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Economic and market snapshot for January 2019

Highlights

- United States (US): The longest government shutdown in history is likely to erode growth in the first quarter of the year, but activity is expected to recover once government staff members return to work.
- Eurozone: Faltering economic sentiment, softer global growth, trade tensions and political uncertainty pose downside risks to the outlook for growth.
- United Kingdom (UK): Popular support for a no-deal Brexit has dipped, while support remains high for a Norway-style deal, where the UK exits, but remains in a customs union with Brussels and in the bloc's single market.
- China: Authorities remain committed to bringing down elevated debt levels, but have implemented measures to prevent a sharper slowdown in the economy through economic and regulatory reforms.
- South Africa (SA): Headline inflation dropped to the midpoint of the SA Reserve Bank's (SARB) 3% to 6% inflation target in December 2018 on account of a significant cut in fuel prices.

Global economic developments

US

Government shutdown to erode growth in the first quarter of the year, but activity expected to recover in the second quarter.

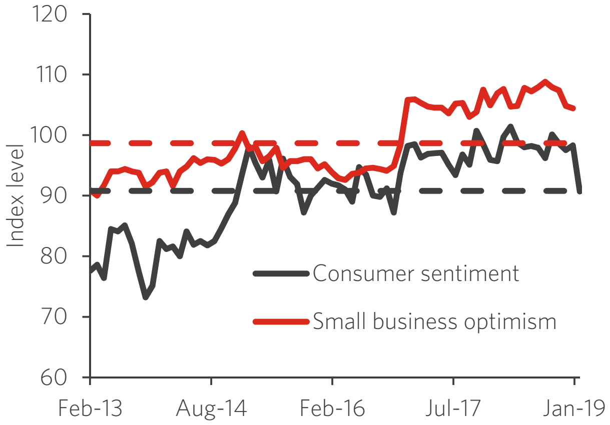
Following a 35-day stand-off, US President Donald Trump and Congress reached a deal to reopen the US government until 15 February 2019, to allow for more time to finalise negotiations over a spending bill.

Nowcast models, which incorporate a wide range of macroeconomic data as it becomes available, have been unable to calibrate more accurate forecasts for growth in gross domestic product (GDP), given the delays in the release of data due to the effects of the partial shutdown of the US federal government.

The Federal Reserve Bank of New York's (New York Fed) Nowcasting report predicts growth for the first quarter of the year at 2.2%, while the GDPNow estimate from the Atlanta Fed forecasts growth at 2.7%. The Bloomberg median consensus projection for the first-quarter growth print has remained unchanged since November 2018 at 3.1%. In contrast, Morgan Stanley suggests the 35-day government shutdown could shave 0.5% off the first-quarter print, given the shortage in staffing. This compares to a 0.13% weekly growth detraction estimated by the Financial Times, which is based on estimates developed by White House economists, which took account of the 800 000 furloughed (instructed not to report to work and not receiving pay) federal workers.

A bounce in growth is likely to follow, based on the experience of the 2013 government shutdown, in which more than 800 000 federal workers were furloughed for 16 days. Jobs growth and economic activity staged a firm recovery once government employees were back at work, but there is evidence of a knock-on effect to consumer spend. In a paper by Scott Baker called "Income changes and consumption: Evidence from the 2013 federal government shutdown", Baker noted the 2013 shutdown triggered a 10% to 15% drop in consumer spending by unpaid federal workers.

Chart 1: US shutdown has negatively affected sentiment



Source: Bloomberg, Momentum Investments

Early indications show that interruptions to services provided by the US government have had an effect on consumer and business confidence this time around. The University of Michigan Consumer Sentiment Index dipped from 98.3 points in December 2018 to 90.7 in January 2019, while the NFIB Small Business Optimism Index edged lower to 104.4 in December 2018 (see chart 1). The dip in confidence is, however, likely to be short-lived as federal government workers will get back pay and the spike in unemployment benefits should reverse.

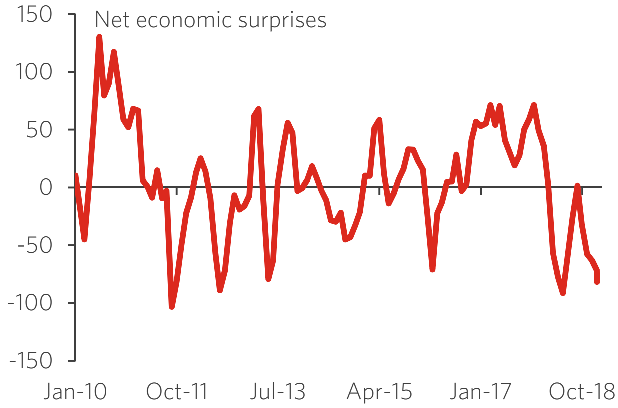
Momentum Investments expects growth in the US to average 2.4% for the year as a whole, taking account of a softer first quarter print and an expected rebound in the second quarter. Moreover, core inflation, remaining around the 2% target, should allow for further modest tightening in interest rates in the second half of the year. Monetary authorities are increasingly likely to focus on incoming data to determine their monetary policy decisions as interest rates approach neutral territory.

Eurozone

Faltering economic sentiment

Forecasts for the outlook for economic activity in the Eurozone are increasingly being threatened by low growth prospects, political tensions and trade conflict. The Citigroup Economic Surprise Index, which measures forecasts against realised data, registered a large disappointment in economic activity, almost comparable to the negative surprise registered in 2011 during the European Sovereign Debt Crisis (see chart 2).

Chart 2: Eurozone data is surprising to the downside



Source: Bloomberg, Momentum Investments, data to January 2019

Although the local economy should continue to recover in line with an acceleration in real income growth, still accommodative monetary policy, resilient labour markets and looser fiscal policy, the outlook for fixed investment has deteriorated given elevated levels of uncertainty, partly related to the Sino-US trade war. Moreover, the negative consequences of trade tensions will exacerbate weaker external demand.

The potential for a further escalation in the ongoing trade dispute between the US and China, a no-deal Brexit and a renewed debt crisis in Italy remain key downside risks to the growth recovery in the Eurozone and will continue to weigh on economic sentiment. Although the European Commission Economic Sentiment Index remained above its long-term average of 100.9 points at 107.3 points, the index has been on a downward trend since December 2017, after reaching a peak of 115.2 points.

Moreover, core measures of inflation remain stubbornly around 1%, deferring the need for a tighter monetary policy stance. In its December 2018 policy-setting meeting, the European Central Bank (ECB) noted "uncertainties and risks related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets (EMs) and financial volatility remained prominent" and warned "the situation remained fragile and fluid". Although the Governing Council's decision to retire its €2.6 trillion asset-purchase programme was unanimous, the futures market has removed the possibility for an increase in the interest rate in 2019. The Bloomberg median consensus has shifted out the prospect of the first interest rate hike from the fourth quarter of 2019 to the first quarter of 2020, in line with the ECB's hint (at a news conference in January 2019) it may take longer for the bank to start lifting interest rates.

UK

Popular support for a no-deal Brexit has dipped

Ministers in the UK parliament rejected a Brexit deal, by a record-breaking 432 votes to 202 on 15 January 2019. Despite its defeat, after being negotiated by Prime Minister Theresa May for 18 months with the European Union (EU), May's deal remains one of the most likely bases for a compromise to be reached.

According to the Financial Times, a number of surveys are highlighting a decline in support for a no-deal Brexit. In a survey question posed by Opinium, asking respondents what should happen next following the defeat of May's Brexit deal by the House of Commons, 24% suggested the UK should leave without a deal with the EU without any further votes on it. Another 22% opted for holding a public vote on the terms of the exit deal versus remaining in the EU. A fifth of the responses favoured the option of the UK government going back to the EU to try to negotiate a better deal within the original timeframe, while 12% preferred to have a general election, after which the victor can try to resolve matters. The remainder of the responses were split between holding a public vote on the terms of the exit compared to leaving the EU without a deal and being unsure what the best next step was to take (see table 1). Although those who backed a no-deal Brexit in the Opinium Survey constituted nearly a quarter of the vote, this was the second-lowest share in the past six months that the question was asked.

Table 1: What should happen next in the Brexit timeline?

Option	Vote
The UK should leave without a deal with the EU, without any further votes on it	24%
A public vote on leaving on the terms of the exit deal compared to remaining in the EU	22%
The government should go back to the EU and try to negotiate a better deal in the time before the UK leaves the EU in March 2019	20%
A general election takes place so whoever wins can try to resolve things	12%
A public vote on leaving on the terms of the exit deal compared to leaving the EU without a deal	9%
Don't know	13%

Source: Opinium, Momentum Investments

The Financial Times has suggested a Norway-style deal (one in which the UK leaves the EU, but remains in the bloc's single market and remains in a customs union with Brussels), appears to be the least divisive of all the options available, as seen in a survey conducted by YouGov. Only 27% considered a Norway-style resolution as a 'bad outcome', whereas 41% view a referendum as a 'bad outcome'.

Finally, NatCen Social Research has found that around two-thirds of previous 'remain' voters back a second referendum, but previous 'leave' voters views vary greatly depending on how the vote is framed.
More than a quarter of previous 'leave' voters are in favour of remaining in the EU, with less than half opposed, suggesting a second referendum may reverse the result achieved in 2016.

China

Authorities are employing countermeasures to prevent a sharper slowdown in growth

Growth in real economic activity in China slowed for a fifth consecutive quarter to 6.4% in the final quarter of 2018, from 6.5% in the third quarter (see chart 3).

China's growing importance in the world economy implies a slowdown in the country could have far-reaching effects. According to the International Monetary Fund, China accounted for 18.2% of world gross domestic product (GDP) in 2017 in purchasing-power-parity (PPP) terms (relative to the US at 15.3%) and contributed to nearly a third of the GDP in EMs. China is an equally important player in world trade, contributing 29.3% to exports in EMs and 10.7% of world exports.

Chart 3: Managed slowdown in Chinese growth

Source: Bloomberg, Momentum Investments, data up to December 2018

China took on substantial debt, as it borrowed to stimulate growth in recent years. However, authorities have committed to actively deleveraging the economy and have shifted their focus away from high-speed growth towards a higher-quality and more sustainable growth rate. As such, growth in China is becoming increasingly reliant on consumption and moving away from commodity-intensive investment. More than three quarters of growth in GDP came from consumption in China in 2018, which is up from 35% in 2003.

Conversely, activity in manufacturing, exports and the property market is slowing. Momentum Investments expects Chinese growth to slow to 6.2% in 2019, partly due to the ongoing rebalancing effect (shifting the economy away from investment and towards consumption) and concerted efforts to deleverage, but also as a direct consequence of the Sino-US trade war. Should Trump extend the 10% tariff on US$200 billion worth of Chinese imports to 25%, nearly 0.8% could be shaved off baseline growth in China by 2021. If trade tensions escalate further and the US imposes a 25% tariff on the remaining US$250 billion worth of imports from China (of which around 40% are consumer-related imports), almost 1.7% could be detracted from Chinese GDP growth by 2021, according to Citibank estimates.

Momentum Investments believes Chinese authorities are unlikely to engage in a large-scale stimulus plan, as they remain committed to relieving the economy from its elevated debt levels. Nevertheless, a targeted stimulus response to prop up the economy is underway. China has forged ahead with significant structural reform, which has placed the country at 46th out of 190 countries in the World Bank's Ease of Doing Business Survey for 2018, from 78th position only a year before. China has improved its access to credit, by providing credit enhancements and meeting corporate demand for loans through a quota system. Moreover, China has sought to foster competitive neutrality, to ensure its state-owned enterprises no longer have an advantage over its private sector counterparts. China has also taken steps to reduce most tariffs on intra-Asian trade through its participation in the Regional Comprehensive Trade Agreement, providing a boost to future exports.

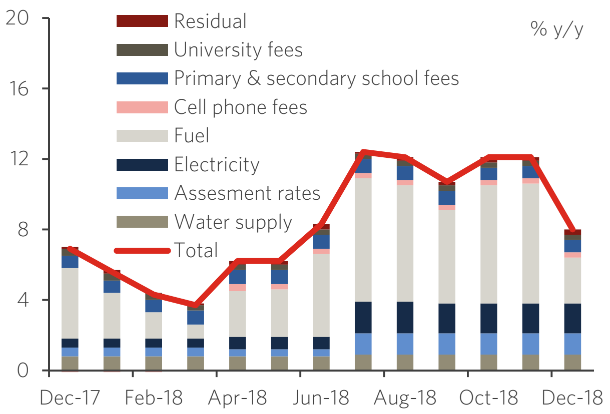
Local economic developments

Headline inflation dropped on account of a significant cut in fuel prices

Headline inflation released by Statistics SA for December 2018 registered in line with expectations of dip to 4.5%. The significant drop from 5.2% a month earlier was largely due to a R1.84 c/l cut in the price of petrol. A dip in fuel inflation from 19.2% to 7.7% between November and December 2018 resulted in a decline in administered price inflation from 12.1% to 8.0% (see chart 4).

Administered price inflation, which is primarily driven by fuel prices and electricity, water and sanitation charges, has averaged 7.1% since 2009 and remains an upside threat to the inflation forecast. The SA Reserve Bank (SARB) projects a 9% increase in electricity prices for 2019, which is below the energy utility's (Eskom) 15% requirement.

Chart 4: Fall in fuel inflation contributed to a decline in administered price inflation



Source: SARB, Momentum Investments

Inflation, excluding administered prices, recorded at 3.8% in December 2018, which is notably below the midpoint of the SARB's 3% to 6% inflation target. Given the SARB's influence over administered prices through monetary policy is relatively limited, an argument can be made that the current monetary policy stance is appropriate.
However, the SARB has reiterated its intention to bring inflation expectations closer to the midpoint of the inflation target range in order to create more flexibility in monetary policy to deal more effectively with external shocks.

Although fourth-quarter data for inflation expectations (surveyed by the Bureau of Economic Research (BER) between 30 October and 4 December 2018) showed a slight downward shift in the average five-year ahead inflation expectation from 5.5% to 5.3%, the disaggregated data showed a different picture.
The decrease was largely driven by a downward revision by analysts from 5.3% to 5.1% and a cut in forecasts from trade unions from 5.5% to 5.2%.
However, the expectations of the price-setters in the economy (namely businesses) kept their forecasts unchanged at 5.7%. Similarly, near-term forecasts for 2019 and 2020 were revised lower by analysts and trade unions, but remained elevated for businesses at 5.7% for 2019 and 5.8% for 2020.

If the SARB's forecasts for a lower inflation outlook were to materialise, it is likely interest rates would remain steady from current levels. In Momentum Investments' view, potential supply shortages in the international oil market, administered price pressures, geopolitical tensions, trade war risks, a negative shift in sentiment and unfavourable domestic political developments all pose an upside risk to the SARB's inflation forecasts. Should these upside risks materialise, a further modest tightening in monetary policy would be warranted.

Financial market performance

Global markets

After wild swings during November and December 2018, global equity markets sailed smoothly into January 2019. The MSCI All World Index recovered to 7.9% in the black in January 2019, with developed equity markets and emerging equity markets posting strong returns.

Despite rising fears of slowing global growth, ongoing trade tensions between the US and China, lingering Brexit uncertainty and the US government shutdown, the CBOE volatility index (VIX), or fear gauge, dropped by nine index points in January 2019.

The MSCI Developed Market (DM) Index lifted 7.8% in the month, benefiting from a rise in European and US markets. US equities had a promising start to the year. The S&P 500 Index rose steadily in the first half of the month, before tracking sideways and finished the month 8.0% higher despite the disruptions to government activities caused by the 35-day partial shutdown of the federal government, triggered by a stand-off between Trump and Congress for US$5.7 billion worth in funding to build a wall on the Mexican border.

Markets may have been boosted by an adjustment in the language used by the US Fed to indicate it may keep interest rates unchanged in the near term. The latest economic projections modelled by the Fed indicated it would raise interest rates twice more in 2019, but investors have removed the likelihood of an interest rate increase for this year according to the Fed fund futures market.

Despite ECB President Mario Draghi highlighting the recent deterioration in 'hard' (actual) and 'soft' (survey-based) data and noting near-term growth was weaker than expected in Europe, European equity markets ended the month firmly in positive territory. The Eurostoxx 50 Index climbed 5.6% in January 2019. Gains in the Japanese market were softer at 3.8% as lower demand by China hurt global manufacturers' earnings and as poor results from US manufacturers spelt trouble for Japanese suppliers of machinery.

Emerging equity markets fared even better than their DM counterparts, in line with a robust 5.4% uptick in the Bloomberg Commodity Price Index. The MSCI EM Index increased by 8.8% in the month, driven by stellar returns in the Latin American market. The MSCI Latin America Index marched 14.9% higher in January 2019, largely owing to impressive returns in Brazilian shares. Investor sentiment has risen on the possibility of key reforms (including changes to the pension system) being passed by Brazil's new president, Jair Bolsonaro.

The MSCI Europe, Middle East and Africa (EMEA) Index recovered strongly (10.8%) in January 2019, following a consistent negative return from Russian markets for three out of the four quarters in 2018, on the back of sanctions, the Ukraine crisis, geopolitical risks, lower oil prices and corruption scandals.
The MSCI Asia Index lagged the EM composite, increasing by 7.3% in the month. Shares were hit late in the month on news the US Justice Department had accused a Chinese telecommunications firm of violating sanctions on Iran.

Risk in the EM composite decreased in line with a retracement in the VIX. The JP Morgan EM Bond Index (EMBI) spread contracted by nearly 57 basis points in January 2019. Spreads for Malaysia (27 basis points), Chile (25 basis points) and Argentina (22 basis points) improved the most during the month.

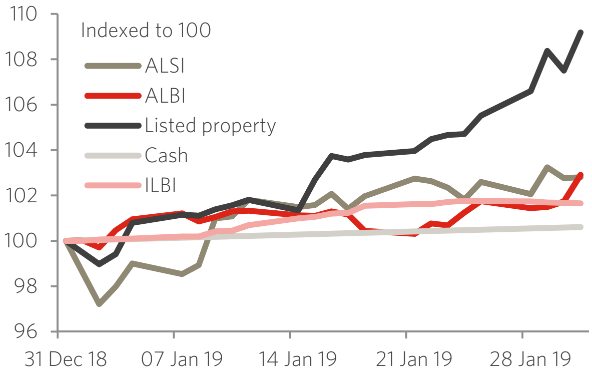
A reversal in negative sentiment towards EMs was evident in the appreciation of the JPMorgan EM Currency Index against the US dollar of 3.3%. Notable gains were made in the SA rand (8.2%), Russian ruble (6.6%), Brazilian real (6.2%) and Chilean Peso (6%).

Local markets

The SA equity market followed the direction of global markets. The FTSE/JSE All-Share Index edged 2.8% higher in the month (see chart 5), buoyed by gains in financial shares.

The FTSE/JSE Financials Index shot 6.0% higher, after posting a mild 0.6% gain in the previous month.
This was followed by a 3.3% uptick in the FTSE/JSE Resources Index. Resource shares were aided by a 3.0% bounce in gold prices and a 3.3% gain in platinum prices. Fears of a weakening trend in global growth have caused an increased demand for safe-haven investments. A downward guidance of the interest rate path by DM central banks has further supported the gold price in the recent month.

Chart 5: Returns on local asset classes (%)



Source: IRESS, Momentum Investments, data up to 31 January 2019

Gains in the FTSE/JSE Industrials Index were muted at 0.9% for January 2019, with mid-cap shares (2.3%) outperforming small-cap shares (2.0%) in the month.

Listed property shares staged a comeback in January 2019, soaring 9.2% in the month from a low base. The SA ten-year government bond yield sold off by nearly ten basis points following the SARB's interest-rate setting meeting, in which interest rates remained steady and a more dovish view on monetary policy was communicated. The JSE ASSA All Bond Index edged 2.9% higher in the month, while the JSE ASSA Government Inflation-linked Bond Index (ILBI) gained 1.6%. SA cash posted a 0.6% gain in the same period.

The SA rand was the best-performing currency against the US dollar in January 2019. The rand appreciated by 7.9% against the euro and 5.5% against the British pound in the corresponding period.

The British pound has remained relatively resilient with May surviving a vote of no confidence and attempting to reopen Brexit negotiations, which may include a renegotiation of the backstop (to prevent a hard border on Ireland) and a longer transition period. In line with a firmer local currency against the majors, SA's five-year corporate default swap (CDS) spread narrowed by 47 points during the month.

Indices summary for January 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)	2.81%	3.77%	-6.06%	6.36%	4.46%	6.86%	8.16%	10.25%	13.43%
FTSE/JSE Shareholder Weighted Index (SWIX)	3.09%	5.43%	-8.31%	5.57%	3.45%	7.30%	8.54%	10.79%	13.92%
FTSE/JSE Capped SWIX All Share index	2.77%	3.65%	-8.06%	4.59%	2.61%	6.59%	7.94%	10.27%	
FTSE/JSE All Share Top 40 Index	2.72%	4.27%	-6.01%	5.82%	4.55%	6.47%	7.97%	10.05%	13.12%
FTSE/JSE Mid Cap Index	2.34%	4.31%	-7.53%	7.01%	2.46%	7.71%	7.85%	10.03%	14.42%
FTSE/JSE Small Cap Index	2.04%	-2.14%	-12.60%	4.39%	-0.10%	4.97%	7.30%	10.11%	12.87%
FTSE/JSE Resources Index	3.25%	2.64%	15.63%	24.74%	4.14%	-0.86%	-0.08%	-0.28%	4.46%
FTSE/JSE Financials Index	5.96%	7.17%	-0.35%	8.35%	5.15%	11.80%	11.08%	14.12%	16.51%
FTSE/JSE Industrials Index	0.88%	2.54%	-17.17%	-0.64%	1.57%	6.09%	8.99%	12.97%	16.57%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	2.51%	2.60%	-2.91%	12.15%	5.86%	7.05%	7.83%	9.63%	13.48%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	2.45%	2.21%	-3.30%	11.99%	5.27%	6.76%	7.53%	9.27%	12.80%
FTSE/JSE SA Listed Property Index (SAPY)	9.18%	6.63%	-9.43%	2.78%	1.45%	9.18%	7.54%	10.61%	13.21%
Interest-bearing indices									
JSE ASSA All Bond Index (ALBI)	2.90%	7.56%	8.79%	10.46%	6.20%	9.05%	7.00%	7.93%	8.25%
JSE ASSA All Bond Index 1-3 years (ALBI)	0.67%	3.50%	8.74%	9.21%	7.88%	8.22%	7.28%	7.34%	7.65%
JSE ASSA SA Government ILB Index	1.65%	1.23%	3.45%	3.18%	3.51%	5.85%	4.35%	6.17%	7.61%
Short-term Fixed Interest Composite Index (SteFI)	0.60%	1.79%	7.25%	7.42%	7.19%	6.95%	6.65%	6.49%	6.66%
Commodities									
NewGold Exchange-Traded Fund	-4.76%	-2.42%	10.01%	-0.77%	4.32%	4.09%	2.41%	3.34%	6.00%
Gold price (in rands)	-4.52%	-1.43%	10.02%	-0.40%	4.78%	4.68%	2.75%	3.77%	6.61%
Platinum Exchange-Traded Fund	-4.18%	-11.90%	-8.54%	-7.88%	-6.64%	-7.09%			
Platinum price (in rands)	-4.88%	-11.98%	-9.03%	-7.80%	-6.94%	-6.69%	-6.25%	-6.18%	0.05%
Currency movements									
Rand/euro movements	-7.33%	-9.01%	2.93%	-3.99%	3.76%	0.22%	3.87%	5.87%	1.54%
Rand/dollar movements	-7.60%	-10.14%	11.73%	-5.85%	3.38%	3.52%	6.81%	7.88%	2.69%
Inflation index									
Consumer Price Index (CPI)			4.49%	5.31%	5.29%	5.30%	5.31%	5.36%	5.34%

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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