MARKET MATTERS

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THE GREENBACK MAKES A COMEBACK

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In the past two weeks, the two major global central banks both held monetary policy meetings that ended with interest rates unchanged. What is more important than what was done (or not) is what was said.

In the case of the European Central Bank (ECB), the question was how worried they are about the slowdown in Eurozone growth. The ECB not only kept its policy interest rates unchanged, but also left its €30 billion per month bond-buying programme in place until at least September. Eurozone year-on-year economic growth slowed from 2.8% in the fourth quarter to 2.5% in the first quarter. Noting "some moderation" in growth, it still believed the expansion was "solid and broad-based".

After surprisingly strong economic growth in 2017, the Eurozone suddenly and unexpectedly lost momentum over the past few months. There are several theories as to why, including severe snowstorms. Another is that the Eurozone was growing faster than its underlying potential, resulting in supply chains being stretched and key inputs becoming scarce. If this is the case, it has happened without putting upward pressure on prices. Core inflation in the Eurozone fell below 1% in April.

SYMMETRIC TARGET NOT A CEILING

In the case of the US Federal Reserve, the question was how they view the recent rise in inflation. The Fed's preferred inflation measure (personal consumption expenditure deflator excluding food and energy) has also almost hit the 2% target, supported by a low base formed by unexpectedly low inflation a year ago.

This low base and higher oil prices will probably keep inflation above 2% for the next few months. However, for the Fed to get a fright and substantially speed up the pace of rate hikes (which would be a nightmare scenario for both bond and equity markets), price increases that are even more rapid and sustained will be required. The key phrase from the Fed statement was that medium-term inflation was expected to run "near the symmetric 2% objective". By explicitly emphasising the symmetric nature of the target for the first time, the Fed reminds the market that it is not a ceiling, and inflation can run above it for some time, having spent most of the past decade below it. It is therefore unlikely to hike rates aggressively.

A key input in how the Fed sees inflation trajectory is whether declining unemployment puts upward pressure on wages and, in turn, on consumer prices. On Friday, after the Fed meeting, payroll data showed decent growth in new jobs in April and a decline in the unemployment rate to an 18-year low of 3.9%. However, wage growth declined slightly to 2.6%. So there is still no evidence of labour market strength driving inflation.

Against this backdrop, the US 10-year government bond yield briefly rose above 3% for the first time since January 2014 (bond yields and prices move in opposite directions). Apart from rising inflation expectations due to the higher oil price, the other headwind for the US bond market is that the US government is borrowing more to fund its widening budget deficit. However, even at 3% the bond market is not pricing in runaway growth, inflation or interest rates. In fact, 3% is pretty much where the US Fed sees its policy rate settling over the long term. Shorter-term yields have been rising faster than longer-term yields since the former more closely reflect Fed hikes. The yield curve – the difference between long and short yields – has therefore been flattening. A negative or inverted yield curve (when short yields exceed long yields) is typically a harbinger of recession, but we're not there yet and US growth is still solid. The US economy expanded by 2.8% in the four quarters to end March, the seventh consecutive quarter of annual growth accelerating.

In other words, while the Eurozone grew faster than the US in late 2017, the roles are now reversed again. At the same time, inflation has picked up in the US and is declining in the Eurozone. This supported the dollar against the euro, and it strengthened below $1.20 per euro. The dollar also gained against other major currencies, while emerging market currencies declined substantially against the greenback. The trade-weighted dollar is therefore on the rise again, having somewhat unexpectedly declined since the start of 2017 (see chart 1).

EMERGING MARKETS **UNDER PRESSURE**

Some emerging market currencies were punished more than others. Argentina's currency hit a record low and the central bank responded by hiking rates three times last week (to 40%). The Turkish lira also hit a record low against the dollar. S&P Global downgraded Turkey deeper into junk status last week as the weak currency increases the country's sizable foreign private sector debt burden. Much of this is denominated in dollars. Of course, news of the downgrade did not help the currency. Turkey's inflation rate soared to 12% in March, and the weaker lira is likely to make the situation worse.

A stronger dollar will also increasingly revive fears about dollar-denominated debt elsewhere in the world, but before getting carried away, remember that the trade-weighted dollar is still 5% lower than a year ago. The Bank for International Settlements estimates that dollar-denominated debt outside the US increased by 8% during 2017 to $11.4 trillion. Whether these borrowers will get hurt will depend on whether they hedged the forex exposure or earn dollar incomes. Mining companies sell their output in dollars, for instance.

The rand did not escape the strengthening dollar and it sold off. It is worth noting that at last week's close of R12.50, it is still somewhat stronger than a year ago, and it is therefore premature to worry about upward pressure on inflation from non-oil imports becoming more expensive (oil is almost 40% more expensive in rand terms than a year ago). But it does mean that further interest rate cuts are off the table for now. Fortunately, dollar-denominated debt levels are moderate and not a huge concern for the local economy since neither the government nor the private sector struggles to access credit in the local market.

WEAKER RAND **SUPPORTS LOCAL EQUITIES**

Where the weaker rand does help is on the JSE, where the largest companies generate most of their revenues abroad. The weaker currency also means local investors saw the benefit of positive global equity markets in rand terms. The local equity market recovered some of the losses of February and March during April. The FTSE/JSE All Share Index (ALSI) returned 5.4% in April, but the first few days of May have been choppy. The one-year ALSI return at the end of April was 11.5%.

Though all the main sectors were positive, resources had the best performance in the month with an 8.6% return. Industrials returned 5.2% in April. Financials also had a good month, returning 3.2% and lifting one-year returns to 17%. Banks delivered 1% in April, but are up 40% over 12 months.

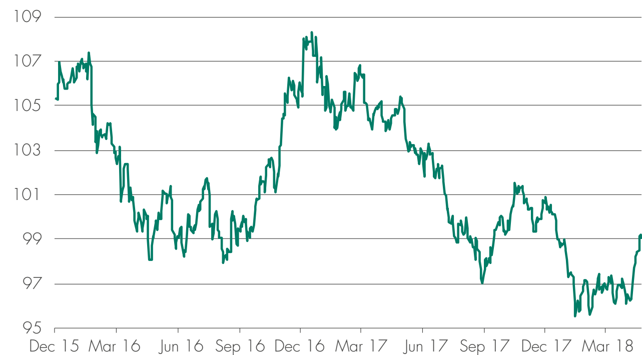
The bombed-out local listed property sector enjoyed some respite in April. The FTSE/JSE SA Listed Property Index returned 7.6% in April, but is still down 13% so far in 2018 and flat over the preceding two years.

APRIL A **MUCH BETTER MONTH**

Bonds had a negative month as the rand retreated and global bonds sold off. The All Bond Index (ALBI) lost 0.7% in the month as the 10-year government bond yield rose from 7.9% to 8.19% during the month. The ALBI's 2018 return of 7.3% is still well above cash, while a 13.7% return over 12 months means it is still the top performing asset class for local investors over this period.

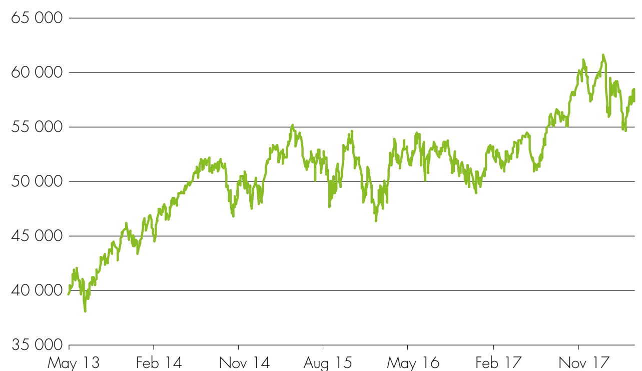
Though yields have increased across the boards in emerging markets, South African yields remain attractive and among the highest. It would have been nice if all asset classes always moved up simultaneously, but in reality it doesn't work this way, and that is why diversification is important. All in all, April was a much better month for local investors after a tough first quarter. It shows the benefit of sitting tight through market volatility, provided you have an appropriate investment strategy.

CHART 1: TRADE-WEIGHTED US DOLLAR INDEX



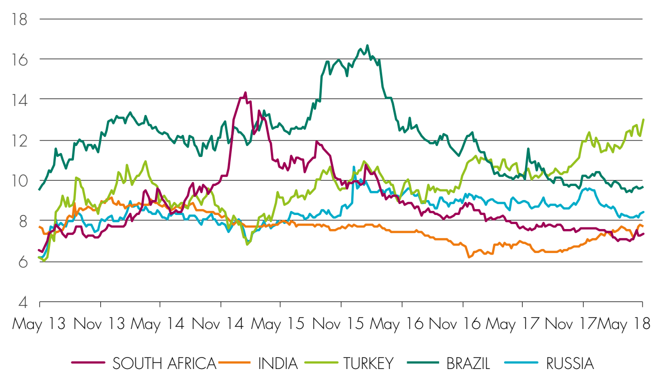
Source: Thomson Reuters Datastream

CHART 2: JSE ALL SHARE INDEX



Source: Thomson Reuters Datastream

CHART 3: SA AND OTHER EMERGING MARKETS' 10-YEAR GOVERNMENT BOND YIELDS, %



Source: Thomson Reuters Datastream

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 071.0	-1.19%	-0.77%	-1.52%	9.81%
United States	S&P 500	US$	2 663.0	-0.26%	0.57%	-0.41%	11.42%
Europe	MSCI Europe	US$	1 765.0	-1.29%	-1.34%	-1.78%	7.10%
Britain	FTSE 100	US$	10 236.0	-1.00%	-0.98%	-1.59%	9.27%
Germany	DAX	US$	1 444.0	0.49%	0.63%	-1.16%	13.70%
Japan	Nikkei 225	US$	206.0	0.00%	0.25%	1.96%	19.04%
Emerging Markets	MSCI Emerging Markets	US$	1 138.0	-1.56%	-2.23%	-1.73%	16.12%
Brazil	MSCI Brazil	US$	2 039.0	-6.34%	-5.43%	0.79%	11.85%
China	MSCI China	US$	88.9	0.04%	-1.22%	0.52%	31.76%
India	MSCI India	US$	583.6	-0.71%	-1.09%	-4.49%	9.08%
South Africa	MSCI South Africa	US$	540.0	-4.26%	-4.76%	-10.74%	11.34%

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	57 649.0	0.34%	-1.04%	-3.12%	7.94%
All Share	All Share (Total Return)	Rand	8 291.0	0.38%	-1.00%	-1.88%	11.18%
TOP 40/Large Caps	Top 40	Rand	7 305.0	0.43%	-1.00%	-1.92%	11.97%
Mid Caps	Mid Cap	Rand	16 651.0	0.01%	-1.69%	-1.91%	6.47%
Small Companies	Small Cap	Rand	21 170.0	2.09%	0.76%	0.70%	2.36%
Resources	Resource 20	Rand	2 453.4	1.62%	0.79%	7.32%	26.75%
Industrials	Industrial 25	Rand	14 400.0	0.40%	-1.33%	-4.74%	4.83%
Financials	Financial 15	Rand	9 670.0	-0.78%	-2.23%	-0.38%	22.87%
Listed Property	SA Listed Property	Rand	2 062.0	-1.66%	-3.33%	-16.31%	-4.54%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	949.0	-0.64%	-0.64%	0.09%	4.54%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY					
All Bond	BESA ALBI	Rand	623.1	-0.93%	-1.23%	6.03%	12.25%
Government Bonds	BESA GOVI	Rand	619.7	-0.94%	-1.24%	5.68%	11.97%
Corporate Bonds	SB JSE Credit Indices	Rand	119.0	-0.36%	-0.24%	-5.67%	-16.11%
Inflation Linked Bonds	BESA CILI	Rand	256.2	0.17%	0.03%	1.42%	3.46%
Cash	STEFI Composite	Rand	392.4	0.13%	0.08%	2.47%	7.42%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	75.0	0.64%	-0.07%	11.87%	52.96%
Gold	Gold Spot	US$	1 315.0	-0.68%	-0.15%	1.39%	7.08%
Platinum	Platinum Spot	US$	909.0	-0.33%	0.33%	-2.26%	0.55%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	12.50	-1.34%	-0.28%	-0.94%	9.15%
ZAR/Pound	ZAR/GBP	Rand	16.91	0.47%	1.42%	-1.01%	4.26%
ZAR/Euro	ZAR/EUR	Rand	14.95	-0.01%	0.66%	-0.61%	0.19%
Dollar/Euro	USD/EUR	US$	1.20	0.83%	0.67%	0.08%	-8.33%
Dollar/Pound	USD/GBP	US$	1.35	1.88%	2.02%	-0.20%	-4.64%
Dollar/Yen	USD/JPY	US$	0.01	0.02%	-0.23%	-3.18%	-2.92%

Source: I-Net, figures as at 4 May 2018

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Mining and manufacturing production

US

- Job openings
- Inflation

CHINA

- Trade balance
- Inflation
- Credit growth

JAPAN

- Current account balance

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