The Macro Research Desk

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Economic and market snapshot for October 2017

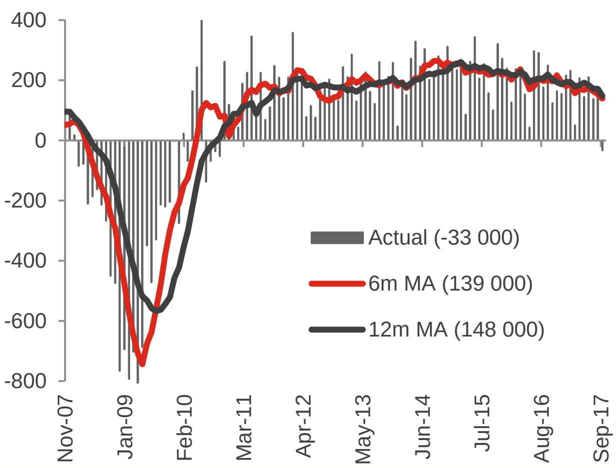
Global economic developments

United States (US)

Hurricane-related fall in employment growth in September should rebound in October 2017

Hurricanes Harvey and Irma skewed the September 2017 US non-farm payrolls data due to large-scale evacuations and severe damage to several homes and businesses. With many employees absent from work during this period and establishments not open for business, some workers would not have been registered on the payroll for September.

Chart 1: A weather-related blip in US payrolls data



Source: Bloomberg, Momentum Investments

From the net 33 000 drop in non-farm payrolls, the Bureau of Labour Statistics reported the leisure and hospitality sector having the most losses (110 000). This was the largest number of jobs shed in the sector since 1939. Employment in food services and drinking places also fell by 105 000 in September 2017.

Capital Economics suggested 1.5 million people could not work because of weather conditions in September 2017. The same survey registered 1.8 million people following the 1996 blizzard. Following the blizzard (when payrolls contracted by 15 000 in January 1996), payrolls rebounded strongly to 420 000 in February 1996.

This time around, Momentum Investments expects a softer rebound, which may extend into November 2017. As slack in the labour market continues to shrink, US firms are finding it more and more difficult to fill positions. Employment growth has slowed, as the US economy continues to push up against supply constraints. The headline rate of unemployment fell to the lowest level since 2001, while the labour force participation rate has steadied, as more Americans have come back into the workforce. Although wages have been slow to accelerate, Momentum Investments expects the ongoing strengthening of the labour market to sustain higher wage growth and stabilise inflation around the US Federal Reserve's target of 2% in upcoming quarters.

Eurozone

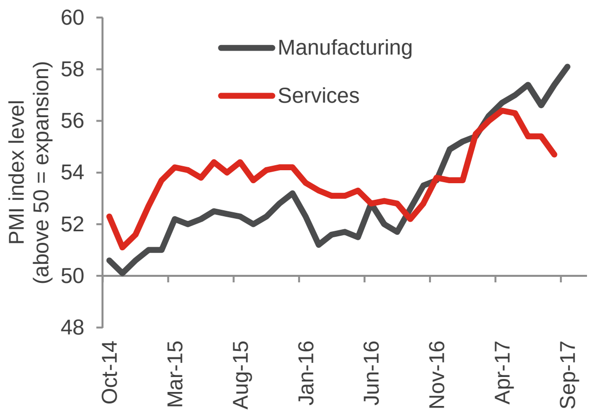
Strong sentiment indicative of healthy growth

Softer high-frequency data for July and August 2017, including industrial production and retail sales growth, are signalling a slowdown in the third quarter of 2017, relative to a more robust second quarter.

Nevertheless, surveyed sentiment (see chart 2) continues to paint a positive growth picture. The composite Purchasing Managers' Index (measuring sentiment in the services and manufacturing sectors) rose to 56.7 index points in September 2017, which is consistent with a 0.6% quarterly rise in gross domestic product (GDP).

In the same month, a broader economic sentiment survey (calibrated by the European Commission) reached its highest level since July 2007, suggesting quarterly growth could reach 1%. The outlook for exports remains favourable.

Chart 2: Eurozone manufacturing sentiment powering ahead



Source: Bloomberg, Momentum Investments

The European Commission's export order index increased to levels last seen in early 2011, boding well for the contribution from net exports to overall growth activity. Although growth in export values to the US dipped this year (owing to exchange rate effects), there was a turnaround in growth in exports to the United Kingdom (UK) and growth in exports to Asia remained firm.

At its September 2017 meeting, the European Central Bank (ECB) raised its Eurozone growth forecast to 2.2%, representing the fastest growth in a decade. While this signals a dialling down of stimulus is around the corner, interest rate hikes may still be some way off.
In September 2017, ECB President Mario Draghi warned a "very substantial degree of monetary accommodation" was necessary to help boost inflation and interest rates were expected to "remain at their present levels for an extended period of time".

UK

Slowing economy and rising inflation pressures create a conundrum for UK policymakers

The UK consumer price index ticked higher to 3.0% in year-on-year (y/y) terms in September from 2.9% in August 2017 (see chart 3). Currency pass-through effects and higher electricity and petrol prices have exerted upward pressure on headline inflation in recent months.

Prolonged uncertainty related to Brexit negotiations has driven the sterling weaker since Britons voted to leave the European Union. Using a historic relationship between movement in the currency and core or underlying inflation in the UK suggests further upward pressure in inflation measures in upcoming months.

The rise in inflation has squeezed living standards in the UK, by compressing growth in average wage settlements, which have been moving sideways at 2% for some time now.

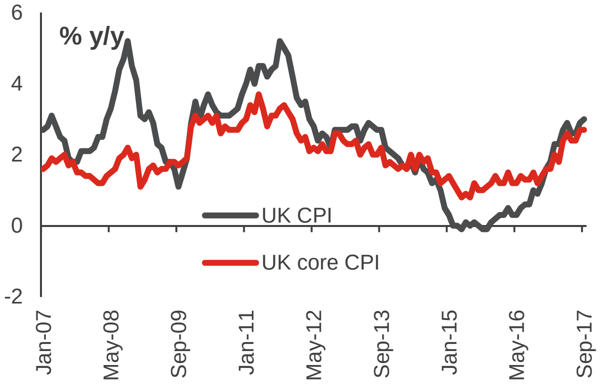
Though the services sector prevented a worse growth outcome in the first quarter of the year, Brexit uncertainty and higher import costs arising from a more depreciated sterling are starting to undermine business confidence in the services sector, which accounts for 80% of economic activity.

Moreover, in a recent statement, Moody's rating agency downgraded Britain's credit rating by a further notch to Aa1 from Aa2, in line with other rating agencies. It voiced its concerns that Britain would be unable to secure a replacement free-trade agreement with the EU, which would have mitigated the hit from a Brexit fallout.

With the September 2017 print being the most updated inflation data available at the upcoming interest rate-setting meeting in November 2017, the five-year high on inflation is likely to raise the heat on the Monetary Policy Committee (MPC), which will have to balance a rise in inflation pressures with a fragile growth outlook.

Previous comments by MPC members that rates will have to be increased at a pace faster than the market expects were previously discounted. As such, it is likely that more hawkish rhetoric will emerge at the upcoming MPC meeting.

Chart 3: Sterling weakness pushes UK inflation higher



Source: Bloomberg, Momentum Investments

China

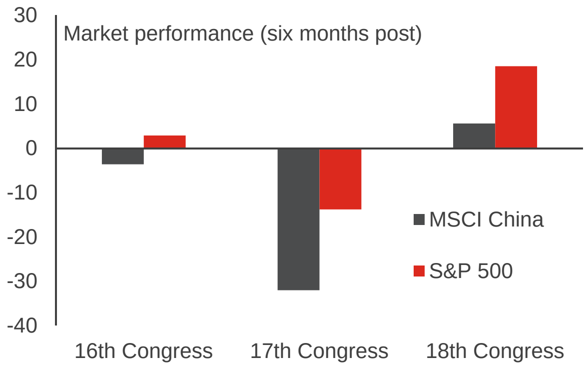
Markets have the 19th Chinese Communist party congress in its sights

Once every five years, the Chinese Communist party hosts a congress to select new members for the 350-member Central Committee, the 25-member Politburo and the seven-member Politburo Standing Committee.

Although not typically a market-moving event, markets will be watching the outcome of the party congress for clues about changes to monetary policy, capital controls and state-owned enterprise (SoE) reform.

A reorganisation of China's financial regulatory services and a crackdown on financial behaviour has left authorities with the task of striking balance between supporting growth and curbing excessive growth in credit.

Chart 4: Chinese equities followed US markets following past congresses



Source: RMBMS, Momentum Investments

Monetary policy efforts were aimed at deleveraging when the annual growth target was firmly in reach, but now that growth is slowing, investors are more uncertain about how much monetary policy tightening authorities are likely to embark on.

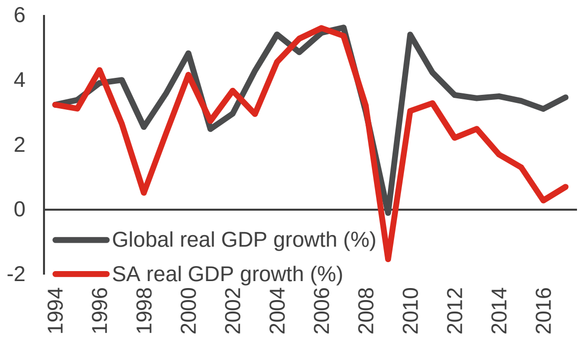
Communist party leaders have given more attention to increasing efficiencies at China's SoEs. The market will be closely watching its move towards partial privatisation or mixed ownership reform, which could improve corporate governance and harness sustainable competitiveness.

Local economic developments

South Africa (SA) is missing out on the global economic recovery

The SA Reserve Bank (SARB) calculates a strong relationship between global and domestic growth historically. Between 1996 and 2016, a 1% increase in global growth was matched by a 0.94% increase in the level of SA output. Graphically, a notable divergence opened between SA and global growth in 2011, widening in 2013 (see chart 5).

Chart 5: SA growth decoupling from global activity



Source: Stats SA, Global Insight, Momentum Investments

The SARB investigated five key factors, which affected domestic growth between 1996 and 2013. These included real commodity prices, the real effective exchange rate (as a measure of competitiveness), consumer confidence and fiscal and monetary policy settings. In its October 2017 Monetary Policy Review, the SARB concluded local growth could have registered at 2.1% in 2016 (2.4% in 2015), rather than the paltry 0.3% (1.3% in 2015), which was recorded, if these variables followed their longer-run averages.

The results of the study highlight subdued confidence and lower real commodity prices, as the main drivers behind SA's growth underperformance. The SARB warns of the costs of policy uncertainty and the need for restoring confidence in the domestic economy. It further suggests normalising confidence is insufficient on its own to achieve healthy growth rates above 3%. It proposes a structural reform agenda, including lowering prices in network industries and raising investment towards 25% of GDP to further growth prospects internally.

Financial market performance

Global markets

Despite a number of risks on the horizon, including the stand-off between Madrid and Catalonia, the impending decision on the new Federal Reserve Chair and ongoing Brexit talks, global stock markets edged up throughout the month, ending October 2017 1.9% higher.

The MSCI Developed Markets Index rose 1.8% in the month, driven by gains in the Japanese and US markets. The Japanese Nikkei soared 8.2% on Prime Minister Shinzo Abe's emphatic election win, which signals a continuation of ultra-accommodative monetary policy and further progress on constitutional and economic reform. Despite pre-election polls signalling a slide in Abe's approval ratings, the decision to call an election almost a year earlier than scheduled proved successful.

US equities were buoyed by the US Senate's approval of a US$4 trillion budget measure by a 51 to 49 vote. This measure makes provision for a tax bill, requiring only a simple 51-vote majority in the Senate. This implies Democratic support is not needed to support the tax-cut plan.

A step closer towards advancing on proposed tax reforms lifted the S&P 500 by 2.2% in October 2017.

European stocks experienced milder gains in the first three weeks of the month, as investors reacted to the negative news in Catalonia. The announcement by the ECB in the final week of October 2017, however, boosted markets on news it would be buying around €45 billion per month in the first nine months of 2018 (after taking reinvestments into account).

The MSCI Emerging Market (EM) Index climbed 3.2% in October 2017, more than reversing its losses in the previous month. Asian stocks finished the month 4.6% firmer, followed by a 1.4% gain the MSCI EMEA (Europe, Middle East and Africa) Index. The MSCI Latin America Index lagged in performance, declining by 2.9% in the same period.

Local markets

The SA equity market rose 4.3% ahead of National Treasury's October 2017 Medium-term Budget Policy Statement, supported by gains in resource and industrial shares.

Domestic equity market returns were driven by a strong return from industrial shares, which gained 7.6% in October 2017. The FTSE/JSE Resources Index followed suit, strengthening 7.1% by month end, on a softer rand and a 2.0% uptick in commodity prices. The FTSE/JSE Financial Index increased 2.5% in the same period.

The FTSE/JSE Mid-cap Index recovered in October 2017, after slumping 5.1% in September 2017, while the FTSE/JSE Small-cap Index experienced gains of 2.6%.

At its worst point in the month, SA ten-year government bond yields ratcheted nearly 70 points higher on a poorer-than-expected budget outcome.

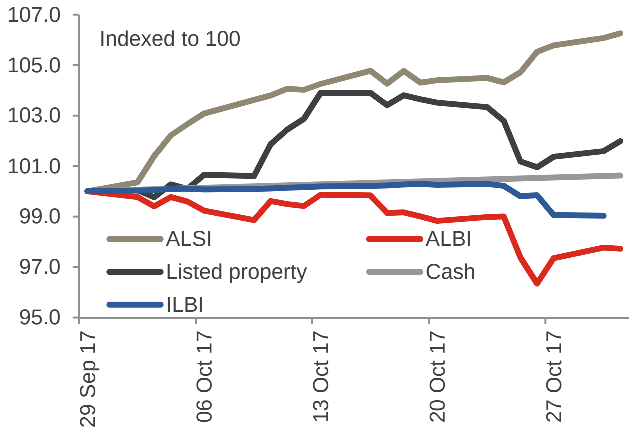
The Inflation-linked Bond Index (ILBI) dipped 1% in the month, while the FTSE/JSE Listed Property Index outperformed on a relative basis by 2.0%. SA cash increased 0.6% in the same period.

The rand wobbled mid-month on the announcement of another Cabinet reshuffle. The key affected departments include the energy portfolio, which remains crucial for any future decision-making on a potential nuclear deal, Home Affairs, State Security and the Department of Higher Education and Training. The latest reshuffle has weakened the SA Communist Party representation at senior level, coinciding with strains within the Alliance.

Recent weakness in the rand, exacerbated by negative fiscal news, leaves its return against the major currencies as the third-weakest in the EM composite (following the Argentinian peso and the Turkish lira) for the year to date.

The rand depreciated by 4.2% against the US dollar and by a lesser 2.7% against the euro and 3.9% against the British pound in October 2017. Despite rising expectations for an interest rate hike by the Bank of England, weak economic data and slow progress on the Brexit negotiations hurt the sterling in the first half of October 2017.

Chart 6: Local asset class returns



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

Indices summary for October 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)	6.26%	8.12%	20.11%	9.00%	9.88%	12.97%	13.89%	13.23%	9.70%
FTSE/JSE Shareholder Weighted Index (SWIX)	6.51%	7.20%	17.27%	8.63%	10.55%	13.53%	14.87%	14.10%	10.58%
FTSE/JSE Capped SWIX All Share index	4.88%	5.55%	13.43%	7.11%	9.38%	12.58%	14.06%		
FTSE/JSE All Share Top 40 Index	6.60%	8.91%	22.92%	8.89%	9.75%	12.98%	13.70%	13.20%	9.36%
FTSE/JSE Mid Cap Index	4.12%	3.27%	1.98%	7.80%	8.95%	11.25%	13.39%	12.19%	11.33%
FTSE/JSE Small Cap Index	2.56%	4.86%	4.04%	6.77%	9.28%	14.26%	16.01%	14.08%	9.24%
FTSE/JSE Resources Index	7.06%	11.31%	23.12%	-3.03%	-3.62%	-2.31%	-2.20%	-1.33%	-1.69%
FTSE/JSE Financials Index	2.47%	2.55%	10.54%	6.64%	10.36%	13.89%	16.58%	15.13%	9.95%
FTSE/JSE Industrials Index	7.61%	9.38%	23.57%	11.86%	13.24%	18.21%	20.11%	19.48%	15.97%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	4.84%	7.57%	19.39%	8.01%	8.46%	11.12%	12.12%	11.63%	9.57%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	4.89%	7.22%	17.97%	7.64%	8.01%	10.80%	11.77%	11.13%	8.97%
FTSE/JSE SA Listed Property Index (SAPY)	1.99%	3.99%	11.13%	10.92%	12.98%	14.06%	16.32%	15.33%	13.62%
Interest-bearing indices									
BEASSA All Bond Index (ALBI)	-2.30%	-0.20%	5.04%	5.61%	6.44%	5.98%	7.15%	7.23%	8.01%
BEASSA All Bond Index 1-3 years (ALBI)	-0.18%	1.22%	8.25%	7.39%	7.05%	6.64%	6.86%	7.18%	7.87%
Barclays BEASSA SA Government ILB Index	-0.87%	0.27%	-0.82%	3.73%	5.70%	5.25%	7.56%	7.96%	8.88%
Short-term Fixed Interest Composite Index (SteFI)	0.62%	1.82%	7.60%	7.08%	6.74%	6.43%	6.29%	6.22%	7.18%
Commodities									
NewGold Exchange-Traded Fund	3.79%	7.32%	4.05%	11.32%	7.41%	3.29%	4.45%	9.31%	12.79%
Gold price (in rands)	3.41%	7.42%	3.33%	11.98%	7.87%	3.75%	4.81%	9.64%	13.24%
Platinum Exchange-Traded Fund	4.64%	4.86%	-2.38%	-1.69%	-1.73%				
Platinum price (in rands)	5.19%	4.95%	-1.70%	-0.96%	-1.35%	-4.26%	-3.10%	-3.55%	-1.10%
Currency movements									
Rand/euro movements	3.21%	5.85%	11.45%	5.98%	4.89%	7.88%	6.94%	7.91%	5.70%
Rand/dollar movements	4.73%	7.12%	4.88%	8.57%	9.02%	10.20%	10.20%	10.68%	8.02%
Inflation index									
Consumer Price Index (CPI)			5.06%	5.26%	5.42%	5.53%	5.52%	5.55%	5.97%

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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