Herman van Papendorp
Head of Investment Research & Asset Allocation

Sanisha Packirisamy
Economist

The Macro Research Desk

Economic and market snapshot for November 2018

Highlights

- United States: With the Democrats winning the House of Representatives, Republicans are no longer able to pass legislation with Republican votes alone.
- Eurozone: Bottlenecks in the automotive industry resulted in a slowdown in growth in the third quarter of the year, but tentative signs of a normalisation in production could lead to a slight improvement in the fourth quarter, leaving full-year growth around 2%.
- United Kingdom: The European Union has endorsed the Withdrawal Agreement and the Political Declaration, but the British Parliament still needs to approve the deal.
- Emerging markets: A further tightening in monetary policy is likely, given capacity constraints and rising core inflation in many emerging economies.
- South Africa: Interest rate hike to 6.75% reflects the Reserve Bank's intolerance for inflation expectations at the top end of the target band and its need to create more flexibility in monetary policy to deal with shocks.

Global economic developments

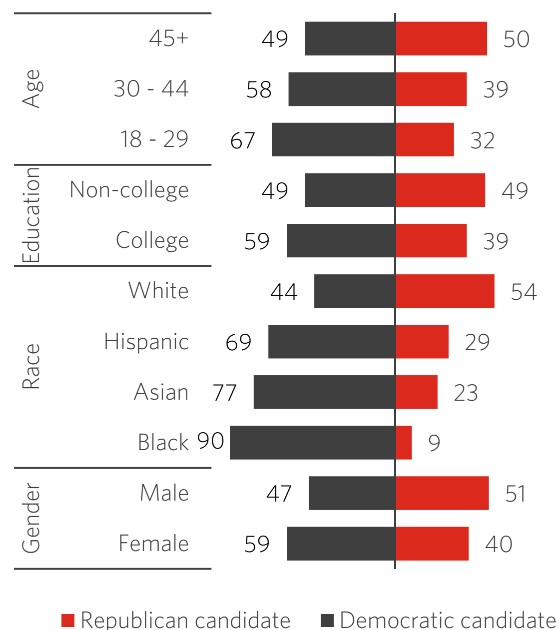
United States (US)

Democrats win the House of Representatives, but Republicans added to their narrow majority in the Senate.

The voter turnout for the 2018 midterm elections reached the highest in more than a century, with 49.3% of the voting-eligible population turning out to vote. Wide differences in voting patterns between males and females, young and old, whites and non-whites and those with lower and higher levels of education were evident (see chart 1).

The exit polls pointed to 59% of women voting for a Democratic candidate, while only 47% of men suggested they voted for a Democrat. On a racial split, the widest margin in voter preferences was seen among Black voters (90% voted for a Democratic candidate), followed by Asian voters (77%) and Hispanic voters (69%). In contrast, 54% of white voters chose a Republican candidate. This is likely due to the differing attitudes between social groupings on whether minorities are favoured or not and whether sexual harassment is adequately addressed or not.

Chart 1: Breakdown of the votes in the midterm elections



Source: Pew Research Centre, Momentum Investments

your goal is our benchmark

momentum investments

On the basis of educational attainment, 59% of voters supported a Democratic candidate, while vote discrepancies were also apparent across different age groups. While votes by those without a college degree were evenly split for Republican and Democrat support, 59% of voters with a college degree voted for a Democrat. Votes were more evenly split for those older than 45, while younger voters overwhelmingly favoured Democratic candidates.

The midterm elections resulted in Democrats securing a victory in the House of Representatives for the first time since 2010, but the Republicans narrowly increased their majority in the Senate. The economic and legislative implications of a Democratic majority in the House include a potential blocking of the Republican's legislative agenda, further momentum behind the investigations into President Donald Trumps' finances and the allegations against the Supreme Court Justice. Even though articles of impeachment could be introduced against Trump, it is less likely that he could be voted out of office, as this would still require a majority in the Senate.

Eurozone

Bottlenecks in the automotive industry dulled growth in the third quarter of the year

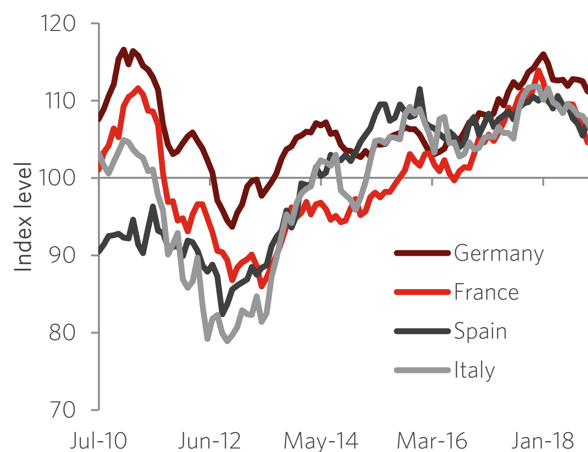
The second estimate of growth in gross domestic product (GDP) in the third quarter of the year confirmed the economy lost traction. Growth grinded lower to 0.2% in seasonally adjusted terms from 0.4% printed in the second quarter of the year. The figure disappointed the market consensus, which was expecting growth to remain steady at 0.4%.

According to Capital Economics, bottlenecks (including emissions testing) in the automotive industry were behind the slowdown. If production had remained steady, growth would have likely matched the consensus estimate in the third quarter of the year. Capital Economics noted a resumption in car production data more recently, which is indicative of a slight rebound in growth in the final quarter of the year.

Economic sentiment data from the European Commission dipped in November 2018, but remained encouraging for growth in the fourth quarter of the year. The index was supported by an improvement in Germany and France, but poor data for Italy dragged the overall sentiment index lower to 109.5 points from 109.7 points in October 2018. The index showed a stable reading for the services and industrial sub-indices, but the retail and consumer indicators softened further.

Consumer confidence in the Eurozone fell to a 20-month low in November (see chart 2). Households are feeling less optimistic about economic conditions in the next year. Moreover, higher headline inflation has eroded real wage gains for consumers, while a tighter labour market points to slower gains in employment.

Chart 2: Eurozone consumer confidence slips



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

Softer global growth and a likely appreciation in the euro on a trade-weighted basis (in response to an ongoing shift away from loose monetary policy) should weigh on growth prospects for the Eurozone in 2019. Momentum Investments expects growth in the Eurozone to slow from an anticipated 2.0% in 2018 to 1.8% in 2019.

United Kingdom (UK)

UK debates Brexit deal ahead of a vote in Parliament

At a special meeting of the European Council in November 2018, the leaders of the 27 countries belonging to the euro bloc endorsed the Withdrawal Agreement (terms under which the UK will leave the European Union (EU) in March 2019) and the Political Declaration, which is an outline for negotiation for a future trade deal.

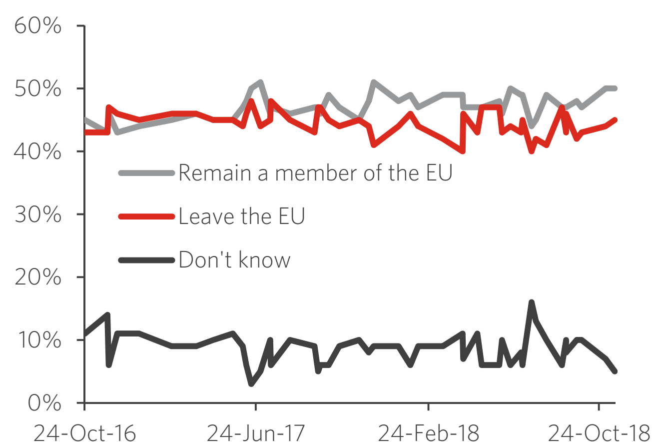
Although the EU has endorsed these, negotiations are far from over. It is now up to the UK Parliament to approve the deal. A 320 vote is required for a majority, but little support for it exists in Parliament. As previously indicated, the opposition Labour Party stated it would vote against the deal. This sentiment is shared by the Scottish National Party and other opposition parties. Between 80 and 90 Members of Parliament (MPs) in UK Prime Minister Theresa May's own party (including hard-line 'Brexiters' and 'Remainers') indicated little appetite for the deal.

The EU claimed it would not reopen negotiations, pushing up chances of a no-deal Brexit. However, it is more likely that a deal would be forced through on a second or even third Parliamentary vote.

Despite May finding herself under intense pressure after releasing the detail behind the proposed deal, the popular vote turned in her favour. A YouGov poll, surveying 1 647 adults in the UK, showed her standing had improved, even among the 'leave' voters. Only 39% of 'leave' voters intimated she should be ousted compared to 55% a week before the deal was delivered.

Even though the gap has opened between polled citizens opting to remain in the EU compared to those who would prefer leaving, the voting preference remains tight (see chart 3). Some MPs are demanding a second referendum for UK citizens, but the reality is remaining within the EU is no longer something Britain can decide on its own. Even if voters are asked to accept or reject the final withdrawal deal concluded between the UK and the EU, a no-deal Brexit would be undesirable for all parties involved.

Chart 3: Should the UK remain a member of the EU?



Source: Economic and Social Research Council, Momentum Investments, data up to 15 November 2018

Emerging markets (EMs)

Monetary policy tightening likely has further to go, given capacity constraints and rising core inflation

According to Capital Economics, aggregate inflation across EMs rose to 4.2% in year-on-year (y/y) terms in October 2018 from 4.1% in September 2018 due to an increase in fuel inflation from 19.1% y/y to 19.5% in the same period. The international price of oil has, however, softened since a peak of US$86/bbl in early October to below US$60/bbl in late November 2018.

Table 1: EMs that have hiked interest rates in the past six months

Country*	Reason
Argentina 45.5%	*15% hike to 60%* Forced to raise interest rates to stem inflation pressure arising from a sharp depreciation in the peso.
Chile 2.9%	*0.25% hike to 2.75%* Surprised the market by hiking interest rates. The decision to hike earlier was made in fear of falling behind the curve in a rising inflation cycle.
Czech Republic 2.2%	*0.25% to 1.75%* Raised interest rates to combat fast-rising wages and inflationary pressures.
India 3.3%	*0.25% hike to 6.5%* Interest rates increased to counter inflation pressures. Growing risks from global trade and currency tensions were noted.
Indonesia 3.2%	*0.25% hike to 5.75%* Interest rates were hiked in an attempt to curb a further sell-off in the rupiah and to strengthen the stability of the economy.
Mexico 4.9%	*0.25% hike to 8%* The outlook for inflation had deteriorated significantly. Inflation risks are associated with the possible adoption of policies that could structurally affect the economy's price formation process.
Russia 3.5%	*0.25% hike to 7.5%* Interest rates were increased in response to mounting inflation risks, currency depreciation and the rising threat of US sanctions.
Saudi Arabia 2.1%	*0.25% hike to 2.75%* Interest rates hiked to prevent money market rates from falling too far below US rates, which could trigger capital outflows.
Turkey 25.2%	*6.25% hike to 24%* Strong monetary policy tightening was triggered to support price stability and stem currency depreciation.

*Source: global-rates.com, cbrates.com, Reuters, Mexico News Daily, Momentum Investments, * below or within target = blue, above target = red*

Nonetheless, core measures of inflation, which exclude the effect of volatile food and fuel items, continued to pick up to 3.3% y/y in October 2018 and is expected to drift higher in upcoming months, as a number of EMs face capacity constraints. Moreover, the lagged effect of previous currency depreciation is likely to manifest in a further uptick in core inflation.

The International Monetary Fund expects headline inflation in EMs to increase to 5.2% in 2019 from an expected average of 5.0% in 2018. Although a number of EMs have already hiked interest rates in the past six months (see table 1), monetary policymakers across EMs are likely to continue hiking interest rates into 2019 to keep inflation under control.

Local economic developments

Interest rates hiked to manage inflation expectations closer to the midpoint of the target band

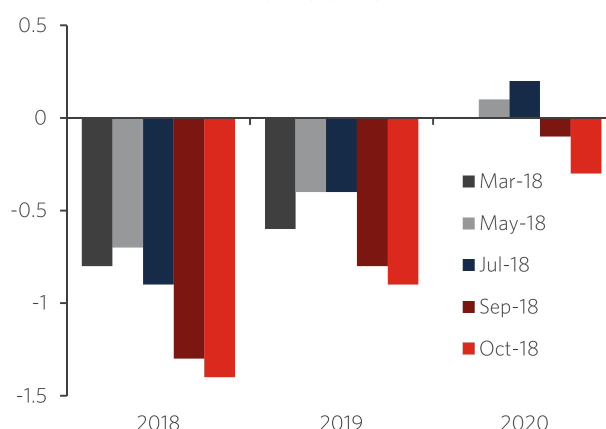
The South African Reserve Bank (SARB) Monetary Policy Committee (MPC) hiked interest rates by 25 basis points, for the first time since March 2016, to 6.75%. Although the SARB acknowledged near-term risks to the inflation outlook had subsided, it warned that tighter global financial conditions, higher wage growth, international oil prices and rising electricity and water tariffs continue to pose upside threats in the long run. The SARB emphasised the need to create more flexibility in monetary policy to deal with shocks and aims to do this by leading inflation expectations closer to the midpoint of the 3% to 6% inflation target band.

The SARB's near-term growth outlook has been revised lower, but forecasts in the outer years were little changed. The output gap is expected to narrow in the medium term, but will remain negative into 2020 (see chart 4).

Tighter global financial conditions and SA's relatively poor macro fundamentals highlight the need to maintain an attractive real interest rate profile, but a muted growth outlook prevents a sharper acceleration in interest rates.

The interest rate decision was preceded by a very robust debate as evidenced by the even split in preferences on the MPC between no interest rate hike and a hike of 25 basis points. The SARB reiterated the difficulty in making interest rate decisions at the turning points in the monetary policy cycle. It had to balance the risk of acting too soon (with less confirmation of a materialisation in inflation risks) and acting too late, where elevated inflation expectations could result in higher inflation, which could solicit a much stronger response in monetary policy.

Chart 4: The SARB's output gap expectations (%)



Source: SARB, Momentum Investments

With the SARB acting early, it is likely that a shallow interest rate hiking cycle will follow. Lower growth and in-target inflation should prevent a more aggressive cycle in the absence of a faster-than-anticipated normalisation of monetary policy in developed markets or broad-based negative sentiment towards EMs. Momentum Investments expects a shallow interest rate hiking cycle and forecasts two further interest rate hikes during 2019 and 2020.

Financial market performance

Global markets

Global equity markets recovered in the last week of November 2018, after falling 1.7% in the first three weeks of the month, due to a sell-off in retail, energy and technology shares. Although fears over a weakening in global growth, ongoing trade disputes and the prospect of higher interest rates rattled global equity markets earlier in the month, the MSCI All World Index managed to print at 1.5% in the black by the end of the month. The Group of 20 (G20) world leaders' summit left equity markets higher on news that Trump had agreed to hold off on increasing tariffs on US$200 billion worth of Chinese imports from 10% to 25% in January 2019. The CBOE volatility index (VIX) tracked largely sideways during the month, but dipped to 18 points by the end of the month on a near-term avoidance of a further escalation in trade wars.

Gains were firmer in EM equity markets, while the MSCI Developed Market Index only inched higher by 1.1% in the month. A dip in the European equity market detracted from solid returns from US and Japanese equities. The Eurostoxx 50 Index fell 0.7% in November 2018, as lingering Brexit uncertainty and a possible escalation in trade tensions with the US continued to spook investors. Meanwhile, the S&P 500 Index rose 2% in the same period. Investors were encouraged by the comments out of the

US Federal Reserve Bank (Fed) indicating its interest rate decisions would continue to be dependent on data. Fed Chair Jerome Powell's comments that "Interest rates are still low by historical standards, and they remain just below the broad range of estimates of the level that would be neutral for the economy — that is, neither speeding up nor slowing down growth" were perceived by the market as a signal of a potential slowing in the pace of interest rate hikes in the US.

Gains in the Nikkei 225 picked up pace in the final week of the month, with the index ending 2.0% higher, despite a weakening in the US dollar.

Even though commodity prices were down 0.6% for November 2018, EM equities still performed well on the back of Powell's comments, which hinted at a slow rise in US interest rates. The Bloomberg Commodity Price Index was dragged lower by a 22% drop in international oil prices in the month, rather than due to a broad-based decline in commodity prices. The MSCI EM Index jumped 4% in November 2018, boosted by gains in the Asian equity market. The MSCI Asia Index finished the month 5.2% higher, buoyed by an ease in the trade row between the US and China. A strong return from the Asian equity market was followed by a 4.5% uptick in the MSCI Europe Middle East and Africa (EMEA) Index. Meanwhile, the MSCI Latin America Index bucked the trend and slipped 2.2% in the month.

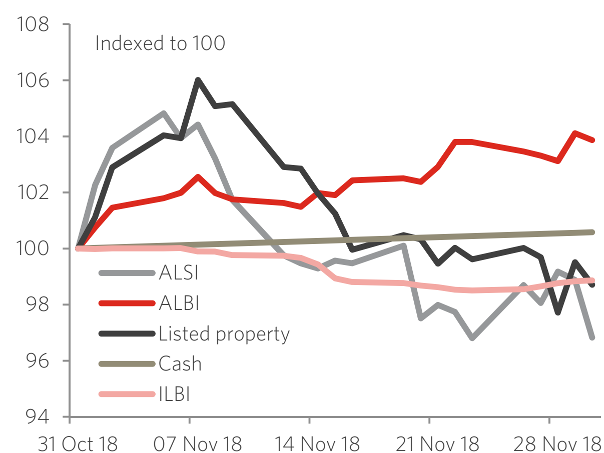
Despite a 1.6% recovery in the JPMorgan EM Currency Index in November 2018, the JPMorgan EM Bond Index (EMBI) spread widened by 27 points in the corresponding period. The Turkish lira (7.1%), South African (SA) rand (6.6%), Indonesian rupiah (6.3%) and Indian rupee (6.3%) firmed up against the US dollar in November 2018, while the Argentine peso (negative 4.9%), Brazilian real (negative 3.7%) and Russian rouble (negative 1.6%) faltered further. Corporate default swap (CDS) spreads mostly deteriorated across the EM composite in the month, except for in Indonesia, China, Philippines and SA, where spreads narrowed by 11, 5, 4 and 2 points, respectively. Russia, Peru, Colombia and Argentina experienced the worst widening in spreads (13, 10, 9 and 8 points, respectively) in the same period.

Local markets

SA equities suffered a blow in November 2018, as a stronger rand eroded gains among resource shares. The FTSE/JSE All-Share Index ended the month 3.2% in the red, with only financial shares recording gains (see chart 5).

The FTSE/JSE Resources Index plunged 11.5% in the month on rand strength and softer platinum prices. Platinum was down 4.6% in the month, while gold inched 0.5% higher in the same period. Notwithstanding the negative effect of rand strength on the dual-listed shares in the industrials composite, the FTSE/JSE Industrials Index managed to limit losses in the month to 0.5%. Financial shares held onto gains of 0.5% in November 2018.

Chart 5: Returns on local asset classes (%)



Source: IRESS, Momentum Investments, data up to 30 November 2018

The FTSE/JSE Mid-cap Index edged 1.4% lower in the month, while the FTSE/JSE Small-cap Index sank 3.3%.

Listed property shares were hurt through a contagion effect triggered by a report released by short-seller Viceroy Research. The index closed 1.3% down in November 2018.

In line with an improvement in investor sentiment towards EM, following comments by the US Fed, the SA ten-year local government bond yield rallied by more than 40 basis points in the month. The JSE ASSA All Bond Index bounced back 3.9% in November 2018, after falling by 1.7% in October. In contrast, the JSE ASSA Government Inflation-linked Bond Index (ILBI) ended the month 1.1% softer. SA cash posted a 0.6% gain in the same period.

The SA rand was the second-best-performing currency against the US dollar for the month. The rand appreciated by 6.1% against the euro and 6.7% against the British pound in the corresponding period. In line with a stronger local currency, SA's five-year CDS spread narrowed by 7 points in the month, but it remains around 70 basis points wider than at the start of the year.

Indices summary for November 2018

	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)	-3.17%	-12.56%	-12.56%	2.30%	3.39%	5.51%	8.04%	9.65%	12.32%
FTSE/JSE Shareholder Weighted Index (SWIX)	-0.61%	-10.92%	-14.29%	1.71%	3.01%	6.05%	8.51%	10.34%	13.03%
FTSE/JSE Capped SWIX All Share index	-1.69%	-10.19%	-12.39%	1.07%	2.32%	5.48%	8.02%	9.92%	
FTSE/JSE All Share Top 40 Index	-3.10%	-13.81%	-13.62%	1.58%	3.19%	5.16%	7.81%	9.31%	11.83%
FTSE/JSE Mid Cap Index	-1.40%	-4.33%	-8.53%	4.46%	2.70%	5.90%	7.72%	10.01%	14.46%
FTSE/JSE Small Cap Index	-3.28%	-8.14%	-10.53%	-0.79%	1.20%	4.57%	8.46%	11.18%	12.78%
FTSE/JSE Resources Index	-11.50%	-14.12%	2.40%	16.10%	-0.56%	-2.32%	-1.50%	-2.08%	2.63%
FTSE/JSE Financials Index	0.52%	-4.66%	-1.70%	2.59%	4.84%	9.33%	11.42%	14.35%	14.79%
FTSE/JSE Industrials Index	-0.69%	-15.65%	-22.73%	-2.75%	1.80%	5.21%	9.41%	12.76%	16.23%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	-5.32%	-12.14%	-7.44%	7.90%	4.33%	5.65%	7.71%	9.07%	12.31%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	-5.38%	-11.59%	-7.35%	7.59%	3.94%	5.31%	7.42%	8.79%	11.81%
FTSE/JSE SA Listed Property Index (SAPY)	-1.29%	-5.48%	-21.28%	-2.90%	1.58%	6.14%	6.40%	10.45%	12.74%
Interest-bearing indices									
JSE ASSA All Bond Index (ALBI)	3.87%	2.40%	13.05%	8.31%	6.53%	7.81%	6.79%	7.82%	8.34%
JSE ASSA All Bond Index 1-3 years (ALBI)	1.77%	3.87%	10.42%	8.70%	7.80%	7.71%	7.19%	7.33%	7.83%
JSE ASSA SA Government ILB Index	-1.14%	-0.08%	4.54%	2.03%	2.86%	4.72%	4.38%	6.26%	7.39%
Short-term Fixed Interest Composite Index (SteFI)	0.58%	1.76%	7.25%	7.38%	7.15%	6.88%	6.59%	6.45%	6.74%
Commodities									
NewGold Exchange-Traded Fund	-7.00%	-5.14%	-4.08%	2.75%	6.09%	5.22%	1.17%	2.30%	7.00%
Gold price (in rands)	-6.09%	-4.95%	-3.90%	3.10%	6.51%	5.80%	1.60%	2.17%	7.51%
Platinum Exchange-Traded Fund	-10.84%	-4.99%	-14.08%	-2.80%	-4.95%	-5.01%			
Platinum price (in rands)	-10.07%	-4.01%	-13.81%	-2.66%	-4.43%	-4.35%	-5.47%	-3.35%	1.71%
Currency movements									
Rand/euro movements	-6.15%	-7.99%	-3.42%	1.04%	3.35%	2.56%	5.25%	5.35%	2.10%
Rand/dollar movements	-6.11%	-5.45%	1.64%	-1.29%	5.86%	6.40%	7.70%	7.99%	3.26%
Inflation index									
Consumer Price Index (CPI)			5.09%	5.43%	5.24%	5.38%	5.40%	5.43%	5.23%

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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