Communiqué

Monthly

South Africa

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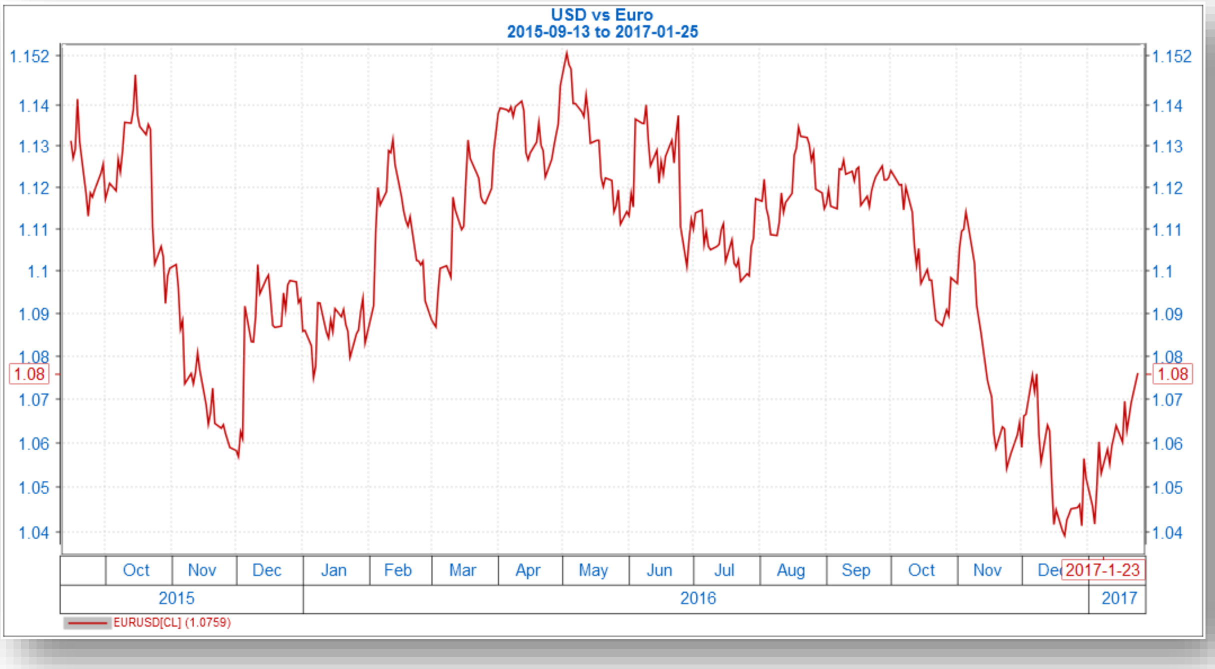
Reality Check

Abroad

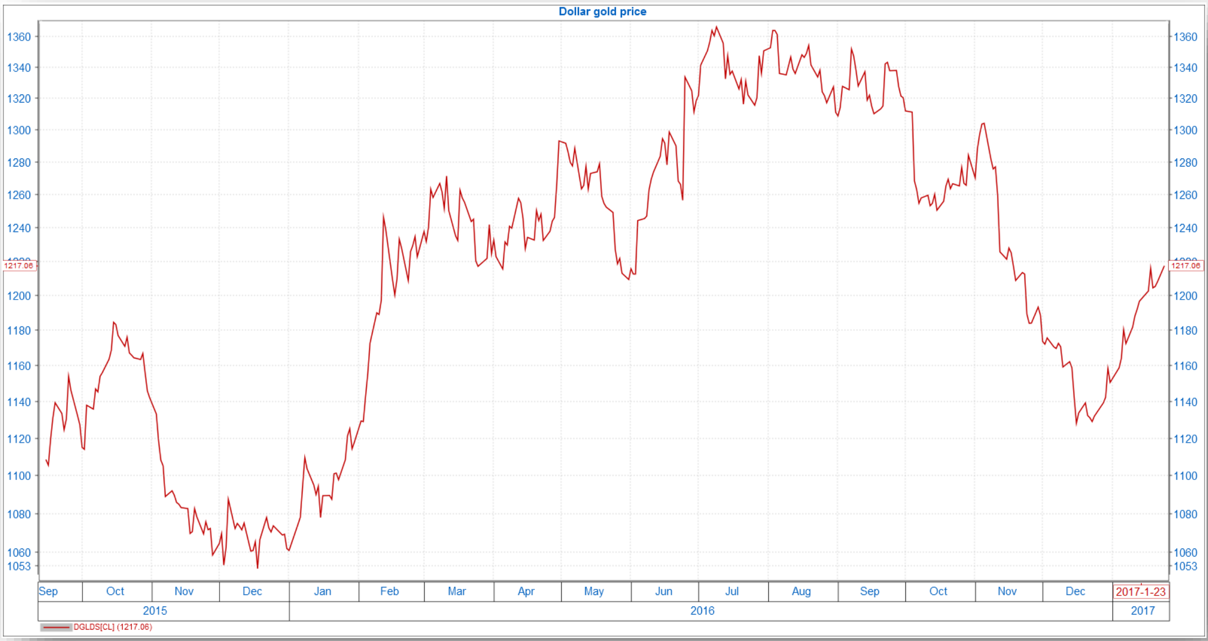
The rally in global stock markets following the Trump election seems to be waning somewhat as markets realise that things might not be that strait forward. The "Trump Trades" have been based on the assumption that new policies will beget booming economic growth. Market sentiment has been giving way to more measured views of what will happen going forward. The "Trump Trade" has caused a rally in global equities accompanied by a stronger dollar and a sell-off in gold as well as emerging markets. Of late, we have started to witness a reversal in these trends which are likely to gain momentum as reality sets in.

The dollar advance was driven far more by expectations of dollar-friendly US fiscal and monetary policies than by actual widening of real interest rate differentials. The sentiment is now reversing somewhat. We expect this to benefit emerging markets in due course supported by further strength in commodity prices.



Source: iNet Bridge

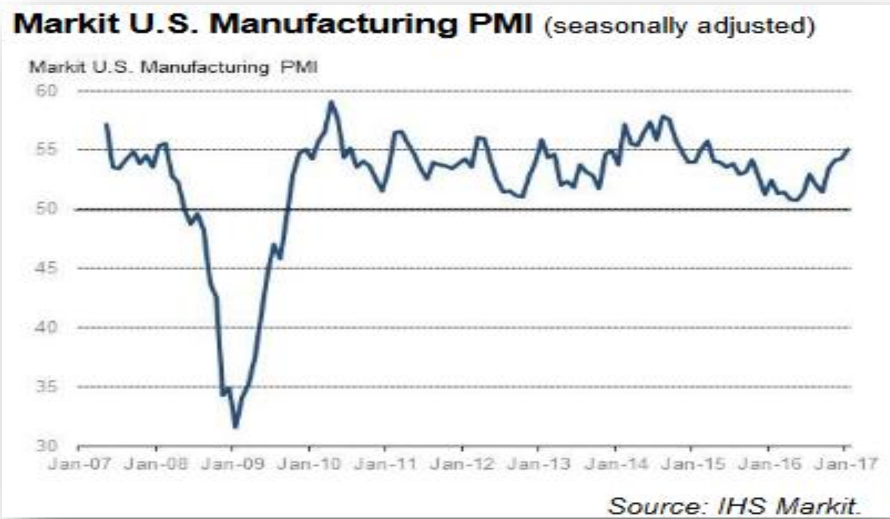
We expected gold to rally after the election result. It did, but was short lived. However, gold has started to strengthen lately as the dollar weakened, therefore maintaining its historic inverse correlation with movements in the dollar. The longer-term prospects for gold in our view remain favourable due to very low real interest rates and a likely increase in global inflation underpinned by higher global growth. Gold has now reached its highest level since November last year.

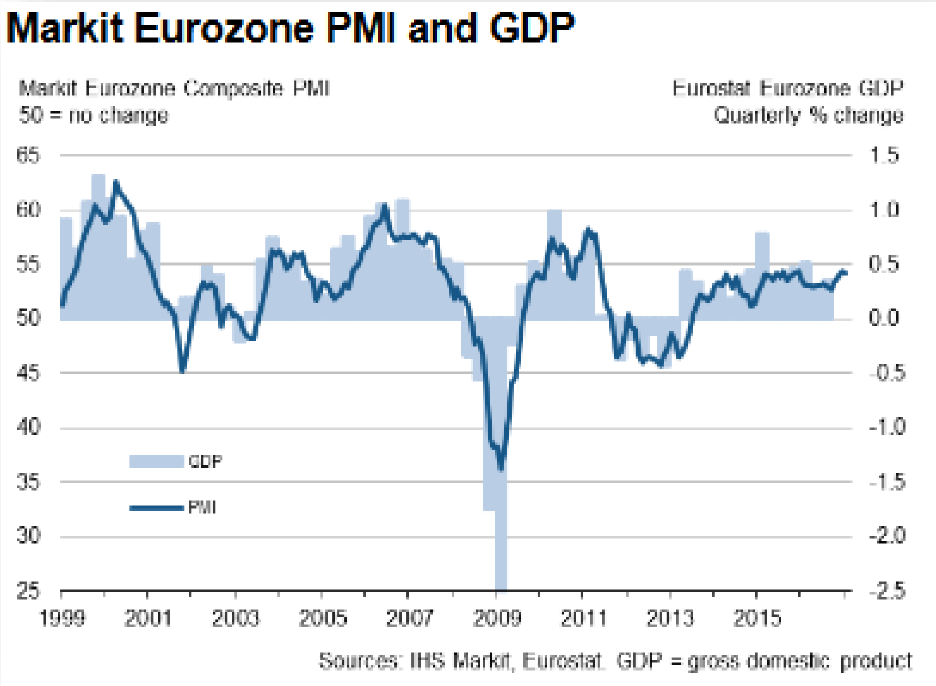


Source: iNet Bridge

Given bullish economic liquidity, accommodative monetary policies (In Europe and China), improved economic growth around the world and an expected earnings recovery that will reduce pressure on multiples, we remain positive on equity prices for the remainder of the year.

The improving backdrop for industrial stocks is evident in the latest global PMI number reaching 53 in December 2016. Most economists believe the trend will continue. The increase is particular significant in developed countries but there is also an acceleration in emerging markets compounded by a rebound in commodity prices and further infrastructure expenditure in China.





However, consumption expenditure is likely to wane as real wages will get squeezed by higher oil prices. This will also lead to higher inflation which will put further pressure on real wages. The oil price has doubled since January last year and estimates are that Brent could remain steady at these higher levels given an expected cut in non-OPEC supply. OPEC themselves are also likely to curb production at some point.

In terms of global trade and the outlook for growth, an interesting development has emerged in that Donald Trump and the Chinese president Xi Jinping have very different views in terms global trade going forward with Trump saying; “we must protect our boarders from ravages of other countries making our products, stealing our companies and destroying our jobs. Protection will lead to great prosperity and strength. We will follow two simple rules; buy American and hire American”. On the other hand, Xi Jinping says;” blaming economic globalisation for the world’s problems is inconsistent with reality. Globalisation has powered global growth and facilitated movement of goods and capital, advances in science, technology and civilisation and interaction among people”. From the Trump camp, this is not chatter, as he has already cancelled US participation in the Trans-Pacific Partnership that took Obama 7 years to negotiate. The risk going forward could be severe for America as this inward focus will likely only favour a few industries. China in particular will retaliate. China and Mexico together account for a quarter of US trade. In a trade war, the disruption of supply chains could severely impact private sector jobs.

If America attacks the system it created, the result could very well result in China pursuing to become the new hegemon. But that will be difficult given the size and power of the US economy and will likely only be achieved with European and Asian cooperation. Mr Xi’s vision is correct but without support from Trump, that objective might not be doable. A free for all trade policy will most likely cause a deceleration in global growth including the US.

Local

Our sovereign rating is not out of the woods yet and the country has to “do the right thing” to avoid a credit downgrade according to Konrad Reuss, managing director of Standard and Poor (S&P) South Africa. According to S & P, the country rating hinges on three issues. The first of these is GDP and fiscal performance.

We have witnessed steady upgrades in local forecast GDP growth for 2017, currently expected to be 0.8% to 1% for the year. But, according to Reuss; “However, if there is no delivery it could put pressure on the rating,” he said.

The second factor is related to institutional strength. If there are signs of “weakening institutions” it’s expected that this will have a negative impact on policy frameworks which will put downward pressure on the rating, said Reuss.

The institutional assessment will be impacted by matters like a Cabinet reshuffle which will be a key factor the rating agencies will focus on and could potentially drive away investment, both local and foreign.

Finally, the risks emanating from government enterprises could put pressure on government’s fiscal position and debt position. This will also add pressure to the rating.

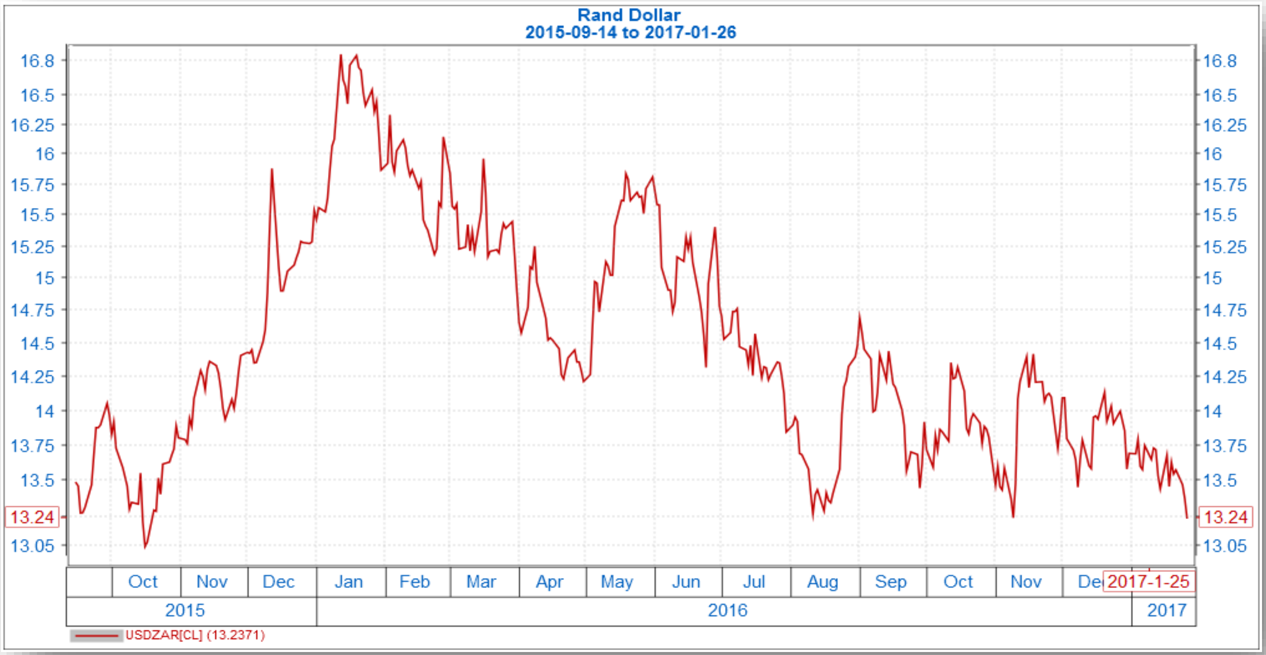
The local economy grew by 0, 2% quarter on quarter in the third quarter of 2016. Mining was the main positive contributor to growth given the rise in commodity prices. After shrinking by 17, 5% in the first quarter of last year, the mining industry recovered strongly in the second quarter, growing by 16, 1%. The growth rate of 5, 1% in the third quarter was mainly a result of increased production in mining with iron production the main driver.

Other industries that recorded positive growth were finance (1, 2%), personal services (0, 6%), construction (0, 3%) and transport (0, 3%). Year-on-year growth in the third quarter of 2016 was 0, 7%.
Despite the upward revisions in the outlook for growth, we remain of the opinion that we will not likely see any increases in interest rate in the near term as the outlook for inflation remains fairly benign given a fairly high base historically and the strong rand (see table).

South Africa | Economic Forecasts | 2016-2020 Outlook

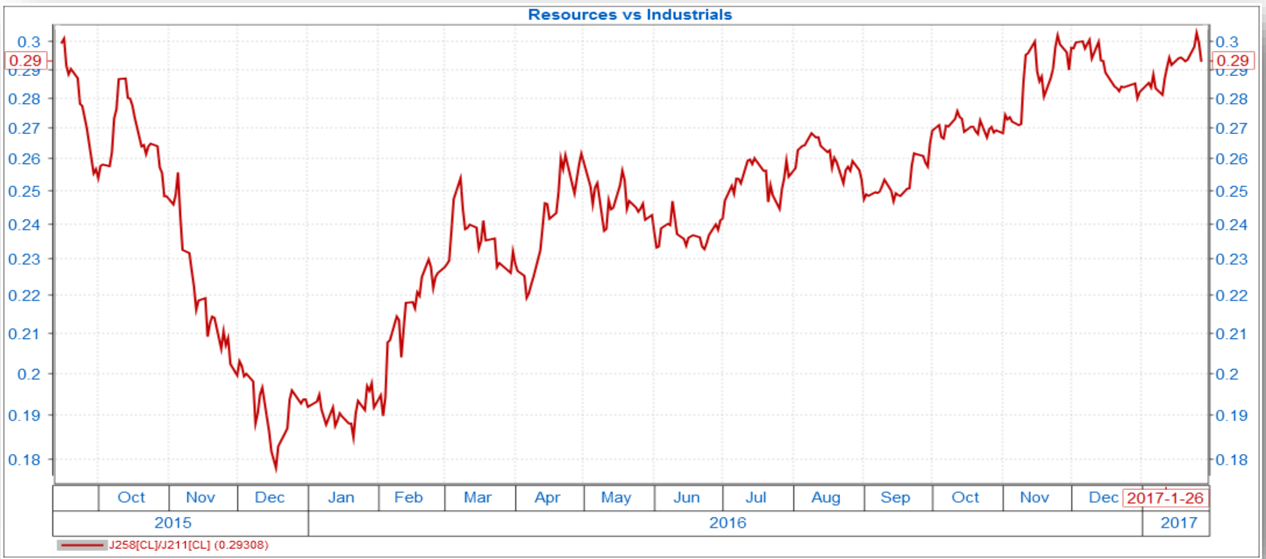
Overview	Actual	Q1/17	Q2/17	Q3/17	Q4/17	2020
GDP Growth Rate	0.20	0.9	1	0.9	1.2	2.1
Unemployment Rate	27.10	26.2	25.7	25	24.5	21
Inflation Rate	6.80	6.6	6.5	6	5.9	4.7
Interest Rate	7.00	7	7.25	7.25	7.5	6

Source: Trading Economics



Source: iNet Bridge

In terms of the local stock market, the rally in resource stocks continue on the back of strong commodity prices despite a strengthening rand against the dollar. The chart below indicates the resources index relative (divided by) to industrials. The resources index was up 36% for the year in 2016. This compares to only a 0.1% increase for the market as a whole. We expect a fairly robust earnings season from miners which will commence shortly and it is therefore likely that the momentum in this sector will continue in the near term. Spot prices will be supported by growth stimulus in China and the prospective growth policies set out by Donald Trump in the US.



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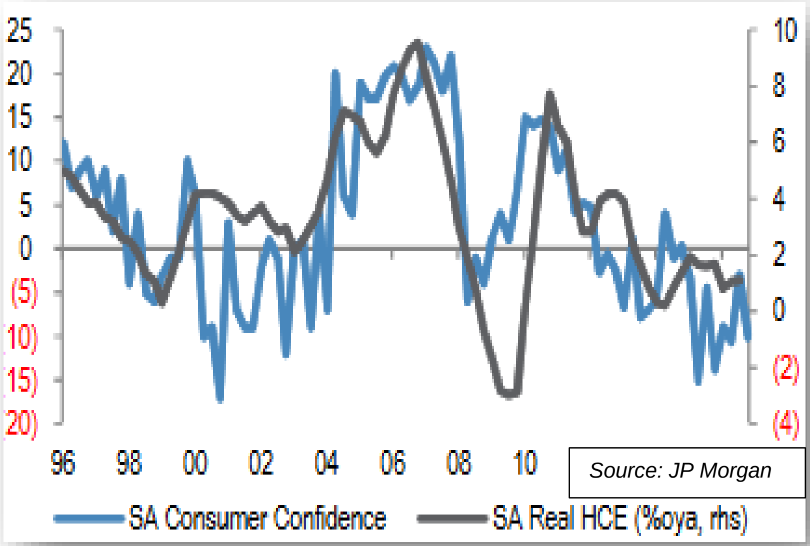
Source: iNet Bridge

Most analysts argue that locally listed General Retailers' earnings could continue to struggle, given a weak SA consumer environment and increasing competition from mainly foreign entrants. However, given the more upbeat numbers for GDP growth this year, we think that earnings numbers for this year might surprise on the upside. In November 2016, real retail sales re-accelerated to 3.8% on a year on year basis, the fastest pace in six months. Although this should bode well for SA consumer stocks, investors remain concerned as the FNB/ BER consumer confidence index declined again in Q4'16, post a rebound in Q2/Q3'16. The consumer confidence index has only been lower on three occasions in the past two decades.

SA consumer confidence vs. disposable income



Given the size of mining and related activities in the economy as well as the recovery in commodity prices, we expect an improvement in the SA consumer environment in 2017. Also, given the continued strength in the rand, it's likely that inflation could decelerate in the coming months which will bode well for our interest rate outlook. This also will be positive for growth in real wages and hence discretionary spending. Seeing that most retailers import their products, a firmer rand could lead to a recovery in retail margins in due course.

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To conclude:

- The “Trump Trade” has caused a rally in global equities accompanied by a stronger dollar and a sell-off in gold as well as emerging markets
- Market sentiment has been giving way to more measured views of what will happen going forward
- Gold has started to strengthen lately as the dollar weakened, therefore maintaining its historic inverse correlation with movements in the dollar
- The improving backdrop for industrial stocks is evident in the latest global PMI number reaching 53 in December 2016. Most economists believe the trend will continue
- Trumps more inward focus in terms of global trade could have a severe impact on global trade agreements
- China in particular will retaliate. China and Mexico together account for a quarter of US trade. In a trade war, the disruption of supply chains could severely impact private sector jobs
- A free for all trade policy will most likely cause a deceleration in global growth including the US
- Our sovereign rating is not out of the woods yet and the country has to “do the right thing” to avoid a credit downgrade according to Konrad Reuss, managing director of Standard and Poor’s (S&P) South Africa
- Despite the upward revisions in the outlook for local GDP growth, it’s unlikely that interest rates will go up in the near term as the outlook for inflation remains fairly benign given the strong rand
- Given the size of mining and related activities in the economy as well as the recovery in commodity prices, we expect an improvement in the SA consumer environment in 2017

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Sincerely

Chris

Chris Botha

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