momentum investments

September 2018

Economies at a glance

01 United States

Tax cuts and **firm consumer dynamics** are behind **strong late cycle growth**. An economic **downturn is expected in 2020**, as the fiscal contribution to growth becomes negative and the escalation in trade tensions dents activity. A **tight labour market**, a rebound in surveyed inflation expectations and pipeline producer prices point to a further **rise in inflation**, but technological advances and ongoing gradual policy tightening should prevent it from exceeding the Fed's 2% target on a sustainable basis. Monetary policy is expected to shift **beyond neutral** in upcoming quarters, before reversing course in 2020.

Forecast 2018:
GDP: 2.8%
Inflation: 2.6%
Forecast 2019:
GDP: 2.4%
Inflation: 2.2%

02 Eurozone

The economy hit a soft growth patch, but **falling unemployment** and an expected dip in inflation should underpin consumer spend, while **business sentiment** surveys remain **upbeat**. **Adverse trade measures** could, however, **weaken the external sector** and pose a risk to growth prospects. Underlying **price pressures** remain **subdued**, pointing to interest rate hikes towards the end of 2019 at the earliest. Growing **support for non-mainstream political parties** suggest mainstream parties may need to **reconsider their mandate** to survive in the longer run.

Forecast 2018:
GDP: 2.0%
Inflation: 1.6%
Forecast 2019:
GDP: 1.8%
Inflation: 1.7%

03 Emerging markets

Emerging markets are **facing increasing headwinds**, given their exposure to higher **energy prices, escalating trade concerns and tighter global financial conditions**. A threat to high foreign-denominated debt holdings, in a handful of vulnerable economies, has soured sentiment towards to the emerging market composite recently in fear of contagion effects. While **macro fragilities** in emerging economies have **lessened relative to previous crises**, it will be important to rebalance growth patterns to increase economic resilience against capital flows and exchange rate shocks in the long term.

Forecast 2018:
GDP: 4.8%
Inflation: 4.4%
Forecast 2019:
GDP: 5.0%
Inflation: 4.4%

04 South Africa

Greater political stability has been observed lately, but **constrained growth** remains a function of a slow reform agenda. Consumers appear to have passed the peak point of vulnerability, while corporates are still facing a **tough environment. Some fiscal slippage** is anticipated in the medium term, with the potential need for additional guarantees to fund ailing state-owned enterprises posing a risk to an otherwise stable sovereign rating projection. **Inflation** is expected to rise, but **remain within target**, allowing for a **shallow interest rate hiking** cycle.

Forecast 2018:
GDP: 0.8%
Inflation: 4.7%
Forecast 2019:
GDP: 1.8%
Inflation: 5.5%

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Your goal is our benchmark

Economies at a glance: United States

- The United States (US) Federal Reserve (Fed) continued its gradual cycle of interest rate hikes with another widely anticipated interest rate hike of 25 basis points in its September 2018 Federal Open Market Committee (FOMC) meeting.
- Momentum Investments expects four additional interest rate hikes between now and the end of 2019, given above-trend growth, a solid labour market and rising inflation.
- The US fiscal deficit is expected to widen further in the medium term on the back of tax reforms. Although businesses and consumers are likely to benefit in the short term, higher fiscal deficits threaten the outlook for the US government's already-extended debt ratio and rising interest rate burden.

Chart 1: Slight upward revision in the Fed's growth forecasts

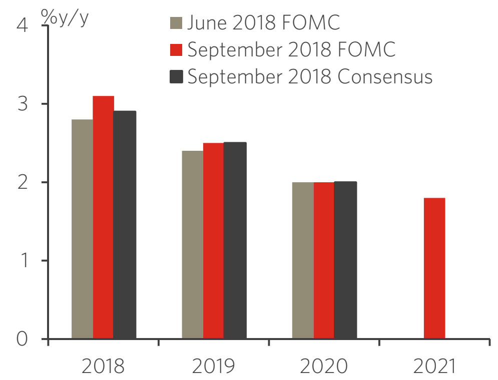


Chart 2: The Fed expects inflation to hover around the 2% target

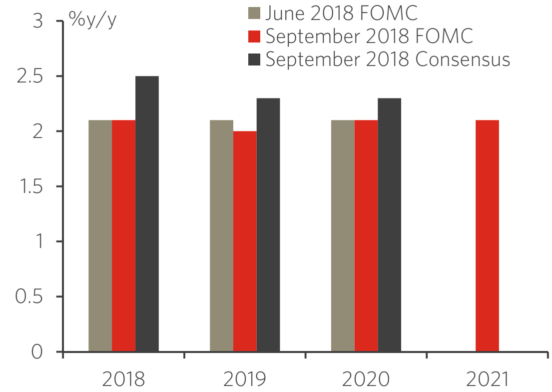


Chart 3: The Fed is more bullish about unemployment relative to the market

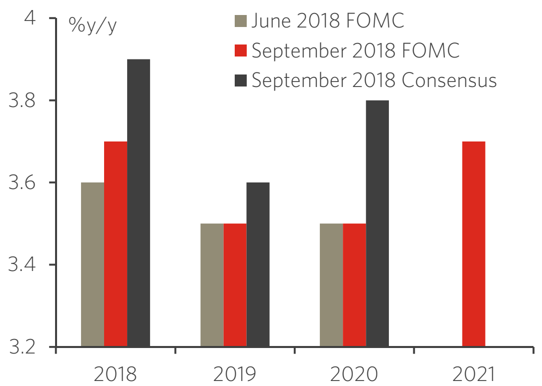


Chart 4: The US fiscal deficit is set to expand on tax reforms

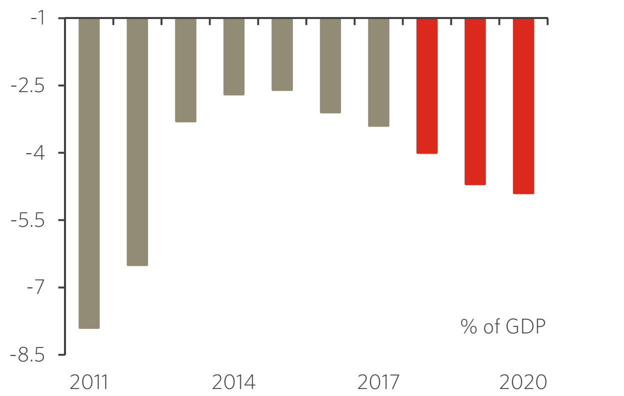


Chart 5: Fed remains more hawkish on its interest rate outlook relative to the market

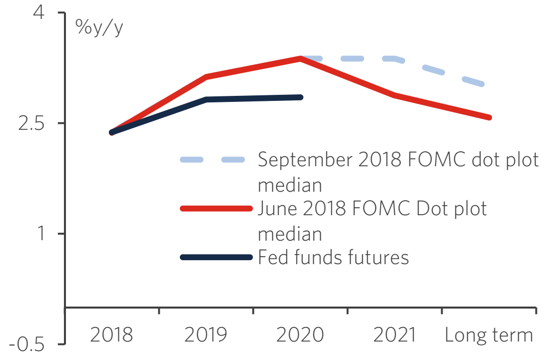
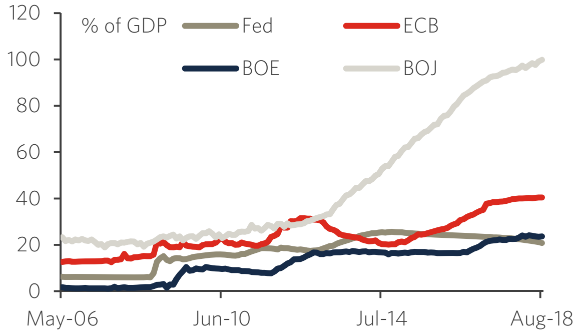


Chart 6: The Fed's balance sheet has been contracting in contrast to other major central banks



Source: Bloomberg, Federal Reserve Bank, Momentum Investments

Economies at a glance: Eurozone

- Growth forecasts show a deterioration ahead, but growth is still expected to track above 1.5% in the next three years. Inflation is expected to remain below the European Central Bank's (ECB) target of 2%, despite higher wage growth in response to a tighter labour market.
- The ECB has signalled net asset purchases will come to an end in the final quarter of 2018, but interest rates are only likely to increase towards the end of 2019 at the earliest.
- Momentum Investments expects the euro to strengthen relative to the dollar in due course, given growth, inflation and quantitative easing differentials, which are moving out of favour for the US.

Chart 1: The ECB expects softer growth ahead

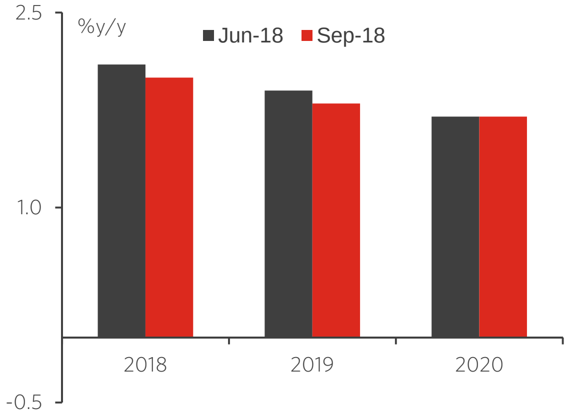


Chart 2: The ECB expects inflation to remain subdued

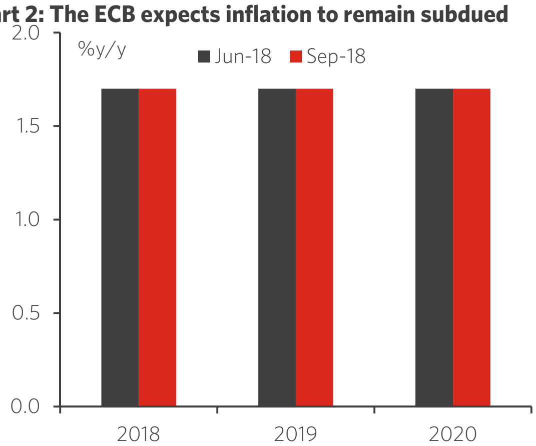


Chart 3: Professional forecasters expect growth to slow to around 1.5% and inflation to rise close to 2%

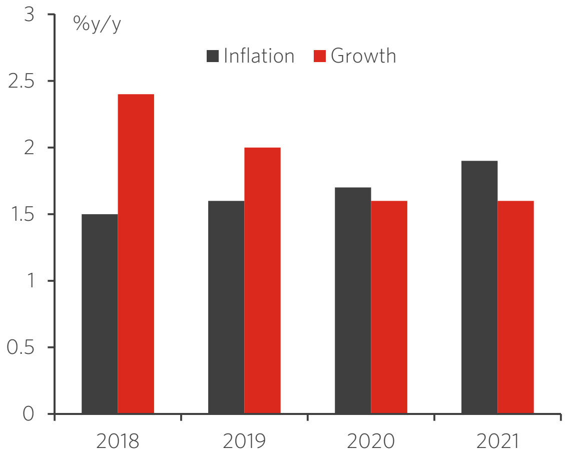


Chart 4: The ECB's balance sheet has increased to 40% of gross domestic product (GDP)

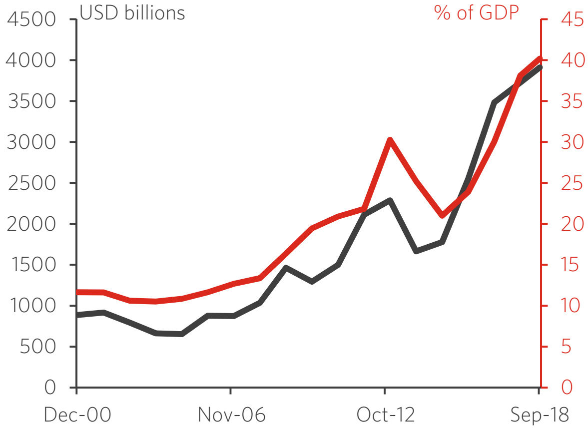


Chart 5: Futures market anticipating looser monetary policy by the ECB relative to the Fed

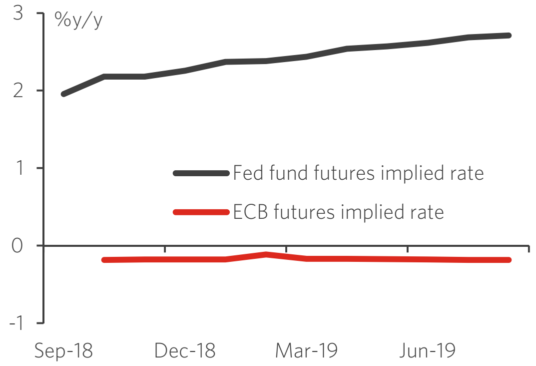
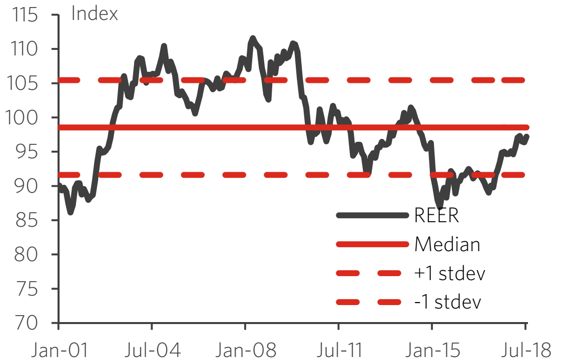


Chart 6: The euro is trading close to fair value on a real effective exchange rate (REER) basis



Source: Bloomberg, Bank of International Settlements, European Central Bank, Momentum Investments

Economies at a glance: Emerging Markets

- Higher energy prices and weaker currencies have caused inflation to tick higher across emerging markets. As a result, an erosion in growth in disposable incomes led to a moderation in consumer spend in the past few quarters.
- Forward-looking sentiment indicators in the manufacturing and services industries have softened, but above-50 prints suggest positive growth in activity is expected to persist.
- The latest export figures do not suggest the escalating trade tensions have had a major effect on trade flows as yet, but rising protectionist forces continue to pose a risk.

Chart 1: SA's economy is not growing fast enough to counter its population growth

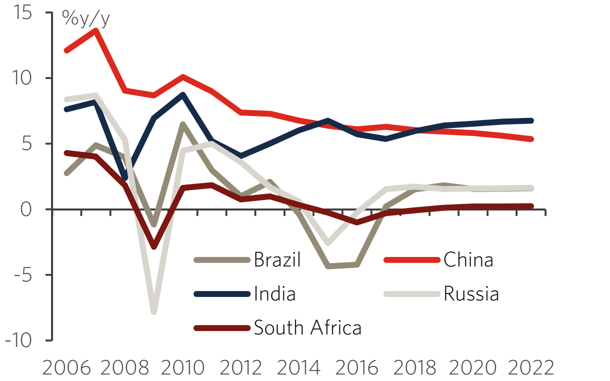


Chart 2: Growth in retail sales slumped, as higher inflation eroded real wage gains

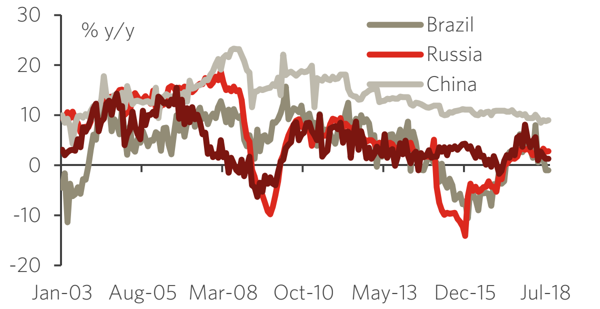


Chart 3: Manufacturing and services sentiment are off their recent highs, but remain above the neutral mark

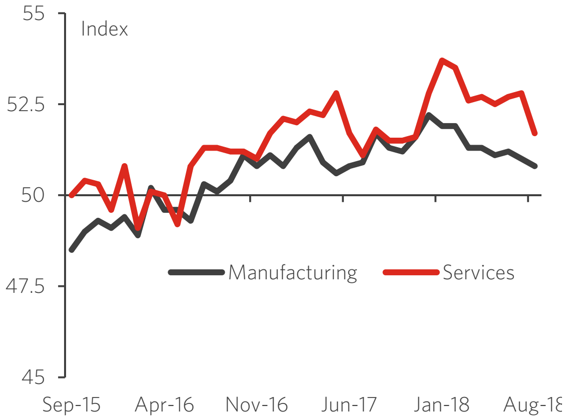


Chart 4: Only slightly negative growth surprises in emerging markets

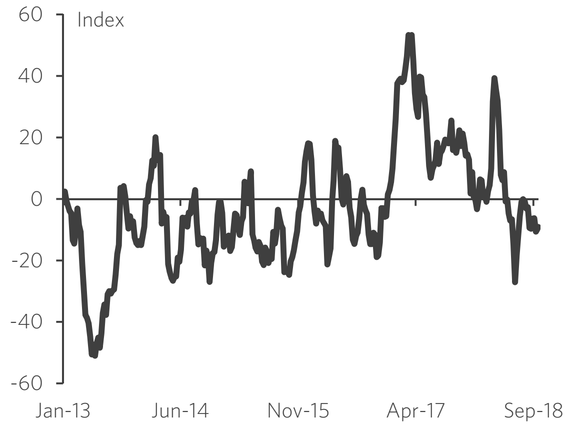


Chart 5: Export growth is holding up in spite of negative trade developments

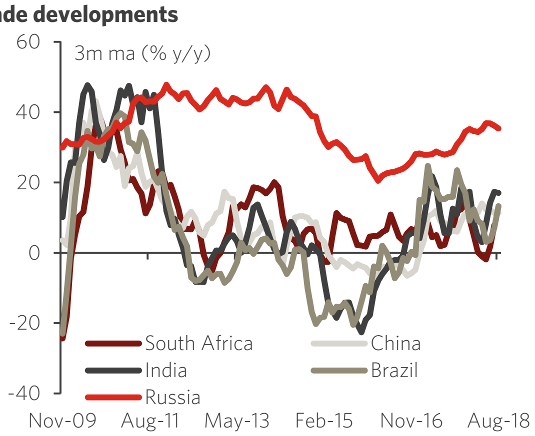
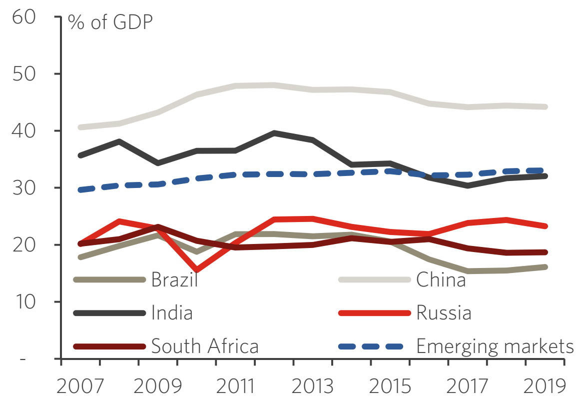


Chart 6: Investment remains muted



Source: Bloomberg, International Monetary Fund, Momentum Investments

Economies at a glance: South Africa

- A narrower current account deficit in the second quarter was driven by an improvement in the trade balance from a deficit to a surplus. The outlook for oil prices remains an important driver of the trade balance, given its 20% share of total South African (SA) imports.
- Intensifying trade wars between China and the US pose a threat to SA's export activity, given these two regions account for more than 40% of SA's exports by destination. Africa's growing share of SA's exports provides the country with an opportunity.
- Growing protectionism poses a threat to global trade activity. Weaker terms of trade, a slowdown in growth momentum in SA's main export destinations and little upside in SA's new export orders index suggest exports will provide limited support for growth in the near term.

Chart 1: Smaller current account driven by the trade balance's swing into surplus

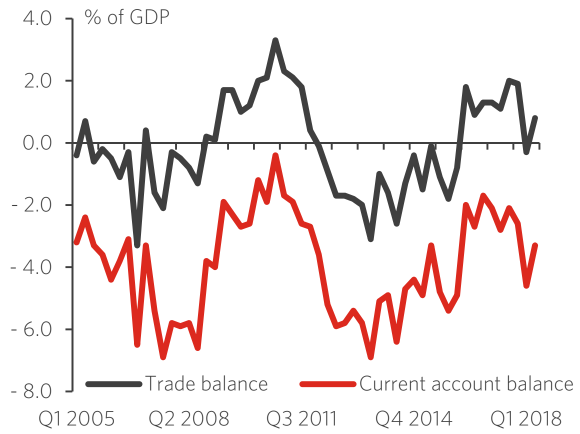
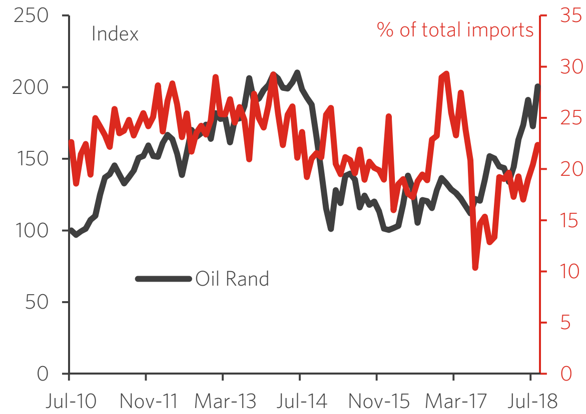


Chart 2: Oil accounts for a quarter of total SA imports*



*Data up to August 2018

Chart 3: Terms of trade deterioration evident

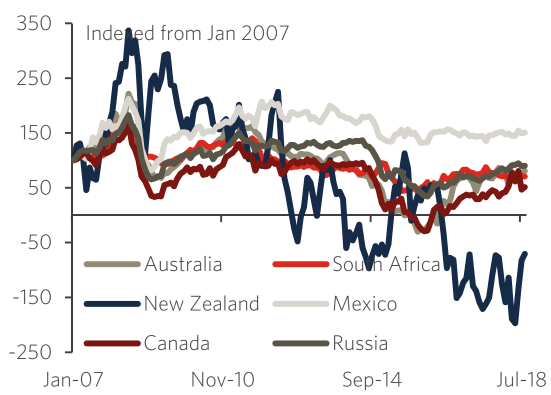


Chart 4: Asia remains SA's largest export destination

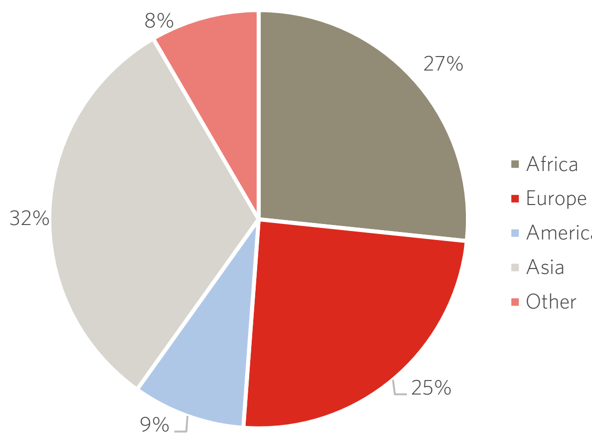
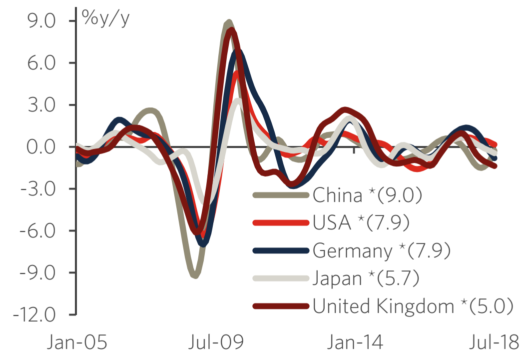
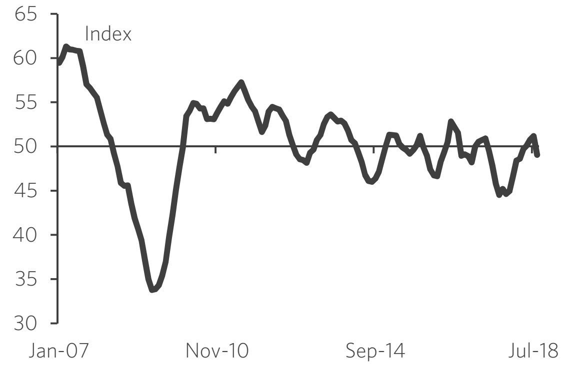


Chart 5: Five-largest exporting countries (bar India) show slowdown ahead, as lead indicator dips



* The share of total exports from SA

Chart 6: SA's new export orders are hovering around the neutral mark



Source: South African Revenue Services, OECD, Bloomberg, Momentum Investments

The macro research desk

Herman van Papendorp is the head of the Momentum Investments research and insights team and takes ultimate responsibility for macro research and asset allocation. Economist, Sanisha Packirisamy, is responsible for providing a macro framework to inform investment opportunities and strategies. Roberta Noise has recently joined the team as an economic analyst.

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