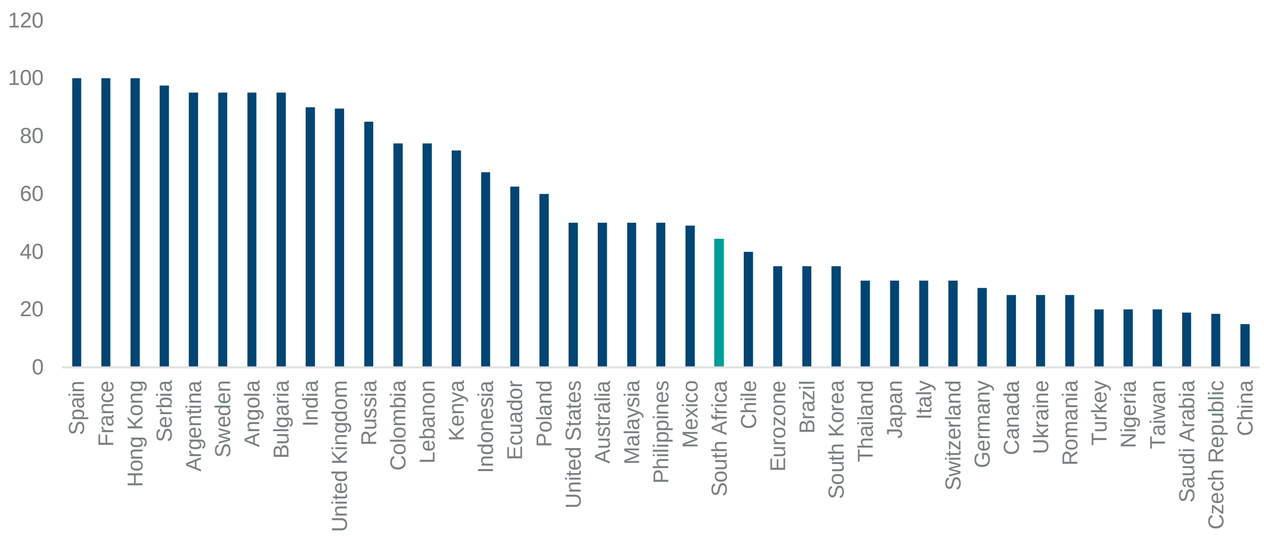
Over the past quarter, the ECB and Bank of Japan have remained the leaders in terms of positive liquidity injections, while the Fed has slowed its pace since June. The ECB's actions resemble the median estimates of the probability of recessions taking place in the region over the next 12 months, according to a Bloomberg survey, with France and Spain being extremely vulnerable. The Fed said in a statement in mid-September that it remains committed to using its full range of tools to support the US's economic recovery. To this end, it aims to purchase US$80 billion and US$40 billion of US treasuries and mortgage-backed securities per month and keep rates low to boost employment and support government funding.

Figure 106: Central banks' balance sheets as at 4 October 2020



Source: Bloomberg

Figure 107: Probability of recession in the next 12 months



Source: Bloomberg

As shown in Figure 108, the Fed balance sheet week-on-week change has shifted above the zero mark since July, but ticked lower in the first week of October. However, since May, excess liquidity in Wall Street seems to have failed to feed into loan growth, which is important for Main Street recovery.

Figure 108: Fed balance sheet week-on-week change

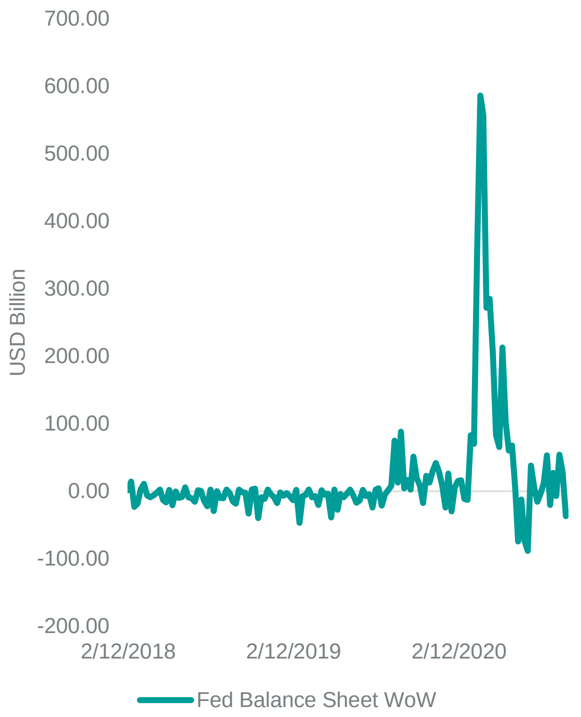
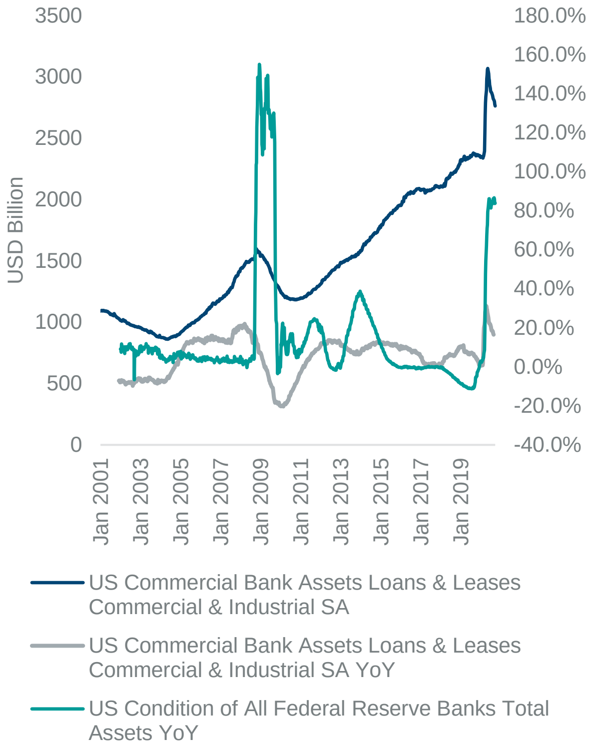


Figure 109: US banks loans vs Fed assets YoY



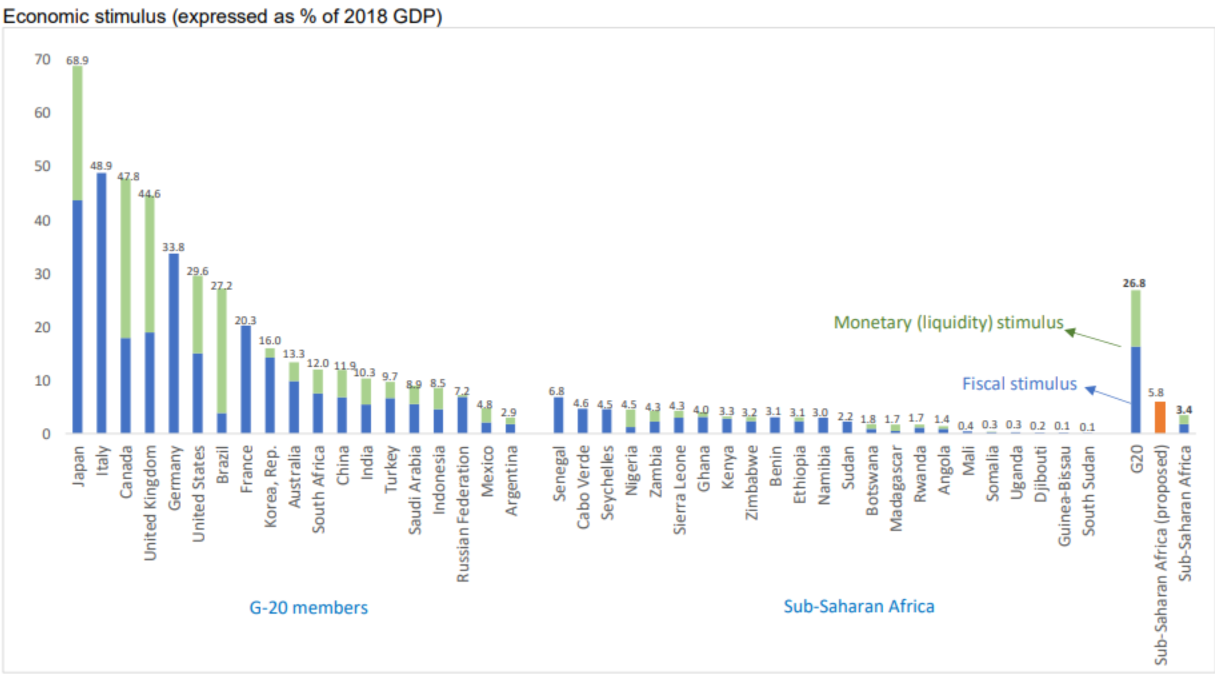
Source: Bloomberg

FISCAL POLICIES TRANSFORMED TO SUIT THE NEW NORM

The COVID-19 crisis has constituted an extraordinary attack on the global economy. Governments, together with central banks, have taken an all-in approach, doing whatever is necessary to cushion the fall-out during the down phase and reverse the contraction in growth. According to VoxEU, CEPR's policy portal, the global economy is likely to undergo three phases: 1. An immediate crisis, where activities are restricted and output levels are disrupted; 2. Recovery mode, where demand remains weak; and 3. The new normal in a post-COVID world. As we have seen in the previous sections, most regions are in the early recovery phase. However, we expect that the transitioning between the three phases may not be in a straight line. There is likely to be movement back and forth between phases, depending on the progression of the pandemic, the underlying health of countries' economies, and the effectiveness and responsiveness of government policies in each country. The time spent in each phase will also differ from one country to the next, with some countries taking longer than others to exit the recovery phase.

The pandemic has also exacerbated income inequality at all levels, both within and across nations. As shown in Figure 110 below, according to Supporting Economic Transformation (SET), the G20 and especially the G10 members have far greater fiscal and monetary capabilities to support their economies than countries in sub-Saharan Africa.

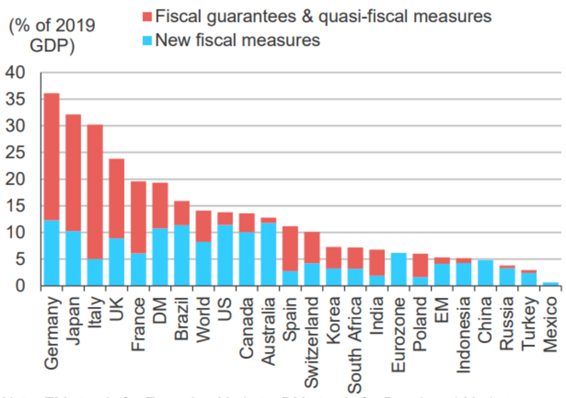
Figure 110: Economic stimulus as % of 2018 GDP



Source: set.odi.org

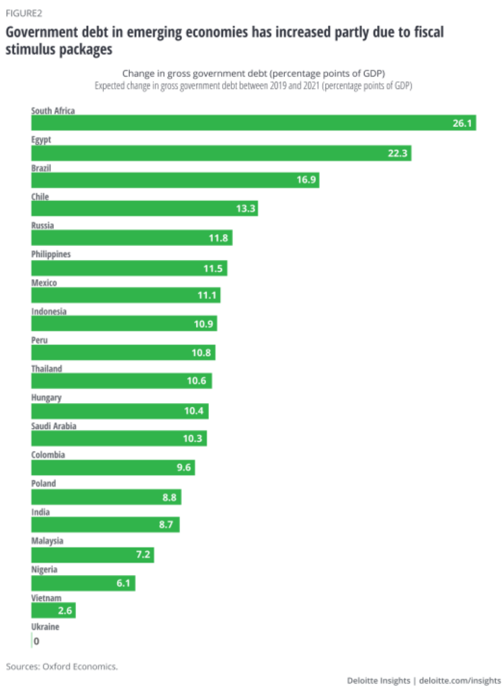
The South African government's ability to support its economic recovery is further constrained by its destabilising debt levels. Research done by Oxford Economics expects South Africa to be the country worst affected by COVID-19 in terms of the debt-to-GDP ratio, which will surge by 26.1 percentage points. This is in line with the forecasts produced by the National Treasury and Moody's, which have both warned that the country's debt-to-GDP ratio will soon pass the 100% mark if no effective measures are implemented to tackle the significantly worsened fiscal conditions.

Figure 111: Fiscal support as % of 2019 GDP



Note: EM stands for Emerging Markets, DM stands for Developed Markets
Source: Fitch Ratings, IMF

Figure 112: Change in government debt % of GDP



Source: FitchRatings, Deloitte Insights, Oxford Economics

Confirming the fiscal slide is the fact that the SA budget deficit widened from –6.3% in Q4 2019 to –8.4% in Q2 2020, with revenue collections plunging by 20% in August, cumulative year on year. Consequently, the outlook for the country's fiscal deterioration remained unchanged from the previous quarter. According to a Bloomberg survey, the median forecast is a 15% deficit for 2020 and near-term expectations are worse than those for Brazil. This is in the wake of a still-anaemic domestic growth environment and the government having been pushed into a corner, trying to balance the need to significantly cut expenditure and introduce structural reforms to stabilise its balance sheet with the need to find ways to boost economic growth.

Figure 113: SA debt-to-GDP % (recalled from Q2 Economic Overview for ease of reading)

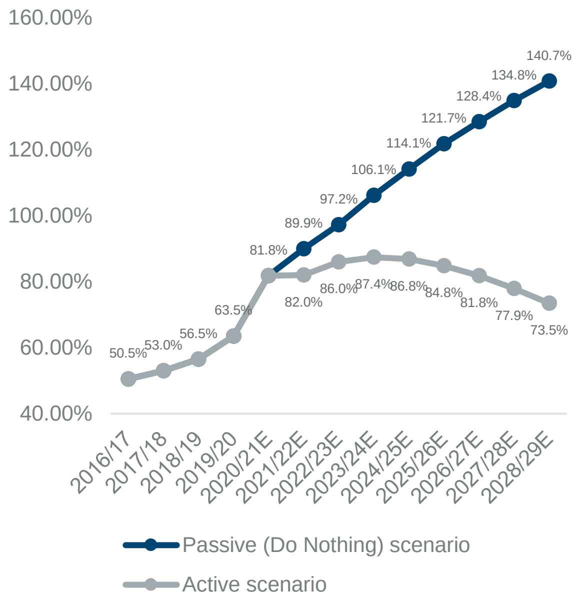


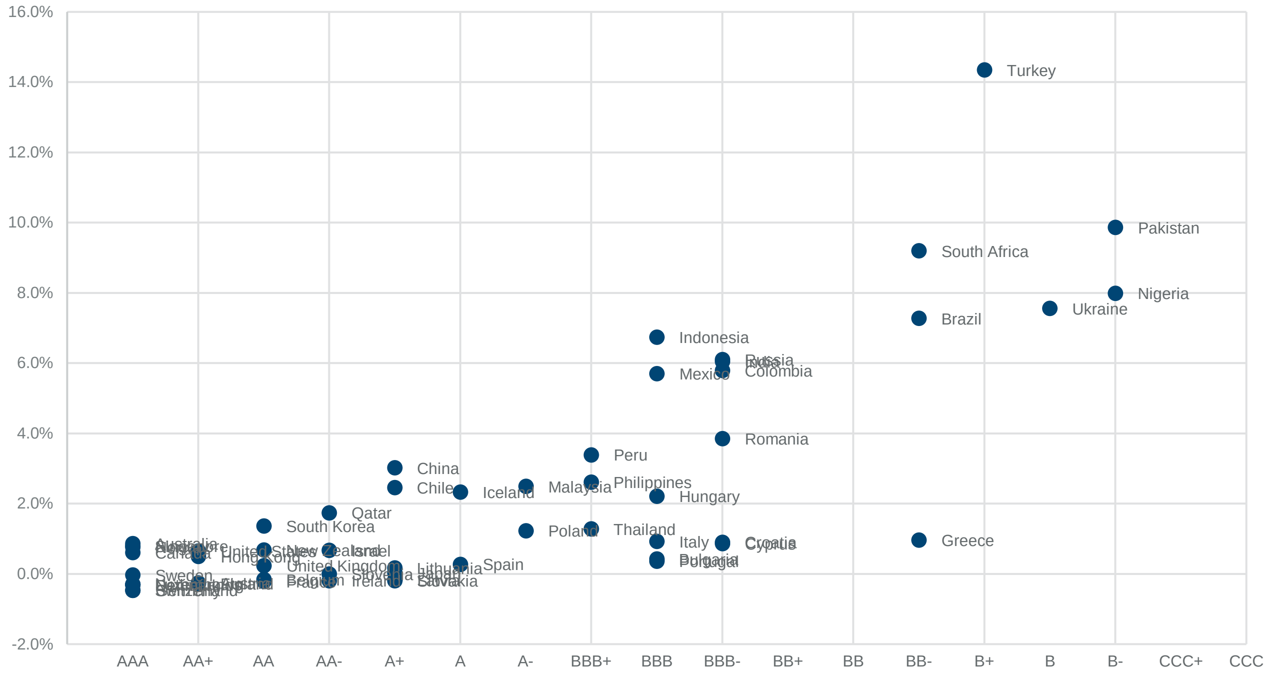
Figure 114: Budget balance to GDP %

Budget balance to GDP	2019 (Actual)	Median Forecast 2020	2021	2022
US	-5%	-16%	-10%	-7%
Germany	1%	-8%	-4%	-2%
France	-3%	-11%	-7%	-4%
Spain	-3%	-12%	-7%	-5%
Italy	-2%	-12%	-6%	-3%
UK	-2%	-14%	-7%	-5%
China	-5%	-7%	-6%	-5%
Brazil	-59%	-16%	-7%	-7%
Russia	2%	-4%	-2%	-1%
India	-4%	-8%	-8%	-7%
South Africa	-6%	-15%	-11%	-10%

Source: National Treasury, Nedbank, Bloomberg

On the other side of the world, the debt-to-GDP ratio in the US and Japan is also set to widen from 79% and 233%, respectively, in 2019 to 130% and 261%, respectively, in 2020, according to FitchRatings. In contrast, emerging markets do not have the luxury of holding the world's reserve currency. Also, some of the worst-performing countries do not carry investment-grade ratings, which may affect their ability to service their rising debts going forward – despite the IMF, World Bank and other multilateral institutions having provided emergency financing. The Fed's liquidity-pumping actions have also assisted sub-investment-grade countries, such as Brazil, to issue government bonds in the international capital markets this year.

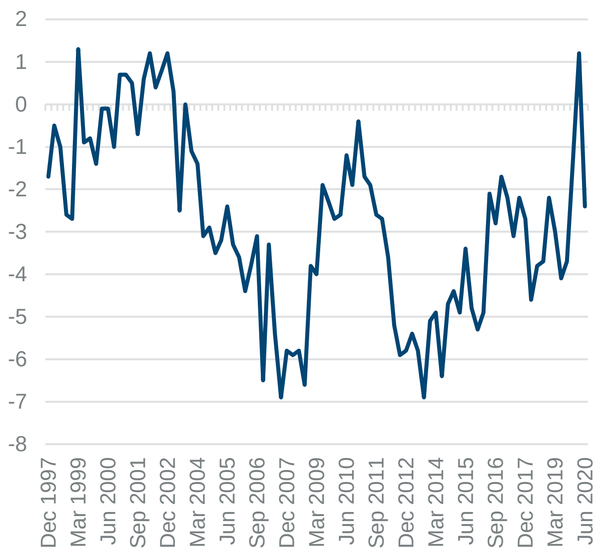
Figure 115: 10-year yield vs S&P sovereign rating as at 6 October 2020



Source: Bloomberg

South Africa's current account balance flipped from a surplus of 1.2% in Q1 to a deficit of 2.4% in Q2. However, with improving exports and relatively less-resilient imports, the trade surplus (R46bn in June, R37bn in July, R39bn in August) should continue to support the current account balance and the rand in the short term.

Figure 116: SA current account balance % GDP



Source: Bloomberg

Figure 117: Current account to GDP %

Current account to GDP	2019 (Actual)	Median Forecast 2020	2021	2022
US	-2%	-2%	-3%	-3%
Germany	7%	6%	6%	6%
France	-1%	-1%	-1%	-1%
Spain	2%	1%	2%	1%
Italy	3%	3%	3%	3%
UK	-4%	-4%	-4%	-3%
China	1%	1%	1%	0%
Brazil	-3%	-1%	-2%	-2%
Russia	4%	2%	2%	2%
India	-1%	0%	1%	-1%
South Africa	-3%	-1%	-2%	-2%

It seems that government debt across the world is unlikely to revert to pre-pandemic levels any time soon, as fiscal and monetary policies remain contingent upon the progression of the pandemic and the path of economic recovery. In the end, we may see a K-shaped recovery, where the rich nations and higher-income earners experience a stronger rebound and upward growth trajectory, while the poor find themselves engulfed by even greater economic and financial hardship.

FINAL WORDS

Near-term uncertainty remains elevated, particularly in the face of a spike in new COVID-19 cases in Europe, the faltering Brexit negotiations (with no clear deal in sight), and increasingly precarious US–China relations underpinned by both countries' quest to be the largest economy in a world where technological prowess is becoming the key to global dominance.

Yet no event has higher stakes than the US presidential election on 3 November. While Biden leads Trump by 7 percentage points, according to a poll by RealClear Politics, the outcome is far from clear. Trump's recent contracting of COVID-19 and self-proclaimed victory over the virus could be a wild card in the coming weeks, with his core support base likely to remain rock solid. Wall Street may favour the GOP candidate over Biden who has pledged to raise the US corporate tax rate from 21% to 28%, thereby reversing some of the tax relief rolled out by the Trump administration. The final outcome may also depend on whether the election result is contested. While we do not know precisely what the consequences of such a move would be, we will most likely see volatility in the coming weeks and months. The market may rise regardless of who wins the election as a further stimulus may only get passed post-election, a vaccine may become available sooner than expected and the global economy may rebound from the COVID slump as life approaches normalcy in the coming months. All of these factors should boost the risk-on sentiment of investors.

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