momentum
investments

The Macro Research Desk

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Economic and market snapshot for August 2017

Global economic developments

United States (US)

Government shutdown looms

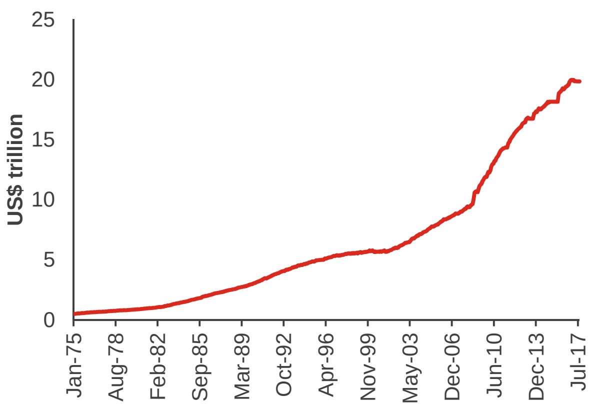
The Treasury projects the US debt limit will need to be raised by 29 September 2017. In addition to raising the borrowing capacity of the Treasury, Congress needs to complete the budget process for financial year 2018 (or pass a continuing resolution, which temporarily funds programmes and agencies) by 1 October 2017.

According to Barclays, the US federal government has experienced 18 funding gaps under the current budget process since 1976, although not all resulted in a shutdown of operations or furloughed workers. The US last endured a federal shutdown, triggered by demands over the Affordable Care Act, in 2013. During the 16-day shutdown, much of the federal workforce (around 800 000) were sent home, with the exception of air traffic controllers and military personnel. Standard and Poor's ratings agency subsequently concluded the shutdown effectively cost the economy $24 billion.

Although Republicans control the executive and the legislative branches of government, history shows that funding gaps do not only coincide with a divided government.

Barclays estimates a brief (one-week) shutdown could knock 0.1% off real gross domestic product (GDP) growth in the fourth quarter of 2017. While this will hardly cripple the economy, it warns a longer shutdown could indirectly affect private sector activity. Barclays emphasises the negative consequences of failing to raise the debt ceiling (see chart 1). According to its calculations, this could require an immediate cut in spending, equating to 3.5% of GDP.

Chart 1: US federal debt has reached its $19.8 trillion cap



Source: Bloomberg, Momentum Investments

The Bipartisan Policy Centre points out that 23% of payments owed by government (including social security and military pay) could go unpaid if no further borrowing is allowed. A sharp decline of this nature would likely disrupt financial markets and have negative repercussions for the real economy.

In Momentum Investments' opinion, the need to address the debt limit could further delay debates over the details of tax reform, particularly if only a short-term extension is agreed upon.

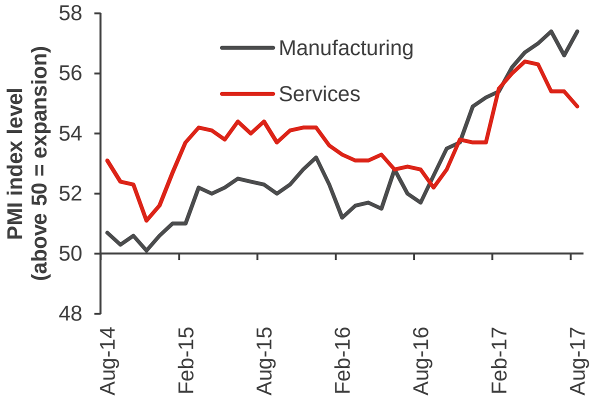
Eurozone

Economic recovery likely to have maintained its pace in the third quarter of 2017

The Eurozone composite Purchasing Managers' Index (PMI) rose from 55.7 index points to 55.8 in August 2017, coming in above market expectations for an unchanged reading.

The increase in the composite reading reflected an increase in the manufacturing index from 56.6 to 57.4 points for the corresponding period, while the services index slowed to a seven-month low of 54.9 points (see chart 2). According to Capital Economics, the overall PMI looks consistent with quarterly GDP growth remaining in line with the quarterly 0.6% rate experienced during the second quarter of the year.

Chart 2: Eurozone PMI firmly printing in expansion territory



Source: Bloomberg, Momentum Investments

The Governing Council notes the pass-through of monetary policy measures supporting domestic demand and facilitating deleveraging. Investment growth has benefited from a rise in corporate profitability, while financing conditions have remained favourable. In the household sector, consumption has grown in response to employment gains and increasing household wealth.

Though the ongoing global growth recovery should benefit Eurozone exports, Momentum Investments expects a firmer euro to temper export gains.

Positive cyclical momentum has driven the Bloomberg consensus real GDP growth forecast for the Eurozone in 2017 higher, to 2.0% in August 2017 from 1.2% a year ago. However, despite firmer growth expectations, the Bloomberg consensus forecast for headline inflation dropped to 1.5% in August 2017 from 1.7% in March earlier in the year.

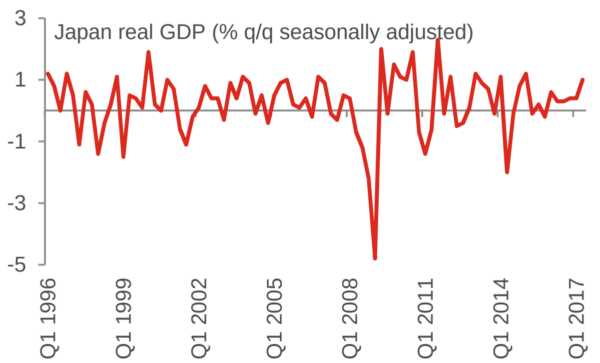
Without evidence of a sustained upturn in underlying inflation, it is likely the European Central Bank will only announce a tapering of its asset purchases (starting in the first half of 2018 from the current pace of €60 billion per month) in the fourth quarter of 2017.

Japan

Longest growth streak in more than a decade

Real GDP growth increased 1.0% in quarter-on-quarter terms (see chart 3) in the second quarter of 2017 (2% year on year (y/y)). This higher-than-expected GDP print represented the sixth consecutive quarter of positive growth in Japan, which is the longest positive streak since 2005/2006.

Chart 3: Longest growth streak in more than a decade



Source: Bloomberg, Momentum Investments

The GDP uptick was driven by firm private consumption and investment spend, while the surge in exports in the previous quarter faded somewhat in the second quarter of the year.

Business sentiment, at 50.6 index points in July 2017, remains around 4 points higher than the average recorded since 2000.

According to the Bank of Japan's July 2017 Tankan survey, large companies across all industries plan to raise fixed investment by 8% for the year through to March 2018.

Unemployment at a multi-decade low and a slight acceleration in real wage gains continue to underpin the Japanese consumer. Nevertheless, structural labour market issues (the increase in temporary workers and sticky full-time wage growth) have prevented the improvement in overall activity from translating into meaningfully faster wage growth.

With inflation pressures remaining subdued, Momentum Investments expects monetary accommodation to persist for the foreseeable future.

China

Growth deceleration expected at a gradual pace

Nominal GDP growth in China moderated in the second quarter of the year, but the first half of 2017 still managed to post the best growth rate since 2011 (see chart 4).

Chart 4: Nominal growth has likely reached a peak

Source: Bloomberg, Momentum Investments

Nevertheless, the widely anticipated slowdown in the Chinese property market has arrived. The y/y growth in floor space sold declined from 21% in June to 2% in July 2017.

Moreover, the growth rate in new starts recorded its first monthly decline in ten months.

Macquarie cautions sales frontloading and rising mortgage rates raise further risks to the property sector in upcoming months, which could extend well into 2018.

Formal credit growth, as captured by the M2 measure, weakened further to 9.2% y/y in July 2017. However, total social financing (a broader measure of financial activity, but which is also adjusted for local government debt swaps and foreign exchange purchases by the People's Bank of China) edged higher to 12.6% y/y for the corresponding period, suggesting that although a slowdown is anticipated in the second half of 2017, it is likely to be gradual. Additionally, the fiscal deficit continues to expand as government feeds infrastructure spending (fixed asset investment is currently growing at 8.3% y/y).

Even though the economy is expected to have passed the peak in its recovery, China is still operating above potential (seen at around 6%) and, as such, Momentum Investments does not expect a so-called 'hard landing' in the medium term.

Local economic developments

South African (SA) inflation drops sharply as expected

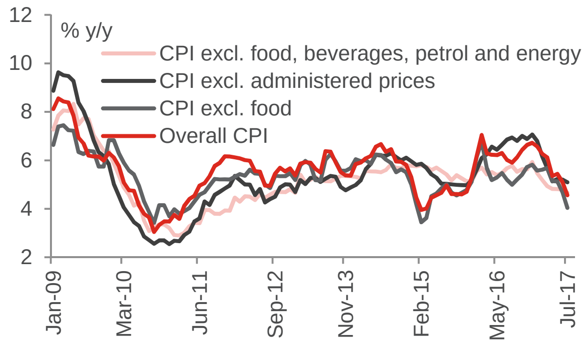
Consumer price inflation (CPI) plunged to 4.6% y/y in Stats SA's July 2017 inflation print, from 5.1% y/y in June, meeting the market's and Momentum Investments' expectations.

In addition to the usual monthly surveys, 36% of the basket (including funeral costs, home insurance, electricity, water tariffs and property rates) was surveyed. Relative to Momentum Investments' forecasts, monthly price increases for food (0.3%) and funeral costs (4.7%) surprised to the upside, while price increases came in below expectations for water tariffs (6.4%) and vehicles (0.2%).

Core inflation (headline excluding food, beverages and energy) declined from 4.8% y/y in June to 4.7% in July 2017, while headline inflation excluding the food category dropped to around 4% y/y in July 2017 (see chart 5). Disinflation in core goods has largely been responsible for the downward trend in overall core inflation, while core services inflation has persisted at higher levels.

If inflation continues to track lower in line with expectations and projections remain for inflation to stay well within the target band for the foreseeable future, this should create enough room for the SA Reserve Bank (SARB) to consider reducing interest rates further by a cumulative 50 basis points (two cuts of 25 basis points each) by the end of the first quarter of 2018.

Chart 5: Underlying inflation heads lower in SA



Source: Stats SA, Global Insight, Momentum Investments

The timing of the two additional interest rate cuts will likely depend on currency moves, in reaction to a potential rise in global risk aversion and domestic political developments.

Momentum Investments still expects the current interest rate cutting cycle to be comparatively shallow relative to previous cycles, given the lingering risk of further ratings downgrades (which could negatively affect currency and inflation expectations), ongoing political uncertainty, potential negative swings in emerging market (EM) sentiment and uncomfortably high domestic inflation expectations.

Financial market performance

Global markets

Global stock markets dropped in the second week of August 2017 on heated threats by North Korea to fire missiles over several Japanese islands and into international waters close to Guam, which hosts two major US military bases. The Chicago Board Options Exchange Volatility Index (CBOE VIX) rose to 16 points on the news, but fell back to 11 points by the end of August 2017. By month end, global equities closed 0.4% firmer, partly recouping earlier losses.

The MSCI Developed Markets Index finished broadly flat, as Japanese and European equity market returns disappointed. The S&P 500 Index traded in a narrow band during the month, ending 0.3% in the black. At its worst point, the S&P 500 dropped by 1.6% relative to the end of July 2017, in response to a terrorist attack in Barcelona and fears that President Donald Trump's strategy for the US economy (primarily tax cuts and deregulation) would not materialise, given rising speculation that Trump's main economic adviser was about to resign from his position.

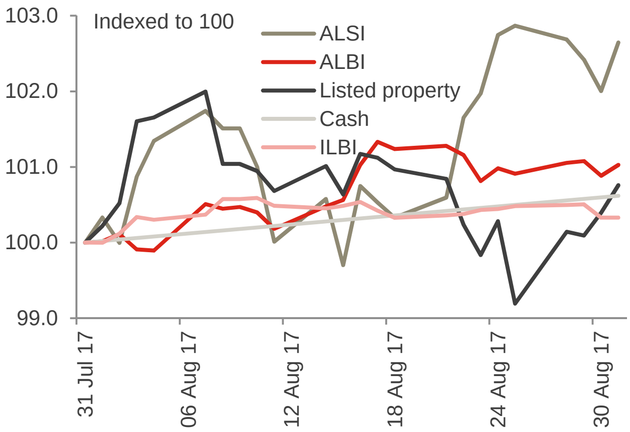
The Nikkei 225 Index grinded steadily lower throughout the month, ending August 2017 1.3% weaker, as a stronger yen weighed on exporters' profits. The Eurostoxx 50 followed suit, closing 0.7% weaker.

The MSCI EM Index outperformed developed markets, gaining 2.2% in August 2017. Gains were driven by a strong return from the MSCI Latin America Index (4.6%). The MSCI EMEA (Europe, Middle East and Africa) Index traded 4.4% firmer in the same period, followed by a 1.4% uptick in the MSCI Asia Index.

Local markets

The local equity market continued its upward trend, following robust gains in July 2017. The FTSE/JSE All Share Index rose 2.6% in August 2017 (see chart 6), helped by solid returns from resource shares.

Chart 6: Local asset class returns



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

The FTSE/JSE Resources Index rose 6.5% in the second half of the month, supported by higher metal prices. Metal prices surged late in the month on news that Chinese demand is holding up well, while measures to increase environmental controls and cut Chinese capacity were underway.

Interest-rate-sensitive stocks also pushed the market higher in August 2017, buoyed by hopes of additional monetary easing in response to a well-behaved currency and a steep drop in domestic inflation. The FTSE/JSE Financials and Industrials indices ended the month 2.1% and 2.0% firmer, respectively.

The FTSE/JSE Mid-cap Index posted a healthy 4.5% return in August 2017, while the FTSE/JSE Small-cap Index edged higher by a lesser 2.2%.

SA ten-year government bonds yields were range-bound in August 2017, edging three basis points lower by month end.

The Inflation-linked Bond Index (ILBI) ticked up 0.3% in August 2017, while the FTSE/JSE Listed Property Index outperformed on a relative basis at 0.8%. SA cash increased 0.6% in the same period.

At its worst point, the rand weakened 1.0% against the US dollar in the month, but ended the month 1.3% firmer. Compared with a basket of EM peers, the rand is still one of the best performers against the US dollar on a twelve-month rolling basis, second only to the Czech Koruna.

The rand traded 0.6% firmer against the euro and 3.4% stronger against the British pound in August 2017, as concerns over Britain's exit from the European Union and soggy economic data weighed on the latter.

Indices summary for August 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)	2.65%	6.04%	10.14%	6.56%	10.79%	13.10%	13.90%	14.32%	10.18%
FTSE/JSE Shareholder Weighted Index (SWIX)	2.42%	4.74%	7.92%	7.11%	11.91%	13.50%	14.77%	15.11%	11.13%
FTSE/JSE All Share Top 40 Index	2.57%	6.45%	10.91%	6.06%	10.36%	13.13%	13.66%	14.22%	9.78%
FTSE/JSE Mid Cap Index	4.52%	5.55%	3.37%	7.94%	12.07%	11.81%	14.14%	13.90%	12.27%
FTSE/JSE Small Cap Index	2.15%	0.06%	1.09%	6.91%	11.30%	13.96%	15.79%	15.30%	10.31%
FTSE/JSE Resources Index	5.10%	15.43%	17.31%	-10.08%	-3.88%	-1.18%	-2.17%	0.08%	-0.94%
FTSE/JSE Financials Index	2.05%	4.92%	10.57%	8.37%	13.86%	14.18%	17.01%	15.94%	10.80%
FTSE/JSE Industrials Index	1.96%	3.22%	7.96%	10.09%	13.76%	17.48%	19.87%	20.23%	15.83%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	3.70%	8.56%	15.71%	5.30%	9.72%	11.57%	12.31%	12.79%	10.16%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	3.70%	8.56%	15.57%	5.17%	9.38%	11.25%	12.01%	12.53%	9.59%
FTSE/JSE SA Listed Property Index (SAPY)	0.76%	4.79%	9.40%	13.02%	14.78%	11.65%	15.78%	15.60%	14.58%
Interest-bearing indices									
BEASSA All Bond Index (ALBI)	1.03%	1.58%	10.20%	6.65%	7.90%	6.31%	7.48%	7.69%	8.57%
BEASSA All Bond Index 1-3 years (ALBI)	0.82%	2.38%	9.82%	7.79%	7.47%	6.71%	6.97%	7.30%	8.11%
Barclays BEASSA SA Government ILB Index	0.17%	0.03%	0.25%	4.23%	6.79%	6.07%	7.30%	7.74%	9.30%
Short-term Fixed Interest Composite Index (SteFI)	0.62%	1.86%	7.66%	7.02%	6.65%	6.36%	6.24%	6.20%	7.22%
Commodities									
NewGold Exchange-Traded Fund	2.35%	2.41%	-11.54%	7.23%	4.16%	3.53%	4.65%	9.00%	13.03%
Gold price (in rands)	2.55%	2.79%	-10.40%	7.67%	4.50%	4.23%	5.03%	9.27%	13.55%
Platinum Exchange-Traded Fund	4.29%	3.44%	-16.80%	-5.68%	-2.31%				
Platinum price (in rands)	4.93%	4.78%	-15.96%	-5.06%	-2.10%	-4.95%	-2.76%	-3.50%	-0.72%
Currency movements									
Rand/euro movements	-0.73%	4.19%	-5.76%	3.33%	3.43%	7.78%	7.44%	7.40%	4.73%
Rand/dollar movements	-1.52%	-1.42%	-11.56%	6.92%	6.14%	9.05%	10.88%	8.44%	6.18%
Inflation index									
Consumer Price Index (CPI)			4.54%	5.18%	5.47%	5.65%	5.52%	5.48%	6.04%

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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