

## The Macro Research Desk



From left to right: Herman van Papendorp (Head of Macro Research and Asset Allocation),  
Sanisha Packirisamy (Economist)

# Economic and market snapshot for April 2016

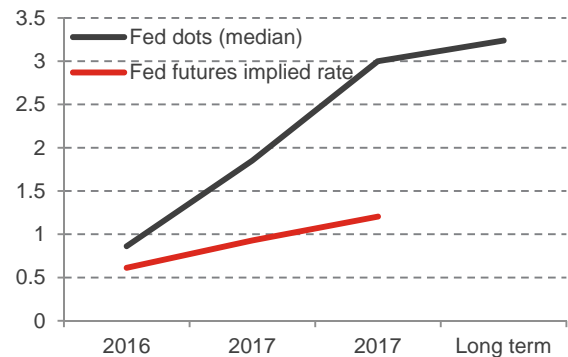
## Global economic developments

### United States (US)

*The US Federal Reserve's (Fed) median interest rate expectations shifted closer to market pricing, but a large gap remains*

Dovish rhetoric by major central banks has helped investors regain risk appetite, aiding a recovery in emerging market (EM) assets. The European Central Bank (ECB) has extended quantitative easing and long-term refinancing operations, as well as recently introducing corporate bond purchases, in its latest attempt to roll out more anti-deflation artillery. Meanwhile, the Bank of Japan (BoJ) cut interest rates into negative territory and will likely expand its quantitative easing programme in upcoming months, given anaemic economic growth forecasts and subdued inflation prints. The Fed also surprised markets this year, signalling that rates in the US would remain lower for longer, which has caused a reversal in the US dollar's appreciating trend.

Chart 1: Divergent interest rate views (%)



Source: Bloomberg, Momentum Investments

Though the Fed has talked down its own dot plot (expected path of US short-term interest rates), the Fed and the market remain far apart on their opinion of where the federal funds rate will end this year and next (see chart 1).

After taking a breather, a resumption in US dollar strength against the euro is likely given the divergences in growth and monetary policy stances between the two regions.

The market anticipates a rosier growth outlook in the US for the remainder of the year (following a poor start to 2016) and rising inflation pressures, as the labour and housing markets continue to strengthen. This should allow the Fed to raise interest rates twice this year, while the ECB (and BoJ) are set to maintain an easy monetary policy bias well into 2017 on discouraging growth and inflation prints.

The robust recovery in EM assets lost steam in April, suggesting that the asset class remains vulnerable to a potential turnaround in the US dollar and renewed concerns about Chinese growth and currency prospects.

### Eurozone

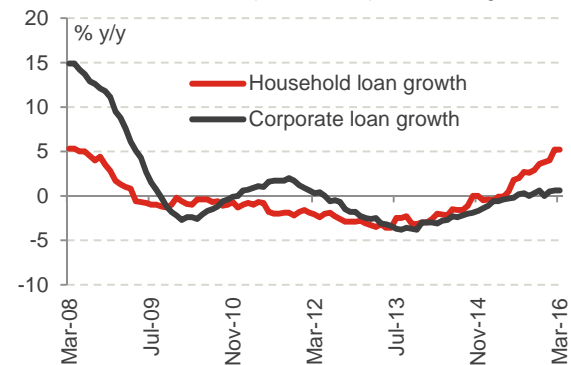
*Accommodative monetary policy stance and improving loan growth to support modest recovery*

The ECB's April 2016 quarterly bank lending survey pointed to an improvement in loan supply conditions for firms and a continued increase in loan demand across all loan categories on the back of monetary policymakers' stimulus efforts. Euro area banks reported a further net easing of credit standards for loans to corporates (with a net 6% of banks reporting less stringent criteria compared with 4% in 4Q15).

In the household sector, credit standards on consumer credit and other lending to households returned to a net easing position in 1Q16 (a net 3% of banks reported easier lending conditions from a net balance of 1% reporting stricter criteria in 4Q15). However, lending standards for household mortgages tightened as a result of a change in European rules.

Credit access is likely to improve in upcoming months, as ECB interventions continue to encourage banks to extend loans. The ECB recently cut interest rates to record lows in March 2016 (the ECB's deposit rate was cut to negative 0.4%, while the benchmark refinancing rate currently trades at zero) and announced a series of Targeted Longer-Term Refinancing Operations (TLTROs). Policymakers also upped their monthly asset purchases from €60 billion to €80 billion.

Chart 2: Slow recovery underway in credit growth



Source: ECB, Bloomberg, Momentum Investments

Meanwhile, previous areas of growth support (including a weaker euro boosting exports and a low oil price benefiting consumers) are fading, suggesting that the onus is now on policymakers to support the fragile growth recovery through monetary and fiscal stimulus efforts.

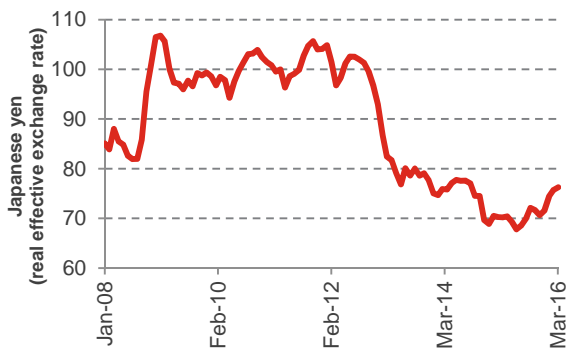
### Japan

*The strengthening exchange rate is a risk to an already-weak growth and inflation outlook*

The Japanese yen strengthened further after the BoJ kept policy on hold at its April 2016 rate-setting meeting. A firmer yen (see chart 3) has damaged business confidence, with the Tankan Business Conditions survey dropping from 12 index points to 6 since the beginning of the year. Currency strength has also pushed down the rate of headline inflation to negative 0.1% y/y in March, prompting the BoJ to downgrade its expectation on average inflation (excluding fresh food) for the fiscal year to March 2017 from 0.8% to 0.5%.

Though the BoJ lowered interest rates into negative territory in a surprise move only three months ago, softer growth and inflation forecasts will likely see the central bank either announcing a deeper move into negative rates territory, a ramp up in the current ¥80 trillion a year quantitative easing programme or a change in the composition of asset purchases in upcoming months.

Chart 3: BoJ struggling to keep the yen down



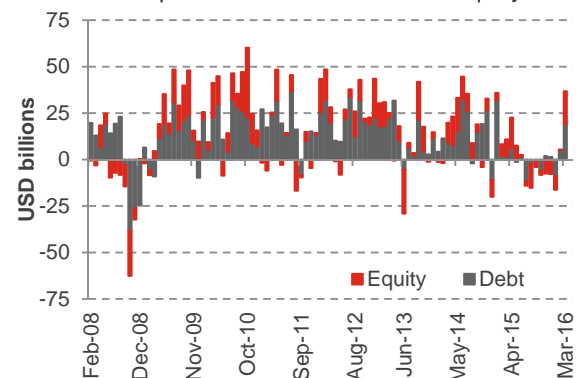
Source: Bloomberg, Momentum Investments

### Emerging markets (EM)

*Robust inflows into EM bonds and equities in global risk-on trade*

According to the Institute of International Finance (IIF), emerging markets were the recipients of US\$36.8 billion foreign portfolio (bond and equity) inflows during March (see chart 4). Although macro fundamentals remained poor across many emerging economies, dovish signals from major developed market central banks and an uptick in economic data surprises in China fuelled a risk-on shift in investor behaviour.

Chart 4: Sharp reversal in EM bond and equity flows



Source: Bloomberg, Momentum Investments

Of the US\$36.8 billion inflows, US\$17.9 billion flowed into EM equity markets. The quantum of equity inflows in March equated to nearly 50% of the EM equity outflows experienced in the second half of 2015. The remainder of the US\$36.8 billion worth in EM portfolio inflows in March poured into EM bond markets, more than matching the extent of bond outflows experienced over 2H15.

The recovery in portfolio inflows into the South African bond and equity markets in March 2016 was in line with the reversal in flows into emerging markets. According to JP Morgan, SA experienced inflows of US\$1.6 billion in March, amounting to roughly 70% of the portfolio outflows endured over 2H15.

### Local economic developments

*SA Reserve Bank (SARB) assesses implications of a sovereign debt rating downgrade to sub-investment grade*

The SARB has estimated the consequences of a downgrade to below investment grade based on a study of foreign-currency debt ratings data (by Fitch rating agency) for 70 economies. The evidence confirmed that countries with investment-grade ratings have lower borrowing costs than their speculative grade peers. As countries migrate from investment grade into speculative grade, costs do not increase in a linear trend with the curve instead steepening.

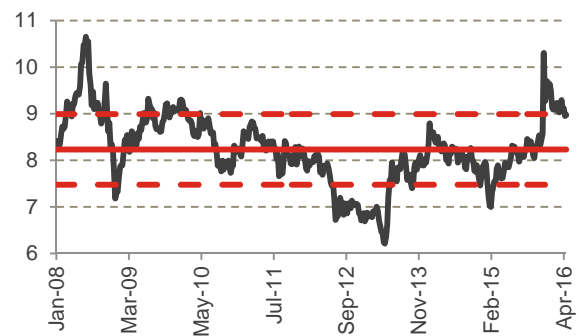
The SARB suggests that these trends prove that markets attribute less significance to variations within investment grade than they do in the speculative grade zone.

Extrapolating trends across the 70 economies led the SARB to estimate a likely 80 basis point increase in short-term rates and a 104 basis point increase in long-term bond yields (see chart 5) in SA, should the foreign-currency debt rating fall to below investment grade.

The SARB warned that higher long-term borrowing costs would result in government allocating more spending towards debt-service costs. Moreover, the private sector would also face a higher cost of investment, given the link between corporate borrowing costs and the sovereign rating.

The SARB assumes a likely depreciation in the rand against major currencies in the event that foreign investors sold out of their holdings, which would induce further inflationary pressures.

Chart 5: SA ten-year government bond yield (%)



Source: INET BFA, Momentum Investments

## Financial market performance

### Global markets

World equity and commodity markets continued to recover off their mid-February lows in April 2016, driven by accommodative policies by global central banks and improved risk sentiment. The volatility index (VIX) rolled back from 27.8 points in mid-February to 15.7 points in late-April, but remained relative steady from a month ago, while commodity prices rose by a further 8.5% in April.

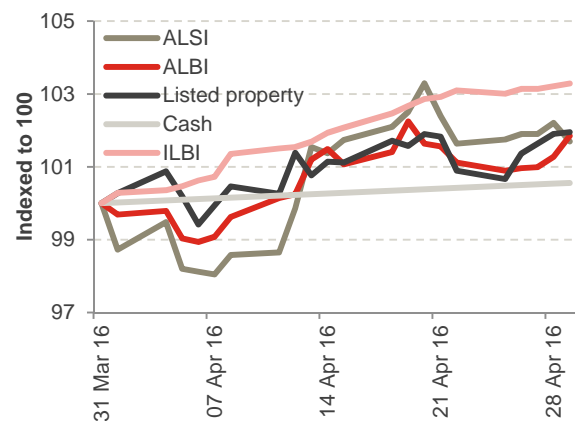
The MSCI All Country World Index (ACWI) increased by 1.5% in April on the back of a firm performance in European stock markets. The Eurostoxx 50 Index gained 1.5% for the month, followed by a mild 0.4% uptick in the S&P 500 Index on the back of disappointing corporate results. The Nikkei 225 Index slipped towards the end of April and ended the month 0.6% lower.

Concerns over the longevity of the EM rally have emerged, as gains across EM equity markets fizzled out in April. The MSCI Emerging Markets Index inched 0.5% higher in April, led by gains in Latin America and Europe, Middle East and Africa (EMEA), while Asian bourses were down slightly. The MSCI Emerging Markets Latin America Index increased by 6.0% for April, followed by a 3.8% rise in the MSCI Emerging Markets EMEA Index, while the MSCI Emerging Markets Asia Index lost 1.3%.

### Local markets

The performance of the underlying sectors diverged markedly across the local equity market in April. The FTSE/JSE ALSI ended the month only 1.7% higher, largely supported by the 13.5% jump in the FTSE/JSE Resources Index. After gaining 11.5% for March, the FTSE/JSE Financials Index lost 0.3% for April, while the FTSE/JSE Industrials Index fell by nearly a percent over the corresponding period.

Chart 6: Local asset class returns



Source: Bloomberg, Momentum Investments, data up to 29 April 2016

Small-caps outperformed mid-caps in April. The FTSE/JSE Mid-cap Index gained 4.6% for the month, while the FTSE/JSE Small-caps Index ended the month 6% firmer.

The ALBI increased by 1.9% (ten-year bond yields ended April at a similar level relative to a month ago, selling off towards month end after a rally from 9.2% to 8.8% in the middle of the month). Listed property posted a marginal gain of 2.0%, leaving cash as the worst-performing asset class for April (0.6%). The Barclays BEASSA SA Government Inflation-linked Bond Index, on the other hand, was the best-performing asset class, gaining 3.3% for the same time period.

The South African rand's gains tapered off in April relative to its marked appreciation in March, as the US dollar reversed nearly a percent of its prior losses against the euro. The rand appreciated marginally during the month in line with a firmer Argentine peso, Colombian peso and Russian rouble. The rand ended the month 2.7% firmer against the US dollar and 1.6% stronger against the euro.

## Indices summary for April 2016

	One month	Three months	One year	Three years	Five years	Ten years
<b>Equity indices</b>						
FTSE/JSE All-Share Index (ALSI)	1.70%	8.89%	0.21%	14.38%	13.45%	12.83%
FTSE/JSE Shareholder Weighted Index (SWIX)	1.25%	9.74%	-0.35%	15.71%	15.12%	13.67%
FTSE/JSE All Share Top 40 Index	1.09%	6.61%	-0.70%	14.24%	12.81%	12.38%
FTSE/JSE Mid Cap Index	4.59%	21.02%	4.64%	14.91%	16.46%	15.26%
FTSE/JSE Small Cap Index	5.95%	23.73%	5.57%	16.43%	18.27%	14.59%
FTSE/JSE Resources Index	13.45%	37.77%	-21.66%	-5.17%	-7.32%	1.57%
FTSE/JSE Financials Index	-0.32%	9.55%	-5.00%	15.90%	18.99%	12.66%
FTSE/JSE Industrials Index	-0.89%	1.68%	3.53%	19.15%	21.58%	18.74%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	6.85%	19.67%	-1.58%	11.96%	11.07%	12.46%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	7.45%	20.18%	-1.98%	11.39%	10.64%	11.80%
FTSE/JSE SA Listed Property Index (SAPY)	1.95%	15.69%	6.57%	12.40%	19.40%	16.67%
<b>Interest-bearing indices</b>						
BEASSA All Bond Index (ALBI)	1.88%	3.75%	1.75%	3.24%	7.71%	7.60%
BEASSA All Bond Index 1-3 years (ALBI)	1.01%	2.46%	6.26%	5.69%	6.79%	7.55%
Barclays BEASSA SA Government ILB Index	3.29%	4.73%	5.94%	5.56%	10.14%	10.03%
Short-term Fixed Interest Composite Index (SteFI)	0.57%	1.70%	6.68%	6.05%	5.84%	7.31%
<b>Commodities</b>						
NewGold Exchange-Traded Fund	0.68%	2.98%	29.66%	11.08%	12.08%	16.18%
Gold price (in rands)	-3.35%	2.39%	30.37%	11.38%	12.50%	16.65%
Platinum Exchange-Traded Fund	5.31%	9.52%	10.88%	1.27%		
Platinum price (in rands)	7.09%	11.02%	13.95%	0.95%	-3.65%	1.99%
<b>Currency movements</b>						
Rand/euro movements	-3.12%	-5.56%	21.32%	11.11%	10.70%	7.71%
Rand/dollar movements	-3.43%	-10.78%	18.65%	16.45%	16.58%	8.68%
<b>Inflation index</b>						
Consumer Price Index (CPI)			6.28%	5.45%	5.65%	6.33%

### Important notes

1. Sources: Momentum Investments (Pty) Ltd, INET BFA, [www.msci.com](http://www.msci.com), [www.yieldbook.com](http://www.yieldbook.com), [www.ft.com](http://www.ft.com).
2. Returns for periods exceeding one year are annualised.
3. The return for Consumer Price Index (CPI) is to the end of the previous month. Due to the reweighting of the CPI from January 2009, this number reflects a compound of month-on-month CPI returns. The historical numbers used are the official month-on-month numbers based on a composite of the previous inflation series (calculations before January 2009) and the revised inflation series (calculations after January 2009).
4. The MSCI World index (All Countries) returns are adjusted to correspond with global investment prices received.
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