The Macro Research Desk

Herman van Papendorp
(Head of Investment Research and Asset Allocation)

Sanisha Packirisamy
(Economist)

Economic and market snapshot for April 2017

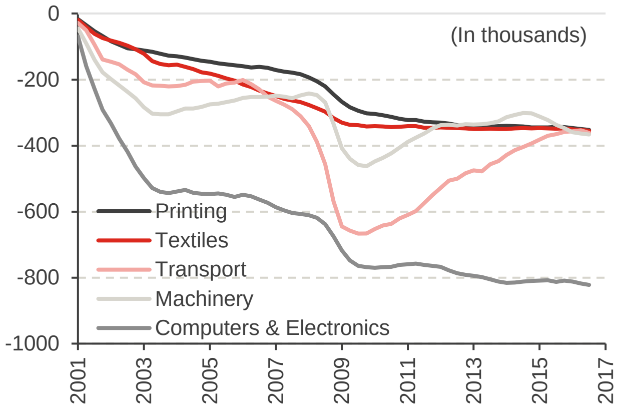
Global economic developments

United States (US)

Protectionist measures are unlikely to significantly boost manufacturing employment

The US economy shed around 5.6 million manufacturing jobs between 2000 and 2010, concentrated in the transport, machinery and electronics sectors (see chart 1). During the same time period, the goods trade deficit with the rest of the world (China and Mexico in particular) widened significantly.

Chart 1: Cumulative changes in US manufacturing jobs



Source: Capital Economics, Momentum Investments

Nonetheless, US output in the above-mentioned sectors rose strongly during the corresponding period. Similarly, productivity growth in manufacturing was double that of the entire US economy. As such, it appears as though globalisation cannot be wholly responsible for the loss in manufacturing jobs and the increasing trend of automation may be playing a larger role, as US factories have achieved higher productivity levels through replacing human labour with machines.

While President Donald Trump's campaign rhetoric centred on proposed efforts to bring back lost manufacturing jobs, this may not be entirely possible, as increasing automation has been partly to blame.
The Financial Times quotes a Boston Consulting Group study, which found that automation can cut costs significantly. The study noted that a human welder would earn more than three times the equivalent operating cost per hour for a robot.

While protectionist policies could bring back some manufacturing jobs, these are likely to be in the lower-skilled manufacturing segments.
Moreover, protectionist policies could elicit retaliation by other countries, resulting in upward pressure on prices and more expensive goods for the US consumer.

As a result, an increasingly protectionist stance by key economies continues to pose a significant downside risk to the expected modest recovery in global growth in the medium term.

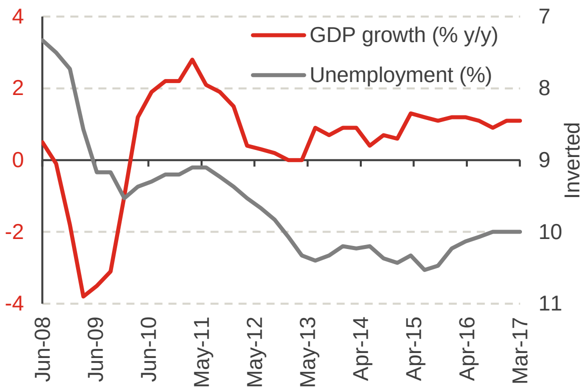
Eurozone

The race for the French presidency

Following the United Kingdom's (UK) choice to leave the European Union (EU) and the victory of Donald Trump in the US presidential election in November 2016, the French election outcome will be closely watched by investors for signs of further populist upheaval.

Given that none of the candidates running won 50% or more in the popular vote in the first round, the two leading contenders, namely Emmanuel Macron (winning 24% of the vote) and Marine Le Pen (capturing 21.3% of the first-round vote), will enter into a run-off election on 7 May 2017.

Chart 2: Low French growth and high unemployment



Source: Deutsche Bank, Momentum Investments

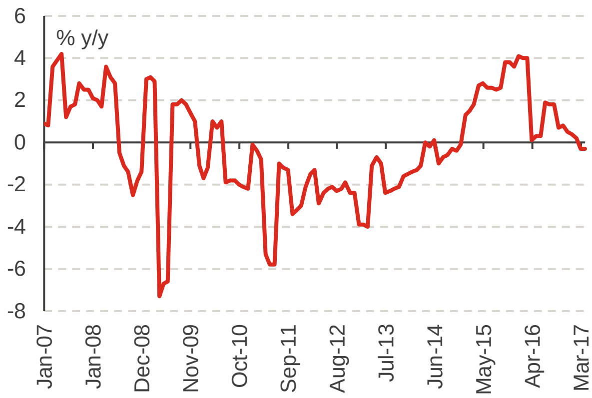
France's next president will face the challenge of tepid growth, high unemployment and rising public debt. Though France remains the second-largest economy in the Eurozone, its recovery from the global financial crisis of 2008 has been slow. Consequently, the jobless rate in France has eclipsed that of many other member nations, creeping above 10% in early 2013 and remaining there (see chart 2). Labour market reforms implemented by President Francois Hollande (watered down to appease the Left), have failed to address long-term unemployment (more than 45% of the unemployed in France have been unemployed for longer than 12 months) and youth jobless rates.

UK

Nominal wages not keeping pace with rising inflation

Higher oil prices, coupled with a steep fall in the value of the sterling, have pushed headline measures of inflation higher in the UK. Growth in earnings, however, has not kept pace, resulting in real wage growth slowing to levels last seen in October 2014 (see chart 3).

Chart 3: Growth in UK real wages slows to 2014 levels



Source: Bloomberg, Momentum Investments

Although the headline rate of unemployment has improved from a peak of 8.4% in the final quarter of 2011 to 4.8% in the fourth quarter of 2016, the Bank of England revised its estimate of full employment, suggesting that (nominal) wage pressures are only likely to build more meaningfully once unemployment reaches 4.5%.

Meanwhile, headline inflation is expected to increase further by year end, as retailers push through further price increases on the back of higher import costs, keeping a lid on real income gains.

UK Prime Minister Theresa May's decision to hold a snap election on 8 June 2017 is likely to secure her with a larger majority in parliament, but it has also enabled her to push back the deadline for the next election to 2022 (from 2020), effectively extending the cut-off date for trade deals. Although this lowers the concerns of a more damaging Brexit deal, Momentum Investments still expects growth in real economic activity in the UK to slow marginally in 2017 from the 1.8% print recorded in 2016, as domestic demand remains under pressure.

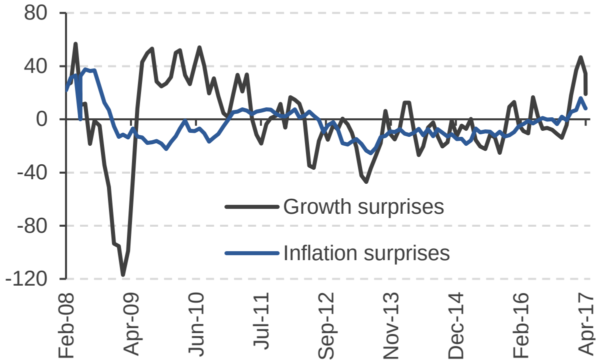
Deteriorating real wage growth, the prospect of job losses and gloomy consumer confidence are expected to weigh negatively on household spend, while uncertainty surrounding the UK's exit from the EU should delay fixed investment spend by firms.

Emerging markets (EMs)

Forecasters catching up to better economic data

Growth and inflation surprises have rolled over, as forecasters have caught up to an improvement in economic data across EMs (see chart 4).

Chart 4: EM data surprises are rolling over



Source: Bloomberg, Citi Research, Momentum Investments

A study conducted by Citi Research, using data from 1999, shows that EM currencies tend to appreciate following a peak in inflation surprises, most likely as a consequence of US dollar weakness. Similarly, firmer EM currencies tend to follow the peak in economic growth surprises. Typically, since 1999, this has also been followed by lower EM interest rates.

While the above flags potential downside in EM interest rates, a rise in political tensions in select countries may prevent a further cut from current levels in upcoming quarters. These countries include, among others:

- South Africa (SA): A damaging Cabinet reshuffle has triggered a sovereign downgrade to junk status.
- Turkey: An increasing centralisation of government power has further polarised the country.
- Brazil: The government is struggling to implement pension reforms.
- Russia: Fading hopes that relations with the US may normalise and sanctions may be lifted.

Local economic developments

The SA Reserve Bank (SARB) warns against a potential correction in financial markets

In its latest Monetary Policy Review (dated April 2017), the SARB flagged domestic and external risk factors, which could prompt a correction in financial markets in the near term.

The first risk is posed by the possiblility for an upside surprise in US inflation data (accompanied by higher domestic demand underpinned by proposed sizeable tax cuts), which could prompt a faster-than-expected rise in US interest rates. The SARB points out that a more rapid rise in US interest rates could negatively affect riskier investments.

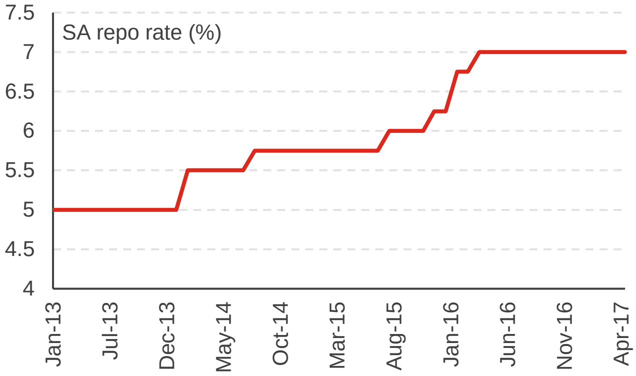
Secondly, the SARB worries that Chinese authorities may be forced to tighten policy more aggressively to address an overheating property market. This would likely have negative repercussions for commodity prices and global market sentiment.

The third source of concern for the SARB arises from domestic risks. In the SARB's opinion, the largest domestic risk is the threat of additional ratings downgrades. A further increase in uncertainty related to the direction of economic policy could, in the SARB's view, trigger capital outflows. This, in turn, could further raise borrowing costs, push the rand weaker and put upward pressure on SA's
inflation outlook.

Rand volatility could persist well into year end, as political turbulence gathers momentum in the lead up to the African National Congress (ANC) National Executive Committee (NEC) meeting in December 2017. As such, Momentum Investments views the scope for monetary easing as limited and expects interest rates to remain on hold for the remainder of the year.

Should fiscal prudence not be exercised and SA's debt ratio continues to climb to more hazardous levels, further downgrades could very well be triggered. In this scenario, following a likely lower growth outcome, the currency could deteriorate further from current levels. If sustained at those weaker levels, inflation prospects could rise to a more uncomfortable level, urging the SARB to raise interest rates to defend its inflation-targeting mandate.

Chart 4: Uncomfortably high inflation expectations limit room to lower interest rates



Source: INET BFA, Momentum Investments

Financial market performance

Global markets

Geopolitical risks relating to Turkey's referendum, attacks in Syria, France's presidential election and North Korea's failed missile test raised concerns among investors in the first half of April 2017. The MSCI All Word Index traded 1% in the red by the middle of the month, but recovered to 1.6% in the black by month end, as signs of a recovering global economy (including strong Chinese economic activity in the first quarter of 2017) emerged, spurring investor sentiment.

The MSCI Developed Markets Index ended April 2017 1.5% firmer, led by a 2% jump in the Eurostoxx 50 and a 1.5% uptick in the Nikkei 225 indices. The S&P 500 Index trailed behind, gaining only 1% during the corresponding period.

Although EMs are supported by higher global aggregate commodity prices (which have increased by 15% since the trough reached in January 2016), geopolitical risks around the globe pose a downside risk to a further extension in the EM rally. The MSCI EM Index advanced 2.2%, as a strong showing in the MSCI Europe, Middle East and Africa (EMEA) Index (4.3%) boosted the overall return from EM. Asian markets rose 2.1% for April 2017, while the MSCI Latin America Index traded sideways.

Local markets

Industrial and financial shares carried the local market higher in April 2017. The 3.6% gain in the FTSE/JSE All Share Index was buttressed by a 5.2% surge in the FTSE/JSE Industrials Index, which benefited from stronger world markets trading on healthy high-frequency economic data. The FTSE/JSE Financials Index offered further support, gaining 3.6% for the corresponding period. Meanwhile, resource shares lagged, edging sideways for the month.

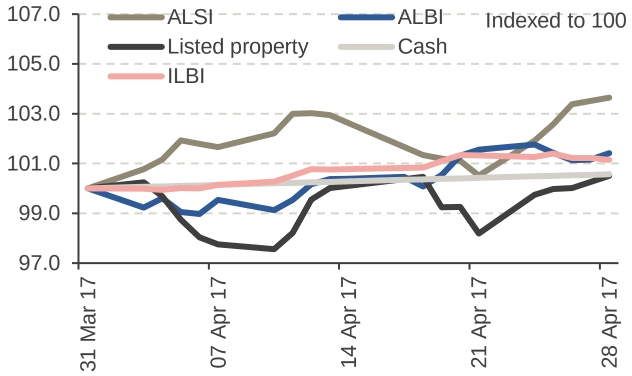
The FTSE/JSE Mid-cap Index decreased marginally by 0.8% for April 2017, while the FTSE/JSE Small-cap Index slid 2.6%.

SA ten-year government bonds sold off to 9.1% at the end of the first week in April 2017, following sovereign ratings downgrades to junk status by ratings agencies Fitch and Standard and Poor's. Yields rallied towards 8.8% by month end, as non-residents continued to buy bonds, offsetting a reduction in exposure by local investors. The Inflation-linked Bond Index (ILBI) inched 1.1% higher for April 2017, followed by a mild 0.5% uptick in the FTSE/JSE Listed Property Index. SA cash gained 0.6% for the same period.

Key EM currencies continued to be supported by a weaker US dollar and investor appetite for riskier investments. The latter has been confirmed by data collated by the Institute of International Finance, showing that, in April 2017, EMs recorded net non-resident portfolio inflows for the fifth consecutive month.

The rand traded as the third-best-performing currency among a basket of EM peers. The rand ended April 2017 0.4% firmer against the US dollar, but 1.8% softer against the euro. The British pound strengthened by 3.6% against the rand for April 2017, driven by expectations of greater support for UK Prime Minister May in the upcoming election.

Chart 5: Local asset class returns



Source: Bloomberg, Momentum Investments

Indices summary for April 2017

	One month	One year	Three years	Four years	Five years	Six years	Seven years	Ten years
Equity indices								
FTSE/JSE All-Share Index (ALSI)	3.64%	4.50%	6.32%	11.82%	12.67%	11.90%	12.73%	9.84%
FTSE/JSE Shareholder Weighted Index (SWIX)	4.06%	4.41%	7.96%	12.77%	13.57%	13.26%	13.89%	10.54%
FTSE/JSE All Share Top 40 Index	4.47%	4.08%	5.41%	11.61%	12.41%	11.30%	12.28%	9.46%
FTSE/JSE Mid Cap Index	-0.80%	2.41%	9.59%	11.65%	12.65%	13.99%	14.22%	11.56%
FTSE/JSE Small Cap Index	-2.56%	4.37%	9.97%	13.29%	15.78%	15.83%	15.17%	10.41%
FTSE/JSE Resources Index	0.01%	2.85%	-13.64%	-3.22%	-4.84%	-5.70%	-2.99%	-1.17%
FTSE/JSE Financials Index	3.56%	2.01%	8.99%	12.26%	15.22%	15.97%	14.97%	9.63%
FTSE/JSE Industrials Index	5.17%	6.17%	11.31%	15.77%	18.65%	18.87%	19.74%	15.48%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	2.75%	5.22%	3.97%	10.24%	10.57%	10.07%	11.05%	9.59%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	2.34%	5.44%	4.01%	9.87%	10.41%	9.76%	10.78%	9.01%
FTSE/JSE SA Listed Property Index (SAPY)	0.51%	0.02%	13.80%	9.16%	15.33%	15.93%	16.16%	13.44%
Interest-bearing indices								
BEASSA All Bond Index (ALBI)	1.47%	10.58%	7.86%	5.02%	7.31%	8.18%	8.36%	8.05%
BEASSA All Bond Index 1-3 years (ALBI)	1.03%	9.41%	7.59%	6.61%	6.75%	7.22%	7.28%	7.87%
Barclays BEASSA SA Government ILB Index	-0.42%	1.14%	5.70%	4.44%	7.25%	8.59%	8.93%	9.28%
Short-term Fixed Interest Composite Index (SteFI)	0.61%	7.62%	6.83%	6.44%	6.22%	6.13%	6.17%	7.28%
Commodities								
NewGold Exchange-Traded Fund	1.82%	-7.80%	7.25%	6.03%	5.42%	8.49%	9.51%	12.97%
Gold price (in rands)	3.24%	-7.69%	7.47%	6.27%	5.66%	8.85%	9.99%	13.39%
Platinum Exchange-Traded Fund	0.05%	-16.79%	-6.08%	-3.58%				
Platinum price (in rands)	-0.80%	-17.78%	-5.60%	-4.10%	-2.42%	-6.16%	-3.11%	-0.23%
Currency movements								
Rand/euro movements	1.56%	-10.25%	-0.06%	5.33%	7.28%	6.90%	5.86%	4.26%
Rand/dollar movements	-0.18%	-5.63%	8.32%	10.48%	11.54%	12.55%	8.91%	6.65%
Inflation index								
Consumer Price Index (CPI)		6.13%	5.48%	5.62%	5.68%	5.73%	5.50%	6.33%
Global indices								
MSCI World Index (All Countries)	1.25%	8.26%	14.13%	18.88%	21.22%	19.54%	17.36%	9.23%
MSCI Developed Markets Index	1.30%	8.19%	14.47%	19.67%	22.63%	20.83%	18.56%	10.83%
MSCI Emerging Markets Index	1.30%	11.64%	9.84%	11.26%	13.04%			
Global Property Research (GPR) 250 REIT Index	0.04%	-9.54%	25.44%	27.97%	34.86%	36.43%	30.75%	16.88%
MSCI Africa Index	4.68%	-1.00%	3.48%	8.15%	8.78%	8.25%	8.24%	
Citigroup World Government Bond Index	0.65%	-8.56%	7.12%	9.97%	10.85%	12.58%	10.74%	9.62%
Three-month US dollar LIBOR rate	-0.09%	-4.76%	8.88%	10.98%	12.03%	12.84%	9.38%	7.79%
Three-month Euro LIBOR rate	1.53%	-10.55%	-0.15%	5.31%	7.31%	7.13%		

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.
5. FTSE/JSE disclaimer: 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.