momentum

investments

The Macro Research Desk

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Economic and market snapshot for October 2016

Global economic developments

United States (US)

The state of the economy and dissatisfaction with the government are among the major problems faced

Gallup, a research-based company popular for its opinion polls in the US, suggests that 31% of Americans cite economic issues (unemployment, the wealth gap and taxes, to name a few) as the largest problems facing the country, followed by 12% dissatisfied with government.

In a survey question posed in October 2016, fewer than one in three Americans responded that they were satisfied with the way things were going in the US. Satisfaction levels have remained below the 37% average since 2006, shedding light on the undercurrent of populist anger that has sprouted in western democratic societies.

Despite Americans citing the state of the economy as a key concern, the 2016 presidential campaign has not centred on economic issues. As such, voters' dissatisfaction levels with both presidential nominees have spiked to the highest level in the past ten presidential elections (see chart 1).

The percentage of Americans saying they are certain they will vote is lagging that of previous presidential campaigns, particularly among younger adults and black Americans.

The American Presidency Project shows that just 72% of registered voters say they are highly interested in the 2016 presidential elections, which is a 15% reduction from 2008 and around 4% lower than in 2012.

Chart 1: Unfavourable ratings for both nominees

Source: Cornell University, Roper Centre (calculated in March to April for each election period)

Despite Trump support recently losing ground, the Reuters/Ipsos poll suggests that a low voter turnout would generally benefit Trump, making the outcome of the upcoming election on 8 November 2016 anything but certain. More certain is that the winning candidate will inherit a polarised nation affected by deepening economic inequality, limiting the capacity to govern effectively.

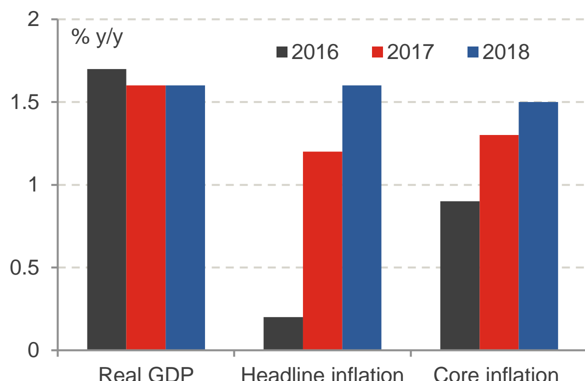
Eurozone

European Central Bank (ECB) fails to outline a more definitive path for monetary policy

As widely expected by the market, interest rates were held steady at the October 2016 ECB monetary policy meeting, but very little detail was divulged whether the ECB's asset purchase programme (a monthly uptake of €80 billion) would be adjusted. Expectations are hence building up to the December 2016 meeting, where a fresh set of economic projections will also be released.

Relating to the September 2016 ECB staff's euro area macroeconomic projections of 1.7% real GDP growth in 2016 and 1.6% in 2017 (see chart 2), ECB President Draghi noted that the economic recovery continues to exhibit "resilience to global uncertainty" thanks to highly accommodative monetary policy. Relatively low oil prices and sustained momentum in job gains were further seen to be underpinning growth.

Chart 2: The ECB's macroeconomic projections



Source: ECB (September 2016), Momentum Investments

However, the outlook remains far from certain. The ECB acknowledges that the external environment continues to pose downside risks to economic activity. Moreover, the underlying inflation trend continues to show no sign of reaching the ECB's target of 2%.

With Draghi suggesting there was no discussion by the ECB's governing council on changes to its monetary stimulus programme, market expectations are ramping up ahead of the meeting on 2 December. His comment that it was unlikely that quantitative easing would come to a "sudden stop" has kept expectations of an extension or expansion of the asset purchase programme alive.

Japan

Market already testing Japan's new monetary policy framework which focuses on controlling the yield curve

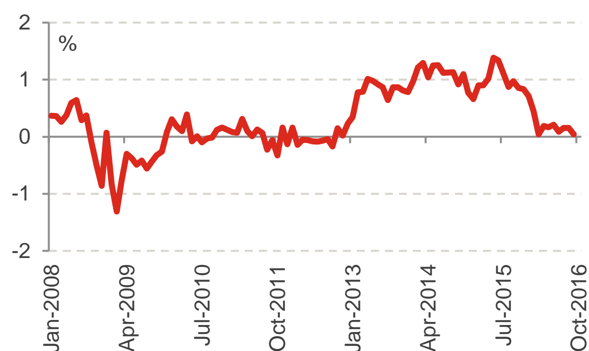
In a bid to reinvigorate economic growth, the Bank of Japan (BoJ) introduced a 0% target for ten-year government bond yields by adjusting its pace of bond purchases. In so doing, banks can earn a profit from lending into Japan's economy by ensuring that long-term interest rates remain above (currently negative) short-term rates.

Previous attempts to support higher levels of inflation, including introducing negative interest rates on selected commercial deposits, have failed, with the headline measure of inflation drifting further into negative territory in the past six months. Japanese five-year inflation swaps remain close to zero (see chart 3), despite rising oil prices and an improving jobs market.

The BoJ continues to battle an entrenched deflationary mindset of businesses and consumers, who have experienced muted inflation or outright deflation in the past two decades.

Although the BoJ has pledged to expand its monetary base further until inflation moves comfortably above its 2% target, fiscal and structural policies are necessary, in Momentum Investments' view, to achieve stable economic growth at higher levels.

Chart 3: Japanese five-year inflation swap rate



Source: Bloomberg, Momentum Investments

Emerging markets (EMs)

Sentiment towards EMs has improved on lower interest rate expectations and reduced Chinese growth concerns
Reduced concerns about China's near-term economic prospects and expectations of lower interest rates in advanced economies provide a mildly favourable backdrop for economic activity in EMs.

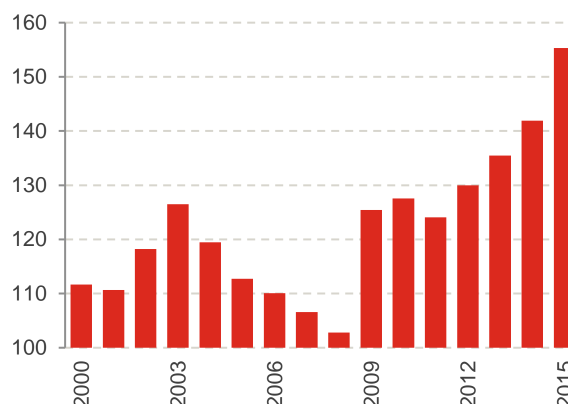
Policy support and strong credit growth in China have aided a mild uptick in commodity prices and have stabilised near-term sentiment in EMs exposed to China.

A more subdued outlook for advanced economies, particularly following Britain's decision to leave the European Union, have placed further downward pressure on interest rates. The expectation for developed-market (DM) monetary policy to remain accommodative for longer has provided additional support to asset prices and EM capital inflows.

Nevertheless, net commodity-exporting countries, particularly those facing high levels of corporate debt or those in need of rebuilding policy buffers, remain vulnerable to sudden shifts in investor confidence.

Moreover, as China's private sector credit-to-GDP ratio rises close to 160% (see chart 4) to support economic growth, downside growth risks in commodity-dependent countries remain significant.

Chart 4: China's private sector credit (% of gross domestic product (GDP))



Source: Bloomberg, Momentum Investments

Local economic developments

Additional taxes and spending cuts used to negate weaker growth effect on fiscus

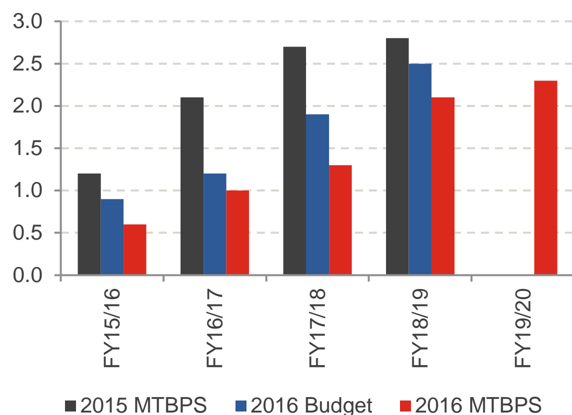
Although Treasury's estimates of growth in real economic activity in SA are only marginally higher than Momentum Investments' estimates, the company sees further downside risks to growth in nominal terms (and hence fiscal revenues) given Momentum Investments' more bullish view on inflation. Treasury anticipates an average headline inflation rate of 6.1% between 2016 and 2018. The company's embedded forecasts that incorporate relative currency strength over the corresponding time horizon (due to an expected mild uptick in commodity prices) and lower food inflation (in 2017, in particular), point to potential downside inflation risk of around 0.5%.

Treasury acknowledges obstacles to achieving a higher rate of trend growth, which it notes has likely fallen from above 4% in 2012 to below 2%. Infrastructure bottlenecks, a lack of competition in key markets, a volatile labour relations environment, regulatory constraints, inefficiencies at state-owned enterprises (SOEs) and policy uncertainty were cited as the main stumbling blocks to achieving a higher growth trajectory.

Treasury warns that a stable debt path will be difficult to sustain at the current level of expenditure, even if no new policy initiatives are taken, should real GDP growth remain stuck below 2% for the longer term.

Subdued economic activity has resulted in a widening of the FY2016/17 budget deficit from 3.2% of GDP estimated in February to a revised 3.4%. Further out, the deficit is expected to be 0.3% wider than the previously anticipated 2.4% share of GDP in FY2018/19. An increase in the revenue share of GDP from 29.7% in FY2016/17 to 30.4% by FY2018/19, accompanied by a stable expenditure share of GDP at around 33% for the same time period, ensures a narrowing of the fiscal deficit and a stabilisation in the debt profile over the medium-term horizon.

Chart 5: Treasury's real GDP growth revisions (%)



Source: National Treasury, Momentum Investments

Financial market performance

Global markets

Global equities ended the month 1.7% in the red, driven lower by a dip in DM equities, while a rotation by investors into EMs drove the MSCI EM Index higher for October 2016. According to the Bank of America Merrill Lynch global fund manager survey, the allocation to EM equities has risen to the highest overweight in three and a half years.

The MSCI DM Index slipped 1.9% for October 2016, driven lower by a 1.8% drop in the S&P 500 Index, while robust gains of 5.9% and 1.9% were recorded for the Nikkei 225 and Eurostoxx 50 indices, respectively.

The MSCI EM Index increased by 0.2% on a mild uptick in commodity prices and the expectation of a measured tightening of monetary policy by the US Federal Reserve.

The MSCI EM Latin America Index surged ahead by 9.9% for October, partly owing to renewed enthusiasm over the ability of Brazil's new market-friendly government to push through economic reforms.

The MSCI EM Asia Index lost 1.4% for the same time period, despite Chinese GDP figures meeting market expectations, while the MSCI Europe, Middle East and Africa (EMEA) Index tracked largely sideways (negative 0.2%).

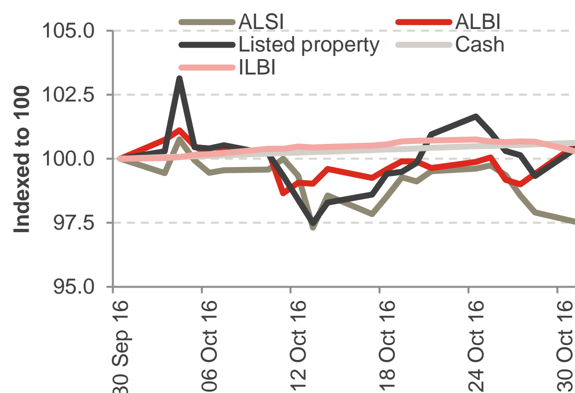
Local markets

During the first week of October 2016, the FTSE/JSE All-Share Index fell by 2.7%, driven by news of fraud charges against Finance Minister, Pravin Gordhan. The index rallied intra-month in line with a better return from global risk asset classes, but dipped again towards month end, ending October 2016 2.5% weaker.

The FTSE/JSE Resources Index backtracked on a slightly firmer rand, declining by 3.4% for October 2016, while the FTSE/JSE Industrials and Financials indices lost 2.9% and 0.8%, respectively.

The FTSE/JSE Mid-cap Index lost 0.8% for October 2016, while the FTSE/JSE Small-cap Index fell by a larger 1.5%.

Chart 6: Local asset class returns



Source: Bloomberg, Momentum Investments

SA nominal bonds weakened by 25 basis points mid-month on the back of renewed local political risk, but strengthened towards month end, as support for Gordhan increased, reducing political uncertainty in the eye of investors.

The FTSE/JSE Listed Property Index edged 0.5% higher for the month, followed by a 0.3% increase in the Inflation-linked Bond Index (ILBI). SA cash earned 0.6% for the same time period.

The rand recouped some of its earlier losses in the month, strengthening around 6.5% against the US dollar from its worst point mid-month and1.9% firmer relative to a month ago. Gains against the euro were higher at 4.4% for October.

Indices summary for October 2016

Equity indices	One month	Three months	One year	Three years	Five years	Ten years
FTSE/JSE All-Share Index (ALSI)	-2.49%	-3.15%	-3.42%	6.66%	12.68%	11.20%
FTSE/JSE Shareholder Weighted Index (SWIX)	-2.81%	-4.31%	-1.21%	8.39%	14.40%	12.44%
FTSE/JSE All Share Top 40 Index	-2.98%	-3.05%	-6.48%	5.69%	11.95%	10.55%
FTSE/JSE Mid Cap Index	-0.76%	-4.75%	14.37%	11.38%	15.82%	14.76%
FTSE/JSE Small Cap Index	-1.47%	1.39%	7.54%	11.09%	18.56%	14.20%
FTSE/JSE Resources Index	-3.41%	0.05%	0.10%	-11.18%	-6.60%	-0.20%
FTSE/JSE Financials Index	-0.82%	-2.74%	-8.10%	10.29%	17.83%	11.31%
FTSE/JSE Industrials Index	-2.87%	-4.48%	-6.15%	9.99%	19.42%	17.33%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-1.78%	-1.71%	3.94%	5.04%	10.71%	10.94%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-1.26%	-0.90%	4.15%	4.88%	10.57%	10.50%
FTSE/JSE SA Listed Property Index (SAPY)	0.50%	-3.38%	2.16%	13.60%	17.38%	16.60%
Interest-bearing indices						
BEASSA All Bond Index (ALBI)	0.64%	1.81%	6.93%	6.91%	7.58%	8.26%
BEASSA All Bond Index 1-3 years (ALBI)	0.50%	1.92%	7.46%	6.66%	6.59%	7.86%
Barclays BEASSA SA Government ILB Index	0.25%	0.71%	6.54%	7.97%	9.32%	9.76%
Short-term Fixed Interest Composite Index (SteFI)	0.63%	1.89%	7.24%	6.46%	6.03%	7.32%
Commodities						
NewGold Exchange-Traded Fund	-5.33%	-8.08%	8.39%	8.55%	4.52%	13.96%
Gold price (in rands)	-5.60%	-7.85%	9.68%	9.43%	5.11%	14.42%
Platinum Exchange-Traded Fund	-7.20%	-17.21%	-3.28%	-1.52%		
Platinum price (in rands)	-6.09%	-16.98%	-2.74%	-1.24%	-3.38%	1.09%
Currency movements						
Rand/euro movements	-4.42%	-4.68%	-3.06%	2.79%	6.06%	4.60%
Rand/dollar movements	-1.78%	-2.74%	-2.30%	10.44%	11.29%	6.21%
Inflation index						
Consumer Price Index (CPI)			6.12%	5.54%	5.61%	6.19%
Global indices						
MSCI World Index (All Countries)	-3.30%	-2.69%	-1.10%	13.65%	19.38%	8.92%
MSCI Developed Markets Index	-3.35%	-3.23%	-1.15%	14.66%	21.34%	10.35%
MSCI Emerging Markets Index	-2.79%	0.80%	6.78%	7.83%	11.90%	
Global Property Research (GPR) 250 REIT Index	-9.81%	-15.34%	0.57%	31.90%	36.50%	16.91%
MSCI Africa Index	-2.62%	-6.11%	-3.96%	4.23%	9.33%	
Citigroup World Government Bond Index	-5.15%	-4.80%	4.06%	10.58%	11.53%	9.77%
Three-month US dollar LIBOR rate	-1.70%	-2.52%	-1.63%	10.87%	12.25%	7.57%
Three-month Euro LIBOR rate	-4.45%	-4.76%	-3.31%	2.79%	6.22%	

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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