Market Overview - September 2018

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Global equities were led higher by strong corporate earnings out of the US with the S&P 500 gaining 3.3%, followed by the Nikkei's 1.4% gain. However, European and Emerging Market equities ended the month lower, fuelled by signs that global growth is no longer synchronized, but rather US-led.
The US growth leadership in combination with increased global policy uncertainty has led to a stronger dollar and dampened demand for risky assets. Against this backdrop, it is not uncommon to experience a large-scale sell-off in emerging market assets and currencies, especially those which are more dependent on portfolio flows to finance current account deficits. That being said, the recent drop in the rand and other emerging currencies were outside of the norm, fuelled by Turkish and Argentinian woes, which the market fears may have a spill-over effect.

Diplomatic and trade ties between Turkey and the US worsened in August, resulting in a sharp sell-off in the Lira and significant credibility loss by the Turkish central bank, as it failed to hike rates in the midst of rising inflation. This in combination with Argentinian woes described earlier, catalysed an EM risk-off, with the Argentine Peso (ARS) falling 28.8%, and the Turkish Lira (TRY) falling 23.4% in August, both against the USD. The rand was the third-worst performing currency in the world in August after the TRY and ARS.

As a result of these events and dampened sentiment, foreign bond outflows from SA were over $1 billion, after small inflows in July, and a record outflow of $2.5 billion in June. The current YTD outflows (bond and equities) are R53 billion – the largest outflow since 2008. After month end, Stats SA released the much anticipated Q2 GDP print, which confirmed that the country entered a technical recession in the second quarter after it contracted by 0.7% q/q – the second consecutive contraction. Growth was dragged lower by five of the ten sectors of the economy, underscoring just how broad-based the weakness is. Agricultural output fell 29.2% q/q, subtracting -0.8 percentage points (pps) from growth, while transport sector growth fell 4.9% (-0.4 pps). The manufacturing, trade and government sectors contracted by 0.3% q/q, 1.9% and 0.5% respectively, shaving a combined -0.4 pps from the headline number.

The only sectors to make any meaningful positive contribution were mining, construction, finance, real estate and business services, all of which came off a very weak base. We don't expect their positive contribution to last. In short, there were very few, if any, positives to take away from the figures.
There is no quick fix as government does not have the fiscal headroom to stimulate the local economy, particularly as current spending continues to crowd out infrastructure investment. Also, the household sector did not provide any support as household consumption dropped 1.3% q/q, with clothing, transport and recreation spend bearing the brunt of consumers tightening their belts.

Data at hand thus far, including the August Absa manufacturing PMI and August vehicle sales, suggest that growth for the rest of the year will continue along these lines, and we believe that growth forecasts will inevitably miss on the low side this year, jeopardising tax revenue and fiscal consolidation targets, and in turn, drawing the unwanted attention of rating agencies.

Global inflation rates accelerated further in July, driven by energy, services and food inflation. In the US, core PCE rose to 2% year-on-year in July while headline CPI remained unchanged at 2.9%, well above the Fed's 2% target. While US jobs growth eased, labour force participation also declined, resulting in a drop in the unemployment rate to 3.9% in July. The Fed remains on track to hike interest rates by 25 bps in September as the current economic data continues to reflect an upbeat economy, with inflation remaining above the 2% target. There is a high probability that we will see another 25 bps rate hike before the end of the year. The ECB will be quite content with inflation having risen above its target as it accelerated to 2.1% y/y, beating expectations of 2%. Around this time last year, the ECB was expecting inflation to remain stubbornly low over the next two years. A key positive has been the pause in tariff attacks between the US and the EU as negotiations persist. On the other hand, consumer spending, which has been a key driver of growth over the last three years, has started to slow, as evidenced by disappointing retail sales prints in May and June. Eurozone GDP growth remained unchanged over the quarter at 0.4%.