momentum investments

July 2019

Economies at a glance

01 United States

The economy is in a late-cycle phase, however, further anticipated interest rate cuts should help cushion the slowdown and extend the expansion. Although growth and employment remain robust, trade war uncertainty is undermining confidence and makes the case for additional interest rate easing. Policy rates are expected to be cut by another 50 basis points before the middle of 2020, before reaching higher in the longer term in response to a recovery in growth and inflation outcomes.

Forecast 2019:
GDP: 2.3%
Inflation: 1.7%
Forecast 2020:
GDP: 1.7%
Inflation: 2.1%

02 Eurozone

Despite falling unemployment and rising wages, growth remains constrained. A turbulent external environment has suppressed investment spending and exports. Even with ultra-accommodative monetary policy, core inflation measures remain below target and inflation expectations have softened further. With policy rates already close to their lower bound, the European Central Bank may have no choice but to extend its asset purchases to combat slow growth and muted inflation.

Forecast 2019:
GDP: 1.1%
Inflation: 1.3%
Forecast 2020:
GDP: 1.2%
Inflation: 1.4%

03 Emerging markets

Softer global demand and heightened trade conflict are expected to weigh negatively on emerging markets (EMs). However, a continuation of an accommodative policy stance by developed markets (DMs) should provide a partial offset. If global growth holds and interest rate policy remains low in developed markets, there should not be a significant cause for concern for growth in EMs, but vulnerabilities do exist. The expectation of more accommodative monetary policy in developed economies, contained inflation pressures and downside risks to growth have created space for EMs to stimulate their economies through further interest rate cuts.

Forecast 2019:
GDP: 4.6%
Inflation: 3.6%
Forecast 2020:
GDP: 4.5%
Inflation: 3.4%

04 South Africa

South Africa (SA) is in its longest economic downturn in history, but fractious politics are stymying the pace of reform. The economy is likely to muddle along at moribund levels and will remain reliant on positive global factors to provide interim growth boosts. Moody's methodology does not warrant a junk rating for SA yet, but the risks are rising and we could see SA losing its stable outlook later this year. There is little sign of demand-pull inflation pressure, providing space for an additional rate cut, but reforms are ultimately needed to drive growth higher.

Forecast 2019:
GDP: 0.6%
Inflation: 4.5%
Forecast 2020:
GDP: 1.3%
Inflation: 4.7%

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Your goal is our benchmark

Economies at a glance: United States

- The Federal Reserve (Fed) has steadily reduced its balance sheet, recovering from its initial response to the financial crisis.
- Dollar liquidity risks are becoming a larger concern. China is one of the largest foreign countries holding dollars.
- Dollar- denominated debt is significantly skewed to the country that has the most dollar holdings.
- Quantitative easing has not translated into a meaningful revival of cash in circulation.
- EM currencies dipped against the US dollar in the first half of 2018 on negative EM sentiment, but the EM currency index has tracked largely sideways since.

Chart 1: The Fed balance sheet has declined as a share of GDP

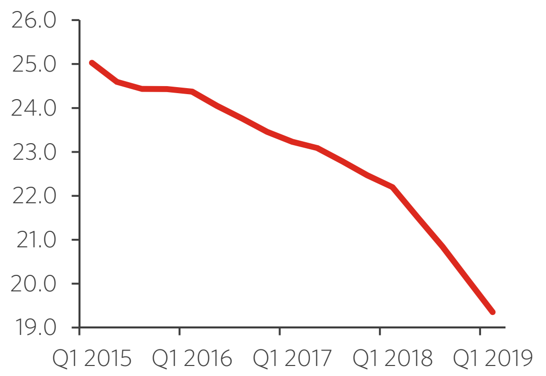


Chart 2: China is the biggest holder of US dollar reserves

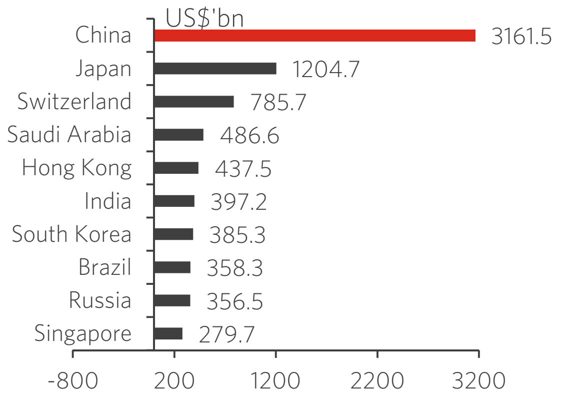


Chart 3: China also has the most dollar-denominated debt

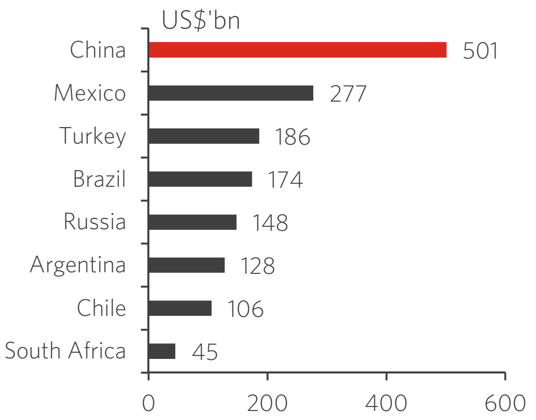


Chart 4: Dollar performance continues to roll over from its steady 2018 build up

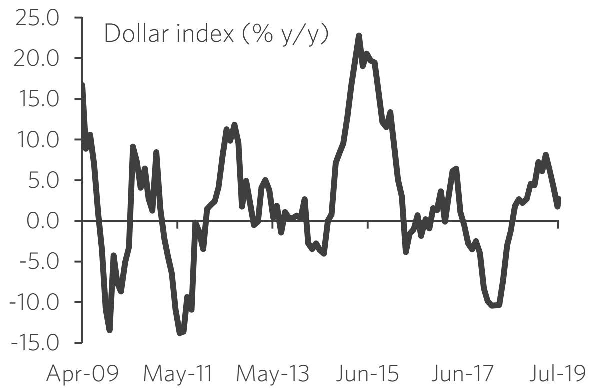
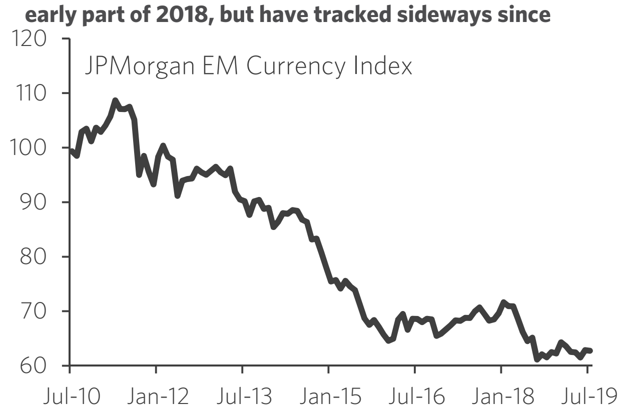


Chart 5: US M1 money supply has rebounded from its six year low but remains in the trenches

Chart 6: EM currencies sold off against the dollar in the early part of 2018, but have tracked sideways since



Source: Federal Reserve Bank, BIS, howmuch.net, Bloomberg, Momentum Investments

Economies at a glance: Eurozone

- Lower inflation in the Eurozone is mimicking Japanese inflation trends. Growth in the Eurozone and Japan are also trending at similar anaemic levels, triggering fears over a Japanification of the Eurozone.
- The Eurozone and Japan both suffer from an ageing work force, which will further dampen productivity and growth levels. The unemployment picture in the Eurozone, however looks worse than in Japan, despite improvement since 2012.
- The debt burden is currently much higher in Japan, but if a Japanification of Europe materialises, debt levels are likely to worsen as authorities attempt to bolster the economy. Monetary policy room to manoeuvre is limited in both economies.

Chart 1: Subdued inflation in the Eurozone and Japan

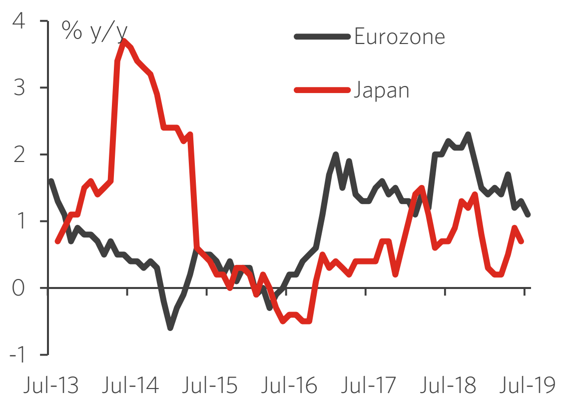


Chart 2: Similar moribund growth trajectory

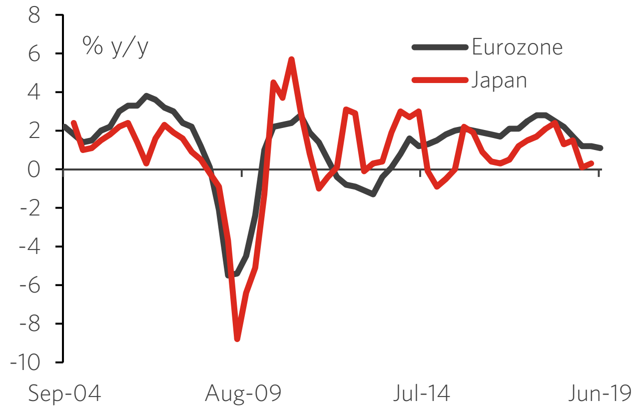


Chart 3: Working age population has steadily declined over the years

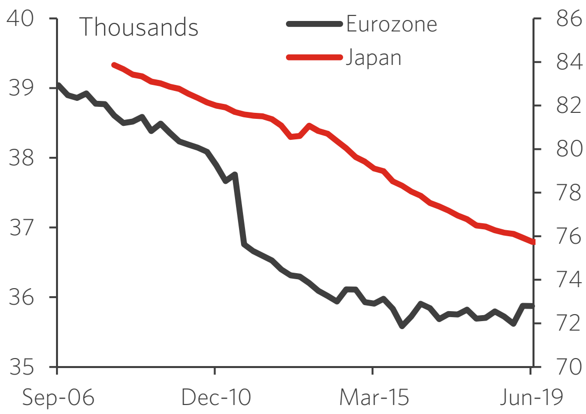


Chart 4: Unemployment has declined in the Eurozone, but remains higher than in Japan

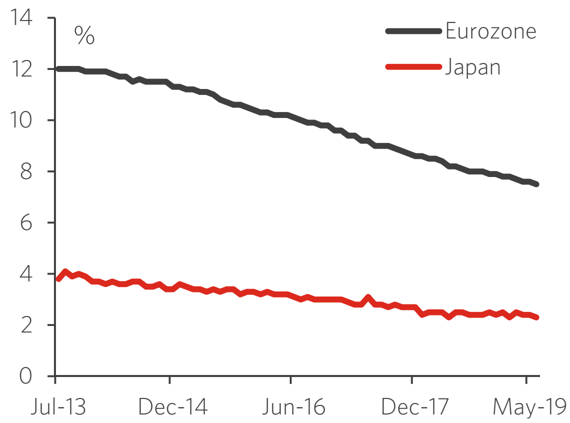


Chart 5: Japan's economy is more heavily indebted

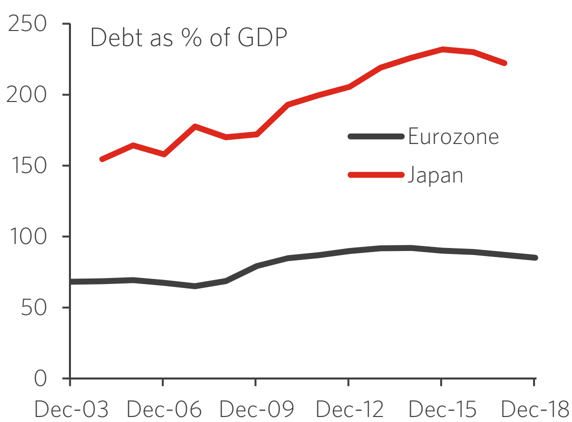
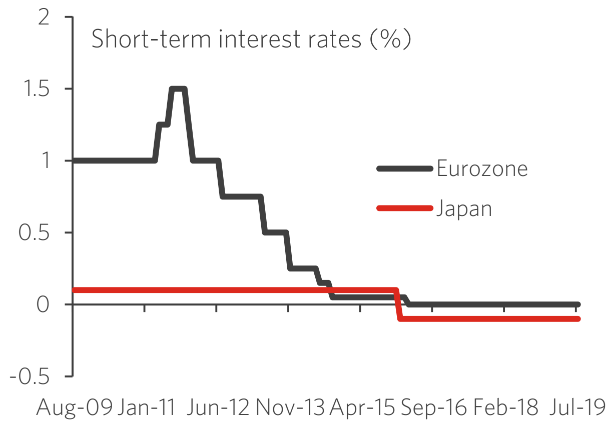


Chart 6: Little room to lower interest rates significantly in the Eurozone and Japan



Source: Bloomberg, Momentum Investments

Economies at a glance: EMs

- Capital inflows have surpassed outflows even when financial conditions tightened towards the end of 2018.
- The share of capital inflows into EMs relative to DMs corroborates the attractiveness of real interest rates.
- Current account balances in EMs are largely in deficit, except for Russia being a net oil exporter.
- The credit default swap spread (CDS) of most EMs are also concentrated around the same level, except for outliers like Turkey which have shown fundamental weaknesses.

Chart 1: Capital inflows were strongest in Brazil since 2011

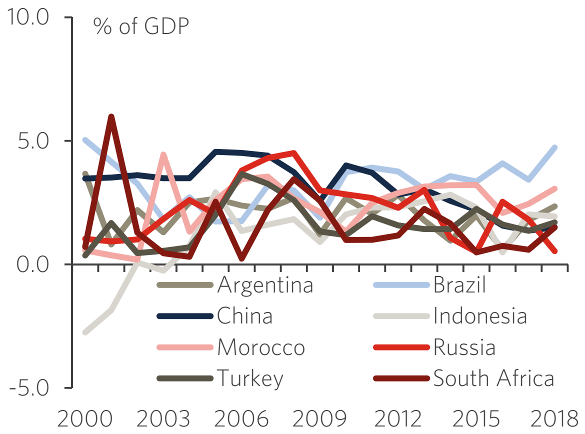


Chart 2: Capital outflows have been significant in Russia and SA since 2012

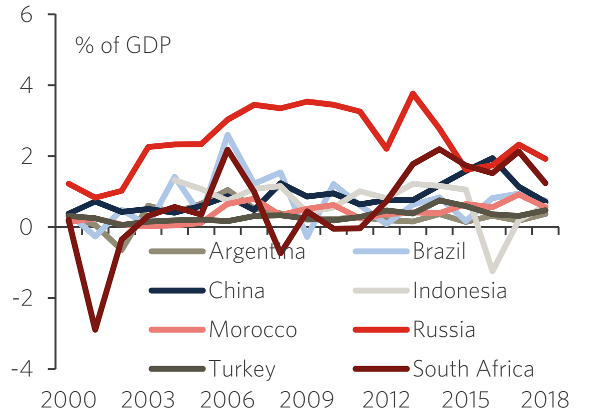


Chart 3: The share of EM capital inflows held up in 2018 when financial conditions tightened

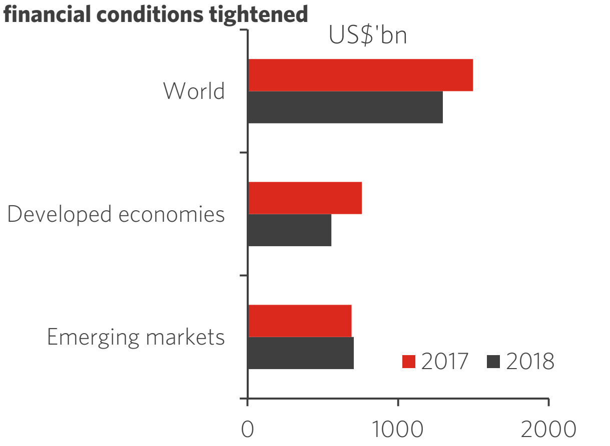


Chart 4: Current accounts mostly in deficit, with Russia the exception due to oil exports

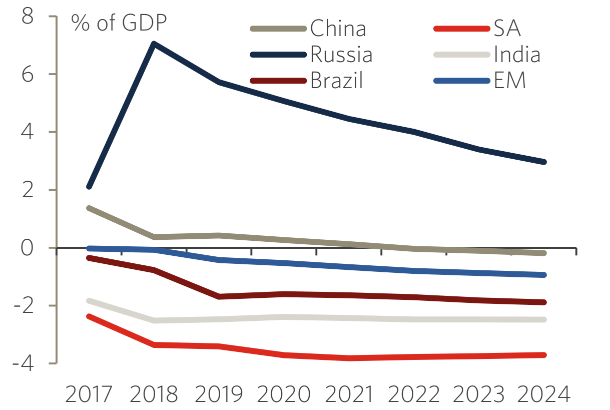
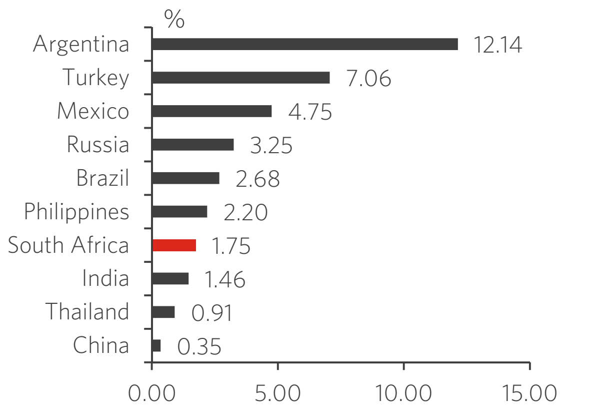


Chart 5: CDS spreads have tightened for most EMs, despite countries experiencing idiosyncratic risks

Chart 6: Real interest rates remain attractive in EM



Source: OECD, Avalara, Capital Economics, International Monetary Fund, Momentum Investments

Economies at a glance: SA

- Gross savings sank to 14% of gross domestic product (GDP) in the first quarter of 2019. Corporate savings declined from 2017 levels, while personal savings have been negative since 2006.
- Household credit increased since 2017 and the ratio of household savings to disposable income has struggled to exceed 1% as economic conditions have constrained consumers. The net wealth ratio has rolled over, driven weaker by low housing prices and a sideways equity market.
- Government savings plummeted since the financial crisis to support the economy and has been unable to escape the negative savings cycle. Relatively high real interest rates should attract foreign savings into SA.

Chart 1: Gross savings ratio close to all-time lows since 2000

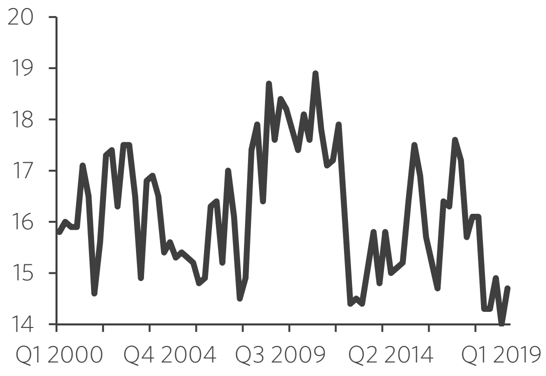


Chart 2: Personal savings are barely positive and corporate savings are declining

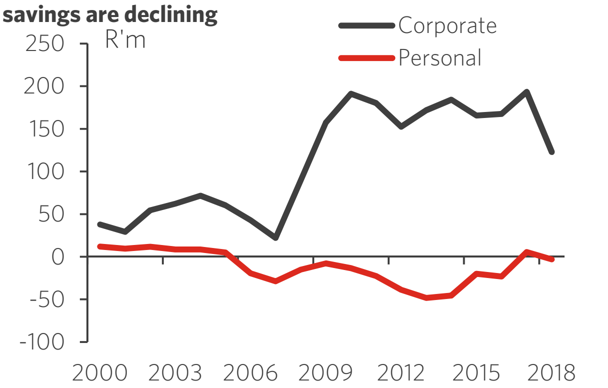


Chart 3: Higher household credit growth and constrained savings highlight consumer pressures

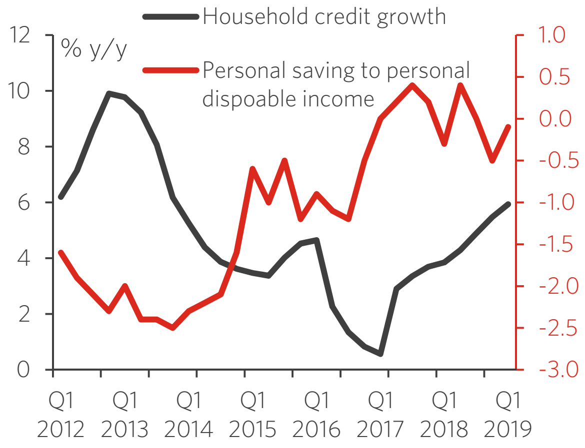


Chart 4: Net wealth to disposable income is on a declining trend

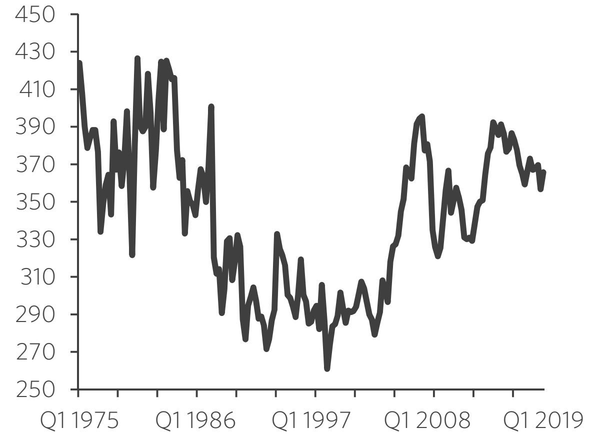


Chart 5: Government dissaving has grown significantly

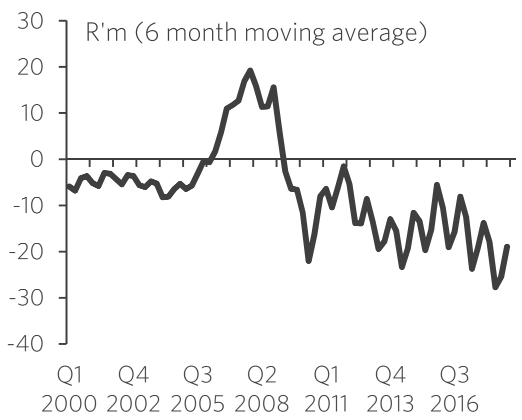
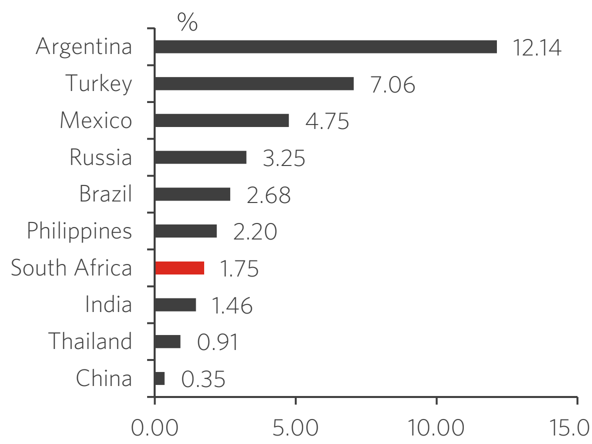


Chart 6: Real interest rates are decent in SA



Source: Sarb, 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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Your goal is our benchmark