MARKET MATTERS

19 MARCH – 23 MARCH 2018

TARIFF TANTRUMS

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An eventful week kicked off with high-flying US technology shares hitting an air pocket last week following revelations of a massive Facebook data breach and a tragic accident involving a self-driving vehicle. The so-called FAANG shares – Facebook, Amazon, Apple, Netflix and Google parent Alphabet – have driven the US markets higher and the tech-heavy Nasdaq has outperformed the broader S&P500 Index by 11% over the past year. South Africa's own tech heavyweight Naspers fell after an announcement that it would trim its holding in Chinese internet giant Tencent.

FED OVERSHADOWED BY TRADE SPAT

The most anticipated event by investors last week was the US Federal Reserve's monetary policy meeting, the first under the leadership of new Chair Jerome Powell. The 25 basis point interest rate increase announced on Wednesday was expected amid an improved outlook for US economic growth. This takes the federal funds rate to a target range of 1.5% to 1.75%. What the market really wanted to know was whether the "dot plot" - the projections of each individual meeting participant - would show a faster path of rate hikes in the future. According to these dots, rates will rise somewhat faster in 2019 and 2020 than previously thought. By 2020, the federal funds rate is expected to be 3.4%, 50 basis points above what the Fed considers to be the long-run (or neutral) rate of 2.9%. In other words, while rates are rising, the Fed's policy stance will be contractionary only by 2020. The current stance is therefore still expansionary, supporting economic activity and financial markets.

However, while the market largely shrugged off the Fed, the reaction to US president Trump's announcement on Thursday of further tariffs of up to 25% on some $60 billion worth of Chinese imports was sharply negative. Major equity indices slumped on Thursday and Friday in a typical knee-jerk response. The truth is that it's too early to gauge what the impact on economic growth and company profits will be. Analysts still expect S&P500 earnings to grow 19% this year. That will depend on whether the trade spat escalates or whether China and the US can come to an amicable agreement. The main reason behind the imposition of the tariffs is the alleged long-running unfair acquisition of US intellectual property by Chinese entities. China's initial response has been muted, raising tariffs on only $3 billion of US goods. Reports over the weekend suggest negotiations between the world's two largest economies on this matter are underway behind the scenes.

NO MOODY'S BLUES

On the local front, the big event was Moody's announcement on Friday of the outcome of their credit ratings review. Moody's maintained South Africa's local and foreign currency ratings at Baa3, the last notch above so-called junk status, and changed the ratings outlook to stable. Moody's noted that the decline in institutional strength had been halted, highlighted last week by the suspension of the SARS Commissioner. The improved growth outlook and return to fiscal consolidation were also key drivers.

As ratings agencies rely on information that is mostly publicly available, they tend to tell investors what they already know. What made this announcement significant is that by maintaining South Africa's investment grade ratings, Moody's allows for our continued inclusion in the Citigroup World Government Bond Index. A downgrade by Moody's on the back of previous downgrades by the other two ratings agencies would have resulted in forced selling by investors tracking this index.

In contrast, Turkey was recently downgraded deeper into junk territory by Moody's, with the deterioration of institutional strength a key concern. In particular, the lack of central bank independence was cited. In contrast, the SA Reserve Bank has full operational independence and has been a pillar of institutional strength. It has arguably kept interest rates too high, rather than too low, as in the case of Turkey.

Despite the Fed rate hike and the market worries over trade, the rand was firm and ended the week 6% stronger against the dollar than a year ago. This is likely to place continued downward pressure on imported inflation in the coming months.

INFLATION LOWER

Overall consumer inflation declined by more than expected in February, with the annual increase in the consumer price index dropping from 4.4% to 4% in January. Goods inflation dropped to 3.2%, with the inflation of durable goods barely positive. Non-durable goods (mostly food) inflation declined to 4.2%. Services prices tend to be more stable than goods prices, as they are less influenced by the exchange rate and globally traded prices. Services are often contractual with price changes happening once a year (for instance, rental escalation). In this sense, services prices reflect underlying inflationary pressures better than goods prices. Interestingly, insurance inflation – a big component of the overall CPI basket with a 10% weight – dropped to 6.8%. It is too soon to tell whether this is a sustained decline, but if it is, it is fairly significant as insurance inflation (including medical aid, life insurance and home and motor cover) has been high and sticky around 8% for the previous five years.

The petrol price dropped in February, capping fuel inflation at 5.1%. March also saw a petrol price cut. Combined with the current higher level of the global oil price, the increases in the fuel and RAF levies in April suggest that fuel inflation is likely to rise in coming months, putting some upward pressure on the overall inflation rate (petrol has a 4.5% weight in the CPI basket).

Core inflation, excluding volatile food, fuel and energy prices, remained steady at 4.1% in the bottom half of the Reserve Bank's 3% to 6% target range.

The impact of the 1% VAT increase effective next month on inflation will depend on how companies choose to pass on costs to consumers. This is a function in turn of the competitive landscape in each industry. Moreover, the impact of VAT on inflation should be more or less temporary unless there is another increase next year (since inflation is measured as the 12-month change). Around 40% of the CPI basket is zero-rated.

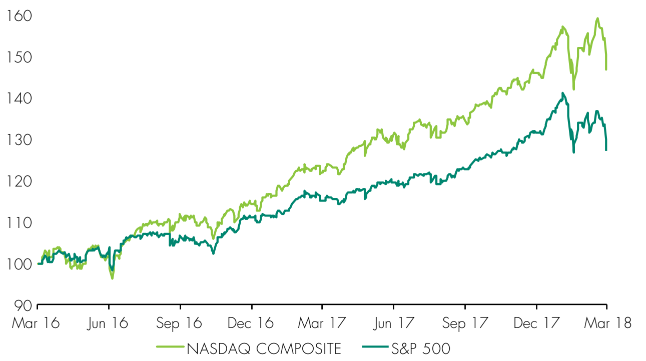
Separately, the fourth quarter current account deficit of 2.9% of GDP was somewhat larger than expected and up from 2.1% in the third quarter. South Africa posted a trade surplus in the fourth quarter, but it was smaller than in the previous quarter as import volumes picked up, reflecting stronger domestic demand. The biggest driver of the current account deficit was therefore a widening of the deficit on the services, income and transfer account deficit to 4.4% in the fourth quarter. This was due to an increase in dividend payments to foreign investors, while dividends received from abroad by locals declined.

CURRENT ACCOUNT DEFICIT
STILL UNDER CONTROL

The current account deficit has over the years been a big concern for the Reserve Bank, as it is typically financed by portfolio inflows (foreigners buying shares and bonds). If these flows dry up, the rand typically comes under tremendous pressure. However, the deficit has more than halved from the almost 7% peak in 2013. That was the same year that the market was surprised by then Fed chair Ben Bernanke's musings that a scaling back or tapering of quantitative easing loomed, a sell-off that was later dubbed the "taper tantrum". The rand depreciated 23% against the dollar in 2013, and the experience clearly embedded itself in the SARB's thinking. The current environment is therefore different in two key respects: the Fed is very careful to signal its intentions and not, as far as possible, to surprise the market, and secondly our external vulnerability to a nasty Fed surprise has diminished.

Therefore, a checklist for an interest rate cut this week is mostly complete. A Fed that doesn't surprise? Check. A Moody's downgrade averted? Check. A fairly robust rand despite global market jitters? Check. Current account deficit under control? Check. Tighter fiscal policy? Check. And, finally, inflation solidly within target, and expected to remain there? Check.

CHART 1: NASDAQ COMPOSITE AND S&P500 EQUITY INDICES, REBASED TO 100

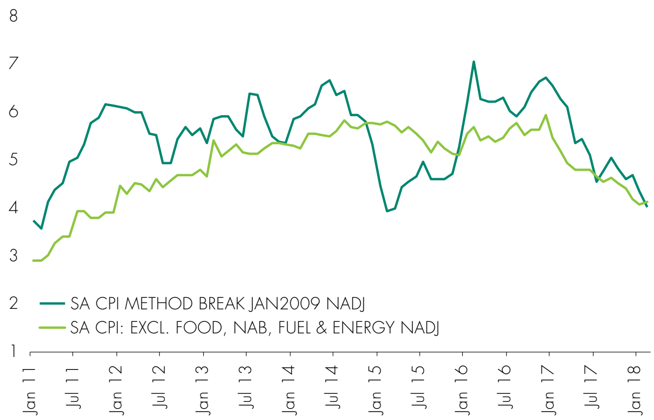


Source: Datastream

CHART 2: RAND TO US DOLLAR EXCHANGE RATE

Source: Datastream

CHART 3: SA CORE AND HEADLINE INFLATION, %



Source: StatsSA

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 073.0	-2.86%	-2.12%	-1.43%	12.36%
United States	S&P 500	US$	2 588.0	-5.96%	-4.64%	-3.22%	10.32%
Europe	MSCI Europe	US$	1 743.0	-2.02%	-1.97%	-3.01%	11.23%
Britain	FTSE 100	US$	9 782.0	-2.10%	-1.71%	-5.95%	6.46%
Germany	DAX	US$	1 393.0	-3.06%	-2.79%	-5.55%	17.85%
Japan	Nikkei 225	US$	196.9	-3.75%	-4.83%	-2.57%	14.61%
Emerging Markets	MSCI Emerging Markets	US$	1 197.0	-1.32%	0.17%	3.37%	23.66%
Brazil	MSCI Brazil	US$	2 244.0	-0.49%	-2.31%	10.92%	23.50%
China	MSCI China	US$	93.5	-3.41%	0.35%	5.65%	39.61%
India	MSCI India	US$	568.1	-1.04%	-3.54%	-7.02%	10.96%
South Africa	MSCI South Africa	US$	605.0	-0.66%	-2.42%	0.00%	17.70%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	56 406.0	-2.92%	-3.29%	-5.21%	8.41%
All Share	All Share (Total Return)	Rand	8 062.0	-2.82%	-2.77%	-4.59%	11.52%
TOP 40/Large Caps	Top 40	Rand	7 099.0	-3.14%	-2.62%	-4.69%	13.99%
Mid Caps	Mid Cap	Rand	16 483.0	-0.24%	-2.68%	-2.90%	-0.19%
Small Companies	Small Cap	Rand	20 560.0	-0.30%	-2.26%	-2.20%	-4.73%
Resources	Resource 20	Rand	2 213.4	-2.25%	-1.80%	-3.18%	16.58%
Industrials	Industrial 25	Rand	14 164.0	-3.42%	-3.10%	-6.30%	10.88%
Financials	Financial 15	Rand	9 701.0	-2.89%	-2.67%	-0.06%	20.49%
Listed Property	SA Listed Property	Rand	1 984.1	-4.26%	-0.79%	-19.48%	-9.36%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	966.1	-0.33%	0.73%	1.90%	7.38%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	634.5	1.84%	1.93%	7.96%	11.96%
Government Bonds	BESA GOVI	Rand	630.9	1.68%	1.81%	7.60%	11.74%
Corporate Bonds	SB JSE Credit Indices	Rand	125.0	-2.93%	-3.21%	-0.96%	-15.07%
Inflation Linked Bonds	BESA CILI	Rand	260.2	3.68%	3.25%	3.02%	3.97%
Cash	STEFI Composite	Rand	389.2	0.14%	0.45%	1.64%	7.46%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	68.8	4.05%	5.88%	2.72%	34.94%
Gold	Gold Spot	US$	1 348.0	2.59%	2.28%	3.93%	8.36%
Platinum	Platinum Spot	US$	947.0	0.11%	-3.37%	1.83%	-1.46%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	11.73	2.11%	0.53%	5.52%	6.29%
ZAR/Pound	ZAR/GBP	Rand	16.59	0.66%	-2.17%	0.90%	-5.97%
ZAR/Euro	ZAR/EUR	Rand	14.50	1.51%	-0.76%	2.48%	-7.31%
Dollar/Euro	USD/EUR	US$	1.24	-0.81%	-1.69%	-3.15%	-12.90%
Dollar/Pound	USD/GBP	US$	1.41	-1.31%	-2.35%	-4.47%	-11.55%
Dollar/Yen	USD/JPY	US$	0.01	-1.18%	-1.83%	-7.04%	-5.74%

Source: I-Net, figures as at 23 March 2018

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- SA Reserve Bank Monetary Policy Committee meeting
- Credit growth
- Producer inflation

US

- Pending home sales
- House prices
- Consumer confidence
- Final fourth quarter GDP
- Personal income and spending

EUROPE

- Eurozone loan growth
- Eurozone economic sentiment indices

JAPAN

- Retail sales

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