

## 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 June 2016

## Global economic developments

---

### United States (US)

*A more cautious mood among US Federal Open Market Committee (FOMC) members*

A dismal payrolls print for May (38 000 jobs added compared to a consensus expectation for a 162 000 gain) led to a significant repricing of interest-rate-hike expectations in the futures market in the run up to the June 2016 meeting. Although the FOMC acknowledged the slower pace of improvement in the US labour market, it noted that general economic activity had picked up.

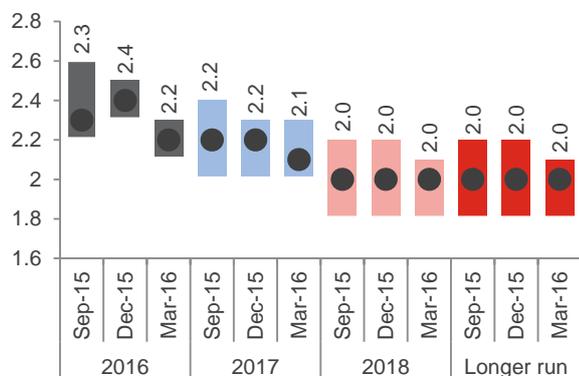
The Citigroup Economic Surprise Index has turned less negative in recent weeks, as the extent of downside surprises in US economic activity lessened. Although real gross domestic product (GDP) growth only expanded at an upwardly revised rate of 0.8% (quarter on quarter) q/q in seasonally adjusted annualised (saar) terms in 1Q16, growth forecasts for the second quarter of the year look healthier. The Atlanta Federal Reserve (Fed) NowCast (a model predicting GDP growth based on high-frequency data releases) indicates that growth could have expanded at 2.7% q/q saar in 2Q16 (above the Blue Chip consensus of 2.5%).

Higher growth will most likely be driven by robust consumption expenditure, which is estimated to have expanded by around 3% in 2Q16 based on realised retail sales figures to date.

The Fed's monetary policy statement was received as having a dovish overtone. The number of committee members only seeing one interest rate hike in 2016 went up from 1 to 6 (out of 17 members) relative to the March round of forecasting. Though the median forecast remains for two rate hikes before the year is up, the poor labour print for May has most likely dented perceptions of strength in the US labour market and the outlook for overall economic activity.

Although a tighter labour market, a gradual acceleration in inflation and firmer economic activity could, in Momentum Investments' view, see the Fed raising interest rates before year end, the committee is likely to closely monitor any negative spillover effects on the domestic economy related to the UK's decision to exit the European Union (EU). External risks are likely to ensure a gradual pace of interest-rate tightening in the US.

**Chart 1: The Fed's long-run growth estimates steady at 2.0%**



Source: Federal Reserve, Momentum Investments (dot = mid-point of central range)

## Eurozone

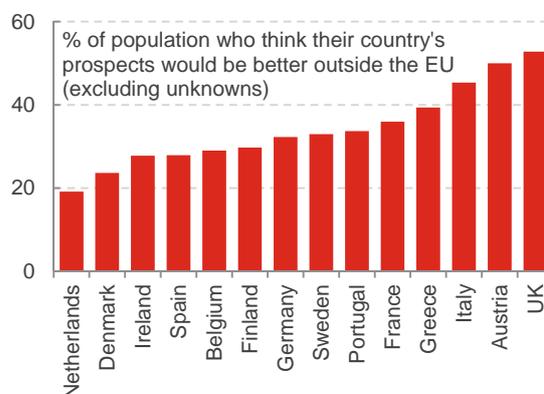
*Concerns rise over growing support for Eurosceptic parties*

The United Kingdom's (UK) vote to leave the EU has raised alarm bells over the growing calls for referendums to be held in other EU member countries.

According to Capital Economics, the most Eurosceptic countries surveyed in an Ipsos poll are Italy, France and Sweden. The European Commission (EC) Eurobarometer, carried out in November 2015, suggested that Austria had the strongest anti-EU views, with 41% of the respondents holding a negative view of the EU. This was followed by 37% of the respondents in Greece, 27% in Germany and 25% in France.

Economic prospects are being displaced with political concerns. Despite respondents in the Netherlands being the least optimistic about their country's chances outside of the EU (less than 25% of respondents in the Netherlands and Denmark were optimistic about their respective country's prospects existing outside of the EU, see chart 2), opinion polls suggest that Eurosceptic parties in the region could capture 57% of the vote.

**Chart 2: Voting on economic prospects outside of the EU**



Source: Capital Economics, Momentum Investments

An upcoming referendum in Italy on constitutional reform in October 2016, followed by elections in the Netherlands in March 2017, French presidential elections in April 2017 and German elections later in the year suggest that political risk will play a major role in preventing a sharper acceleration in growth in the region in upcoming quarters.

Anaemic growth has suppressed price pressures further, with headline inflation printing at a negative 0.1% in May 2016. With downside risks to growth having intensified following the Brexit decision, Momentum Investments expects a further response from fiscal and monetary authorities.

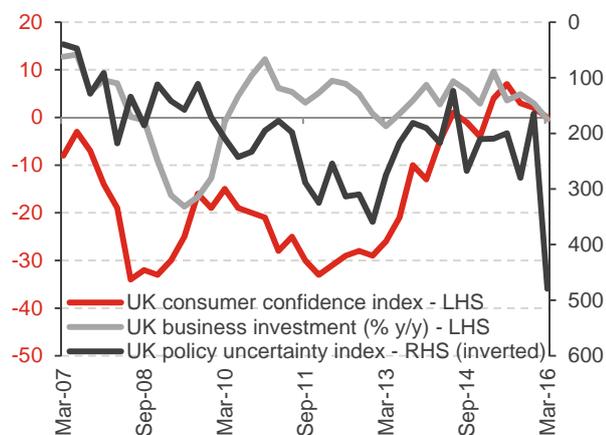
## United Kingdom (UK)

*Britain votes to leave the EU*

Although Scotland, Northern Ireland and London voted in aggregate to stay within the EU, these votes were insufficient to offset a significant 'leave' vote from Wales and pockets of England, resulting in the 'leave' vote obtaining 51.9% of the final tallied votes.

The UK will likely remain inside the EU for at least two years (and possibly even longer), as the UK irons out its future trading relationship with the remainder of the EU and the rest of the world. Political and economic uncertainty is likely to linger for some time, leading to a weaker GBP. As a result, UK businesses are likely to hold off investment and hiring, hence curbing growth (see chart 3). UK consumers are likely to feel the pinch, as hiring intentions suffer and inflation ratchets higher.

Chart 3: Uncertainty has dampened confidence



Source: Bloomberg, Momentum Investments

The Organisation for Economic Co-operation and Development (OECD) estimates that, under Brexit, UK GDP will be 3% below the level it would have been if the UK stayed in the EU. It notes that every country in the EU would suffer a 1% growth decline. The OECD further estimates that financial shocks, as well as weaker European demand, could lower the level of GDP in the BRICS (Brazil, Russia, India, China, South Africa) nations and other non-OECD economies by more than 0.5% by 2018, as Brexit stirs global uncertainty among investors, businesses and consumers, resulting in negative consequences for global growth and the flow of global capital around the world.

UK trend growth is also likely to be negatively affected, as supply-side challenges (including a reduction in the size of the labour force through a possible lowering of net migration inflows) affect longer-term growth. The OECD suggests that UK GDP could be more than 5% lower by 2030 than if the exit had not occurred.

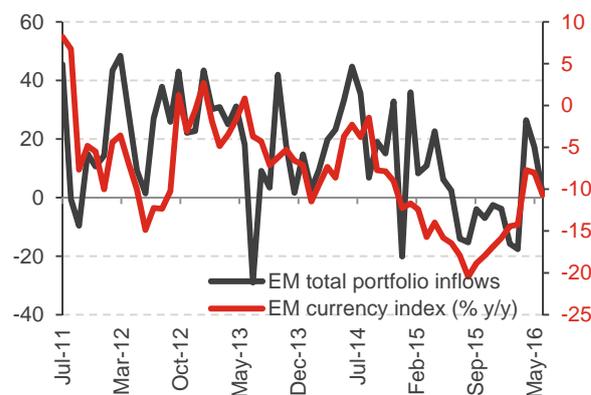
During the period of elevated uncertainty under the Brexit reality, the safe-haven investments will likely be US Treasuries, the US dollar, the Japanese yen, the Swiss franc and gold. A rising risk-off tendency puts all perceived risky investments under pressure – including equities, the euro, the British pound, commodity prices, as well as emerging market (EM) currencies and investments.

## Emerging markets (EM)

*The dust should eventually settle in EM following the initial reaction to Brexit*

The initial shock of the Brexit vote has triggered a flight to safety. As such, capital inflows into EMs are likely to have dipped further in June, following soft May data (see chart 4).

Chart 4: Reduction in positive EM sentiment



Source: Bloomberg, Momentum Investments

Aside from capital flows, diverse growth outcomes across EMs have further been driven by relative sensitivity to a muted commodity price environment, the pace of structural reform momentum, the level of US dollar-denominated debt and the availability of policy buffers.

A negative terms-of-trade (export prices relative to import prices) shock has driven a sharp slowdown in domestic demand in net commodity-exporting EMs, while commodity-importing EMs have been far more resilient. Weaker growth in the former has led to larger external imbalances, an extension of government budget deficits, higher debt levels and elevated debt burdens. This has left more net commodity-exporting nations in a poorer credit standing and with limited policy buffers to protect growth.

Nonetheless, growth in retail sales and exports in the weaker-performing regions appear to be bottoming out. Better weather conditions should enable a mild recovery in drought-inflicted Sub-Saharan Africa next year, while a stabilisation in the oil price should aid a gradual improvement across the Middle East and North Africa. Growth is expected to recover off a low

base in Latin America, Emerging Europe and Central Asia, as domestic challenges abate in 2017. Meanwhile, further policy accommodation and economic reform are likely to drive a stabilisation in Emerging Asia for the same time period.

## Local economic developments

*May's inflation print surprises positively, but headline figure set to rise into 4Q16*

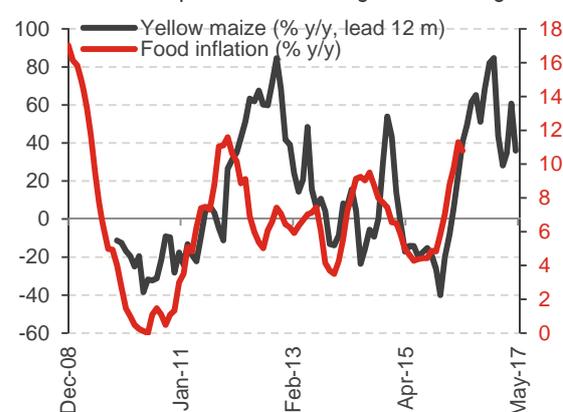
Headline inflation dropped to 6.1% in May in year-on-year (y/y) terms, undershooting Momentum Investments' (6.3%) and the Bloomberg consensus (6.4%) forecast.

The momentum in food price inflation slowed, increasing by a mere 0.2% month on month (m/m). This is significantly lower than the average 2% m/m increase experienced for the previous four months. As a result, food inflation dipped to 10.8% in May from 11.3% in April y/y. The largest contributor to the overall rise in food inflation remains prices of bread and cereals, followed by fruit and vegetables.

A recent reversal in maize prices bodes well for food inflation further down the line. Leading the rand value of yellow maize prices (% y/y) by 12 months suggests an improvement in the food inflation trajectory in 2017 (see chart 5). This downward move has already been partly captured at the producer price inflation (PPI) level, where PPI crop inflation reversed sharply from 44.3% y/y in February to 27.3% y/y in April.

Core inflation (excluding food, beverages, petrol and energy) declined to 5.5% y/y in May from 5.7% y/y in February, despite clear indications of rand-related price pressure in recent months. Momentum Investments expects core inflation to track marginally higher in upcoming months, but to remain below the upper band of the 3% to 6% inflation target range.

Chart 5: Maize prices stabilising and turning lower



Source: Stats SA, Global Insight, Momentum Investments

Momentum Investments expects inflation pressures to build towards year end on the back of higher food prices and pass through from previously unfavourable currency movements. Potential currency shocks and wage cost pressures provide significant upside risks to the inflation trajectory, which is expected to remain outside the target band in upcoming quarters.

Moreover, inflation expectations (businesses and trade unions in particular) remain stubbornly high, posing a threat to second-round inflation pressures.

In addition, a still-elevated current account deficit and recent comments by the SA Reserve Bank (SARB) suggesting that monetary policy remains highly accommodative, suggest that a further 25 basis point hike later this year is still likely. The SARB is unlikely to hike interest rates more aggressively against the backdrop of subdued growth expectations and depressed confidence levels pointing to a shallow growth recovery.

## Financial market performance

### Global markets

World equity markets were down 0.6% at the end of June 2016, led weaker by losses (negative 1.1%) in the MSCI Developed Markets Index, which more than offset gains in the EM composite.

The Eurostoxx 50 Index and the Nikkei 225 Index were among the worst performers in the developed market composite. European stocks lost 6.1% following the UK's vote to quit the EU. Meanwhile, Japanese shares plummeted 9.5% on the back of a firmer yen. The yen strengthened around 6% against the US dollar in the past month, as investors increasingly sought out safe-haven investments in the current risk-off climate.

The MSCI Emerging Markets Index fared better, posting gains of around 4.0% in June 2016. After declining by nearly 11% in the previous month, the MSCI Emerging Markets Latin America Index bounced back in June, increasing by 11.4%. This was followed by a moderate 3.3% uptick in the MSCI Emerging Markets Europe, Middle East and Africa Index and a 2.8% rise in the MSCI Emerging Markets Asia Index.

### Local markets

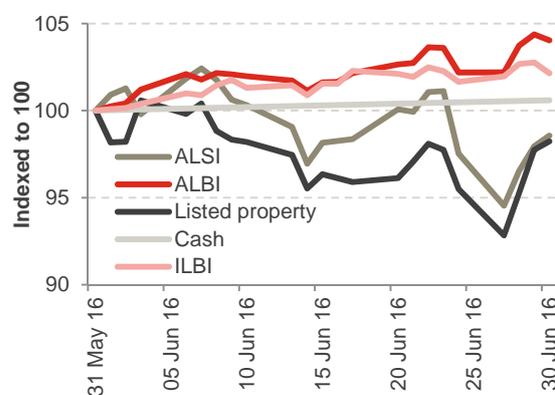
Local equities followed the slump in global markets. The FTSE/JSE All-Share Index fell by 3.0% in June 2016, with losses fairly broad-based across the underlying indices. The FTSE/JSE Industrials Index, which includes many of SA's large dual-listed firms that was negatively affected by the Brexit fallout, lost 3.5%. This was followed by a 2.5% drop in the FTSE/JSE Resources Index and a 2.1% decline in the FTSE/JSE Financials Index.

Mid caps outperformed small caps for the month. The FTSE/JSE Mid-cap Index ended the month 3.2% higher, while the FTSE/JSE Small-caps Index traded largely sideways.

The ALBI gained 4% for the same time period, as the SA 10-year bond yield rallied by 54 basis points. Meanwhile, listed property returns fizzled out, increasing by a mere 1.2%. Inflation-linked bonds rose 2.2%, while SA cash gained 0.6% for the month.

EM currencies ended the month firmer. The SA rand posted the second-largest monthly gain among a basket of EM currencies, second only to the stellar 12.4% appreciation of the Brazilian real against the US dollar. The rand gained 6.8% against the US dollar and a firmer 7.2% against the euro, given the euro's relative losses against the US dollar in the current risk-off environment.

Chart 6: Local asset class returns



Source: Bloomberg, Momentum Investments

## Indices summary for June 2016

	One month	Three months	One year	Three years	Five years	Ten years
<b>Equity indices</b>						
FTSE/JSE All-Share Index (ALSI)	-3.02%	0.44%	3.83%	13.03%	13.81%	12.62%
FTSE/JSE Shareholder Weighted Index (SWIX)	-1.27%	1.31%	4.12%	14.80%	15.68%	14.02%
FTSE/JSE All Share Top 40 Index	-4.12%	0.10%	2.63%	12.77%	13.35%	11.99%
FTSE/JSE Mid Cap Index	3.24%	1.84%	11.07%	14.03%	15.75%	16.37%
FTSE/JSE Small Cap Index	0.10%	2.27%	4.58%	15.36%	17.53%	15.46%
FTSE/JSE Resources Index	-2.47%	6.44%	-16.59%	-6.18%	-7.39%	-0.23%
FTSE/JSE Financials Index	-2.09%	-4.34%	-2.78%	15.36%	18.40%	13.02%
FTSE/JSE Industrials Index	-3.51%	0.51%	7.52%	16.97%	22.01%	19.82%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-0.84%	2.43%	1.58%	10.48%	10.83%	11.70%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-0.65%	2.66%	0.60%	9.75%	10.26%	11.25%
FTSE/JSE SA Listed Property Index (SAPY)	1.17%	-0.43%	11.04%	14.32%	18.54%	18.78%
<b>Interest-bearing indices</b>						
BEASSA All Bond Index (ALBI)	4.04%	4.40%	5.24%	6.29%	7.90%	8.38%
BEASSA All Bond Index 1-3 years (ALBI)	1.51%	2.86%	7.51%	6.56%	6.92%	7.86%
Barclays BEASSA SA Government ILB Index	2.15%	4.67%	8.94%	8.64%	9.80%	10.19%
Short-term Fixed Interest Composite Index (SteFI)	0.59%	1.78%	6.85%	6.18%	5.90%	7.32%
<b>Commodities</b>						
NewGold Exchange-Traded Fund	1.19%	6.10%	35.45%	16.55%	13.11%	15.55%
Gold price (in rands)	2.36%	3.38%	36.70%	18.11%	13.88%	16.11%
Platinum Exchange-Traded Fund	-3.43%	2.59%	12.16%	1.76%		
Platinum price (in rands)	-2.13%	4.98%	14.62%	1.28%	-3.47%	1.94%
<b>Currency movements</b>						
Rand/euro movements	-7.19%	-3.03%	20.13%	8.01%	10.60%	5.97%
Rand/dollar movements	-7.02%	-0.38%	20.54%	13.88%	16.64%	7.45%
<b>Inflation index</b>						
Consumer Price Index (CPI)			6.12%	5.77%	5.70%	6.32%

### 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.
5. FTSE/JSE disclaimer: [www.jse.co.za](http://www.jse.co.za)
6. The information reproduced in this document has been compiled by or arrived at by Momentum Investments (Pty) Ltd from sources believed to be reliable.
7. Although reasonable steps have been taken to ensure the validity and accuracy of the information in this document, Momentum Investments (Pty) Ltd does not accept any responsibility for any claim, damages, loss or expense, howsoever arising, out of or in connection with the information in this document, whether by a client, investor or intermediary.
8. The content of this document is confidential and remain the property of Momentum Investments (Pty) Ltd and may not be reproduced without written permission.