Herman van Papendorp
Head of Investment Research & Asset Allocation

Sanisha Packirisamy
Economist

The Macro Research Desk

Economic and market snapshot for April 2019

Highlights

- United States (US): Higher inventories and lower imports contributed to a higher-than-expected growth print for the first quarter of 2019, but a resumption in imports and weak investment should lead growth lower from here.
- Euro area: A further slump in consumer and business sentiment is reflective of ongoing economic troubles.
- United Kingdom (UK): Political uncertainty continues to disrupt business plans, but firms have indicated they are implementing contingency plans in case of a 'no-deal' Brexit.
- China: There are tentative signs of an improvement in economic conditions, but a major rebound is not expected due to the nature of the targeted stimulus response implemented by Chinese authorities.
- South Africa (SA): Households are feeling the pain of previous tax and tariff increases. Although credit growth is improving off its lows, consumer spend is likely to remain soft in the near term.

Global economic developments

US

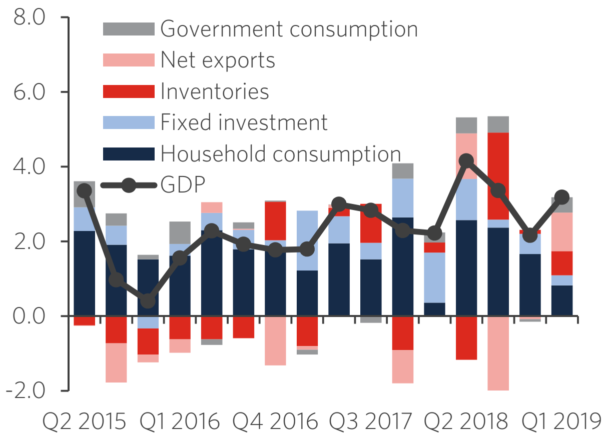
Higher inventories and lower imports contributed to a higher-than-expected growth print

According to the Bureau of Economic Analysis (BEA), the initial estimate for growth in US economic activity increased by 3.2% in the first quarter of 2019 (in quarter-on-quarter (q/q) annualised terms). This print positively surprised consensus, which anticipated a milder increase of 2.0%. The upside surprise in growth came from a higher-than-expected contribution from next exports (due to weakness in imports) and gains in inventories. The BEA estimated the direct effects of the government shutdown shaved off 0.3% from growth in the first quarter of the year.

Net exports contributed to a third of overall growth in the first quarter of the year, after subtracting from growth in the previous two quarters (see chart 1).

Exports grew by 3.7% in q/q seasonally-adjusted terms, while imports experienced a 3.7% annualised decline in the same period. A sharp dip in imports from China contributed to headline imports dropping in the first quarter of the year.

Chart 1: Contribution to US growth (% q/q saar)



Source: BEA, Momentum Investments

Based on softer growth projections for exports (due to unfavourable trade developments), the Bloomberg consensus expects a further deterioration in the current account to 2.8% by 2021. The forward-looking ISM indicators for export orders are pointing to more stress in the near term, while forward-looking import measures indicate a reversal back into positive growth territory. Cumulatively, this should contribute to a further widening in the current account gap. The current account deficit in the US widened to its highest level (US$134.4 billion) in ten years in the fourth quarter of 2018. This was equivalent to a current account balance of negative 2.6% as a share of gross domestic product (GDP).

Despite the expectation for a drop in inventories, the category contributed positively to GDP for a third consecutive quarter. This larger-than-expected build-up in inventories, however, makes a stronger case for a reversal in the second quarter of 2019 and could detract from near-term growth prospects.

Growth in real consumption disappointed at 1.0% q/q annualised in the first quarter of the year. According to Capital Economics, this could largely be linked to the knock to net household wealth from lower equity prices in the final quarter of 2018. Nevertheless, household spend should recover in the second quarter of the year in line with a recovery in equity prices, a healthy pace of employment creation (an average of 180 000 jobs were created in the past three months) and robust consumer confidence, which, according to the University of Michigan Consumer Sentiment Index, remains above the long-term average of 86.2 points at 97.2.

Although business investment climbed 2.7% in the first quarter of the year, the increase was largely owing to sharp growth (8.6%) in intellectual property products, while investment in structures fell 0.8%. Growth in residential investment declined for a fifth consecutive quarter. Forward-looking indicators illustrate further weakness in investment in the US. Housing stats dropped 0.3% in March 2019 relative to expectations of a rise to 6.5% and existing home sales fell by the most since 2015, both pointing to ongoing weakness in residential investment. Meanwhile, capacity utilisation dipped to 78.9% in the first quarter of the year (below its long-term average of 80.2%), which lessens the need for firms to invest.

The Bloomberg consensus expects growth in the US to soften to 2.5% in the second quarter of the year. This view is premised on the anticipated increase in household spend being insufficient to offset a slowdown in private investment and exports as well as a resumption in imports. Although the second quarter growth estimate dipped from 2.8% in December 2019 to 2.5% in the latest data for April, the growth expectation for 2019 as a whole still registered at 2.4%, in line with projections made a year earlier.

Euro area

Waning consumer and business sentiment is reflective of ongoing weakness in the economy

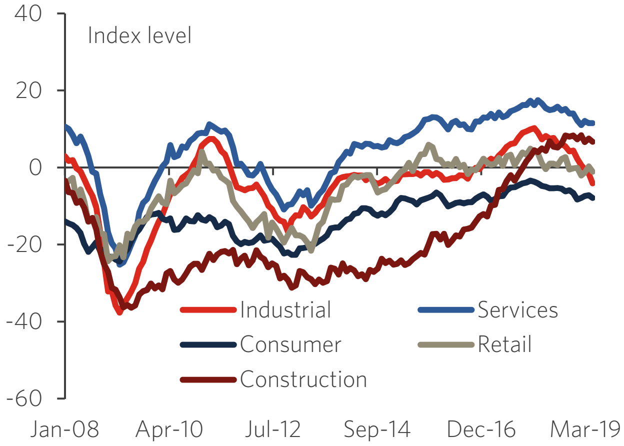
The European Commission's (EC) Economic Sentiment Indicator fell from its previous peak of 114.5 points in December 2018 to 104 in April 2019, indicating the region's struggle to recover from its recent slump in growth.

The index, which measures the mood of consumers and businesses in the Eurozone, fell to its lowest level observed since September 2016. The EC confirmed the deterioration in sentiment could be attributed to lower confidence in industry (order books and production expectations in particular) and retail trade, but, also to a lesser extent, less optimism among construction firms and consumers. Meanwhile, sentiment remained unchanged in the services sector due to brighter demand expectations.

From the contributing sectors, the largest deterioration was in the industrial sector, which sank to levels last seen in September 2014 (see chart 2). This likely relates to softening economic activity in the global economy. The Markit Purchasing Managers' Index (PMI) for the Euro area trended below the neutral 50 mark for the third consecutive month in April 2019 at 47.8 points and reflected continued negative sentiment in the industrial sectors of the economy.

Underlying growth data indicate growth in economic activity will remain muted in upcoming quarters. Exports to all major markets slowed and projected growth in the Euro area's main trading partners points to little chance of a major rebound.

Chart 2: Moderating sentiment in the Euro area



Source: EC, Momentum Investments

Although growth in domestic demand performed better than exports, employment surveys and an increase in household savings (in response to rising uncertainty) highlight a less favourable environment for consumers.

In addition to lingering trade tensions, a slight decline in capacity utilisation in the Euro area to 82.8% could further discourage investment by the private sector. Moreover, corporate lending growth slowed to 3.5% in March 2019 from 4.3% in September 2018. The European Central Bank's (ECB) latest survey on bank lending pointed to a reduction in appetite for debt. The percentage of banks reporting an increase in the demand for loans to businesses dropped worryingly from 9% to 0%.

Against this backdrop, Momentum Investments expects growth in the Euro area to sink from 1.9% in 2018 to 1.1% in 2019. Lacklustre growth and subdued inflation substantiates the ECB's decision to keep interest rates on hold for the remainder of 2019 and backs its announcement to provide another round of ultra-cheap loans.

UK

Firms have indicated they are implementing contingency plans in case of a 'no-deal' Brexit

According to the latest March 2019 survey (conducted between November 2018 and January 2019), the Decision Maker Panel (which includes members of the Bank of England (BoE) and academics from Stanford University and the University of Nottingham) pointed out that 54% of businesses reported Brexit as one of the top three sources of uncertainty. This reading is the highest on record since the survey was launched in August 2016. The survey confirmed firms, which viewed Brexit as being an important source of uncertainty, have typically spent less on fixed investment since the referendum than those firms that worried less about the potential effects of Brexit. Companies that viewed Brexit as a key uncertainty reported investment of 5% lower than a year ago in the third quarter of 2018, compared to growth of 10% by firms that were less fazed by Brexit uncertainty.

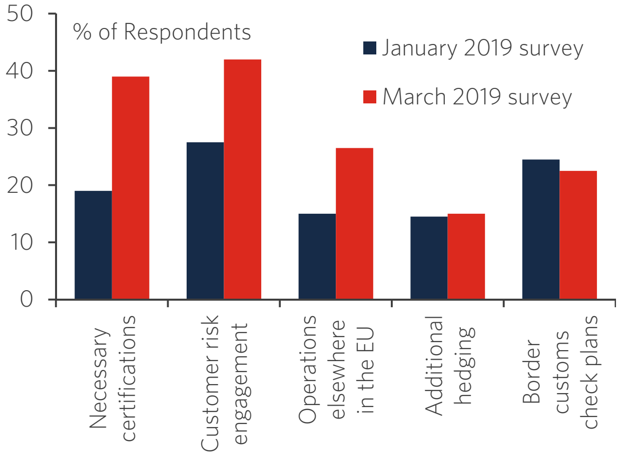
Future investment prospects may further be affected by Brexit. The survey noted the probability of Brexit increasing investment spending in the following year was estimated at 8%, while there was a 33% chance cutbacks would be made to capital spend and a 59% chance investment plans would remain unchanged.

The amount of time spent planning for Brexit has also increased. The share of chief financial officers spending more than one hour a week on Brexit planning increased from 21% in the first-quarter results for 2018 to 43% for the first-quarter results for 2019.

The BoE agents' summary of business conditions for the first quarter of 2019 (which surveys around 300 businesses) highlighted that two thirds of respondents had started implementing contingency plans for a 'no-deal, no-transition Brexit'. Of this portion, around 40% of respondents indicated they were applying for certifications that may be needed to continue trading with the European Union even after Brexit (see chart 3).

A similar share is engaging with customers directly to manage risks. Meanwhile, around a quarter is either planning to or already carrying out the setting up of operations elsewhere.

Chart 3: Firms putting contingency actions in place



Source: BoE, Momentum Investments

Despite an increase in contingency planning, firms have acknowledged there is a limit to planning for Brexit, particularly with regards to tariff issues, border frictions, movements of exchange rates and the recognition of certifications. These uncertainties have continued to weigh negatively on business sentiment and growth. The latest extension to Brexit to 31 October 2019 could prolong uncertainty for businesses and could keep a lid on investment projects in Momentum Investments' view.

China

Signs that economic conditions have improved recently, but a major rebound is not expected

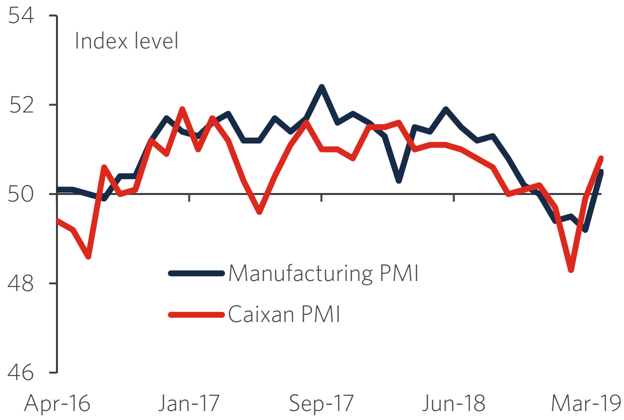
Chinese policymakers have implemented measures to spur household consumption, where spend has slowed recently, particularly for purchases of property and cars. These measures included lifting the personal income tax threshold in October 2018 and expanding individual tax deductibles (to education, health treatment, interest on mortgages, rent and elderly care) in January 2019.

Growth in fixed investment staged a mild recovery in March 2019 on the back of front-loaded local government bond issuance. Investment in real estate continued to grow at around 10% during the past three months on average, relative to a year ago, while spend on infrastructure was slower at around 5% for the same period.

Manufacturing sentiment rebounded in March 2019. The Caixan Purchasing Managers' Index (PMI), which focuses on smaller firms, increased to 50.8 points from a previous low of 48.3 points in January 2019. Meanwhile, the official PMI rose to 50.5 in March 2019 from February's three-year low of 49.2 points.

The ease in trade tensions between the US and China in recent weeks has buoyed hopes for a positive deal. However, in Momentum Investments' opinion, export growth is unlikely to recover strongly given weaker demand in China's key trading partners.

Chart 4: Tentative recovery in Chinese manufacturing sentiment



Source: CEIC, Momentum Investments

It is likely the People's Bank of China (PBoC) will respond to slowing economic activity by providing additional policy support in the coming months. The PBoC has cut the reserve requirement ratio from 17% at the beginning of 2018 to 13.5%, but further cuts could be on the cards. While the additional loosening of monetary policy could feed through into higher credit growth (which looked to be tentatively bottoming in March 2019), officials have taken a smaller-scale and more targeted approach to policy support this time around. As such, Momentum Investments is not expecting a significant rebound in either credit or economic activity.

Local economic developments

Consumer spend is likely to remain constrained in the near term

Household consumption as a share of GDP rose from a trough of 41% in the third quarter of 1967 to a peak of 62% in the final quarter of 2018. However, growth in consumer spend has been tracking below its longer-term average of 3.5% since the beginning of 2013. In the latest print, for the fourth quarter of 2018, growth in consumption slowed to 1.3%.

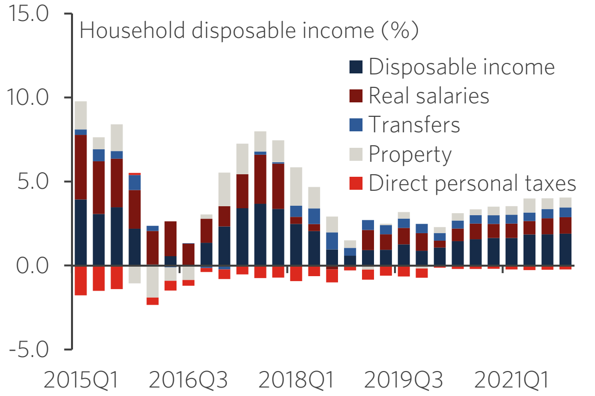
Growth in all four of the contributing sectors underperformed their long-term averages in the final quarter of 2018. Consumer spend on services (which accounted for 43% of total consumer spend in the fourth quarter of 2018 – the highest on record) grew at 1.6% relative to the long-term average of 4.1%. Spend on non-durables, which includes food and fuel, accounted for 37% of spend in the same period and grew at 1.1% in the final quarter of 2018, which was below its long-term average of 2.8%. Spend on durables (cars and furniture) and semi-durables (clothing and footwear) accounted for a fifth of total consumer spend in the corresponding period and grew at 0.7% and 1% in the fourth quarter of 2018, relative to their respective longer-term averages of 2.8% and 4.6%.

Consumer confidence dropped to two index points in the first quarter of the year from seven points in the previous quarter, but plunged 24 points relative to the reading taken a year before. While load shedding may have contributed to the dip in sentiment (the survey was conducted between 4 and 25 March, when load shedding intensified), other factors have also been weighing on the consumer.

Growth in real wages has slowed in recent quarters. According to the SA Reserve Bank (SARB), remuneration in the public sector averaged 8.5% since 1998 (2.7% in real terms). The latest data for 2018 showed a sharp decline in real public sector wage growth to 0.1%. Similarly, remuneration for workers in the private sector averaged 9% for the same period (3.3% in real terms), but slowed to 0.1% in real terms in 2018. Data from the Andrew Levy Employment Publications, however, show a brighter picture, with real wage growth averaging 2.6% in 2018.

The SARB indicates direct personal taxes have been detracting from disposable income since 2015, but expects this to lessen in 2020 (see chart 5).
Higher tariffs on electricity and an escalation in indirect taxes have placed further pressure on disposable income growth.

Chart 5: Downward revision in SARB's real GDP growth forecasts (% y/y)



Source: SARB, Momentum Investments, forecasts between 2019 and 2021

Growth in household net wealth remains positive, though it has slowed significantly relative to its long-term average. While a recovery in household credit could support spend at the margin, consumer spend is likely to remain constrained in the near term.

Financial market performance

Global markets

The rally in global equity markets continued in April 2019, following a strong (12.2%) first quarter of the year. The MSCI All Country World Index rose 3.4% in the month despite downgrades by the International Monetary Fund to world growth estimates from 3.5% in January 2019 to 3.3% in its April 2019 World Economic Outlook. Similarly, the CBOE Volatility

Index ignored fears of softer global growth prospects and declined to 12 points intra-month, before inching up one point by the end of the month. Investors found comfort in ongoing trade talks between the US and China. Media reports suggested a deal would be made, in which Beijing would be granted until 2025 to step up its commodity purchases (mostly soybeans and energy products) from the US, while the US would be allowed to wholly own enterprises in China.

Gains in developed equity markets drove global equities higher in April 2019. The MSCI Developed Market (DM) Index finished the month 3.5% higher, followed by a 2.1% gain in the MSCI Emerging Market (EM) Index. European and Japanese stocks were the star performers within the MSCI DM Index in the month. The Nikkei 225 Index jumped 5.0% higher in April 2019 on the back of a pledge by the Bank of Japan (BoJ) to keep interest rates at ultra-low levels for at least one more year. BoJ Governor Haruhiko Kuroda qualified this comment by adding "the timeframe could be much longer than that" in the event of weaker growth outcomes.

The Eurostoxx 50 climbed by a similar 5.5% in the month, despite weaker industrial data out of Germany and France, which emphasised the Euro area's vulnerability to a slowdown in global demand and milder growth forecasts in the region's key trading partners. The market also shrugged off reports of US President Donald Trump promising retaliation with regards to tariffs on a number of items from the Euro area, including passenger helicopters, cheese, wine and motorcycles.

Dovish rhetoric at the ECB press conference early in the month, which guided towards steady interest rates at record lows for the remainder of the year, buoyed European markets. ECB President Mario Draghi acknowledged geopolitical and trade uncertainties, which continued to hit the Euro area and weak data, particularly in the manufacturing sector, were likely to extend into the current year. Draghi noted "significant monetary policy stimulus is being provided by our forward guidance on key ECB rates, reinforced by the reinvestments of the sizeable stock of acquired assets and the new series of targeted long-term refinancing operations (TLTROs)". The ECB guaranteed this ultra-accommodative monetary policy stance would persist "for as long as necessary to ensure the sustained convergence of inflation to our objective".

The S&P 500 Index lagged at 4.5% in the month. Economic data remained supportive of the index, with a positive surprise on jobs growth of 196 000 in March 2019 and a higher-than-anticipated initial estimate on GDP growth in the US. Moreover, the Federal Reserve minutes indicated rates should be on hold for the remainder of the year. At the time of writing, around 80% of the companies on the S&P 500 Index, which reported results, exceeded market estimates. This left the market ending comfortably in the black for the month.

DM government bond yields rose marginally in the month. The US 10-year government bond yield nudged 10 basis points higher to 2.5% by the end of April 2019, while the German 10-year government bond yield moved up by 5 points to 0% in the same period.

EM equities were supported by strong returns in the MSCI Europe, Middle East and African (EMEA) Index. The MSCI EMEA Index was helped along by a strong return from Russian equities. Despite sanctions on its most significant companies in the banking and natural gas industries, the rise in the oil price benefited the equity composite.

Unplanned supply cuts from Venezuela and Libya (due to an ongoing economic crisis and renewed conflict, respectively) as well as the US's decision to end waivers on sanctions on Iranian oil caused the price of Brent crude oil to reach an intra-month high of US$75/bbl. Trump warned countries that continue to import Iranian Oil (China, India, Japan, South Korea and Turkey) could face penalties. Additionally, the Organisation of the Petroleum Exporting Countries (OPEC) will only be meeting in June to decide on whether to extend supply cuts. The oil price retraced towards the end of the month on news from the US Energy Information Administration (EIA), which reported that US crude oil production rose to

12.2 million barrels per day (bpd), making the country the world's largest oil producer (ahead of Russia and Saudi Arabia). This helped put a lid on oil prices in the month.

The MSCI Latin American Index ended the month 0.4% higher. The market flattened towards month-end on fears of further obstacles, which lie ahead for pension reform in spite of the Constitutional and Legal Affairs Committee's vote that successfully approved the constitutionality of the pension reform bill.

The MSCI Asian index lagged the MSCI EM Index at 1.8% for April 2019. The market peaked intra-month after reports that China had grown by 6.4% in the first quarter of the year, marginally higher than consensus forecasts for growth of 6.3%. This suggested tax cuts and supportive monetary policy measures were positively affecting the economy. Gains were, however, capped by negative news of a surge in bad debts at small banks around the country.

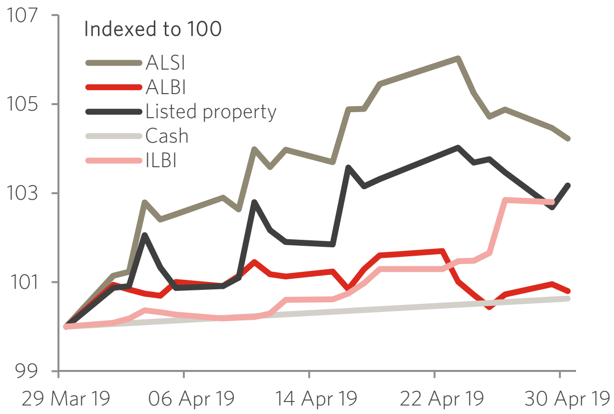
Sentiment towards EMs, in general, shifted marginally more positive in April 2019, with the JP Morgan EM Bond Index (EMBI) spread stabilising in the month. Spreads for Argentina (48 basis points) and Turkey (6 basis points) deteriorated the most in the month, with the former reflecting concerns over the future of President Mauricio Macri's government against the backdrop of alarmingly high inflation and dull growth prospects. The largest improvements in spreads were observed in Romania (17 basis points lower) and Thailand (14 basis points lower).

In line with a slight narrowing in the EMBI spread, the JPMorgan EM Currency Index strengthened by 0.1% in the same period. Notable losses were made in the Turkish lira (6.6%), South Korean won (2.8%) and Argentine peso (2.0%), while the Mexican peso (2.5%) and Russian ruble (1.5%) strengthened.

Local markets

SA equities followed global markets higher in April 2019. The FTSE/JSE All-Share Index built on gains made in the first quarter of the year (8%) and rose by 4.2% in April 2019. Gains were firmest among industrial and financial shares, while resource shares retraced.

Chart 6: Returns from local asset classes (%)



Source: IRESS, Momentum Investments

The FTSE/JSE Industrials Index shot up 6.6% in the month, driven higher by rand hedges.
The FTSE/JSE Financials Index matched this return for the same period. The FTSE/JSE Resources Index bucked the trend and fell by 2.0% in the month. The US dollar price of gold fell to a four-month low late in April 2019, as investors shifted into riskier asset classes.
Palladium prices dipped 15% at its worst point in the month relative to the high in the middle of March 2019, while the price of platinum rose to its best level since June 2018.

The SA 10-year government bond yield barely budged in the month and remained relatively stable at 9.0%. The JSE ASSA All Bond Index shifted 0.8% higher in the month, while the JSE ASSA Government Inflation-linked Bond Index (ILBI) and the FTSE/JSE SA Listed Property Index outperformed at 2.8% and 3.2%, respectively. SA cash posted a 0.6% gain in the same period.

The SA rand was volatile in the month on movements in the US dollar and liquidity concerns over energy utility, Eskom. Nonetheless, the rand strengthened by 1.3% against the US dollar, 1.4% against the euro and 1.4% against the sterling by the end of April 2019. Likewise, the SA five-year corporate default swap (CDS) spread narrowed by 15 points in the month and around 35 points since the end of 2018.

Indices summary for April 2019

	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)	4.23%	9.47%	3.87%	6.55%	4.93%	6.83%	10.39%	11.20%	14.27%
FTSE/JSE Shareholder Weighted Index (SWIX)	5.72%	8.71%	1.76%	5.24%	3.81%	7.03%	10.35%	11.25%	14.59%
FTSE/JSE Capped SWIX All Share index	5.00%	6.11%	-1.67%	3.15%	2.35%	5.79%	9.31%	10.35%	
FTSE/JSE All Share Top 40 Index	4.58%	10.41%	4.96%	7.07%	5.07%	6.67%	10.60%	11.30%	14.11%
FTSE/JSE Mid Cap Index	2.64%	3.07%	-4.58%	1.43%	2.23%	6.05%	7.96%	9.18%	14.17%
FTSE/JSE Small Cap Index	4.82%	-0.79%	-13.48%	-3.02%	-0.94%	3.05%	6.26%	8.91%	12.76%
FTSE/JSE Resources Index	-2.05%	11.80%	27.61%	16.35%	5.40%	-0.27%	5.04%	2.58%	5.51%
FTSE/JSE Financials Index	6.55%	0.11%	-2.79%	5.14%	2.51%	8.09%	10.39%	12.74%	15.94%
FTSE/JSE Industrials Index	6.59%	13.50%	-2.47%	3.07%	3.18%	7.30%	10.82%	13.49%	18.03%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	3.60%	8.61%	4.99%	8.58%	5.95%	6.46%	10.26%	10.49%	14.11%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	3.69%	8.41%	4.20%	8.21%	5.57%	6.22%	9.79%	10.19%	13.65%
FTSE/JSE SA Listed Property Index (SAPY)	3.17%	-4.13%	-9.63%	-3.46%	-1.04%	5.80%	4.17%	9.06%	12.31%
Interest-bearing indices									
JSE ASSA All Bond Index (ALBI)	0.75%	1.64%	4.97%	9.70%	7.66%	8.42%	6.42%	7.86%	8.64%
JSE ASSA All Bond Index 1-3 years (ALBI)	0.83%	2.03%	9.24%	9.06%	8.35%	8.11%	7.36%	7.36%	7.62%
JSE ASSA SA Government ILB Index	3.47%	2.13%	2.51%	2.32%	3.21%	4.58%	3.93%	6.00%	7.27%
Short-term Fixed Interest Composite Index (SteFI)	0.63%	1.76%	7.27%	7.44%	7.25%	7.04%	6.74%	6.54%	6.58%
Commodities									
NewGold Exchange-Traded Fund	-2.15%	4.27%	11.75%	-0.36%	6.42%	5.77%	5.21%	4.89%	8.95%
Gold price (in rands)	-2.10%	4.31%	12.26%	0.22%	7.03%	6.24%	5.66%	5.31%	9.39%
Platinum Exchange-Traded Fund	3.72%	16.21%	11.91%	-6.04%	-2.07%	-3.75%	-2.45%		
Platinum price (in rands)	4.79%	18.57%	13.72%	-5.75%	-1.17%	-3.05%	-2.46%	-1.48%	0.67%
Currency movements									
Rand/euro movements	-0.84%	5.53%	6.53%	-0.37%	4.66%	1.92%	5.21%	6.62%	3.66%
Rand/dollar movements	-0.65%	8.06%	14.85%	0.36%	4.65%	6.36%	8.10%	9.18%	5.42%
Inflation index									
Consumer Price Index (CPI)			4.52%	4.82%	5.18%	4.95%	5.13%	5.25%	5.19%

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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