momentum
investments

The Macro
Research Desk

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Economic and market snapshot for February 2017

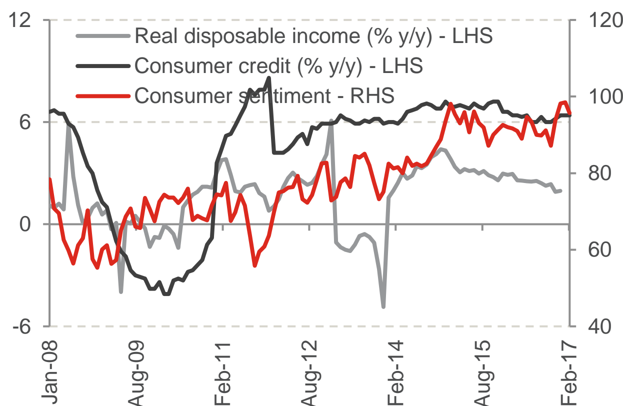
Global economic developments

United States (US)

Consumer sentiment has risen on the back of anticipated tax cuts, which have not yet been delivered

The sharp rise in US consumer sentiment since the US presidential election has not been accompanied by a surge in the extension of consumer credit or real disposable income growth (see chart 1). As such, consumer exuberance has not translated into a boost in household spending yet.

Chart 1: Consumer sentiment surged following US elections



Source: Bloomberg, Momentum Investments

The University of Michigan Consumer Confidence Survey suggested that consumers who self-identified as Democrats were the most optimistic in June 2016, while Republicans were the least positive. The survey results switched positions following the election, with the expectations sub-index among Democrats falling around 24 points for the same time period, while that of Republicans rose more than 50 points. Among Democrats, income expectations one year out decreased, while inflation expectations for the corresponding period increased. The opposite was true for Republicans. Moreover, while 46% of Democrats expected rising unemployment in December 2016 (17% in June 2016), only 3% of Republicans expected further net job losses (from 41% in June 2016).

Morgan Stanley research shows that luxury spending has dropped meaningfully, following the election, while general discretionary spend (excluding the high-end) has held up well. The research also pointed to a smaller confidence boost in the richest segment of the market. Confidence of households with annual income between US$35 000 and US$50 000 has risen 32 points since the election, while household confidence in the richest segment (>US$125 000) increased by only 7.8 points.

Given that potential tax cuts are likely to benefit the richest Americans disproportionately, higher-income earners' fears may be centred on President Donald Trump's anti-globalisation rhetoric.

That said, Momentum Investments continues to see support for consumption expenditure in 2017, particularly if the promised tax cuts materialise in the second half of the year. Household debt levels (as a share of disposable income) have dropped from 133% in late 2007 to 104% in late 2016, while household credit growth remains supportive. Additionally, broad and narrow measurements of unemployment have been ticking lower.

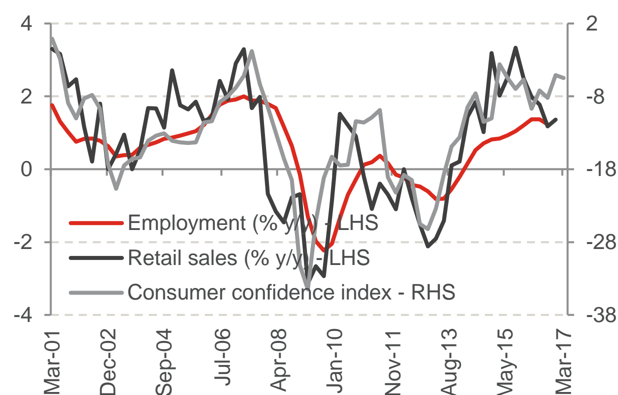
Eurozone

Political clouds continue to loom over the Eurozone's economic outlook

Consumer confidence in the Eurozone slipped in the first two months of 2017, suggesting that less-supportive consumer drivers (including higher oil prices and rising inflation) are beginning to weigh on the growth outlook. Higher oil prices are anticipated to squeeze real wages this year and employment growth appears to be slowing (see chart 2).

Ultra-expansionary monetary policy and less austere budgets should, however, prevent a sharper slowdown in real growth this year, although without the help of prior tailwinds supporting economic activity, real gross domestic product (GDP) growth is set to slow marginally from the 1.7% rate experienced in 2016.

Chart 2: Eurozone consumer confidence reversing course



Source: Bloomberg, Momentum Investments

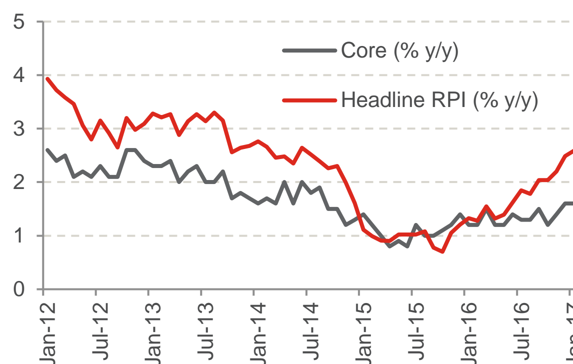
Although headline inflation in the euro area picked up sharply to 1.8% y/y in January 2017, core prices only picked up by 0.9% y/y. The European Central Bank Governing Council noted this, saying "underlying inflation pressures had remained subdued and signs of a convincing upward trend were still lacking". It indicated that the council would look through the spike in headline inflation. Together with continued downside risks to the growth trajectory, Momentum Investments expects to see bond purchases remaining intact this year.

United Kingdom (UK)

Fuel, food and a weaker sterling contribute to rising inflation

Retail price inflation (RPI, which includes housing costs) reached its highest rate in two-and-a-half years in January 2017, increasing to 2.6% year on year (y/y) from 2.5% y/y a month before (see chart 3).

Chart 3: Inflation pushes higher in the UK



Source: Bloomberg, Momentum Investments

Fuel prices (which climbed to a level not seen in two years), together with an uptick in food prices, contributed to the increase in inflation. A weaker sterling is likely to have more of an effect on consumer inflation in coming months. Input prices at the producer price level rose by 20.5% y/y in January 2017, thanks to pound weakness. As firms pass the rising cost of fuel and imported raw materials onto consumers, further pressure is likely to be seen at the consumer level.

Rising inflationary pressures have also been observed elsewhere in the developed market composite. In fact, the Citigroup inflation surprise index showed inflation surprising to the upside for the first time since the first

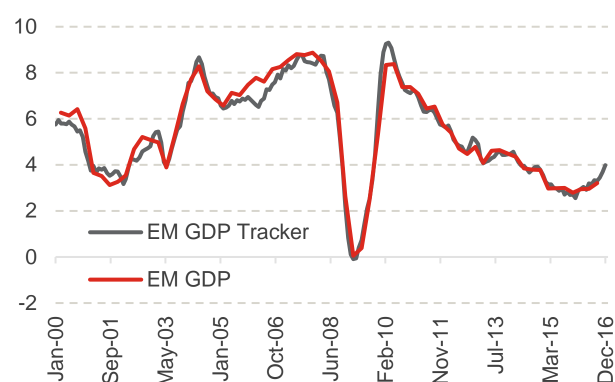
quarter of 2012 for the G10 economies (the ten-largest developed economies) in December 2016.

Emerging markets (EMs)

EM recovery driven by China

Capital Economics' GDP tracker shows that EM GDP growth (in real terms) is accelerating at its fastest pace in nearly three years. The GDP tracker, a compilation of output and spending data, ticked up to 5% y/y in December 2016, from 3.7% in November (see chart 4).

Chart 4: EM GDP growth picks up pace (% y/y)



Source: Capital Economics, Momentum Investments

Nonetheless, a large driver of the recovery is China, which has observed an improvement in electricity production, rail freight volume growth, steel production and manufacturing sentiment in the recent months.

Though the recovery in Brazil and Russia (following a deep recession) remains intact, the largest EM growth driver – China – could slow marginally this year. Chinese authorities are shifting their focus away from supporting growth through significant policy easing.

Rising credit risks (UBS calculates that China's debt-to-GDP ratio rose to 277% at the end of 2016 from 254% at the end of the previous year) have urged the People's Bank of China (PBoC) to marginally raise interest rates on its medium-term loan facility. The PBoC also raised the seven-day open market operations rate by 10 basis points.

Aside from its reliance on Chinese growth, EMs are also the most exposed to a deterioration in trade conditions with the US. The shift in regime in the US poses a threat to global trade activity and could derail the expected recovery in EM should the anti-globalisation undercurrent gain support.

Local economic developments

Tax hikes and expenditure cuts keeps SA on a prudent fiscal management path

Amid a low-growth environment, Finance Minister Pravin Gordhan kept SA on a prudent fiscal management path by pulling a number of tax levers and cutting back on non-interest expenditure.

Overall, the budget was negative for SA consumers, but government attempted to alleviate the pressure for lower-income earners through a partial compensation for bracket creep (through raising the tax-free threshold), raising the level at which transfer duties are paid and maintaining real growth of 2.3% per year in social grants for the next three fiscal years.

Meanwhile, in line with government's redistributive efforts, the higher-income earners bore the brunt of tax increases. The top income tax bracket was raised from 41% to 45% and dividend withholding taxes were lifted from 15% to 20%.

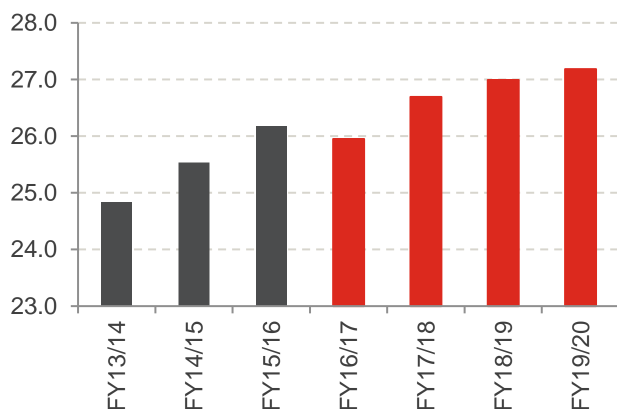
As government attempts to stick to its fiscal consolidation plan and debt targets in a low-growth environment, SA's tax burden is likely to drift higher. SA's tax-to-GDP ratio is set to climb from 26.2% in FY2015/16 to 27.2% by FY2018/19 (see chart 5) and could rise further in the longer term with the implementation of additional tax measures.

The rising tax burden, accompanied by fiscal consolidation, implies that the budget is removing spending power from the economy on a net basis. Spending growth (averaging 7.9% per year in nominal terms between FY2017/18 and FY2019/20) lagging revenue growth (averaging 8.7% per year for the corresponding period) also implies a net drain on economic activity.

It is crucial that this effect be partly offset by maintaining spend on essential services and preserving social security benefits, including social grants and unemployment insurance fund benefits, that protect the more vulnerable income-earning groups. While Treasury has put these

measures in place in the short term, longer term a leaner government and deficit reduction are necessary to positively affect the private sector and overall growth.

Chart 5: SA's tax burden set to rise further



Source: National Treasury, Momentum Investments

Financial market performance

Global markets

Global stocks extended their rally in the first half of February 2017, but performance petered out in the latter half of the month, as investors questioned the likelihood of swift tax reforms and robust spending plans from the new US administration.

The MSCI All World Index rose 2.8% for February 2017, supported by healthy gains in EM equities (3.1%), while the MSCI Developed Markets Index followed suit, increasing by 2.8%.

Within developed markets, the S&P 500 Index delivered a healthy return of 4.0%, but the pace of gains softened into month-end on the back of a speech made by the Trump administration, warning that the effect of selected growth measures (including the prospective tax cuts) would take time to be felt in the economy.

Despite political threats posed by populist parties throughout Europe, firming growth and inflation data in the Eurozone led to the largest weekly inflows into European equity portfolios in more than a year during the final week of February 2017. The Eurostoxx 50 Index added 2.9% in February 2017. Meanwhile, gains on the Nikkei 225 Index were notably lower (0.5%), as a stronger yen hurt exporters.

EM resilience has been supported by expectations of a strengthening US economy that is anticipated to encourage growth in developing nations. Commodity prices tracked largely sideways for the month, but remain nearly 20% higher than a year ago.

Within EM equities, the MSCI Latin America Index and the MSCI Asia Index were the best performers, both achieving gains of 3.6%. Gains in the MSCI Europe, Middle East and Africa (EMEA) Index lagged at 0.1% for the corresponding period.

Local markets

SA equities ignored global markets and shed 3.1% in February 2017. The biggest loser was the FTSE/JSE Resource Index, which plunged 9.9% thanks to rand strength, despite commodity prices (in aggregate) picking up by 0.2% for the same time period. Large price drops were, however, noticeable in iron ore and copper, following reports from the US that the Trump administration's infrastructure programme would not be implemented before the end of 2018.

The rand was bid higher following the local budget speech, which was generally viewed as being fiscally prudent amid challenging circumstances. Moreover, dollar weakness following the release of the minutes of the latest Federal Reserve (Fed) interest rate-setting meeting (held between 31 January and 1 February 2017)

drove US dollar weakness later in the month. The Fed minutes pointed to a number of participants suggesting that some time would be required for the outlook to become clearer before acting on rates.

Rand gains late in the month also took the shine off the FTSE/JSE Industrials Index, which ended the month 1.6% lower. Meanwhile, the FTSE/JSE Financials Index edged 0.2% higher.

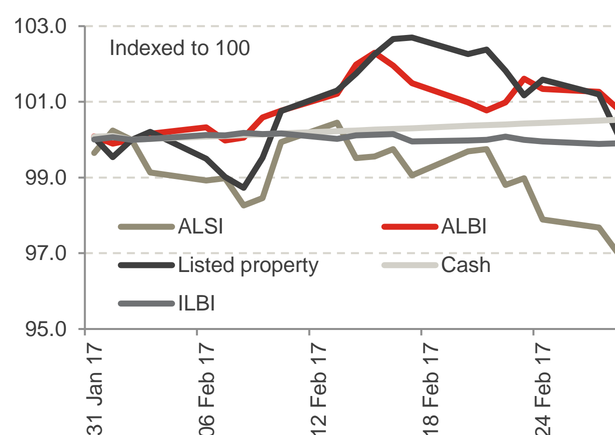
The FTSE/JSE Mid-cap Index decreased marginally by 0.4% for February 2017, while the FTSE/JSE Small-cap Index rose by 1.9%.

SA ten-year government bonds rallied around 20 basis points between 31 January 2017 and the day following the budget announcement, expressing relief over the finance minister's commitment to fiscal consolidation, which left fiscal and debt ratios broadly in line with the October 2016 medium-term budget projections. Nevertheless, the market remains jittery (closing only 2 basis points lower by month-end) in light of rumours of a Cabinet reshuffle, including speculation around changes to appointments in the finance ministry.

The Inflation-linked Bond Index (ILBI) decreased marginally by 0.1% for February 2017, while the FTSE/JSE Listed Property Index fell by 0.4%. SA cash gained 0.6% for the same period.

The rand ended February 2017 2.5% firmer against the US dollar and 4.8% stronger against the euro.

Chart 6: Local asset class returns



Source: Bloomberg, Momentum Investments

Indices summary for February 2017

Equity indices	One month	Three months	One year	Three years	Five years	Ten years
FTSE/JSE All-Share Index (ALSI)	-3.11%	2.04%	6.28%	5.69%	11.58%	10.21%
FTSE/JSE Shareholder Weighted Index (SWIX)	-1.49%	3.03%	7.63%	7.46%	12.78%	11.00%
FTSE/JSE All Share Top 40 Index	-3.91%	1.10%	3.41%	4.05%	10.83%	9.64%
FTSE/JSE Mid Cap Index	-0.40%	5.33%	17.32%	13.19%	14.11%	12.85%
FTSE/JSE Small Cap Index	1.91%	6.03%	22.69%	12.84%	17.33%	12.34%
FTSE/JSE Resources Index	-9.91%	-3.83%	19.13%	-13.36%	-6.60%	-0.47%
FTSE/JSE Financials Index	0.24%	3.02%	10.23%	11.65%	15.65%	10.35%
FTSE/JSE Industrials Index	-1.57%	4.23%	0.86%	8.96%	17.83%	15.51%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-4.88%	-0.15%	13.67%	4.31%	9.59%	10.07%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-5.48%	-0.01%	16.25%	4.79%	9.70%	9.55%
FTSE/JSE SA Listed Property Index (SAPY)	-0.36%	5.55%	10.96%	16.23%	16.26%	14.58%
Interest-bearing indices						
BEASSA All Bond Index (ALBI)	0.71%	3.66%	13.49%	7.95%	7.32%	7.97%
BEASSA All Bond Index 1-3 years (ALBI)	1.08%	2.69%	10.06%	7.55%	6.69%	7.83%
Barclays BEASSA SA Government ILB Index	-0.07%	1.05%	6.49%	7.81%	8.02%	9.62%
Short-term Fixed Interest Composite Index (SteFI)	0.57%	1.84%	7.54%	6.71%	6.16%	7.30%
Commodities						
NewGold Exchange-Traded Fund	1.37%	-0.90%	-16.93%	4.56%	4.01%	12.42%
Gold price (in rands)	0.20%	-0.71%	-17.05%	4.84%	4.40%	13.03%
Platinum Exchange-Traded Fund	0.85%	4.11%	-8.54%	-5.39%		
Platinum price (in rands)	0.25%	4.52%	-9.25%	-4.76%	-4.04%	0.70%
Currency movements						
Rand/euro movements	-4.54%	-6.59%	-18.92%	-2.13%	6.89%	3.77%
Rand/dollar movements	-2.90%	-6.71%	-17.08%	6.80%	11.92%	6.05%
Inflation index						
Consumer Price Index (CPI)			6.58%	5.74%	5.68%	6.23%
Global indices						
MSCI World Index (All Countries)	1.20%	5.75%	0.45%	12.07%	21.07%	9.08%
MSCI Developed Markets Index	0.74%	6.30%	-0.76%	12.82%	22.55%	10.62%
MSCI Emerging Markets Index	4.77%	1.40%	9.71%	8.18%	12.15%	
Global Property Research (GPR) 250 REIT Index	-3.04%	0.77%	-21.32%	24.12%	36.28%	16.14%
MSCI Africa Index	0.93%	-1.37%	1.89%	4.16%	8.24%	
Citigroup World Government Bond Index	-1.11%	-5.11%	-14.85%	5.24%	10.21%	9.48%
Three-month US dollar LIBOR rate	-1.43%	0.20%	-14.56%	6.97%	12.02%	7.66%
Three-month Euro LIBOR rate	0.86%	-1.54%	-15.57%	-1.15%	7.44%	

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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