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Economic and market snapshot for April 2018

Highlights

- United States: The economy is typified by late-cycle conditions, but an imminent recession is unlikely, given the pro-cyclical fiscal policy stance adopted by government.
- Eurozone: The broad-based economic recovery is expected to taper off marginally.
- United Kingdom: The announcement of a transition deal has eased Brexit concerns, but business confidence will, ultimately, be determined by the country's ability to strike a deal with the European Union.
- Emerging markets: A rising growth differential with developed markets is expected to support capital inflows into the region.
- South Africa: Consumer sentiment registered at an all-time high, boding well for durable goods spend.

Global economic developments

United States (US)

The economy is typified by late-cycle conditions, but an imminent recession is unlikely

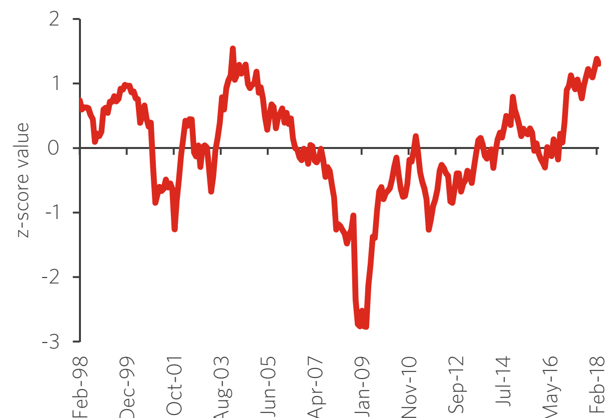
The low magnitude of growth in gross domestic product (GDP) and subdued inflation have prolonged the economic cycle in the US. Although the economy is likely operating under late-cycle conditions, Momentum Investments views the risk of a recession as being low, given the pro-cyclical fiscal policy stance adopted by government.

Typically elevated levels of unemployment are accompanied by a loosening of the fiscal reins, as the public sector attempts to support growth in a weak growth environment. This time around, however, the fiscal deficit (as a share of GDP) is expected to expand from 3.4% in 2017 to 4.9% in 2019 (Bloomberg consensus). This is at a time when the rate of headline unemployment is expected to improve from 4.4% to 3.7% in the corresponding period, according to the Bloomberg consensus.

This has kept economic optimism elevated across all facets of the economy, including consumer sentiment, manufacturing, services, small businesses and the housing market.

The z-score (number of standard deviations from the average) of the average of these indicators is close to the high previously reached in January 2004 (see chart 1).

Chart 1: Elevated US economic optimism



Source: Deutsche Bank, Bloomberg, Momentum Investments

Twin deficits in the US (negative current account and fiscal balances) and an overvaluation in the real effective exchange rate suggest the US dollar is likely to weaken in upcoming months, despite recent oversold levels leading to a bout of US dollar strength.

Quantitative tightening by the US Federal Reserve (Fed) against a backdrop of ongoing quantitative easing in Eurozone (albeit it at a slower pace), points to further weakness in the US dollar against the euro.

Dollar weakness, a tightening labour market and pro-cyclical fiscal policy in the US all point to rising inflation in upcoming months. As such, Momentum Investments expects the Fed to shift monetary policy beyond a neutral stance in upcoming quarters, in response to robust growth and moderately rising inflation.

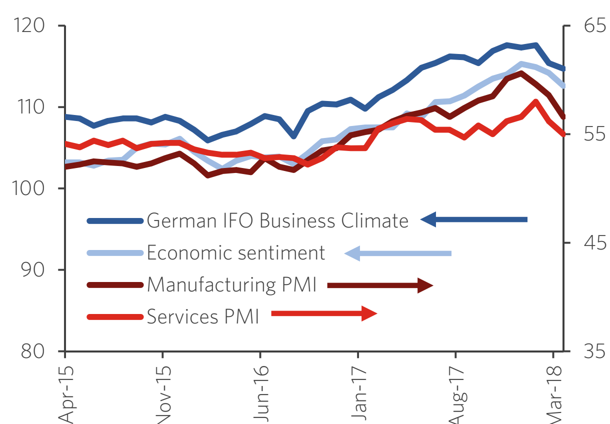
Eurozone

The broad-based economic expansion is set to soften slightly

Growth in the Eurozone appears to be tapering off, but at a marginal pace. Although the fourth-quarter GDP print for 2017 pointed to a broad-based economic expansion, growth slowed from the third quarter on a slowdown in consumption expenditure. This was partly offset by a robust contribution from exports, despite an appreciation in the euro.

Geopolitical issues in the Eurozone and rising uncertainty due to the imposition of US import tariffs are affecting overall economic and investment sentiment. Sentiment indicators, including gauges of the manufacturing and services sectors and broader economic confidence indicators, have all shifted lower in recent months (partly due to strikes and poor weather), but remain in expansionary territory (see chart 2).

Chart 2: Eurozone sentiment indicators point to firm, but softening, growth (index level)



Source: Bloomberg, Momentum Investments

Buoyant domestic demand should support solid, but slowing, growth in 2018, as growth drivers remain firmly in place. Tighter labour markets (unemployment has shrunk from 12.1% in the first quarter of 2013 to 8.7% in the fourth quarter of 2017), positive sentiment and still accommodative monetary policy should underpin economic activity in upcoming quarters, even though the contribution from exports could wane in a firmer euro environment.

The softer tone of economic data suggests the European Central Bank (ECB) is unlikely to announce an end to its asset purchases any earlier than the September 2018 interest-rate-setting meeting.

Although underlying price indicators in the manufacturing sentiment gauge and consumers' inflation expectations point to rising core inflation in upcoming quarters, inflation is likely to remain below the ECB's 2% target in 2019. Consequently, Momentum Investments does not expect an interest rate hike before the second half of 2019.

United Kingdom (UK)

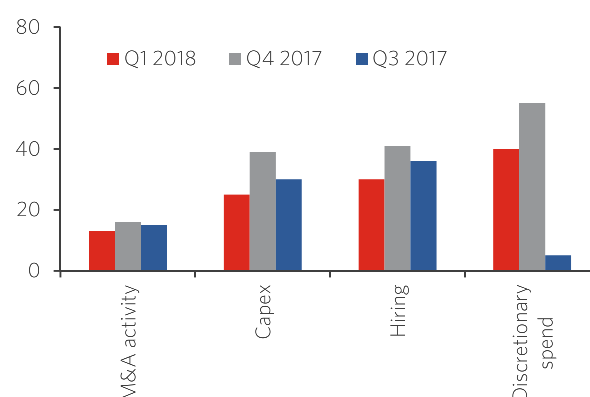
The announcement of a transition deal has eased Brexit concerns

The Deloitte chief financial officers (CFO) survey for the UK in the first quarter of 2018 captured an increase in sentiment, following the announcement of the Brexit transition deal on 19 March 2018. Perceptions of uncertainty have dropped to their lowest levels since 2016, before the European Union (EU) referendum.

Before the transition was announced, 60% of CFOs suggested the business environment would be worse in the long term, as a result of Brexit. The survey results released, after the transition was announced, suggested only 32% of CFOs expected a worse outcome in the long run.

Similarly, a net 14% of CFOs were optimistic about the financial prospects of their company compared to three months ago, relative to a net 8%, who were pessimistic before the transition announcement was made.

Chart 3: % of CEOs expecting to decrease spend within the next three years, as a consequence of Brexit



Source: Deloitte, Momentum Investments

The effect of the transition deal has likewise been positive on spending intentions. While 55% of CFOs in the fourth quarter survey in 2017 suggested discretionary spend would decrease in the next three years, as a consequence of Brexit, only 40% indicated the same in the first-quarter survey of 2018 (see chart 3). By the same token, only 25% of CFOs indicated a decrease in capital spending in the next three years in the first-quarter survey, relative to 39% in the final quarter of 2017.

While these figures are likely to improve further in the second-quarter reading in 2018 (given that some CFOs may have filled out the survey before the transition deal was announced), business confidence will, ultimately, be determined by the UK's ability to strike a deal with the EU and have it endorsed by Parliament this year.

Emerging markets (EMs)

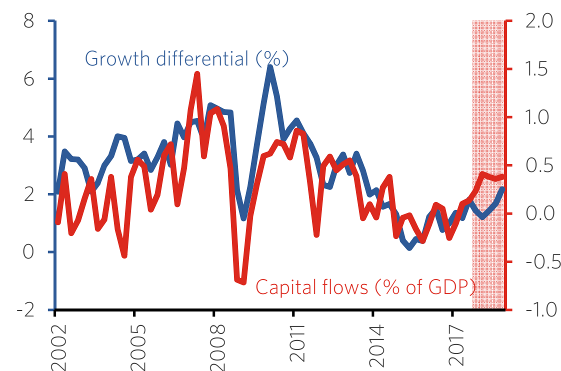
A rising growth differential between EMs and developed markets is expected to support capital inflows

The decline in metal prices, commencing in 2011, drove a wedge between the growth performance of stable net commodity-importing countries and underperforming net commodity exporters. The turnaround in growth in economic activity in EMs in 2016 and 2017 was largely attributable to a recovery in the latter, in line with an upturn in commodity prices and higher global demand.

Stable commodity prices, resilient global growth and still accommodative monetary policies will likely boost growth in EMs and further drive the differential with developed markets in upcoming quarters.

Despite a tapering in global central bank net asset purchases, the projected favourable trend in the growth differential should further drive capital inflows into EMs (see chart 4).

Chart 4: Capital inflows likely to follow the favourable growth differential



Source: JP Morgan, Momentum Investments

However, risks in the medium term are titled to the downside. An escalation in US President Donald Trump's trade policy poses a considerable downside risk to the EM growth outlook through the direct effect of a potential financial market fallout or the indirect effect through supply chains.

Moreover, a handful of EMs (exhibiting either an extended current account deficit, an elevated level of external debt or a substantial foreign holding of their government bonds) are highly exposed to a faster-than-expected rise in developed market interest rates and a rapid tightening in global financial conditions, including a faster-than-expected rise in interest rates by the US Fed or faster removal of policy accommodation by the ECB.

Local economic developments

Consumer sentiment registered at an all-time high in the first quarter of 2018

The Bureau of Economic Research's (BER) Consumer Confidence Index surprised at a record high (since the survey's inception in 1982) of 26 points for the first quarter of 2018, rising from a negative 8 point reading in the previous quarter. The index printed 12 consecutive quarters of negative sentiment before the significantly positive print recorded in the first quarter of 2018.

The survey comprises three questions, which include: consumers' expected economic position in South Africa (SA) in the next 12 months (34 index points from negative 2 points in the previous quarter), the expected financial position of households in the next 12 months (31 index points from 2 previously) and consumers' rating of the present time to buy durable goods (13 index points from negative 24 previously).

All three components showed a positive and significant reading for the first time since the global financial crisis. This is indicative of the demand side of the economy set to improve in the ensuing months of 2018, which is a welcome reprieve, given the continual pressure the local economy has faced since the start of the ongoing business cycle downturn since late 2013.

Household expenditure, accounting for the bulk of the domestic demand side of the economy, has benefited from a decline in inflationary pressures, which significantly eroded household purchasing power throughout 2016 and the first half of 2017. Food inflation averaged above 9% during this

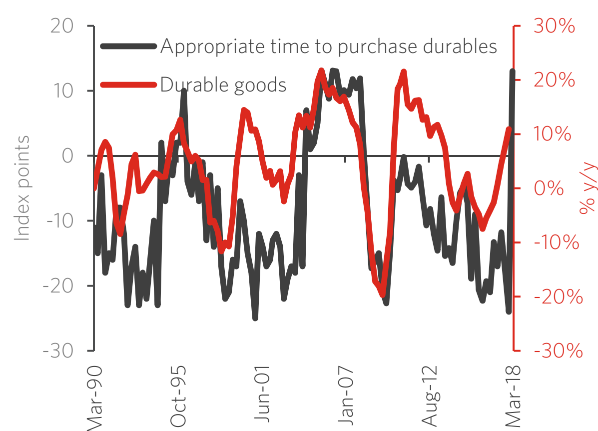
period, but has since subsided to levels well within the 3% to 6% inflation target band. Meat inflation has stubbornly remained above 6% for the past year but is showing some form of easing, as the momentum from the incline has slowed in recent prints.

The recent SA Reserve Bank (SARB) 25 basis point interest rate cut in March 2018 has additionally created some ease for the consumers' pockets, which bodes well for their general appetite and ability to spend.

Growth in domestic demand is on the rise and is expected to continue its upward trajectory, given a revival in confidence, higher real wage growth and a more upbeat employment outlook. Growth in retail sales has already showed signs of an improvement, registering 2.9% in year-on-year terms for 2017 compared to a year ago at 1.7% and 4.1% year-to-date for 2018.

A revival in consumer confidence points to increased spend on durable goods, as muted inflation and easier financial conditions have translated into a more appropriate time to buy items such as cars, furniture and recreational equipment (see chart 5).

Chart 5: Consumers are more optimistic this is an appropriate time to buy durables



Source: BER, SARB, Momentum Investments

Financial market performance

Global markets

Global equity markets rose in the second week of the month, after a slow start. Hopes for an improvement in the US/China trade dispute paved the way for renewed gains in the MSCI All World Index, which ended April 2018 1.0% firmer. Risk sentiment also improved, with the CBOE volatility index (VIX) retracing nearly 5 index points during the month.

The MSCI Developed Markets Index rose 1.1% in April 2018, bolstered by strong gains in European and Japanese equities, while the US equity market displayed a pedestrian performance.

Healthy corporate earnings buoyed the S&P 500 Index into mid-month, overriding negative geopolitical and trade-news headlines. US bourses were hit later in the month by disappointing results from US technology and consumer staple stocks. Late in the month, a better-than-expected first-quarter GDP print (2.3% against expectations of 2.0%) aided a recovery in US equities.

The US ten-year government bond sold off notably in April 2018, by nearly 22 points, as market concerns over growing federal borrowing arose. The German 10-year government bond yield rose by only 6 points in contrast in the same period.

The Eurostoxx 50 Index had an almost uninterrupted rise in April 2018, finishing the month 6.0% higher, aided late in the month by an upside surprise in the latest consumer confidence print for April 2018, despite a negative miss on the German economic indicator. The index dipped slightly in the run up to ECB interest-rate-setting meeting, where ECB President Mario Draghi hinted "the possible extension of QE (quantitative easing) has not been discussed by the Governing Council", but soon recovered.

The April 2018 monetary policy statement from the Bank of Japan (BoJ) contained few surprises for the Nikkei 225 Index, which ended the month 4.7% in the black. The BoJ left its guidance unchanged and remained committed to ongoing monetary easing. Firm Japanese data, including a higher-than-expected March 2018 manufacturing sentiment reading and a lead economic indicator, which printed higher than consensus for February 2018, further supported Japanese equities in the month.

The MSCI EM Index tracked sideways in the first half of the month, but shifted lower in the second half, leaving the index 0.4% weaker than a month ago. The MSCI Asia Index started to stage a recovery late in the month, on the new that the North Korean leader met with South Korea's president for talks about the North's nuclear programme, which Capital Economics suggests could potentially remove a major tail risk for the region's markets and economies.

The MSCI Latin America Index shed 1.3% in April 2018, despite a 2.3% rise in the Bloomberg commodity price index for the corresponding period, while the MSCI EMEA (Europe, Middle East and Africa) Index underperformed, losing 2.4% by the end of the month.

Local markets

SA equities outperformed global shares and staged a solid performance in the first three weeks of the month, before trading sideways. The FTSE/JSE All Share Index increased by 5.4% in April 2018, buttressed by a surge in resource shares.

The FTSE/JSE Resources Index soared nearly 9% in the month, with the first half of the month's gains abetted by a rally in gold prices (in response to escalating geopolitical risks) and a further uptick in platinum group metals prices. A weaker rand further supported gains in resource shares in April 2018.

The FTSE/JSE Financials Index sustained losses late in the month, as the rise in long bond yields negatively affected locally-listed financial institutions.

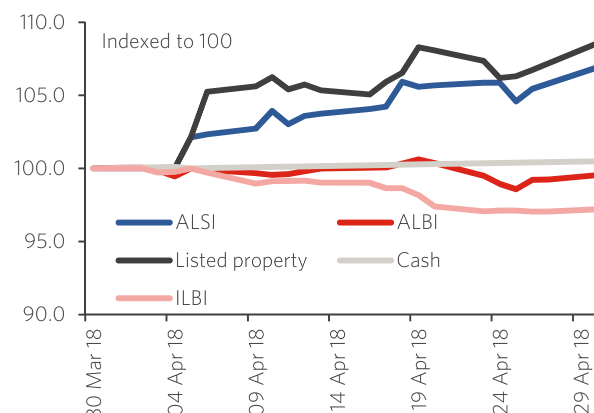
The FTSE/JSE Industrials Index was supported by decent retail sales figures reported mid-month and the highest consumer confidence print on record for the first quarter of 2018. Rand weakness in April 2018 further supported rand hedges in the industrials composite.

The FTSE/JSE Mid-cap Index closed 3.5% higher in April 2018, while the FTSE/JSE Small-cap Index drifted 1.2% weaker in the month.

Listed property shares recovered by almost 7.7% in April 2018, partly on the news that an independent review found no evidence of executive misconduct of breaches of governance rules by real estate investment trust, Resilient.

The fixed income indices suffered losses in April 2018. The Inflation-linked Bond Index (ILBI) lost 3.0%, while the SA ten-year government bond yield sold off 20 points. SA cash posted modest gains of 0.6% in the corresponding period.

Chart 6: Local asset class returns (%)



Source: INET BFA, Momentum Investments, data up to 30 April 2018

The rand traded weaker against major currencies, as the market's focus shifted to geopolitical events, including the US/China trade tariff dispute and rising tensions between the US and Syria.

Rising US yields saw mounting pressure throughout EMs later in the month, given an ongoing sell-off in riskier asset classes. The rand weakened by 5.1% against the US dollar in April 2018, which represented the third-worst return from a basket of EM peers. Losses against the sterling and euro were limited at 3.6% and 3.1%, respectively.

Indices summary for April 2018

	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)	5.40%	-0.99%	11.45%	5.28%	7.58%	11.75%	12.47%	11.84%	9.80%
FTSE/JSE Shareholder Weighted Index (SWIX)	4.33%	-2.05%	9.70%	4.50%	8.39%	12.15%	12.91%	12.75%	10.98%
FTSE/JSE Capped SWIX All Share index	4.10%	-0.75%	8.63%	3.75%	7.76%	11.65%	12.49%		
FTSE/JSE All Share Top 40 Index	5.76%	-1.12%	12.34%	5.11%	7.10%	11.76%	12.40%	11.45%	9.08%
FTSE/JSE Mid Cap Index	3.54%	-0.12%	6.80%	4.60%	8.89%	10.66%	11.65%	12.94%	14.11%
FTSE/JSE Small Cap Index	1.24%	0.23%	1.01%	3.63%	7.66%	10.72%	13.17%	13.59%	11.52%
FTSE/JSE Resources Index	8.69%	1.30%	20.02%	-1.11%	-6.23%	1.03%	-1.09%	-2.40%	-2.61%
FTSE/JSE Financials Index	3.23%	2.61%	17.21%	4.34%	10.99%	13.23%	15.55%	16.15%	13.97%
FTSE/JSE Industrials Index	5.20%	-3.62%	5.73%	5.14%	9.89%	13.69%	16.39%	16.89%	15.98%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	4.96%	0.44%	15.89%	6.27%	6.83%	11.34%	11.44%	10.88%	10.34%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	4.96%	0.60%	15.32%	6.03%	6.73%	10.94%	11.22%	10.54%	9.89%
FTSE/JSE SA Listed Property Index (SAPY)	7.68%	-3.91%	-0.45%	2.00%	10.06%	7.17%	12.53%	13.43%	15.29%
Interest-bearing indices									
BEASSA All Bond Index (ALBI)	-0.70%	5.34%	13.75%	8.57%	9.30%	6.71%	8.35%	8.96%	9.63%
BEASSA All Bond Index 1-3 years (ALBI)	0.00%	1.56%	8.53%	8.06%	7.82%	6.99%	7.05%	7.41%	8.23%
Barclays BEASSA SA Government ILB Index	-3.02%	3.07%	3.32%	3.45%	5.10%	4.22%	6.59%	7.82%	8.29%
Short-term Fixed Interest Composite Index (SteFI)	0.58%	1.74%	7.43%	7.24%	6.98%	6.64%	6.42%	6.32%	7.01%
Commodities									
NewGold Exchange-Traded Fund	4.17%	2.65%	-3.98%	4.70%	4.32%	3.94%	3.79%	6.61%	9.11%
Gold price (in rands)	4.48%	2.23%	-2.85%	5.35%	4.79%	4.38%	4.19%	7.09%	9.53%
Platinum Exchange-Traded Fund	3.07%	-5.03%	-10.92%	-6.33%	-7.32%	-5.09%			
Platinum price (in rands)	2.66%	-5.15%	-10.46%	-5.69%	-6.84%	-5.41%	-3.81%	-6.79%	-5.67%
Currency movements									
Rand/euro movements	3.52%	1.97%	3.44%	4.04%	0.80%	4.95%	6.63%	6.39%	2.52%
Rand/dollar movements	5.37%	5.12%	-6.73%	1.45%	4.34%	6.80%	8.27%	9.57%	5.17%
Inflation index									
Consumer Price Index (CPI)			3.81%	5.40%	5.06%	5.26%	5.37%	5.45%	5.67%

Important notes

1. Sources: Momentum Investments, 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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