momentum
investments

The Macro Research Desk

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Economic and market snapshot for January 2017

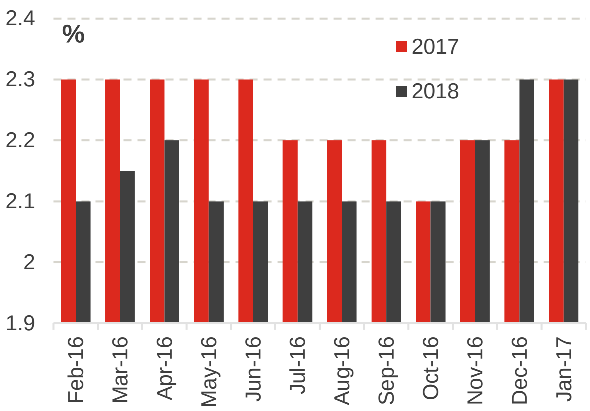
Global economic developments

United States (US)

Electoral outcome casts an uncertain shadow on the global economy

Optimism around proposed tax cuts and an anticipated surge in infrastructure spending by the incoming administration has driven real economic prospects for the US economy higher, since the November 2016 presidential election. The Bloomberg consensus is now expecting real gross domestic product (GDP) growth to expand by 2.3% in 2017, up from 2.1% in November 2016 (see chart 1).

Chart 1: Migration of consensus US GDP forecasts



Source: Bloomberg, Momentum Investments

However, President Donald Trump's rhetoric on trade during the election campaign is fast turning into action and could threaten growth momentum in the medium term. Trump recently signed an executive action to withdraw from the negotiating process of the Trans-Pacific Partnership – one of the hallmarks of the Obama administration. The trade deal was designed to create a single market between twelve countries bordering the Pacific Ocean and representative of 40% of the world's economic output.

Moreover, relations are souring between the US and Mexico. After Canada and China, Mexico is America's third-largest goods-trading partner, mainly thanks to the North American Free Trade Agreement (Nafta), which came into effect in 1994. Trump has, however, proposed a 20% tax on imports from Mexico, which could be the first step towards the US exiting the accord. Nevertheless, it is the US consumer who may ultimately feel the pain of higher consumer prices. Supply chains of US manufacturers are also intricately tied to operations in Mexico, suggesting US car manufacturers may initially be forced to pay more for imported parts.

Trump's trade officials have additionally threatened to impose high tariffs on Chinese goods, particularly those that are heavily subsidised. The creation of the National Trade Council and the appointment of its head, who has been a fierce critic of China, could have a strong role in shaping trade policy.

Barclays estimates that, all else equal, border adjustments could leave core inflation in the US 0.5% to 1% higher and real GDP growth 1% to 1.5% lower. Meanwhile, Deutsche Bank estimates that a fiscal stimulus scenario (including a corporate tax cut to15%, personal tax cuts that generate 3% higher after tax income for consumers and an additional 0.5% fiscal spending per year) could boost real GDP growth by nearly 1.2% by the end of 2018.

While tax cuts, deregulation and fiscal spending could provide an impetus for growth in the shorter term, anti-globalisation sentiment could drag medium- to longer-term growth prospects lower.

Eurozone

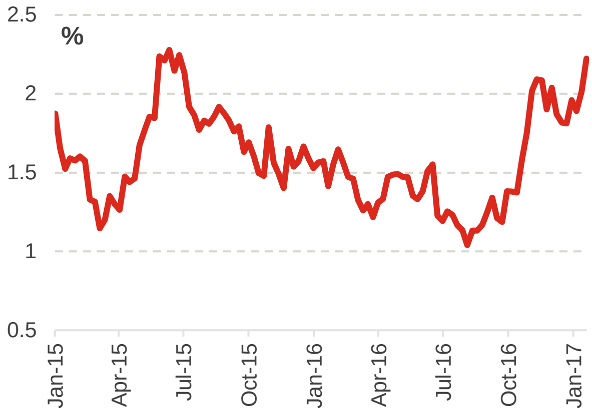
Italian bonds face heavy selling pressure, as the potential for fragile political coalitions rises

Italy's constitutional court ruled that an electoral law passed by the former Prime Minister Matteo Renzi in 2015 had violated the constitution. Under the old law, the winner of the run-off election round between the two leading candidates would get a supermajority (55%) in the lower chamber of parliament. The run-off round has, however, been found to violate the constitution and, as such, elections in the lower house of parliament will be based on a single ballot.

If one party wins more than 40% of the vote, it will be awarded the supermajority. Italy's two leading parties, namely Renzi's Democratic Party and Beppe Grillo's populist Five Star Movement, only have around 30% of the vote each. This raises the likelihood of an unstable coalition.

The court's ruling additionally increases the chances of an election earlier than February 2018. Given the uncertain political outcome, economic growth could face further headwinds. Real GDP growth has averaged 0.3% in Italy since 2000 and negative 0.8% since the global financial crisis.

Chart 2: Italian government bond yield



Source: Bloomberg, Momentum Investments

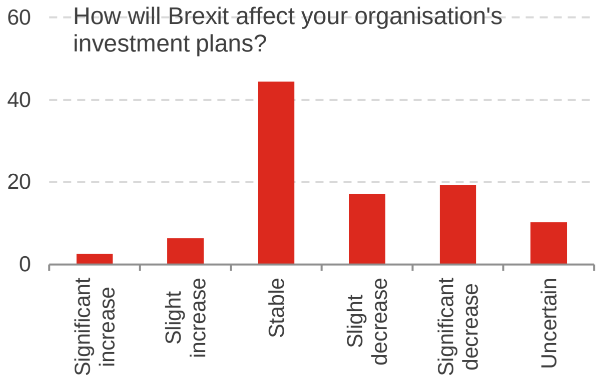
United Kingdom (UK)

Sterling's plunge and weak hiring intentions could squeeze real household incomes

Despite the UK economy posting the highest growth rate from the G7 (Group of Seven industrialised democracies) economies in 2016, growth is set to slow in 2017, as a weaker sterling and elevated uncertainty regarding Britain's vote to leave the European Union (Brexit) creates a more challenging backdrop for economic activity in 2017.

Following Brexit, the Institute of Directors' survey pointed to cautious UK corporates. A third of UK businesses responded negatively to the survey's question on hiring intentions, while 80% answered that they expected to either halt or cut investment plans (see chart 3).

Chart 3: Brexit uncertainty to delay fixed investment plans



Source: Bloomberg, Momentum Investments

Although the UK unemployment rate dropped sharply from a peak of 8.5% in early 2012 to 4.9% more recently, weak hiring intentions could dampen consumer spend. A Brexit-induced plunge in the sterling further threatens the outlook for real disposable income growth. UK inflation reached a two-and-a-half year high in December 2016, hitting 1.6%, as sterling depreciation continues to push up prices.

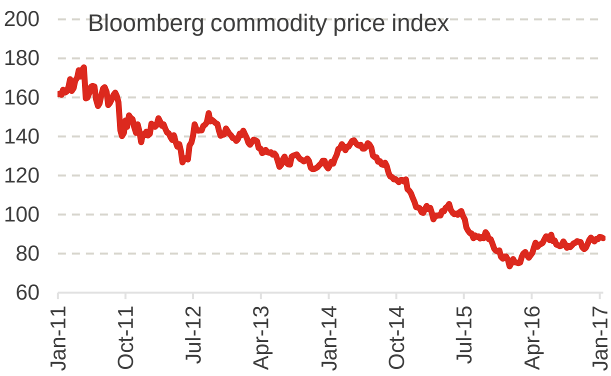
The Bloomberg consensus predicts UK inflation at 2.7% by the final quarter of 2017, far exceeding the Bank of England's (BoE) 2% inflation target. Though Momentum Investments expects the BoE to maintain an accommodative monetary policy stance to support weaker growth, the bank noted that "there are limits...to the extent to which above-target inflation can be tolerated".

Emerging markets (EMs)

Increased protectionism could hurt EM growth

The countries, which were hardest hit by the fall in commodity prices, are likely to stage a meaningful recovery following the c.20% uptick in commodity prices since mid-January 2016 (see chart 4). As such, Momentum Investments expects the growth gap between commodity exporters and commodity importers to narrow during the course of the year.

Chart 4: Commodity prices are c.20% off their recent lows



Source: Bloomberg, Momentum Investments

Though macro fundamentals have improved significantly across the EM composite, elevated dollar-denominated debt (in a strong US-dollar environment) and high trade exposure remain as risks for select economies.

According to the International Monetary Fund (IMF), global trade growth in 2016 recorded its weakest performance since the global financial crisis. While part of the slowdown can be blamed on stagnant global investment (capital goods account for roughly a third of global goods trade), structural forces, including a slower pace of trade liberalisation and more trade restrictive measures could weigh negatively on potential growth in EM.

Heightened uncertainty in advanced economies is also likely to have a negative effect on economic growth in emerging countries. According to the IMF, a 10% increase in the Chicago Board Options Exchange (CBOE) volatility index (VIX) could lead to a 0.6% decrease in fixed investment in EM and, consequently, a 0.2% decline in EM GDP growth. Given trade linkages, EM is more geared to the Euro Area. A one standard deviation shock in economic policy uncertainty could lead to a much larger 1.5% cut to EM fixed investment growth.

Trump's campaign rhetoric around raising tariffs on Chinese goods could have negative spillover effects on the rest of EM. According to the IMF, a 1% decrease in Chinese GDP growth could lead to a 0.5% cut in GDP growth of net commodity importers and a larger 1.0% decline in GDP growth in net commodity exporters.

Local economic developments

No major changes to forecasts following revised consumer price index (CPI) weightings and methodology changes

In line with international best practice, Stats SA updated the consumer basket of goods and services, taking account of the Household Income and Expenditure and Living Conditions surveys, which were conducted between October 2014 and October 2015.

While the previous basket included 396 items, the new basket comprises 412 items, after excluding a number of obsolete items (for example stamps and DVDs) and adding new items (sectional title levies, instant noodles, car rentals and car wash costs, to name a few). A number of methodology changes were also incorporated. Domestic worker wages will now be captured from the Quarterly Labour Force Survey, while different pricing methodologies will be used for capturing lottery ticket prices (taking the pay-out ratio into account) as well as used cars.

Categories, which saw the largest upward revisions, included food (largely owing to the upweighting of meat), non-alcoholic beverages and recreation (to capture higher-pay television services). Meanwhile, weightings for public transport, fuel (in response to lower international oil prices), education (following the rollout of free education to a large proportion of students) and restaurants (possibly as a result of lower disposable income) were adjusted lower (see table 1).

Applying the new weightings does not significantly alter Momentum Investments' inflation expectations pitched at around 5.5% in 2017 and drifting marginally below 5% in 2018. The biggest risks to the company's inflation view, at this stage, include unexpected currency depreciation (owing to a more aggressive interest rate hiking cycle in the US, negative global trade policies or destabilising domestic politics), higher-than-expected international oil prices and/or less significant food disinflation either owing to steeper meat prices or an army worm infestation of SA crops.

Table 1: CPI weighting changes

Weightings	Old	New
Food and non-alcoholic beverages	15.4	17.3
Alcohol and tobacco	5.4	5.6
Clothing and footwear	4.1	3.8
Housing and utilties	24.5	24.6
Household contents	4.8	4.3
Health	1.5	1.5
Transport	16.4	14.3
Communication	2.6	2.6
Recreation and culture	4.1	5.2
Education	2.5	2.0
Restaurants and hotels	3.5	3.1
Miscellaneous excluding insurance	14.7	15.1
- Insurance (incl. medical)	9.9	10.1

Source: Stats SA, Momentum Investments
(Green font = lower weighting, red = higher weighting, numbers do not add up to 100 due to rounding)

Financial market performance

Global markets

Global equities remained buoyant on hopes that US President Trump's promises to ramp up infrastructure spend, reduce regulatory barriers and cut taxes would ultimately boost corporate profits, all while brushing aside trade protectionism concerns. The MSCI All World Index climbed 2.7% in January 2017, thanks to decent returns in developed markets and further exuberance across EMs.

The MSCI Developed Markets Index rose by 2.4% for January, supported by a 1.9% return from the S&P 500 Index, while the Nikkei 225 Index (negative 0.4%) and the Eurostoxx 50 Index (negative1.7%) lost ground. Japanese stocks dipped on yen strength, while the fall in European stocks could largely be attributed to a poor returns from financial shares.

EM equities have rebounded meaningfully since the post-election sell-off, as attractive valuations and improving macro-fundamentals continue to support this asset class. The MSCI EM Index surged ahead by 5.5% for January 2017, led higher by robust gains (7.6%) from the MSCI Latin America Index and the MSCI Asia Index (5.9%). The MSCI Europe, Middle East and Africa (EMEA) Index lifted 2.1% for the corresponding period.

Local markets

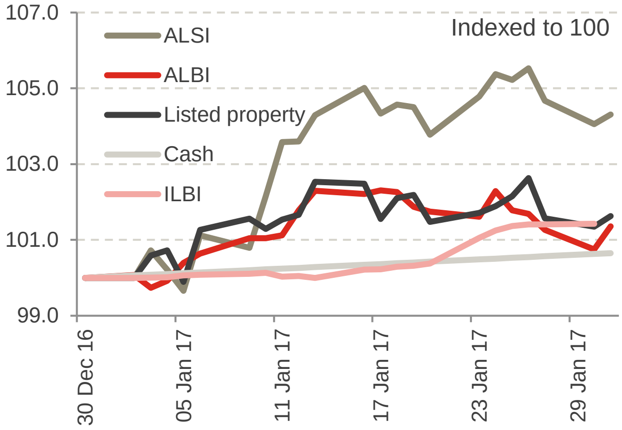
SA equities followed global markets higher. The FTSE/JSE All-share Index strengthened by 4.3% for the first month of 2017 underpinned by exuberant returns from the FTSE/JSE Resource Index (10.7%). The FTSE/JSE Industrials Index increased by 4.0% for the corresponding period, while the FTSE/JSE Financials Index edged 0.7% lower.

The FTSE/JSE Mid-cap Index inched 1.7% higher for January 2017, while the FTSE/JSE Small-cap Index rose by a larger 2.4%.

SA ten-year government bonds rallied 30 basis points for the first half of the month, but sold off in the second half of January 2017, partly owing to renewed sensitivity to domestic political news flow around a rumoured cabinet reshuffle. The Inflation-linked Bond Index (ILBI) increased marginally by 1.4% for January 2017, while the momentum behind property returns petered out. The FTSE/JSE Listed Property Index ticked 1.6% higher, following a sizeable gain of 4.2% for the previous month. SA cash gained 0.6% for the same time period.

The rand reacted negatively to speculation of an imminent Cabinet reshuffle late in the month, but nevertheless ended January 1.7% firmer against the US dollar. For the corresponding period, the rand weakened by 0.7% against the euro.

Chart 5: Local asset class returns



Source: Bloomberg, Momentum Investments

Indices summary for January 2017

Equity indices	One month	Three months	One year	Three years	Five years	Ten years
FTSE/JSE All-Share Index (ALSI)	4.31%	4.73%	10.35%	8.52%	12.67%	10.73%
FTSE/JSE Shareholder Weighted Index (SWIX)	2.57%	2.13%	9.32%	9.73%	13.75%	11.31%
FTSE/JSE All Share Top 40 Index	4.67%	4.65%	7.01%	7.30%	12.04%	10.21%
FTSE/JSE Mid Cap Index	1.66%	3.48%	25.60%	14.11%	14.88%	13.30%
FTSE/JSE Small Cap Index	2.42%	4.54%	29.82%	13.31%	17.50%	12.50%
FTSE/JSE Resources Index	10.74%	13.27%	52.82%	-8.98%	-5.05%	0.87%
FTSE/JSE Financials Index	-0.66%	3.07%	8.37%	14.17%	16.52%	10.44%
FTSE/JSE Industrials Index	3.97%	2.02%	0.09%	11.10%	19.10%	15.73%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	3.89%	7.89%	25.45%	7.74%	11.10%	10.82%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	5.79%	9.28%	28.68%	8.31%	11.25%	10.39%
FTSE/JSE SA Listed Property Index (SAPY)	1.63%	2.40%	15.43%	18.15%	16.58%	15.01%
Interest-bearing indices						
BEASSA All Bond Index (ALBI)	1.33%	1.04%	11.82%	8.56%	7.20%	8.04%
BEASSA All Bond Index 1-3 years (ALBI)	0.80%	1.74%	9.04%	7.50%	6.57%	7.82%
Barclays BEASSA SA Government ILB Index	1.41%	0.08%	6.93%	8.95%	8.17%	9.59%
Short-term Fixed Interest Composite Index (SteFI)	0.63%	1.88%	7.50%	6.66%	6.13%	7.31%
Commodities						
NewGold Exchange-Traded Fund	1.60%	-6.05%	-9.38%	4.25%	3.14%	12.66%
Gold price (in rands)	2.98%	-5.68%	-8.37%	5.24%	3.74%	13.25%
Platinum Exchange-Traded Fund	6.24%	0.45%	-4.17%	-5.33%		
Platinum price (in rands)	8.39%	1.34%	-3.03%	-4.35%	-4.56%	0.62%
Currency movements						
Rand/euro movements	0.89%	-1.46%	-15.32%	-1.10%	7.37%	4.45%
Rand/dollar movements	-1.52%	-0.05%	-15.25%	6.49%	11.55%	6.41%
Inflation index						
Consumer Price Index (CPI)			6.76%	5.76%	5.67%	6.26%
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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