momentum investments

The Macro Research Desk


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Economic and market snapshot for January 2016

Global economic developments

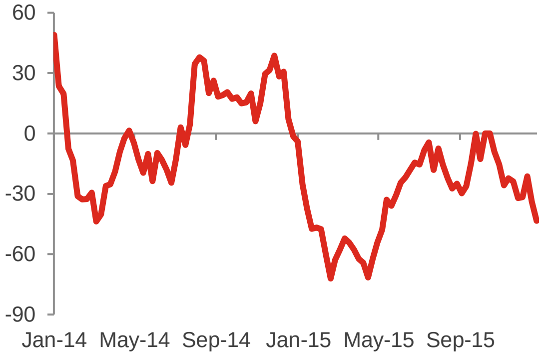
United States (US)

US futures market pushed out interest rate increase expectations in response to negative growth surprises.

In line with market expectations, the US Federal Reserve (Fed) kept benchmark interest rates on hold at the first rate setting meeting of 2016 after lifting rates for the first time in nearly a decade, from a range of 0% to 0.25% to 0.25% to 0.5%, in December 2015.

The Federal Open Market Committee (FOMC) admitted to slowing economic growth in the final quarter of 2015 despite a further improvement in labour market conditions. Although economic growth surprises have moved decisively into negative territory (see chart 1), Momentum Investments expects firmer growth to resume during 2016 on the back of a strong employment recovery, firm credit extension and supportive real wage growth.

Chart 1: Negative growth surprises in the US



Source: Bloomberg, Momentum Investments

Nevertheless, tighter financial conditions, tame inflation and uncertainty around potentially negative spill over effects (arising from adverse global economic and financial market developments) are likely to remain key considerations in further gradual adjustments in the stance of monetary policy.

Eurozone

European Central Bank (ECB) talked up prospects of additional stimulus to boost ultra-low inflation.

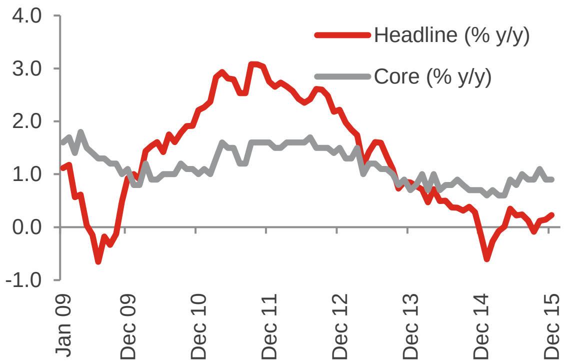
The ECB kept policy on hold at the January 2016 interest rate meeting, but kept the door open to further easing. ECB President Mario Draghi hinted that the Bank was ready to respond to disinflationary pressures by launching additional stimulus on top of the current €1.5 trillion programme. In the news conference following the rate decision, Draghi disclosed that the entire governing council had agreed to "review and possibly consider" the bank's stimulus at the next rate-setting meeting in March.

Draghi warned that a sharp drop in oil prices and headwinds from financial and commodity markets could entrench ultra-low inflation in the Eurozone (see chart 2).

In Momentum Investments' view, growth fragilities, given still-weak corporate credit extension and fading growth support from lower oil prices and a weaker euro (relative to 2015), could further urge the ECB into action – either through an additional cut in the deposit rate or an expansion in current monthly asset purchases.

Although Momentum Investments expects the ECB to take stock of the effectiveness of its latest actions before embarking on additional easing, it will need to convince the market about the capacity of the Bank to act timeously against rising deflationary risks.

Chart 2: Eurozone inflation remains stubbornly low (%)



Source: Bloomberg, Momentum Investments

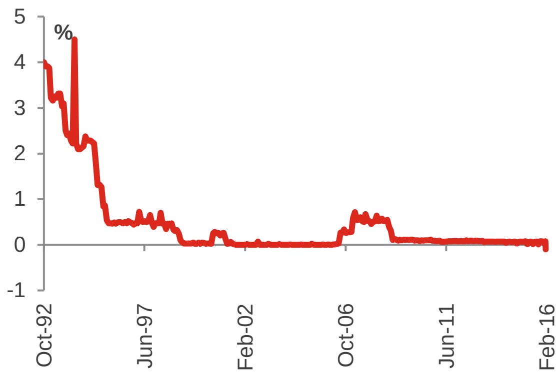
Japan

The Bank of Japan (BoJ) shifted focus away from quantitative balance sheet expansion back to interest rates.

In a widely unanticipated move, the BoJ (in a narrow 5 to 4 vote) cut their benchmark interest rate below zero (to be implemented in mid-February), effectively charging 0.1% on selected current account deposits that financial institutions hold with it (see chart 3).

Although the BoJ stated its intention to continue with its bond buying programme, embarking on negative interest rate policy (NIRP) could be an indication of declining effectiveness of large-scale asset purchases. The Bank indicated that it could cut the interest rate further into negative territory "if judged necessary".

Chart 3: Japan embraces NIRP



Source: Bloomberg, Momentum Investments

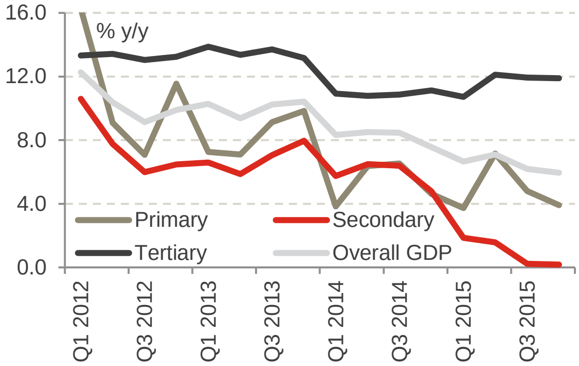
The BoJ still sees a moderate recovery underway in the Japanese economy, boosted by higher real wage growth, but concerns over recent negative developments in emerging markets raise risks to the growth outlook. In Momentum Investments' view, a slowdown in growth in investment spend and a muted response from export volumes to a weaker currency pose further downside risks to economic activity.

Emerging markets (EM)

EM fragilities remain a threat to shallow global growth recovery.

Despite an increase in real incomes, rising unemployment has weighed negatively on private consumption spend in key EMs, while slowing credit growth has led to an underperformance in investment spend. Eroding fiscal and monetary policy buffers are further likely to limit a faster acceleration in domestic demand growth. Meanwhile, soft commodity prices (owing to a significant supply overhang and China's shift away from commodity-intensive growth – see chart 4) and increased on-shoring by developed markets have suppressed global trade activity, curbing emerging economies' export contributions to overall GDP growth.

Chart 4: Chinese GDP growth buoyed by services



Source: China NBS, Momentum Investments, data up to 4Q15

A 6.9% print in 2015 marked the slowest annual growth rate in China in a quarter of a century, marginally undershooting the official 7% growth target. Momentum Investments expects a managed slowdown in the economy, as the central government steers the country away from an export- and investment-led growth model towards less commodity-intensive consumption and services growth.

A deeper adjustment in the low value-add manufactured goods industries and moderating investment growth is unlikely to arrest a slowdown in primary and secondary GDP sectors, whereas government support and steady confidence is likely to keep services and consumption growth afloat.

Local economic developments

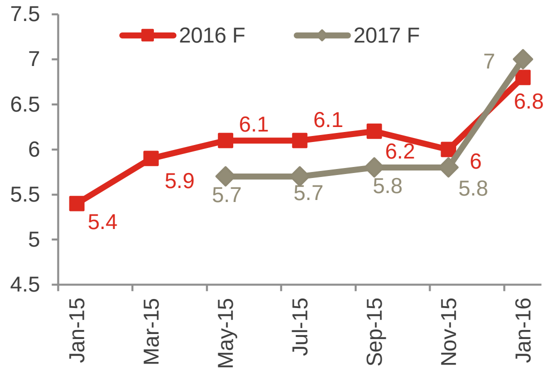
The South African Reserve Bank (SARB) raised rates by 50 basis points amid weak growth.

Despite signs of a weakening domestic economy, the SARB raised interest rates by 50 basis points in an effort to contain rising prices. A sharp 12.9% depreciation in the trade-weighted currency since the November meeting and drought-inflicted food price shocks have driven the SARB's inflation projections considerably higher during the next two years relative to its previous November 2015 forecasts.

The SARB now sees average headline inflation at 6.8% in 2016 (previously 6.0%, see chart 5), peaking at 7.8% in 4Q16 and 1Q17 (previously 6.9% in 1Q16). Headline inflation is expected to remain outside the target band for the full forecasted horizon (two years), whereas previously it was expected to breach for two quarters only.

The Bank has shown a firm commitment to its inflation targeting regime by reacting pre-emptively to a rising inflation trajectory. In Momentum Investments' view, a higher inflation profile, stubbornly-high inflation expectations and a sizeable current account deficit still point to the need for a further rise in interest rates.

Chart 5: SARB headline CPI forecast revisions (%)



Source: SARB, Momentum Investments

Momentum Investments expects interest rates to rise by a further three increments of 25 basis points each during 2016 and 2017, as the Monetary Policy Committee (MPC) continues to balance rising inflation pressures against further downside risks to economic growth. The pace of additional interest rate tightening will likely remain a function of how inflation expectations react to the increasing risks of a low growth and high inflation environment.

Financial market performance

Global markets

A violent lurch lower in world stock markets at the start of 2016 was initially triggered by renewed fears of an economic slowdown in China, after the region posted its lowest annual growth rate in two and a half decades. An oil price slide further compounded the pessimism in financial markets.

World stock markets staged a recovery in the last week of January on further talk of easing by the ECB and the adoption of NIRP by the BoJ. The MSCI World Index declined by 6% in January, driven by an 8% decline in the Nikkei 225 and a 6.6% decline in the Eurostoxx 50 indices, followed by a 5.0% dip in the S&P 500 Index.

Intra-month, the Eurostoxx 50 Index jumped by 5.8% in late January on the increased likelihood of additional stimulus measures, while the Nikkei 225 Index surged by 9.4% following an unexpected cut in the benchmark rate into negative territory.

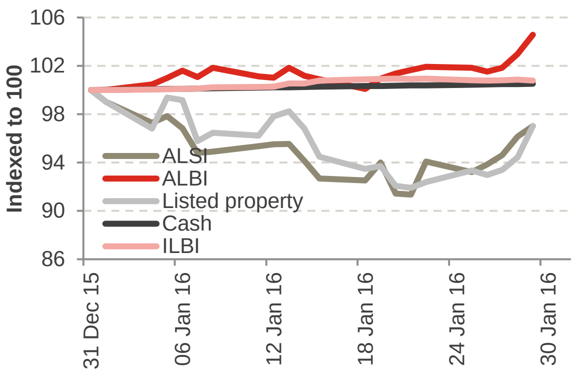
The MSCI Emerging Markets Index suffered a 6.5% blow in January, with the MSCI Emerging Markets Asia Index collapsing by 7.3% on the back of Chinese growth concerns. This was followed by a 4.6% drop in the MSCI Latin America Index and a 4.2% drop in the Emerging Markets EMEA Index.

Following a 1.7% dip in commodity prices, the VIX volatility index nudged higher by 2 index points in January.

Local markets

The South African equity market (FTSE/JSE ALSI) followed global markets lower, dipping by 3% during January (see chart 6).

Chart 6: Local asset class returns



Source: Bloomberg, INET BFA, Momentum Investments

The FTSE/JSE Financials Index was the hardest hit, falling by 3.3% in January while the FTSE/JSE Industrials Index and the FTSE/JSE Resources Index lost 2.9% and 2.7%, respectively. The FTSE/JSE Mid-cap Index gained 2.7% in January, while the FTSE/JSE Small-caps Index weakened by a further 4.6% for the corresponding period.

The ALBI posted gains of above 4.6% (SA ten-year yields rallied by 55 basis points), while further losses (negative 3.0%) in listed property were noted in January. Inflation-linked bonds ended the month marginally higher (0.8%), followed by a 0.5% gain in SA cash.

The rand staged a recovery in late January, following a decisive 50 basis point move higher in domestic interest rates in an effort to combat rising inflationary pressures, but earlier losses in the month still left the rand 2.5% weaker against the dollar and 2.4% weaker against the euro.

Indices summary for January 2016

Equity indices	One month	Three months	One year	Three years	Five years	Ten years
FTSE/JSE All-Share Index (ALSI)	-2.99%	-8.33%	-1.06%	9.98%	12.77%	12.74%
FTSE/JSE Shareholder Weighted Index (SWIX)	-2.31%	-7.71%	-2.66%	11.59%	14.44%	13.41%
FTSE/JSE All Share Top 40 Index	-3.75%	-8.55%	0.84%	10.15%	12.71%	12.49%
FTSE/JSE Mid Cap Index	2.71%	-5.77%	-10.06%	8.70%	12.81%	14.19%
FTSE/JSE Small Cap Index	-4.62%	-13.40%	-12.42%	10.30%	13.55%	13.49%
FTSE/JSE Resources Index	-2.72%	-25.81%	-39.42%	-19.96%	-12.50%	-0.78%
FTSE/JSE Financials Index	-3.34%	-12.59%	-3.89%	13.87%	18.04%	12.44%
FTSE/JSE Industrials Index	-2.92%	-4.34%	8.49%	19.56%	23.09%	19.39%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-0.90%	-10.60%	-10.96%	3.68%	8.37%	11.06%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-1.57%	-11.54%	-12.56%	3.24%	7.64%	10.41%
FTSE/JSE SA Listed Property Index (SAPY)	-2.98%	-9.38%	-2.42%	12.51%	17.31%	16.45%
Interest-bearing indices						
BEASSA All Bond Index (ALBI)	4.62%	-3.38%	-5.61%	3.65%	7.52%	7.38%
BEASSA All Bond Index 1-3 years (ALBI)	1.77%	0.27%	3.97%	5.39%	6.88%	7.49%
Barclays BEASSA SA Government ILB Index	0.78%	-0.29%	4.51%	5.54%	9.67%	9.85%
Short-term Fixed Interest Composite Index (SteFI)	0.56%	1.64%	6.49%	5.89%	5.77%	7.31%
Commodities						
NewGold Exchange-Traded Fund	7.27%	12.37%	21.19%	5.69%	12.82%	17.26%
Gold price (in rands)	8.40%	12.89%	21.98%	6.00%	13.39%	17.85%
Platinum Exchange-Traded Fund	1.88%	1.39%	-2.83%			
Platinum price (in rands)	0.31%	1.65%	-4.33%	-4.68%	-5.38%	2.69%
Currency movements						
Rand/euro movements	2.27%	12.81%	30.95%	12.37%	11.81%	8.81%
Rand/dollar movements	2.72%	15.21%	36.90%	21.19%	17.25%	10.08%
Inflation index						
Consumer Price Index (CPI)			5.23%	5.31%	5.54%	6.16%
Global indices						
MSCI World Index (All Countries)	5.82%	21.22%	31.11%	32.20%	25.80%	13.26%
MSCI Developed Markets Index	5.49%	18.12%	32.72%	33.95%	27.44%	14.79%
MSCI Emerging Markets Index	3.11%	14.60%	13.74%	13.80%		
Global Property Research (GPR) 250 REIT Index	16.94%	32.68%	83.24%	61.92%	54.72%	26.60%
MSCI Africa Index	-2.37%	0.04%	-1.86%	8.12%	8.86%	
Citigroup World Government Bond Index	8.17%	10.48%	28.92%	18.81%	18.63%	12.79%
Three-month US dollar LIBOR rate	7.44%	12.09%	34.33%	22.50%	18.92%	11.15%
Three-month Euro LIBOR rate	10.49%	8.97%	20.19%	14.70%		

Important notes

1. Sources: Momentum Investments (Pty) Ltd, INET BFA, www.msci.com, www.yieldbook.com, 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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