momentum investments

The Macro Research Desk

 

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Economic and market snapshot for March 2017

Global economic developments

United States (US)

Federal funds rate hiked, but interest rate projections largely unchanged

The US Federal Reserve (Fed) raised the target range for the Fed funds rate for the third time since the global financial crisis. The increase left the target range higher at between 0.75% and 1%, from between 0.5% and 0.75% previously. With only two more hikes signalled for the remainder of the year and one member dissenting from the vote for a rise in interest rates, it is likely that the market perceived the March 2017 interest rate hike by the Federal Open Market Committee (FOMC) as dovish in nature.

The Fed left its real gross domestic product (GDP) growth forecast of 2.1% for 2017 unchanged from estimates tabled in December 2016. Growth expectations were revised marginally higher to 2.1% for 2018, but remained at 1.9% in 2019 and 1.8% for the longer term. During the question and answer session following the statement, Fed Chair Janet Yellen remarked that the Fed would not rush its judgement on the effect of potential changes to tax and spending policies, despite market expectations that looser fiscal policy could boost growth prospects, in 2018 in particular.

Despite fiscal stimulus proposals by the new administration supporting a more upbeat growth and inflation outlook, the policy environment remains uncertain. As such, Momentum Investments expects interest rates to increase in line with the Fed's median expectation as outlined in the so-called 'dot plot' (the interest rate projections of the FOMC members). However, the company holds a more sanguine view on interest rates further out. Potential growth (based on estimates for factors including productivity and population growth) is likely to have fallen to around 2.2% (see table 1), suggesting a lower long-run interest rate peak. Momentum Investments projects the neutral interest rate to be around 2%, a full percentage point lower than the Fed longer-run (steady-state) expectation of 3%.

Table 1: Potential growth stack up

	Population growth	Labour force participation	Labour force productivity	Real GDP growth
1994 to 2004	1.35	-0.09	2.40	3.66
2004 to 2014	1.10	-0.47	1.00	1.63
2014 to 2024	0.80	-0.32	1.70	2.18

Source: S&P Global Ratings, BLS, Momentum Investments

In addition, Momentum Investments does not anticipate the unwinding of the Fed balance sheet to disrupt markets. The FOMC reiterated its intention to maintain its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities as well as to roll over maturing Treasury securities at auction. It went on to say that it intends doing so until "normalisation of the federal funds rate is well under way".

Eurozone

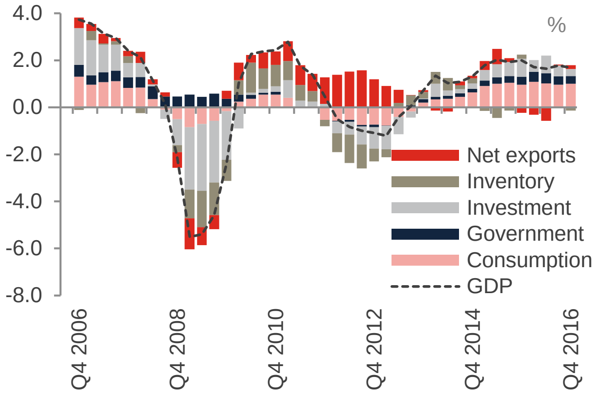
Narrowly-based economic growth recovery vulnerable to political polarisation and banking stress

Even though previous euro depreciation should provide some uplift for Eurozone export volumes and lessening economic slack paints an optimistic trajectory for non-residential fixed investment spend, the recovery in the euro area to date has been largely dependent on consumer spend (see chart 1).

A highly accommodative monetary policy stance taken by the European Central Bank (ECB) and a slower pace of fiscal consolidation has supported household spend, while lower oil prices in 2016 benefited consumers' real wage growth.

Heading into 2017, consumer headwinds have started to fade. Oil prices are ticking higher, while unemployment remains stubbornly high. This, together with elevated political uncertainty related to three major general elections this year (kicking off with the Netherlands in March 2017 which showed an increase in support, although not a victory, by the eurosceptic Party for Freedom), has dented consumer confidence. Household sentiment ticked lower for the Eurozone's four-largest economies (namely Germany, France, Italy and Spain) in February 2017 relative to readings taken a month earlier.

Chart 1: Euro area recovery dependent on the consumer



Source: Deutsche Bank, Momentum Investments

Idiosyncratic risks for some large banks and countries remain elevated and further argue for caution when reading the latest statistics on the sustainability of the economic recovery in the Eurozone.

Though prospects for higher inflation (higher oil prices and a weaker euro) could add pressure to the ECB to taper asset purchases earlier, underlying measures of inflation remain low at below 1%. Muted core inflation coupled with ongoing political risks (which could dampen confidence and ultimately growth), suggests the ECB would be hesitant to withdraw stimulus early.

Japan

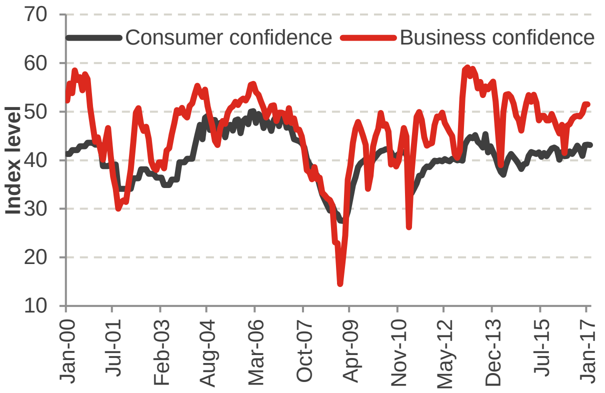
Improving domestic activity, but monetary policy to stay on hold

Domestic demand is recovering in Japan. A slowing rate of unemployment and a rise in the ratio of job offers to applicants, close to all-time highs, are indicative of a tighter Japanese labour market. Private loan growth has ticked higher to more than 2%, a level last seen in 1996. These factors have contributed to household and business sentiment levels nudging higher (see chart 2), boding well for growth in domestic demand going forward.

Although the growth picture in Japan is brightening, Momentum Investments expects the Bank of Japan (BoJ) to stay on hold until it has further evidence of rising inflation, brought about by a weaker yen. Core inflation ticked higher into marginally positive territory, while the five-year/five-year swap rate (five-year forward expected inflation in five years' time) ticked up from 0.01% in

November 2016 to 0.55% in March 2017. This, however, remains low in relation to the BoJ's inflation target of 2%.

Chart 2: Japanese confidence levels edging higher



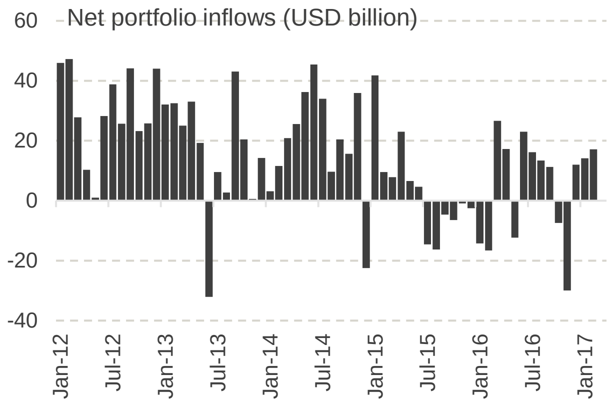
Source: Bloomberg, Momentum Investments

Emerging markets (EMs)

Improving fundamentals, but tighter financial conditions and protectionist policies pose downside risks

A positive EM growth story has led to a resurgence in net portfolio inflows in the region (see chart 3). This is particularly true for countries that are dependent on domestic demand and less so on global trade, which remains vulnerable to a rise in protectionist policies. In addition, Momentum Investments expects countries experiencing improving fundamentals (including those facing a narrower current account deficit thanks to an uptick in commodity prices) and those with an appetite for structural reform to do well this year and next.

Chart 3: Better prospects increasing EM attractiveness



Source: Bloomberg, Momentum Investments, data up to February 2017

Although Momentum Investments expects the growth gap between EM and developed markets to widen in EMs' favour in the medium term, tighter financial conditions and anti-globalisation rhetoric poses a threat to the extent of the recovery anticipated in the region.

Should economic growth or inflation surprise to the upside in the US, the Fed may be forced to tighten interest rates at a faster pace. With dollar-denominated debt in EM at its highest level since 1998 (and debt service ratios at their highest level since 1999), EMs could face tighter financial conditions.

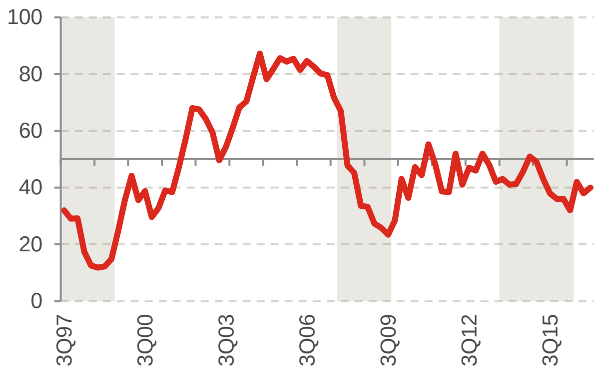
The new US administration has threatened to take a firmer anti-globalisation stance by implementing onerous tariffs on key trading partners including Mexico and China. The latter in particular could trigger retaliatory measures resulting in lower growth for all.

Local economic developments

SA businesses are still feeling the pressure of a low-growth and highly uncertain environment

The Bureau of Economic Research's (BER) Business Confidence Index (BCI) inched higher by two index points to 40 in the first quarter of 2017 (see chart 4), only marginally higher than a dismal 37 index point-average posted during 2016. This implies that only four out of every ten respondents were satisfied with prevailing business conditions at the beginning of the year (the survey was conducted between 15 February and 7 March 2017).

Chart 4: Business confidence index (>50 = expansion)



Source: BER, Momentum Investments, economic downturns shaded in grey, data up to 1Q17

The BER notes that despite a handful of industries benefiting from the revival in agriculture, mining and manufacturing exports, most sectors appear to be in a holding pattern, experiencing continually weak underlying activity. Moreover, survey detail points to a reluctance on the part of corporates to hire additional workers or to ramp up fixed investment. A stagnant hiring environment is likely to depress household spend this year, while sluggish fixed investment spend is expected to compound weakness in domestic demand in 2017.

The expected recovery in overall (real) GDP growth this year from 0.3% in 2016 to just higher than 1% in 2017 is likely to be a function of inventory build and higher export growth piggy-backing off higher-expected global GDP prospects, while domestic demand is only anticipated to recover more meaningfully in 2018 on an improvement in sentiment following a clearer outlook on SA's future political leadership and economic policy direction.

An already-high degree of political uncertainty has been aggravated by President Zuma's third cabinet reshuffle in his eight-year tenure. Recent negative political developments are likely to weigh on business sentiment and fixed investment growth this year.

Financial market performance

Global markets

Expectations for pro-growth policies from the new US administration and global data surprises at near six-year highs have fuelled equity markets around the globe since the US presidential election in November 2016. After a decent start to the month, global stocks weakened in the latter half of March 2017, as US President Donald Trump's setback on the Obamacare replacement for health care revived doubts over his ability to pass significant tax cuts and ambitious infrastructure plans.

The MSCI All World Index ended the month marginally higher at 1.2%, driven by robust gains in EM equities (2.5%), while the MSCI Developed Markets Index advanced by a lesser 1.1% for March 2017.

Within developed markets, the Eurostoxx 50 Index was one of the strongest performers, ending the month 5.7% higher. The index benefited earlier in the month, as jitters over a potential Marine Le Pen (far-right candidate) victory in the upcoming French presidential election faded after a strong performance from Emmanuel Macron (the favoured centrist candidate) in a televised debate. The S&P 500 Index barely inched higher by month end, in line with rising concerns over Trump's ability to deliver on his campaign promises, while the Nikkei 225 Index lost 0.4% for the same time period.

EM received support from a fall in the US dollar index and lower US treasury yields, while resilient profits by Chinese manufacturers sketched a positive picture for broader EM growth. The 2.5% gain in the MSCI EM Index was largely supported by buoyant Asian markets. The MSCI Asia Index jumped 3.3% for March 2017, followed by a 0.6% uptick in the MSCI Latin America Index. Gains in the MSCI Europe, Middle East and Africa (EMEA) Index lagged at 0.5%.

Local markets

A firmer rand capped the return from SA equities in the first three weeks of March 2017. With a significant portion of SA company earnings being earned in foreign currencies, rand strength implies lower earnings translated back into rand terms.

However, the rand wobbled in the last week of March 2017 on news reports that Finance Minister Pravin Gordhan and his deputy, Mcebisi Jonas, were recalled from an international roadshow, reigniting fears of a cabinet reshuffle. These fears materialised after hours on 30 March 2017, when President Zuma announced a major cabinet reshuffle involving the Treasury portfolio, among others.

Currency losses towards month-end firmed up resource and other dual-listed shares. For March 2017, the FTSE/JSE All Share Index increased by 2.7%, driven higher by industrial shares, while a weaker rand late in the month buttressed the monthly return from the FTSE/JSE Resource shares (2.9%).

The FTSE/JSE Industrials Index rose 4.2% for March 2017, while the FTSE/JSE Financials Index shed 0.7%, as fears of a sovereign downgrade were rekindled.

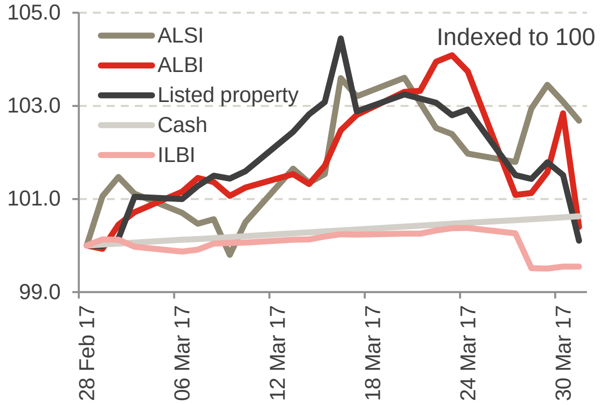
The FTSE/JSE Mid-cap Index decreased marginally by 0.1% for March 2017, while the FTSE/JSE Small-cap Index edged 0.2% higher.

Before the recent political saga broke out, SA ten-year government bonds had rallied around 47 basis points relative to 28 February 2017. Nonetheless, yields climbed back up to 8.9% late in the month, responding to negative political headlines.

The Inflation-linked Bond Index (ILBI) dipped marginally by 0.5% for March 2017, while the FTSE/JSE Listed Property Index performed slightly better, ending the month marginally in the black. SA cash gained 0.6% for the same time period.

The rand suffered a blow late in the month on the cabinet reshuffle. Relative to levels a month ago, the local unit ended March 2017 2.3% weaker against the US dollar and 3.4% softer against the euro.

Chart 5: Local asset class returns



Source: Bloomberg, Momentum Investments, data up to 31 March 2017

Indices summary for March 2017

Equity indices	One month	Three months	One year	Three years	Five years	Ten years
FTSE/JSE All-Share Index (ALSI)	2.68%	3.78%	2.53%	5.98%	12.49%	9.82%
FTSE/JSE Shareholder Weighted Index (SWIX)	2.24%	3.30%	1.59%	7.08%	13.27%	10.61%
FTSE/JSE All Share Top 40 Index	3.30%	3.90%	0.72%	4.66%	12.07%	9.28%
FTSE/JSE Mid Cap Index	-0.13%	1.12%	7.98%	11.72%	13.43%	12.43%
FTSE/JSE Small Cap Index	0.16%	4.54%	13.47%	11.88%	16.65%	11.71%
FTSE/JSE Resources Index	2.91%	2.66%	16.67%	-12.51%	-4.37%	-1.23%
FTSE/JSE Financials Index	-0.66%	-1.08%	-1.81%	9.16%	15.01%	9.93%
FTSE/JSE Industrials Index	4.19%	6.63%	0.05%	10.00%	18.20%	15.62%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	2.69%	1.49%	9.42%	4.20%	10.50%	9.75%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	1.82%	1.80%	10.71%	4.42%	10.42%	9.23%
FTSE/JSE SA Listed Property Index (SAPY)	0.11%	1.37%	1.46%	14.48%	15.81%	14.24%
Interest-bearing indices						
BEASSA All Bond Index (ALBI)	0.40%	2.46%	11.02%	7.45%	7.38%	8.06%
BEASSA All Bond Index 1-3 years (ALBI)	0.67%	2.58%	9.40%	7.43%	6.72%	7.86%
Barclays BEASSA SA Government ILB Index	-0.45%	0.88%	4.91%	6.71%	7.67%	9.44%
Short-term Fixed Interest Composite Index (SteFI)	0.63%	1.84%	7.59%	6.77%	6.19%	7.29%
Commodities						
NewGold Exchange-Traded Fund	1.52%	4.55%	-8.83%	6.60%	5.07%	12.67%
Gold price (in rands)	-0.29%	2.89%	-13.59%	6.15%	5.07%	13.02%
Platinum Exchange-Traded Fund	-5.75%	0.99%	-12.41%	-6.06%		
Platinum price (in rands)	-5.35%	2.85%	-11.25%	-5.23%	-4.27%	-0.19%
Currency movements						
Rand/euro movements	3.24%	-0.57%	-14.39%	-0.32%	7.03%	4.04%
Rand/dollar movements	2.48%	-2.00%	-8.71%	8.43%	11.82%	6.38%
Inflation index						
Consumer Price Index (CPI)			6.30%	5.73%	5.78%	6.36%
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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