IMARA
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Communiqué

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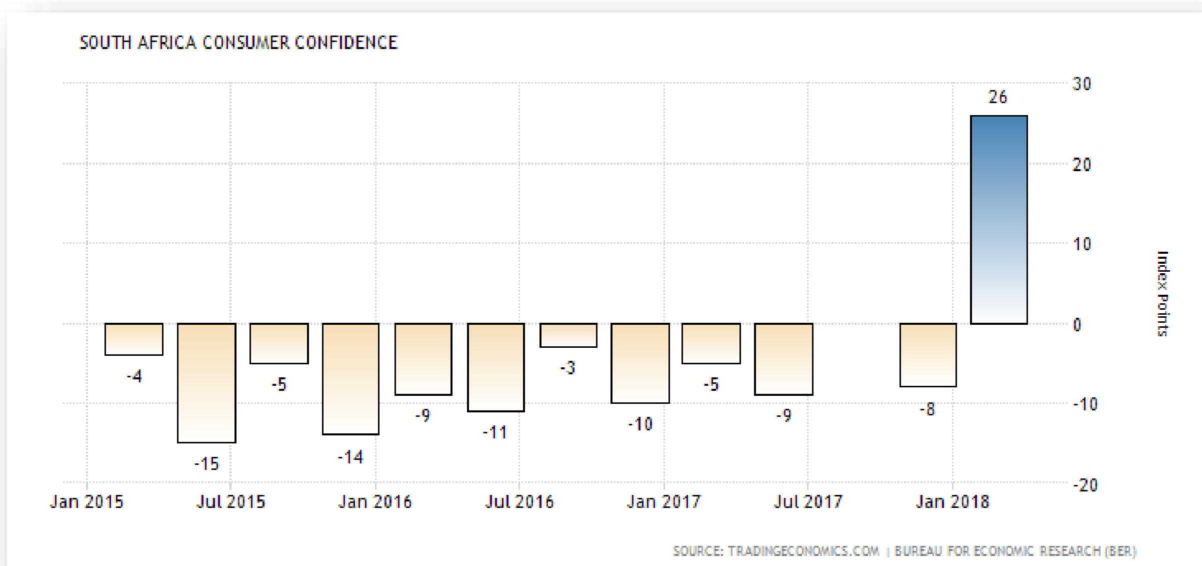
Consumers remain upbeat

Local

The waning of policy and political uncertainty following Cyril Ramaphosa's election as president of the ANC and subsequently the republic, together with the avoidance of a sovereign rating downgrade by Moody's rating agency and a budget more orientated towards fiscal consolidation, boosted the latest reading of the Consumer Confidence Index. The FNB/BER's consumer confidence index surged 34 points to 26 in the first quarter of 2018 from -8 in the last quarter of 2017. This is the highest level since the inception of the index and has surpassed the previous record high of 23.

FNB/BER Consumer Confidence Index



Source: Tradingecomonics

According to the Bureau of Economic Research (BER), "This was well above our expectations. After 12 consecutive quarters of negative readings, the lift to 26 index points signifies that the majority of consumers are optimistic about the outlook for the South African economy and their household finances".

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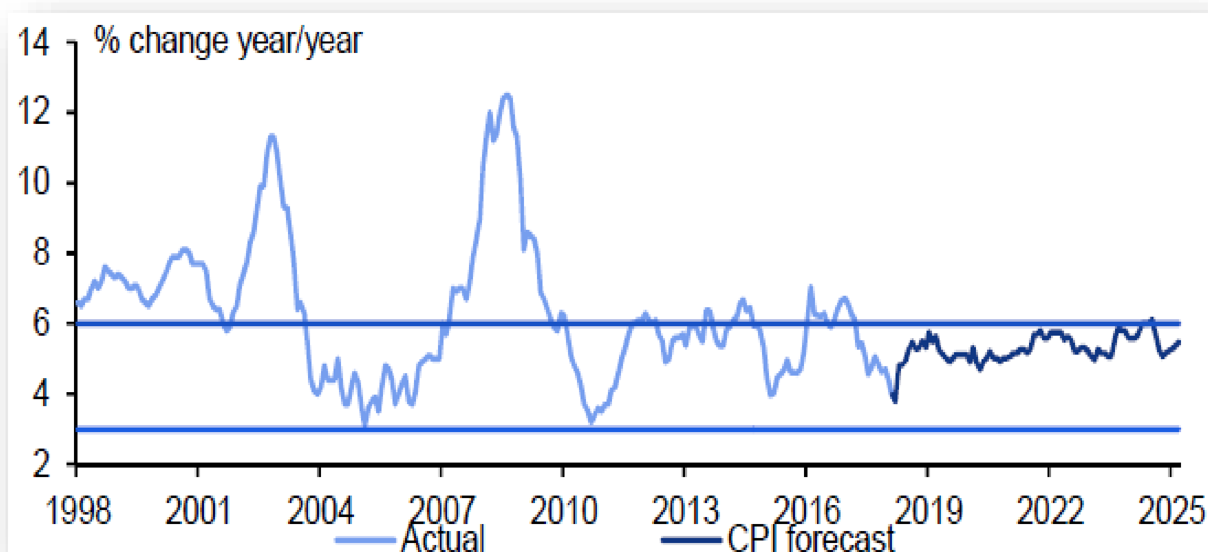
Importantly, the improved mood amongst consumers is accompanied by benign inflation. CPI inflation dropped to 3.8% year on year in March from 4.0% year on year in February primarily due to a decline in sustained low food price inflation (although I am not feeling that personally).

According to Investec Bank, the outcome was below consensus expectations of a lift to 4.2% year on year. On a quarterly basis CPI inflation eased to 4.1% year on year in Q1.18 from 4.7% year on year in Q4.17.

Officially, the rate of food price inflation declined further in March, for the tenth consecutive month to 3.6% year on year, assisted by a decline in meat price inflation to 10% year on year, from 11.4% year on year in February. It is likely that the decline in food price inflation will start to moderate in the next few months as base effects from the drought start to dissipate.

Inflation is likely to increase slightly during the rest of the year but will probably undershoot the Reserve Bank's projections following the recent weak reading. A pick-up in inflation from March levels should come from a combination of factors, mostly by the VAT hike in April as well as the expected increase in electricity tariffs. Finally, the rand is likely to trend softer following recent strengthening as the bond carry trade has become less attractive following the drop in the 10 year bond yield from 9.70% to 8.05%, reducing the deflationary impact of lower import prices.

SA Consumer Inflation forecast

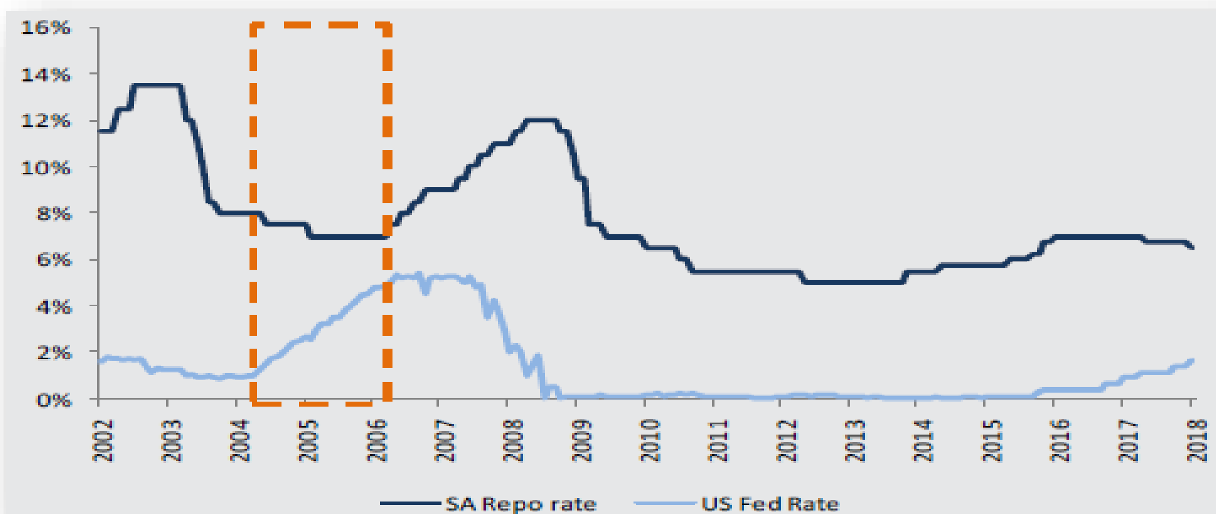


Source: Investec Bank

Although real short-term interest rates remain positive at 2.7%, 61 basis points above the historical average, this is likely to be eroded as inflation picks up during the course of the year, limiting the scope for further rate cuts. Further monetary tightening and rising interest rates in the US will put further pressure on the SARB to hold off on further rate cuts here.

Future policy decisions will be highly data-dependent and sensitive to the balance of risks to the outlook. The implied path suggests a rate hike of 25bps in 2019 and 2 further hikes in 2020 according to research from Arqaam Capital.

SA vs. US interest rates – only diverged in 2004/2005

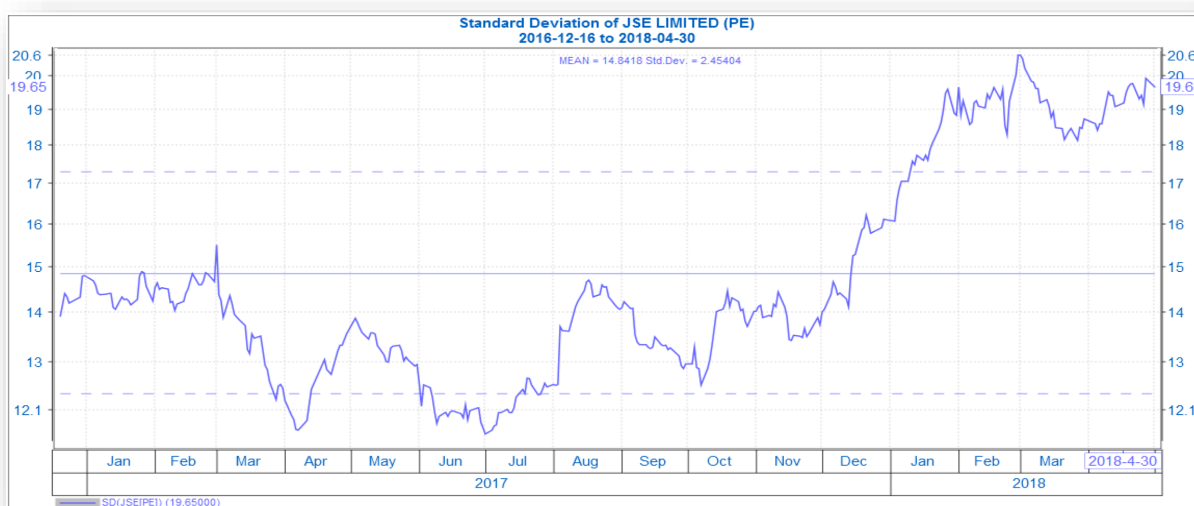


Source: Arqaam Capital

Following an annual growth rate of 1.3% in 2017, the SARB expects a growth rate of 1.7% for 2018 compared with 1.4% previously. The forecast for 2019 is 1.5% and 2.0% for 2020.

Local share prices in our view have mostly priced in the expected rebound in economic activity. The earnings yield and bond yield differential currently stand at 1.5% compared to 1.01% historically, suggesting that a recovery is already discounted. Earnings growth will likely be supported by the recovery in economic growth accompanied by lower interest rates. However, if the rand strengthens again it will lead to lower earnings growth due to the large rand hedge component within the JSE.

JSE All Share price earnings ratio – recovery priced in.



Source: Iress/Imara

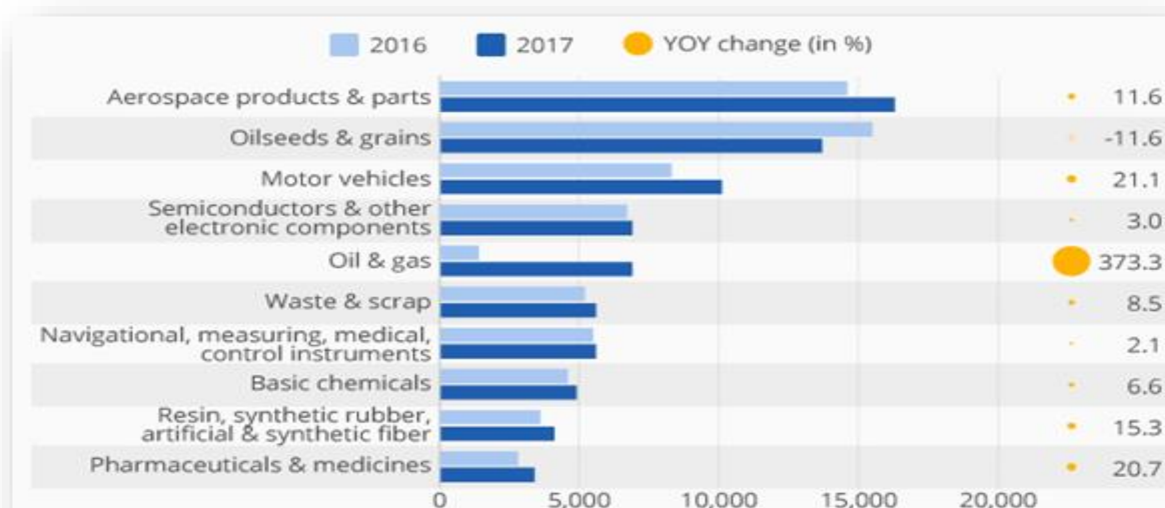
USD/ZAR – weakening trend re-emerging

Source: Iress/Imara

Abroad

The US has implemented new import tariffs on steel and aluminium with no exemptions offered to China. China has retaliated by announcing trade tariffs on 128 American-made products including wine, fruit, and pork products. However, as can be seen in this chart, the overall value of other American goods exported is higher that the above categories according to the Congressional Research Service (CRS).

American exports to China



Source: Statista.com

The U.S. sees China as both partner and rival in terms of international trade. Therefore, the two economies are intertwined and depend on each other. But, when China can ship cars to the U.S. for a 2.5% tariff, and U.S. cars must pay 25% to go into China, things seem out of balance. There are many more examples of this. China is really quite protectionist, more so than other BRIC countries. Despite all of Trump's shortcomings he is correct that China doesn't always reciprocate the trading rights that the U.S. and other governments adhere to.

At its heart, the U.S.-China rivalry is not really a trade war yet. This has been unfolding for a long time. Trump's tariff threats are only the latest move and won't be the last.

The manufacturing activity in the Eurozone decelerated sharply in March with the headline manufacturing purchasing manager's index (PMI) slowing to 56.6 in March, down from 58.6 in February. The lower PMI number – the lowest in 8 months, mainly due to the base effect after the PMI reached a multi-year high earlier this year and also the fear factor of export-oriented economies of the Eurozone, especially the German economy, with the US-led trade wars taking a toll in business confidence.

Eurozone Manufacturing PMI – holding on above 50

Source: Tradingeconomics

The growth rate in manufacturing remains relatively strong by historical standards and the appearance of inflationary pressures will confirm that the ECB policymakers are on the right path towards normalising monetary stimulus.

The stronger euro relative to the dollar is feeding through to higher export prices making the life of the Eurozone exporters harder in some countries.

To quote comments by Chris Williamson, chief business economist at IHS/Markit following the release of the PMI numbers: “the fact that business optimism about the coming year has slipped to a 15-month low suggests there are other factors that are now hitting factory order books. Export growth has more than halved since late last year, linked in part to the appreciation of the euro, and in some cases, demand is being stymied by higher prices.”

Despite this though, Eurozone growth prospects remain firmly entrenched anchored on the upside with the PMI remaining well above 50. Economic growth remains robust by historical standards, with all the major Eurozone countries reporting economic growth and appears to be broad-based.

Eurozone Economic Sentiment Indicator – Stabilising in both Eurozone and EU region.

To Conclude

- In SA, the FNB/BER's consumer confidence index surged 34 points to 26 in the first quarter of 2018 from -8 in the last quarter of 2017. This is the highest level since the inception of the index and has surpassed the previous record high of 23
- The improved mood amongst consumers is accompanied by benign inflation. CPI inflation dropped to 3.8% year on year in March from 4.0% year on year in February primarily due to a decline in sustained low food price inflation
- Following an annual growth rate of 1.3% in 2017, the SARB expects a growth rate of 1.7% for 2018 compared with 1.4% previously. The forecast for 2019 is 1.5% and 2.0% for 2020
- Local share prices in our view have mostly priced in the expected rebound in economic activity. The earnings yield and bond yield differential currently stand at 1.5% compared to 1.01% historically, suggesting that a recovery is already discounted
- At its heart, the U.S.-China rivalry is not really a trade war yet. This has been unfolding for a long time
- The U.S. sees China as both partner and rival in terms of international trade. Therefore, the two economies are intertwined and depend on each other
- Eurozone growth prospects remain firmly entrenched with the PMI remaining well above 50
- The growth rate in manufacturing remains relatively strong by historical standards and the appearance of inflationary pressures will confirm that the ECB policymakers are on the right path towards normalising monetary stimulus

Sincerely

Chris Botha

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