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Economic and market snapshot for March 2018

Highlights

- United States: New steel and aluminium tariffs are expected to have a minor effect on the economy, but retaliatory moves by the country's trading partners still pose a risk to global confidence and investment.
- Eurozone: The Italian lawmakers face the challenge of forming a coalition government after inconclusive elections were held.
- Japan: Realising the 2% inflation target will remain a key challenge in Haruhiko Kuroda's second term of office, suggesting ultra-accommodative monetary policy is likely to persist for some time.
- China: The abolishment of the two-term limit cements President Xi Jinping's power and implies a greater centralisation of decision making. As such, his commitment to structural reform implementation has grown in its importance for trend growth.
- South Africa: The land restitution process is fraught with technical complexities, but it could still dampen confidence, as the debate remains shrouded in uncertainty.

Global economic developments

United States (US)

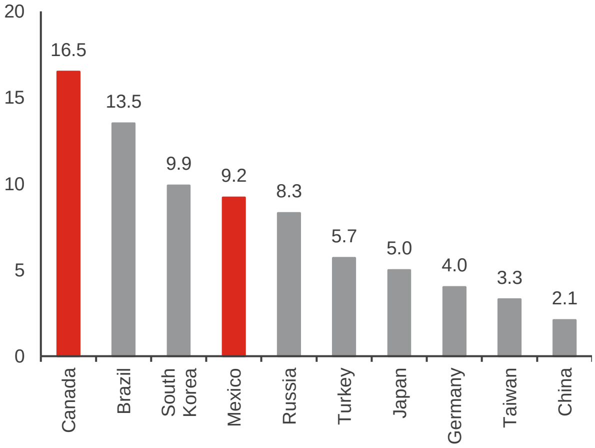
New steel and aluminium tariffs should have a minor macro effect, but retaliation by the US' trading partners is still a risk

US President Donald Trump's decision to impose a 25% tariff on steel and a 10% tariff on aluminium has raised fears of a trade war. A global tariff (as opposed to a targeted one) implies the tariff should affect all exporters of these products equally, but so far Canada, Mexico and Australia have successfully negotiated an exclusion to the tariffs (while Argentina, Brazil, the European Union and South Korea sought temporary exemptions).

According to HSBC, Canada and Mexico together accounted for 26% of US steel (see chart 1) and 56% of aluminium imports in 2017. The Commerce Department recommended a tariff level to boost domestic capacity utilisation in the steel and aluminium industries to 80% (currently 74% for steel and 71% for aluminium). If the Trump administration sticks to its intention to raise capacity utilisation levels to 80%, the exemption of Canada and Mexico, in particular, could imply higher tariffs or quotas to the other countries affected.

While Trump argued the tariffs are intended to correct unfair trade practices, industries using steel and aluminium as inputs could be under pressure to shed jobs to protect profitability levels.

Chart 1: US steel imports by country (% of total)



Source: HSBC, Momentum Investments

In a March 2018 policy brief, Trade Partnership Worldwide calculated a net 146 000 low-skilled and production-related jobs would be lost in the US (less than 0.1% of the total number of employed persons). In a later report, it investigated the effect on jobs if the steel and aluminium tariffs were met with retaliation by the country's trading partners. In this scenario, Trade Partnership Worldwide suggested nearly 469 000 jobs would be lost in the US economy (0.3% of the total number of employed persons).

HSBC noted the imposition of tariffs on steel and aluminium would likely lead to more direct imports of products containing steel and aluminium, resulting in a minor change to consumer price inflation forecasts. Similarly, if the tariffs are successful in decreasing imports and raising domestic production, the effect on gross domestic product (GDP) would be small. HSBC estimates an 11% increase in domestic production of the affected products would raise GDP by only 0.1%.

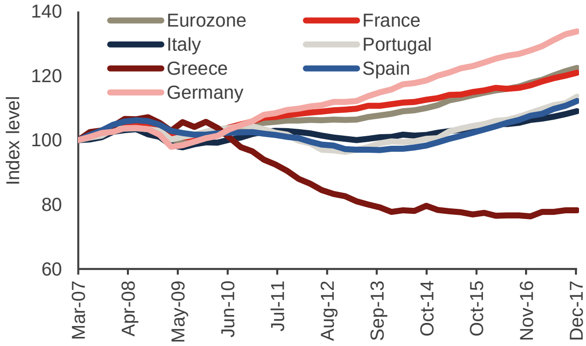
The International Monetary Fund (IMF) pointed out the direct economic effect from the tariffs was not concerning, but it warned an escalation of trade retaliation would damage business confidence and investment worldwide.

Eurozone

Italian lawmakers face the challenge of forming a coalition government after inconclusive elections were held

Nominal GDP in Germany grew 34% between Q2 2007 and Q4 2017. In comparison, Italian GDP increased by only 9% in the same period (see chart 2). Prolonged growth weakness has additionally dampened employment gains. While more than three quarters of Germans between the ages of 15 and 64 are employed, only 58% of Italians in the same age group have a job. A failure to deliver on growth and employment mandates has frustrated Italian voters, who have turned to more populist movements to deliver on macroeconomic policies.

Chart 2: Growth divergence in the Eurozone



Source: Financial Times, Bloomberg, Momentum Investments

The latest election results showed 55% of Italian voters choosing Eurosceptic and anti-establishment parties, signalling further friction between the country and the European establishment. The anti-establishment Five Star Movement won the largest percentage of votes, but did not secure a parliamentary majority.

Voter discontent implies mainstream parties will continue to be under pressure, with a larger portion of the electorate switching their votes to more populist parties.
A February 2016 journal published by the Political Studies Association suggests mainstream European parties have increasingly shifted towards the right since 1980, in terms of issue positions and issue salience to better address the concerns of the median voter.

In Momentum Investments' view, Italy remains vulnerable to political upheaval and its macroeconomic performance is likely to continue lagging that of its Eurozone counterparts.

Japan

Realising the 2% inflation target will remain a key challenge in Haruhiko Kuroda's second term of office

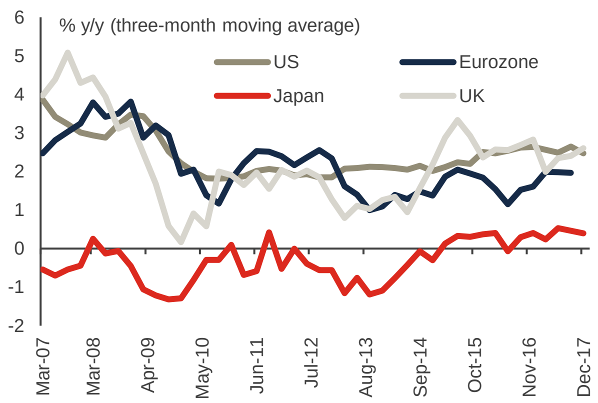
The Japanese parliament approved Haruhiko Kuroda for a second term as central bank governor for the Bank of Japan. During his first term, Kuroda failed to sustainably achieve headline inflation of 2%. Headline inflation averaged 0.9% during his first term, while core inflation (headline less food and fuel costs) averaged at a lesser 0.6% in the same period.

His success was more pronounced on the growth front, where GDP growth recovered to 2% in the final quarter of 2017 (averaging 1.3% in his first term). Although higher fixed investment spend, related to the 2020 Olympic Games, should prop up growth in the near to medium term, the non-renewal of fiscal stimulus could see growth slow marginally in 2018 from 2017 levels. Structurally, Momentum Investments expects trend growth to persist around 1%, given an ageing population, a shrinking workforce and excessive regulation.

Despite a tightening labour market, wage growth has accelerated at a much slower pace than the rest of the developed market composite (see chart 3), leaving inflation expectations muted. The IMF attributes Japan's slow wage growth to limited labour mobility, lifetime employment (a preference for job security) and inflation-linked wages. The IMF proposed a number of labour market reforms to boost wages and growth. These included promoting worker mobility between firms, eliminating disincentives to full-time and regular work and ensuring equal pay for equal work to close gaps in pay.

To foster a higher economic growth rate in the longer term, the IMF proposes a credible medium-term fiscal framework to boost confidence, while placing debt on a more sustainable path. It emphasises structural reforms are, in addition, necessary to enhance investment and productivity.

Chart 3: Japanese wage growth is lagging compensation trends in other developed markets



Source: Capital Economics, Momentum investments

China

Structural reform commitment is increasingly important in the latest abolishment of presidential term limits

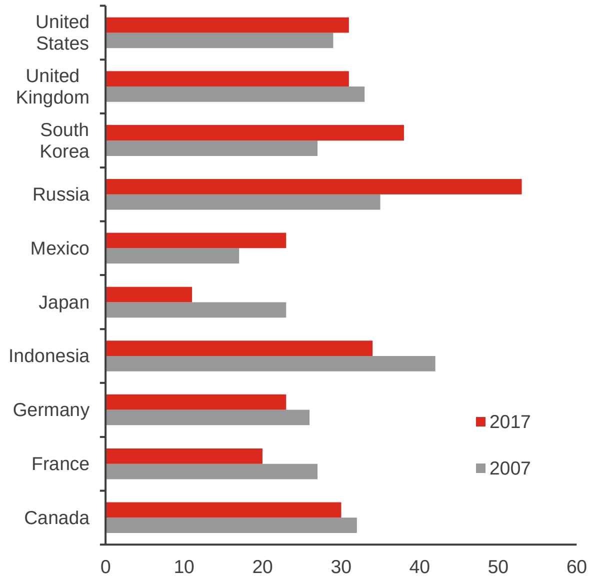
Chinese officials scrapped the two-term limit for president and vice president positions in March 2018, with the market speculating the age limits (age 68) for party leaders will soon too be removed.

These limits were imposed in the 1980s to prevent dictatorships from bruising the economy. With the removal of these limits, leadership transitions could be become less regular and predictable and could result in deep splits over policy and succession.

President Xi Jinping has gradually consolidated his power through a crackdown on corruption (which increased the Party's legitimacy) and control over the military and China's national security forces. Although Xi's lead at the National Security Commission extends his power over foreign policy, the immediate market concerns relate to domestic stability and the implementation of structural reform policies to lift domestic growth in the long run and escape the middle-income trap.

Global views of Xi have tended to vary. The Pew Research Centre suggested Russia's favourable view (see chart 4) is likely a consequence of positive Sino-Russian economic relations and shared political interests on contentious security issues, while Japan's view remained negative, given friction over trade and territorial disputes over uninhabited islands.

Chart 4: Percentage responding they are confident in the Chinese president



Source: Pew Research Centre, Momentum investments

A series of visits by senior Chinese officials to the US may have reduced the likelihood of a trade war, but the effect would still be significant on global growth prospects, should tensions result in a tit-for-tat trade dispute. Given the high likelihood of a lose-lose outcome under a trade-war scenario, Momentum Investments expects trade cooperation in its base-case scenario. Trade cooperation and structural reform efforts are expected to underpin growth of around 6% in China in the medium term.

Local economic developments

The land restitution process is fraught with technical complexities, but it could still dampen confidence, as the debate remains shrouded in uncertainty

Growing pressure on the ruling party in the run up to the 2019 national elections and the threat of social instability in a low-growth environment have revived the debate on land restitution.

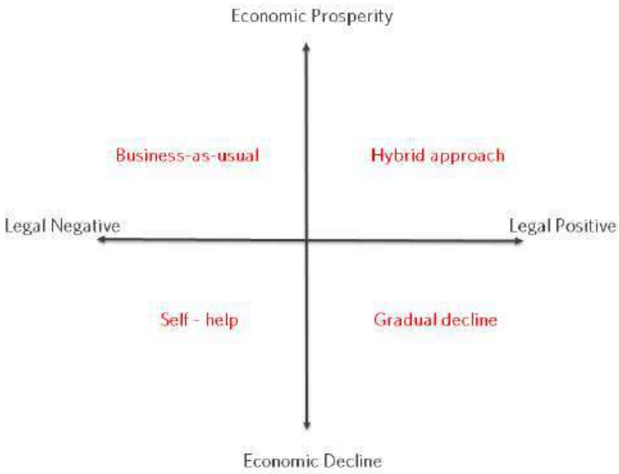
The passing of a motion proposed to amend the Constitution to explicitly allow the expropriation of land without compensation has rattled investors, given the potentially damaging implications for property rights.
Uncertainty is likely to remain elevated in the run up to 30 August 2018, when the Constitutional Review Committee will report back to the National Assembly on its recommendations for constitutional amendments.
The National Assembly will then debate and vote on these recommendations.

In a February 2018 report, Agbiz highlighted possible scenarios on land reform, based on various economic and legal consequences (see chart 5). The 'Hybrid approach' (a moderately good outcome economically and legally) assumes only unbonded, unused and uninhabited productive farmland would be targeted for expropriation. In this scenario, investment confidence is protected through the rule of law being maintained and fundamental rights being respected in an administratively fair process, even if the Constitution is amended. Agbiz assumes affluent individuals/companies, that bought land for recreational purposes, might still suffer economic losses in the 'Hybrid approach'.

The 'Business-as-usual' scenario (good economically, but with mixed legal implications) ensures food security and prevents damage to other sectors of the economy. While this scenario upholds the rule of law and does not amend the Constitution, embarking on an updated land audit and continued disputes over the delivery on government's constitutional mandates to date would prevent an acceleration in land distribution and slow equitable access to land.

The 'Gradual-decline' scenario (economically poor, but legally better) would result in an amendment of section 25 of the Constitution, involving expropriation without compensation within the confines of a fair administrative procedure (no land-grab activity). However, economically, the country is compromised, with a deterioration in the protection of property rights and a decrease in agricultural investment. Exports and agricultural production would suffer under this scenario, dampening economic prospects for SA.

Chart 5: Four scenarios on land reform based on economic and legal consequences



Source: Agbiz

Finally, in the 'Self-help' (a poor outcome economically and legally) scenario, Agbiz assumed a lack of clarity on land reform, which ultimately results in a disregard of the law and an increase in illegal land occupation (land grab). This would result in higher unemployment, lower food security and a rise in imports.

Given the heightened risks to investor confidence and economic stability, Momentum Investments expects a more moderate approach to land reform, but acknowledges the downside risks associated with rising pressure on the new administration to deliver on land restitution in the current electoral cycle.

Financial market performance

Global markets

Global equity markets stumbled mid-month in response to the rise in retaliatory threats by China and the European Union to Trump's decision to impose hefty tariffs on steel and aluminium. Investor caution further lifted into the run up to key central bank monetary policy decisions, a G20 (the 20-largest economies globally) meeting and key Brexit talks. The MSCI All World Index rose 1.8% by the second week of March 2018, but ended the month 2.1% weaker.
The MSCI Developed Markets Index plunged 2.2% in March 2018, driven by losses in the S&P 500 Index (negative 2.5%), while the Eurostoxx 50 and Nikkei 225 lost 2.1% and 2.0%, respectively, in the same period.

The US Federal Reserve's interest rate-setting meeting and a revival of trade war fears overshadowed most other economic news in the month, with the US equity market shifting lower in response to the 0.25% interest rate hike. European equities barely reacted to an uncertain outcome in the Italian general election held early in March 2018, despite a higher percentage of votes being allocated to populist parties, but an escalation in trade friction rhetoric drove the market lower into the end of the month. Japanese equities were supported into mid-month by a weakening in the yen, but investor sentiment was weighed down in the second half of the month on a scandal implicating Prime Minister Shinzo Abe and Finance Minister Taro Aso, over allegations of altered records (linked to a family member of Abe) relating to a discounted sale of state-owned land to a school operator.

The MSCI EM Index fared only marginally better and ended the month 1.9% in the red. Gains in the MSCI Asia Index were tempered early in the month amid ongoing fears of a global trade war and ended March 2018 1.4% down. The MSCI Latin America Index slumped nearly 2% by the middle of the month, following commodity prices lower (the Bloomberg Commodity Price Index dropped 1.5% in the same period). The index ended the month 1.0% lower despite an interest rate cut in Brazil. The MSCI EMEA (Europe, Middle East and Africa) Index underperformed, losing 5.0% by the end of the month.

Local markets

Early in the month, South African (SA) equities benefited from the GDP report (fourth quarter of 2017) published by Stats SA, suggesting the economy performed better than initial market expectations. The local equity market struggled to find direction during the first half of the month, but ended March 2018 decisively weaker (negative 4.2%).

At the start of the month, new Mineral Resources Minister, Gwede Mantashe, promised the new version of the Mining Charter would be finalised by no later than June 2018. Parliament confirmed the Mining Charter would not be completely overhauled, but rather amendments would be considered. Two task teams (for transformation and for growth and competitiveness) have been set up and are expected to report back in late April 2018. The FTSE/JSE Resources Index suffered losses later in the month on rand strength. The index finished March 2018 2.1% lower.

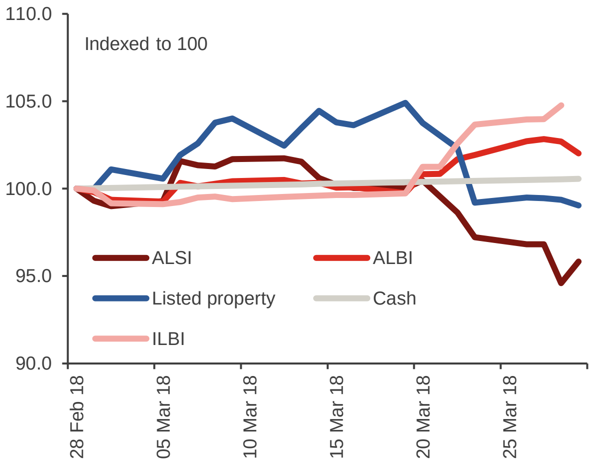
The FTSE/JSE Financial Index fell 3.1% by the end of the month, but losses were more pronounced in the FTSE/JSE Industrial Index, which dove 5.5% by month end. Losses in the latter were driven by a sell-off in Naspers, following the announcement it would be selling 2% of its shareholding (bringing its stake in the firm to 31.2%) in Hong Kong-listed Tencent Holdings.

The FTSE/JSE Mid-cap Index declined 3.4% in March 2018, followed by a 1.3% drop in the FTSE/JSE Small-cap Index.

In the final week of March 2018, the FTSE/JSE Listed Property Index more than reversed its 4% gain experienced in the first half of the month due to losses in the Resilient stable. The Inflation-linked Bond Index (ILBI) fared poorly, plunging 4.8% in the same period.

The SA ten-year government bond yield rallied 15 basis points in March 2018 to 8.2%, on a decision by Moody's rating agency to lift SA's sovereign credit rating outlook from negative to stable, while SA cash posted a pedestrian 0.6% return in the corresponding period.

Chart 6: Local asset class returns (%)



Source: INET BFA, Momentum Investments, data up to 29 March 2018

The rand traded weaker against major currencies at the start of the month, due to the National Assembly's adoption of the Economic Freedom Fighters' motion for land expropriation without compensation. The looming threat against property rights continued to unsettle investors, leaving the rand 2.0% weaker against the US dollar and nearly 3% weaker against the euro by mid-month. The rand weakened by nearly 3% against the sterling mid-month due to a strengthening in the sterling on comments by the chief Brexit negotiator for the European Union that Brexit talks had reached a decisive step and a large part of the final exit treaty had been settled.

Moody's favourable review buoyed the local currency towards the end of March 2018, but a 25 basis point interest rate cut by the SA Reserve Bank saw the rand sell off in the final week of March 2018.

Indices summary for March 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)	-4.18%	-5.97%	9.60%	5.05%	6.87%	10.02%	12.01%	11.35%	9.67%
FTSE/JSE Shareholder Weighted Index (SWIX)	-5.00%	-6.76%	9.41%	4.50%	7.66%	10.83%	12.62%	12.48%	10.93%
FTSE/JSE Capped SWIX All Share index	-3.90%	-5.08%	8.03%	3.85%	7.11%	10.38%	12.24%		
FTSE/JSE All Share Top 40 Index	-4.28%	-6.32%	10.97%	4.90%	6.21%	9.84%	11.89%	10.90%	8.99%
FTSE/JSE Mid Cap Index	-3.42%	-3.63%	2.31%	4.11%	9.29%	9.82%	11.50%	12.84%	13.62%
FTSE/JSE Small Cap Index	-1.33%	-1.27%	-2.77%	4.61%	8.02%	10.71%	13.16%	13.82%	11.12%
FTSE/JSE Resources Index	-2.08%	-3.83%	10.44%	-1.33%	-7.27%	-2.49%	-2.05%	-3.53%	-2.96%
FTSE/JSE Financials Index	-3.10%	-3.56%	17.58%	4.66%	11.21%	12.78%	15.43%	16.10%	13.73%
FTSE/JSE Industrials Index	-5.53%	-7.99%	5.70%	4.77%	8.91%	12.48%	16.02%	16.71%	15.92%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-3.20%	-2.13%	13.44%	7.09%	6.44%	9.43%	10.98%	10.43%	10.23%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-2.96%	-2.51%	12.45%	6.56%	6.37%	9.08%	10.75%	10.08%	9.71%
FTSE/JSE SA Listed Property Index (SAPY)	-0.96%	-19.61%	-7.09%	-0.48%	8.66%	7.11%	11.63%	12.83%	13.70%
Interest-bearing indices									
BEASSA All Bond Index (ALBI)	2.07%	8.06%	16.23%	8.65%	9.58%	7.72%	8.81%	9.42%	9.63%
BEASSA All Bond Index 1-3 years (ALBI)	0.43%	2.62%	9.65%	8.19%	7.98%	7.21%	7.20%	7.56%	8.18%
Barclays BEASSA SA Government ILB Index	4.92%	3.98%	6.09%	5.57%	6.56%	5.34%	7.41%	8.43%	8.67%
Short-term Fixed Interest Composite Index (SteFI)	0.60%	1.76%	7.45%	7.22%	6.94%	6.60%	6.40%	6.30%	7.04%
Commodities									
NewGold Exchange-Traded Fund	1.33%	-1.81%	-6.15%	2.45%	3.26%	0.89%	3.11%	6.64%	7.06%
Gold price (in rands)	1.20%	-2.20%	-4.00%	2.76%	3.52%	1.24%	3.50%	7.00%	7.56%
Platinum Exchange-Traded Fund	-4.92%	-4.02%	-13.54%	-7.73%	-7.99%	-3.83%			
Platinum price (in rands)	-4.82%	-4.40%	-13.48%	-7.43%	-7.37%	-6.24%	-5.87%	-7.44%	-5.53%
Currency movements									
Rand/euro movements	1.17%	-1.98%	1.48%	3.84%	0.12%	4.33%	6.09%	6.15%	1.26%
Rand/dollar movements	0.46%	-4.28%	-11.65%	-0.72%	3.02%	5.24%	7.51%	8.36%	3.85%
Inflation index									
Consumer Price Index (CPI)			4.03%	5.77%	5.30%	5.43%	5.49%	5.58%	5.79%
Global indices									
MSCI World Index (All Countries)	-2.79%	-5.44%	0.60%	6.84%	10.69%	14.76%	17.39%	16.64%	8.56%
MSCI Developed Markets Index	-2.65%	-6.39%	-0.58%	6.86%	10.46%	15.24%	18.14%	17.57%	9.87%
MSCI Emerging Markets Index	-2.93%	-2.65%	10.23%	8.19%	10.11%	10.52%	12.44%		
Global Property Research (GPR) 250 REIT Index	3.78%	-13.76%	-22.44%	0.17%	12.29%	16.20%	23.96%	25.97%	12.86%
MSCI Africa Index	-5.79%	-7.85%	8.74%	0.05%	3.61%	6.68%	8.21%	7.86%	4.96%
Citigroup World Government Bond Index	2.23%	-1.50%	-4.25%	2.70%	4.22%	6.56%	8.49%	9.73%	5.67%
Three-month US dollar LIBOR rate	0.66%	-3.80%	-10.29%	0.22%	3.79%	5.93%	8.17%	8.76%	4.64%
Three-month Euro LIBOR rate	1.14%	-2.07%	1.10%	3.57%	-0.03%	4.25%	6.06%		

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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