GLOBAL GROWTH SLOWING, NOT SLUMPING

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At the gathering of the world's elites in snowy Davos, one of the key topics of discussion was the cooling in global economic activity. The International Monetary Fund (IMF) contributed to this conversation by lowering its forecast of global growth.

The IMF now expects the global economy to grow by 3.5% in 2019, whereas in October it was still expecting 3.7% growth. It estimates that growth in 2018 was 3.7%. In other words, we are not talking about a huge decline as 3.5% is broadly in line with the long-term average of global growth.

EUROPE DOWN TO EARTH

The main area of weakness compared to the October forecast is in the Eurozone, where growth has slowed sharply from a heady 2.4% in 2017 to 1.8% last year with only 1.6% expected this year. Again this is broadly in line with the long-term growth rate of the Eurozone. The European Central Bank (ECB), which kept rates on hold last week, blamed the slowdown on external factors. In particular it noted "persistent uncertainty relating to geopolitical factors and the threat of protectionism".

Brexit, the Yellow Vest protests in France and Donald Trump's trade wars all fall in this category. There are also some once-off problems, such as the low level of the Rhine River impeding the flow of goods in Europe's main water highway and new emission standards impeding car production. Germany in particular is heavily dependent on its auto industry. The one party the ECB did not blame was itself. It has halted its quantitative programme, and while its benchmark rate is still zero, it still expects to start hiking later this year despite the downshift in its growth outlook and inflation being stubbornly low. In other words, it appears to have declared victory prematurely and might still be forced to retreat from its current path of gradually removing stimulus.

CHINA'S CHALLENGES

Notably, the IMF has not changed its growth outlook for China and still expects 6.2% growth this year. This does represent slower growth compared to longer-term trends, but those levels of growth were never sustainable and a slowdown was inevitable as the economy matured. The question has rather been how quickly China decelerates, and how disruptive this process is, given that debt levels have increased dramatically in recent years. The IMF, for political reasons, will work with the official Chinese economic data in its forecasts and has always done so. Most economists in the private sector are sceptical of how accurate they are.

Against the backdrop of slowing growth, there is also the challenge of transitioning the main economic engine from exports and fixed investment to domestic consumption and services, which are more sustainable. Complicating things, recent years have also seen a massive build-up of debt at state-owned companies and local governments, even as private companies were increasingly starved of credit. This growth in debt supported economic activity but at a diminishing rate, with each additional yuan of borrowing boosting productive growth by less and less each year. Authorities have been well aware of these problems and their efforts to tame shady borrowing has slowed economic growth.

It is now attempting to prevent further slowing through a number of stimulus measures, including cutting the reserves banks need to hold against loans, cutting various taxes, and ramping up infrastructure spending. As Nobel Laureate Paul Krugman noted last week, the Chinese government is hindered neither by rigid ideology nor by democratic accountability to voters. It has repeatedly shown the willingness and ability to prop up its economy. It could do so again.

Further complicating things for China is US President Donald Trump's trade war, which had a limited impact on economic activity, but a substantial impact on confidence. Negotiations between the US and China are ongoing. News reports on the progress swing from optimism to pessimism. As talks happen behind closed doors, it is hard for outsiders to know what is really happening. However, the incentive for both parties to strike a deal has increased substantially, given slower growth and nervous stock markets on both sides of the Pacific.

From a local point of view, the biggest impact from slowing Chinese growth is potentially on commodity prices, but so far these are not showing particular signs of weakness, and in fact the iron ore price has been climbing. One point that is often missed is that China added more to its total economy in dollars in 2018 when its growth rate was 6.6% than in 2017 when growth was 6.8%. So China still consumes a lot of commodities.

SELF-FULFILLING RISKS

Apart from the trade tensions, there are several risks to the global outlook, as there always are. One of the biggest risks, not often mentioned in commentaries, is that of a self-fulfilling prophecy. The more investors fear a looming recession, the more their behaviour can result in one, particularly with so much political uncertainty around (including the threat of another US government shutdown).

Many people believe the post-crisis global economic expansion has carried on longer than past cycles, and therefore a global recession is due. This reasoning ignores the fact that there have been two substantial slowdowns – with accompanying market corrections - in this expansion in 2011/12 and 2015/16. These shook out some of the excesses, reset expectations and generally brought everyone down to earth.

The other point is simply that economic cycles don't die just of old age, they are pushed over the edge by some combination of rising interest rates or some other financial shock, accelerating inflation, war or a surge in the oil price. Where we stand today, oil prices have fallen from a level of $85 per barrel in October – with accompanying talk of $100 oil – to $60. With global oil demand running around 80 million barrels a day, this amounts to a daily savings of $1.2 billion dollars for the world's consumers. For the same reason, the oil price surge last year was a significant drain of US dollars from the global financial system, as importing nations need to find dollars to pay for oil.

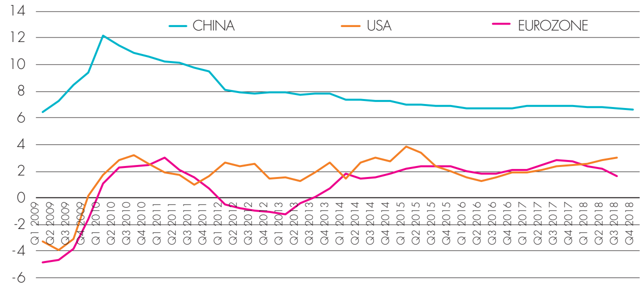
Similarly, market-based interest rates have fallen, taking pressure off borrowers. For instance, American home loan rates are linked to long-bond yields (unlike in South Africa, where they are linked to the central bank's policy rate) and these have fallen from around 5% to 4.5%, a substantial saving for new borrowers.

INVESTMENT IMPLICATIONS

Why should we care about slower global growth? Slowing economic growth can feed into lower company profits, and already the forecast earnings growth for 2019 for the MSCI All Country World Index has been lowered from 10% to 7%. Again, these earnings growth numbers are in line with the long-term annual growth of 6% in US dollars since the start of the Index in 1988. The annual return including dividends from global equities over this period was 9% in US dollars.

Even though the expected growth rate of company profits has been lowered, the decline in share prices has been much worse. This is typical, as short-term market moves are mostly driven by shifts in sentiment from greed to fear and back. Therefore, with the decline in global share prices and the (smaller) decline in global profit growth expectations, the ratio of the two, the forward price:earnings ratio, has fallen to 13.5 (the market has de-rated in the jargon of analysts). This is below the long-term average of 16. Historically, the lower the starting valuation, the better the returns in subsequent years. Even in an uncertain world, global equities should deliver reasonable real returns for investors who can stomach the volatility.

CHART 1: REAL ECONOMIC GROWTH RATES FOR THE BIG THREE ECONOMIES



Source: Thomson Reuters Datastream

CHART 2: MSCI ALL COUNTRIES WORLD INDEX SINCE 2009

Source: Thomson Reuters Datastream

CHART 3: MSCI ALL COUNTRIES WORLD INDEX FORWARD PRICE: EARNINGS RATIO

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$	2 002.0	0.05%	6.26%	6.26%	-10.98%
United States	S&P 500	US$	2 665.0	-0.22%	6.30%	6.30%	-7.24%
Europe	MSCI Europe	US$	1 567.0	0.45%	5.45%	5.45%	-18.13%
Britain	FTSE 100	US$	8 989.0	0.20%	4.71%	4.71%	-17.31%
Germany	DAX	US$	1 220.0	1.58%	7.39%	7.43%	-21.54%
Japan	Nikkei 225	US$	189.6	0.73%	3.84%	3.84%	-12.87%
Emerging Markets	MSCI Emerging Markets	US$	1 032.0	1.38%	6.83%	6.83%	-18.93%
Brazil	MSCI Brazil	US$	2 217.0	0.77%	14.04%	14.04%	-7.35%
China	MSCI China	US$	76.5	1.64%	8.59%	8.59%	-24.54%
India	MSCI India	US$	544.1	-0.96%	-2.50%	-2.50%	-14.72%
South Africa	MSCI South Africa	US$	486.0	2.10%	9.21%	9.21%	-25.46%

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	54 050.0	0.59%	2.49%	2.49%	-12.25%
All Share	All Share (Total Return)	Rand	7 930.0	0.61%	2.59%	2.59%	-9.42%
TOP 40/Large Caps	Top 40	Rand	7 006.0	0.68%	2.59%	2.59%	-9.42%
Mid Caps	Mid Cap	Rand	15 602.0	0.55%	1.81%	1.81%	-10.05%
Small Companies	Small Cap	Rand	18 436.0	-0.07%	2.68%	2.68%	-14.28%
Resources	Resource 20	Rand	2 720.6	0.93%	1.05%	1.05%	12.57%
Industrials	Industrial 25	Rand	12 625.0	-0.63%	1.69%	1.69%	-19.51%
Financials	Financial 15	Rand	9 917.0	3.02%	6.53%	6.53%	-0.28%
Listed Property	SA Listed Property	Rand	1 943.0	1.68%	5.54%	5.54%	-16.82%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	482.1	0.53%	0.66%	0.66%	-1.90%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY					
All Bond	BESA ALBI	Rand	644.2	1.31%	1.75%	1.75%	7.30%
Government Bonds	BESA GOVI	Rand	637.8	1.32%	1.78%	1.78%	6.46%
Corporate Bonds	SB JSE Credit Indices	Rand	102.7	0.50%	0.81%	0.81%	-19.49%
Inflation Linked Bonds	BESA CILI	Rand	257.7	0.11%	1.68%	1.68%	3.09%
Cash	STEFI Composite	Rand	412.9	0.14%	0.49%	0.49%	7.23%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	61.5	-1.80%	13.93%	13.93%	-13.35%
Gold	Gold Spot	US$	1 303.0	1.72%	1.72%	1.72%	-3.91%
Platinum	Platinum Spot	US$	818.0	2.89%	3.15%	3.15%	-19.73%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.62	1.65%	5.41%	5.39%	-12.67%
ZAR/Pound	ZAR/GBP	Rand	17.97	-0.78%	1.95%	1.95%	-6.18%
ZAR/Euro	ZAR/EUR	Rand	15.53	1.27%	6.04%	6.04%	-4.84%
Dollar/Euro	USD/EUR	US$	1.14	0.00%	0.61%	0.61%	8.77%
Dollar/Pound	USD/GBP	US$	1.32	-2.48%	-3.04%	-3.04%	7.57%
Dollar/Yen	USD/JPY	US$	0.01	-0.21%	-0.04%	-0.04%	0.89%

Source: I-Net, figures as at 25 January 2019

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Credit growth
- Trade balance
- Producer prices
- Absa Manufacturing Purchasing Managers' Index

US

- House prices
- Pending home sales
- Federal Reserve interest rate decision
- Non-farm payrolls and unemployment rate

EUROPE

- Eurozone loan growth
- Eurozone economic sentiment indices
- Eurozone Q4 GDP growth
- Eurozone inflation
- Bank of England interest rate decision

CHINA

- Industrial profits
- Manufacturing Purchasing Managers' Index

JAPAN

- Retail sales

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