momentum
investments

The Macro Research Desk

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Economic and market snapshot for May 2017

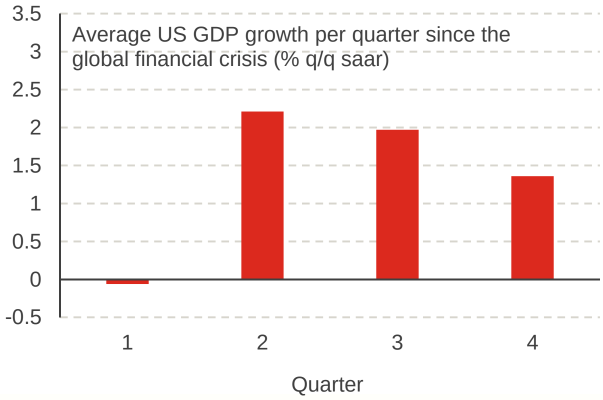
Global economic developments

United States (US)

Growth slowed to a crawl in the first quarter of 2017, but activity is set to rise into the second quarter of the year

Following a familiar seasonal pattern, the US economy grew at a sluggish 1.2% quarterly rate (in seasonally adjusted annualised terms) in the first quarter of 2017. However, a rebound in economic activity is anticipated for the second quarter (see chart 1). The dip in growth reflected a slowdown in household and government spend, as well as a decline in inventories. Export growth, on the other hand, remained encouraging.

Chart 1: Likely rebound in US growth in the second quarter



Source: Bloomberg, Momentum Investments

The tepid rate of economic activity at the start of the year likely understates the health of the US economy. Taking its cue from invigorated corporate sentiment, fixed investment growth recovered and contributed the most it has to growth in the last five years. The collapse in growth in household consumption is likely to reverse partly, thanks to a tight labour market and upbeat consumer confidence driving the solid pace in monthly retail sales data to date. Moreover, the effect of the US dollar's earlier appreciation is starting to fade and with growth in China and Europe remaining stable, exports are unlikely to act as a detractor to overall growth.

The Atlanta Federal Reserve's GDPNow forecasting model (an estimate of gross domestic product (GDP) based on high-frequency data releases) points to a sharp recovery in growth to 4.1% for the second quarter of 2017. Although the Federal Reserve Bank of New York pins its forecast on a more conservative 2.3% expectation, the trend of a stronger second-quarter following a weak first-quarter print seems likely to play out again this year.

While a recovery is anticipated from the 1.6% growth print in 2016, the economy's overall return in 2017 is likely to be capped, at around 2%, by rising doubt over President Donald Trump's aggressive pro-growth promises to target infrastructure spending, tax cuts and deregulation. The lack of detail in the administration's tax plan and the need to first repeal and replace Obamacare suggest additional delays in tax reform. Likewise, setbacks are expected in accelerating infrastructure spend, as a reported request for US$200 billion in federal funding in the next 10 years to upgrade the country's infrastructure is likely to face significant pushback from fiscal conservatives.

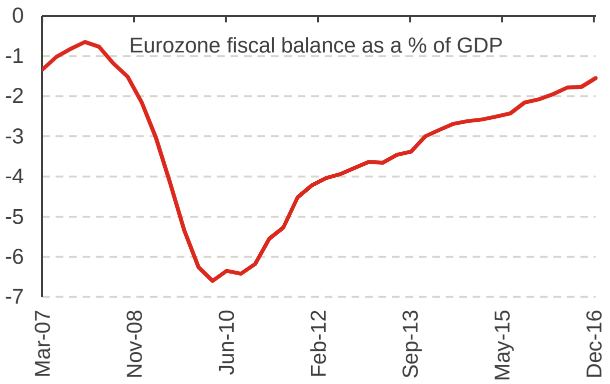
Eurozone

Centrist leader Macron defeats extreme-right nationalist candidate in France's May 2017 election

A comfortable defeat (66%/34%) for the European Union (EU)-friendly candidate Emmanuel Macron against far-right candidate Marine Le Pen in the French presidential race bodes well for a closer co-operation between France and Germany, which serves as a crucial building block to the longer-term viability of the union.

Still, there are differences in opinion over the extent of fiscal integration, ranging from a joint Eurozone budget and extending to an ability to issue debt (see chart 2).

Chart 2: Eurozone fiscal consolidation



Source: Bloomberg, Momentum Investments

The first important challenge President Macron faces is to secure a parliamentary majority for his (relatively new) République en Marche party in the legislative elections in June 2017. Opinion polls are divided on whether the new political group can acquire a majority or whether a coalition will be formed, given the elevated level of dissatisfaction with the EU.

The outcome will determine the degree of success of Macron's economic proposals. Macron has proposed that France commit to €60 billion in spending cuts for the next five years, to be accompanied by a €50 billion stimulus package. He plans to slash corporate taxes from the current 33% rate to the EU average of 25%. Labour-law rigidity is also expected to be addressed by Macron, who proposes to streamline the public sector workforce and award companies more leeway to negotiate working hours and compensation.

In Momentum Investments' opinion, France's new president faces a tough road ahead to revive the economy. The country still suffers from an unemployment rate of nearly 10% and manufacturing output is still tracking 12% below the level observed before the 2008 global financial crisis.

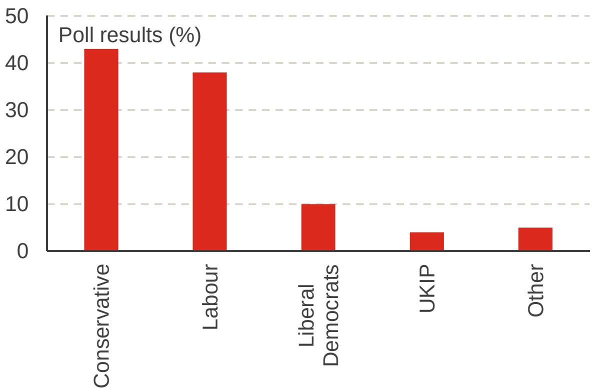
United Kingdom (UK)

The UK's divorce from the EU is unlikely to be without challenges

The UK government has invoked Article 50 of the Treaty of Lisbon, setting in motion the UK's planned departure from the EU. Prime Minister Theresa May has clarified the UK's stance, opting for a so-called "hard Brexit", which would involve the UK having direct control over immigration and bring an end to the jurisdiction of the European Court of Justice in Britain that enforces compliance with EU laws.

It is likely that this stance will remain in place after the general election on 8 June 2017, in which May's Conservative Party is projected to win (although the latest polls suggest the margin is narrowing, raising fears of a hung parliament, see chart 3). Negotiations have been off to a shaky start with Michael Barnier's (the European Council's chief negotiator) primary mandate focusing on the UK's financial obligations to the bloc. While estimates of the Brexit bill are highly variable (assumptions have to be made on Britain's exit date, its share of contributions to the bloc, liabilities and budget rebates), the Financial Times estimates the upfront gross settlement to be anywhere between €91 billion and €113 billion.

Chart 3: Polls narrow ahead of the UK general election



Source: YouGov, Momentum Investments

This could stall talks of a future UK-EU trade partnership. The UK is also required to pursue individual arrangements with non-EU countries, which are a party to any of the EU's 48 trade agreements with the rest of the world. Moreover, the UK will also be required to establish a number of new agencies overseeing regulatory issues (which are currently being overseen by the EU) in areas including food standards, pharmaceutical testing, aviation and nuclear safety.

Emerging markets (EMs)

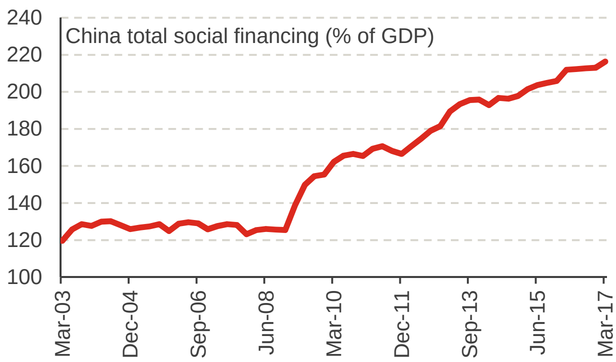
Further sovereign ratings downgrades in response to the political environment heating up

Reuters' analysis suggests that the three-largest rating agencies (Standard and Poors Global (S&P), Moody's and Fitch) have collectively announced more than 150 EM downgrades since the beginning of 2014. After 20 EM downgrades last year, Fitch has already cut the ratings of eight EMs this year (including Turkey and South Africa), as political tensions have bubbled over in a number of economies.

A massive corruption scandal in Brazil, undermining the government's strategy to stabilise the economy and its fiscal position, has recently heightened downside risks to S&P's rating of the country. The agency revised Brazil's outlook to credit watch negative, implying that a further downgrade (from the current BB rating) could materialise in the next three months "amid more stressed political dynamics".

Moody's downgrade of China from Aa3 to A1 (still comfortably within investment grade) was the first in nearly 30 years. Moody's highlighted concerns over China's challenge with rising financial risks resulting from credit-fuelled stimulus in previous years (see chart 4).

Chart 4: Rapid growth in credit in China



Source: Bloomberg, Momentum Investments

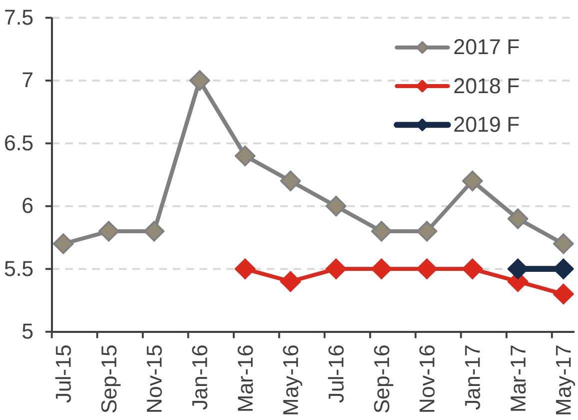
The latest GDP tracker by Capital Economics points to a peak in the EM GDP recovery having been reached in January 2017 at 4.5% year on year (y/y).
While macroeconomic pressures lifted in EM in early 2016 (stronger current account balances, improving growth and controlled inflation), political risks are placing policy continuity at risk in a number of countries.

Local economic developments

Limited headroom to absorb adverse inflation shocks

The South African Reserve Bank's (SARB) interest rate decision was in line with the Reuters' consensus, in which all 24 surveyed analysts predicted that the SA repo rate would remain steady at 7.0%. Despite the SARB paring back its growth projections and adjusting its inflation forecasts lower (see chart 5), the SARB Monetary Policy Committee (MPC) noted that the current level of the repo rate was appropriate for now, but signalled that it is likely at the end of the tightening cycle.

Chart 5: SARB headline inflation forecast revisions (%)



Source: SARB, Momentum Investments

The recent negative moves in SA's sovereign rating and ongoing political noise has, in Momentum Investments' view, raised inflation risks and lowered growth prospects. Political tensions and an unclear outlook on the direction of economic policy continues to suppress consumer and business sentiment, holding back a firmer recovery in domestic demand. The SARB raised concerns over higher funding costs and more difficult access to funding for domestic private sector fixed investment, following the sovereign credit ratings downgrade to junk status.

The rating agencies have warned against politically motivated events detracting from the progress on growth-enhancing reform implementation and negatively affecting the direction of government policy. Consequently, ongoing political friction raises the threat of further ratings downgrades, which could hurt the currency's performance. The currency remains a key source of upside risk to the inflation trajectory (particularly as inflation expectations remain uncomfortably close to the top end of the target), despite the MPC downwardly revising its inflation forecasts in its latest assessment of the economy.

SA's reliance on foreign capital inflows to cover SA's external imbalance should further limit the SARB's ability to lower interest rates aggressively. Though information on fund flows suggests that the EM asset class is still attracting investors, recent developments in China (weaker high-frequency data) and Brazil (political challenges) suggest that political risks can sour the positive sentiment towards EM and have a negative effect on EM investments.

Financial market performance

Global markets

Global stock markets wobbled mid-May, as fears arose over President Trump's ability to push through regulatory changes and deliver on tax reforms in the US. Claims that Trump passed on sensitive intelligence to Russia have created another distraction for the administration. Investors worry that this may stall the introduction of growth-enhancing spending plans and market-friendly legislation. By month end, the MSCI All World Index had recovered, ending May 2017 2.2% higher.

Though gains were firmer in EM, developed markets posted a decent return. The MSCI Developed Markets Index rose 2.1% by month end, supported by a solid 2.4% return in the Nikkei 225, followed by a 1.4% gain in the Eurostoxx 50 and a 1.4% uptick in the S&P 500 Index.

EMs were comforted by the release of the US Federal Reserve interest rate meeting minutes held on 3 May 2017. The detailed minutes assured investors that the central bank favoured a gradual process of unwinding its US$4.5 trillion balance sheet. The minutes further indicated that policymakers agreed that it would soon be appropriate to hike interest rates again. Federal fund futures are (at the time of writing) indicating a strong 91% probability of an interest rate hike in June 2017.

The MSCI EM Index jumped 3.0% for May 2017. The MSCI Europe, Middle East and Africa (EMEA) Index tracked broadly sideways by month end, eroding earlier gains made in line with encouraging high-frequency economic data. Asian shares gathered speed in the second half of the month, finishing 3.0% higher. The MSCI Latin America Index ended the month 2.4% in the red, suffering a bigger blow earlier in the month, after bribery allegations surfaced against Brazil's president, Michel Temer.

Local markets

The local market underperformed the global market for May 2017. The FTSE/JSE All Share Index finished the month 0.4% lower, dragged lower by a 4.1% dip in the

FTSE/JSE Resources Index. Resource shares were the biggest losers, thanks to rand strength late in the month.

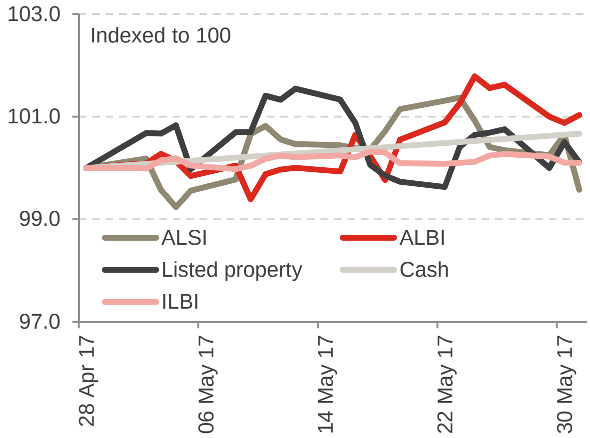
The FTSE/JSE Industrials Index increased 1.4% for May, as a firmer currency pared back gains in SA's dual-listed shares. The FTSE/JSE Financials Index edged 1.3% down for the corresponding period.

The FTSE/JSE Mid-cap Index lost 4.2% for May 2017, while the FTSE/JSE Small-cap Index dropped 2.6 %.

SA ten-year government bonds rallied to 8.7% for May 2017, as non-residents continued to buy bonds. The Inflation-linked Bond Index (ILBI) inched 0.1% higher for the same period, matched by a similar gain in the FTSE/JSE Listed Property Index. SA cash rose by 0.7% for the same period.

The rand traded among the better-performing EM currencies in May 2017 and only underperformed against a handful of countries in the Eastern European bloc. The rand ended the month 2.2% firmer against the US dollar, but 0.9% weaker against the euro. The rand recovered by 2.4% against the British pound for May. This gain was partly due to sterling weakness late in the month on the back of a poll showing the Conservative party's lead had narrowed, raising fears of a hung parliament at the upcoming election, which could cloud the UK economic outlook even further.

Chart 5: Local asset class returns



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

Indices summary for May 2017

	One month	Three months	One year	Three years	Four years	Five years	Six years	Seven years	Ten years
Equity indices									
FTSE/JSE All-Share Index (ALSI)	-0.42%	5.97%	2.18%	5.61%	9.45%	13.40%	11.97%	13.51%	9.61%
FTSE/JSE Shareholder Weighted Index (SWIX)	-0.07%	6.32%	2.95%	7.13%	10.94%	14.27%	13.40%	14.62%	10.56%
FTSE/JSE All Share Top 40 Index	0.21%	8.15%	1.01%	4.82%	8.95%	13.33%	11.52%	13.26%	9.27%
FTSE/JSE Mid Cap Index	-4.24%	-5.13%	3.99%	8.30%	10.43%	12.29%	13.10%	13.77%	11.09%
FTSE/JSE Small Cap Index	-2.59%	-4.93%	5.42%	7.76%	12.45%	15.67%	15.37%	15.48%	9.83%
FTSE/JSE Resources Index	-4.11%	-1.31%	2.52%	-13.58%	-6.94%	-4.29%	-5.91%	-2.64%	-2.21%
FTSE/JSE Financials Index	-1.35%	1.49%	2.67%	8.06%	11.97%	15.14%	15.64%	15.68%	9.92%
FTSE/JSE Industrials Index	1.42%	11.13%	2.45%	10.12%	13.38%	19.57%	19.00%	20.59%	15.68%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-2.09%	3.31%	6.56%	3.42%	7.64%	11.01%	9.84%	11.64%	9.30%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-2.34%	1.75%	7.07%	3.36%	7.39%	10.80%	9.49%	11.35%	8.60%
FTSE/JSE SA Listed Property Index (SAPY)	0.11%	0.73%	3.73%	14.33%	12.45%	15.22%	15.93%	16.55%	13.88%
Interest-bearing indices									
BEASSA All Bond Index (ALBI)	0.98%	2.87%	13.35%	7.80%	6.54%	7.52%	8.10%	8.57%	8.28%
BEASSA All Bond Index 1-3 years (ALBI)	0.68%	2.40%	9.81%	7.58%	6.94%	6.75%	7.23%	7.33%	7.94%
Barclays BEASSA SA Government ILB Index	-0.08%	-0.96%	1.87%	5.01%	4.85%	7.42%	8.22%	8.65%	9.24%
Short-term Fixed Interest Composite Index (SteFI)	0.63%	1.88%	7.65%	6.88%	6.50%	6.26%	6.16%	6.18%	7.27%
Commodities									
NewGold Exchange-Traded Fund	-1.56%	1.75%	-12.85%	7.87%	4.07%	4.07%	7.52%	8.24%	13.06%
Gold price (in rands)	-1.35%	1.55%	-12.86%	8.17%	4.10%	4.61%	7.91%	8.92%	13.51%
Platinum Exchange-Traded Fund	-1.74%	-7.34%	-18.94%	-7.10%	-1.29%				
Platinum price (in rands)	-1.68%	-7.67%	-19.29%	-6.85%	-2.12%	-3.21%	-5.47%	-3.09%	-0.33%
Currency movements									
Rand/euro movements	1.72%	6.66%	-15.36%	0.89%	3.28%	6.97%	7.12%	6.67%	4.47%
Rand/dollar movements	-1.48%	0.78%	-16.20%	7.61%	7.01%	9.01%	11.57%	8.01%	6.37%
Inflation index									
Consumer Price Index (CPI)			5.36%	5.35%	5.55%	5.62%	5.70%	5.49%	6.21%

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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