ECONOMIC REPORT

by Glacier Research

glacier by Sanlam

28 June 2018

REVIEW PERIOD: MAY 2018

DOMESTIC OVERVIEW

The euphoria around the victory of newly elected President Ramaphosa has dissipated as the current political and economic environment is telling a different story. As a result, conservative asset classes rallied in the month of May, while risky assets detracted.

Key Domestic Highlights in May 2018

- SARB Interest rates
- S&P Ratings

SARB Interest Rates

The South African Reserve Bank (SARB) left the repo rate unchanged at 6.5%, in line with market expectations, after cutting it by 25 basis points in the previous MPC meeting. Lesetja Kganyago, the governor of the SARB, reported that the decision to keep rates unchanged was unanimous. The MPC will maintain its vigilance to ensure that inflation remains within the target band of 3% - 6%.

S&P Ratings

S&P Global Ratings decided to keep South Africa's international credit rating unchanged at two notches below investment grade, while rand-denominated South African debt was also kept at one notch below investment grade. The rating agency, therefore, maintained a stable outlook on South Africa, citing the election of Cyril Ramaphosa, business and investor confidence as contributing factors.

While the rating agency highlighted factors such as flexible monetary policy, deep capital markets and a large financial sector, it also raised concerns about the weak pace of economic growth, a large fiscal debt burden and the ruling party's policy regarding land expropriation.

South Africa: Economy

The month of May began with the Department of Energy announcing a fuel price increase of 23 cents to 14.72 for the 93 petrol grade and 49 cents for the 95 petrol grade. This was driven by the depreciation of the rand against the US dollar coupled with an increase in the oil price. Unemployment for the first quarter of 2018 remained at 26.7% as the number of unemployed people increased by 100 thousand to 5.96 million, while the number of employed people rose by 207 thousand to 16.38 million. Inflation, on the other hand, ticked downwards to 4.4% in May, from 4.5% in the prior month, and below market expectations of 4.6%.

	Dec'17	Jan'18	Feb'18	Mar'18	Apr'18	May'18
CPI (y/y)	**4.7%**	**4.4%**	**4.0%**	**3.8%**	**4.5%**	**4.4%**
PPI (y/y)	**5.2%**	**5.1%**	**4.2%**	**3.7%**	**4.4%**	**-**

Sources: SA Reserve Bank, Statistics SA, I-Net, BER, Trading Economics, MorningStar, Reuters

	31 May 2016	**31 May 2017**	**31 May 2018**
USD/ZAR	**15.69**	**13.07**	**12.60**
GBP/ZAR	**22.75**	**16.83**	**17.03**
EUR/ZAR	**17.48**	**14.69**	**14.86**

Sources: SA Reserve Bank, Statistics SA, I-Net, BER, Trading Economics, MorningStar, Reuters

South Africa: Markets

South African indices were mostly down during the month of May. The JSE All Share shed 3.48% driven by losses from Retailers (-12.65%), Industrials (-10.20%) and Financials (-6.26%), while Resources added 4.01%. Property recorded the largest loss for the month at -5.92%, while bonds surrendered 1.95%. Cash was the only asset class that delivered positive returns of 0.59%. In terms of market capitalization, mid-cap stocks led the month's losses, delivering -8.4%, followed by large-cap stocks (-3.1%) and small-cap stocks (-2.4%). Foreigners were net sellers of R20.7 billion worth of SA equities and also net sellers of SA bonds to the value of R31.7 billion.

LOCAL SECTOR RETURNS IN ZAR

2017	March 2018	April 2018	May 2018	Year-to-date
CONSUMER SERVICES 52.66%	GENERAL RETAILERS 0.92%	RESOURCES 8.55%	RESOURCES 4.01%	RESOURCES 8.58%
SA INDUSTRIALS 22.50%	CONSUMER GOODS -1.16%	CONSUMER GOODS 6.56%	CONSUMER SERVICES -3.87%	GENERAL RETAILERS -5.61%
FINANCIALS 20.61%	RESOURCES -2.08%	SA INDUSTRIALS 5.20%	CONSUMER GOODS -4.26%	CONSUMER GOODS -5.65%
GENERAL RETAILERS 19.00%	FINANCIALS -3.10%	CONSUMER SERVICES 4.86%	SA INDUSTRIALS -5.14%	FINANCIALS -6.68%
RESOURCES 17.90%	INDUSTRIALS -4.90%	INDUSTRIALS 3.55%	FINANCIALS -6.26%	SA INDUSTRIALS -8.19%
INDUSTRIALS 14.73%	SA INDUSTRIALS -5.53%	FINANCIALS 3.23%	INDUSTRIALS -10.20%	INDUSTRIALS -8.60%
CONSUMER GOODS -1.12%	CONSUMER SERVICES -8.37%	GENERAL RETAILERS -1.06%	GENERAL RETAILERS -12.65%	CONSUMER SERVICES -9.58%

LOCAL RETURNS IN ZAR

2017	March 2018	April 2018	May 2018	Year-to-date
SA TOP 40 23.07%	SA BONDS 2.07%	SA PROPERTY 7.68%	SA CASH 0.59%	SA BONDS 5.20%
SA EQUITY 20.95%	SA CASH 0.60%	SA TOP 40 5.72%	SA BONDS -1.95%	SA CASH 2.96%
SA PROPERTY 17.15%	SA PROPERTY -0.96%	SA EQUITY 5.37%	SA SMALL CAPS -2.44%	SA SMALL CAPS -2.49%
SA BONDS 10.24%	SA SMALL CAPS -1.33%	SA MID CAPS 3.54%	SA TOP 40 -3.06%	SA TOP 40 -3.99%
SA CASH 7.56%	SA MID CAPS -3.42%	SA SMALL CAPS 1.24%	SA EQUITY -3.48%	SA EQUITY -4.37%
SA MID CAPS 7.36%	SA EQUITY -4.18%	SA CASH 0.58%	SA PROPERTY -5.92%	SA MID CAPS -8.57%
SA SMALL CAPS 2.95%	SA TOP 40 -4.28%	SA BONDS -0.70%	SA MID CAPS -8.37%	SA PROPERTY -18.56%

GLOBAL OVERVIEW

Global equity markets ended the month of May in positive territory. Volatility returned during the month largely due to heighten political risk. Despite the prospect of an Italy snap election and mixed signals from the Trump administration on talks with North Korea, corporate earnings growth far exceeded expectations in the first quarter of the year.

The US equity market shrugged off concerns over the tariffs on steel and aluminium and the reactive measures launched by other countries to end the month on a positive footing. The risk-off sentiment contributed to a significant rise in the value of the US dollar, which strengthened 2% against a basket of major currencies. As a result we saw a boost in sectors that are more sensitive to shifts in the US dollar. Consequently the energy and healthcare sectors was the strongest performing US equity sector over the month. Energy rallied as Brent crude oil pushed through US$80 a barrel for the first time in three and a half years as stocks shook off fears of a correction and supply worries gripped the oil markets. Both global bonds and global equities were positive in ZAR terms as the rand weakened against the US dollar for the month.

United States

US first-quarter growth was revised down marginally to an annualised rate of 2.2%. Earlier estimates from the Bureau of Economic Analysis secured growth at 2.3%. This marked a slower growth rate than in the final quarter of 2017 when the US economy grew by 2.9%. The slowdown was driven by a sharp decline in consumer spending, which extended to 1% in the first three months of the year, compared with 4% in the last quarter of 2017.

However, broader US indicators still suggest that the US economy remains on a strong foundation and the data is not expected to discourage the US Federal Reserve (Fed) from raising interest rates by another quarter point in June. The unemployment rate fell to 3.8% in May, below market expectations. This was the lowest level since the end of 2000. The US jobs creation increased at a healthy pace, as monthly payroll gains increased by 230,000 in May, well above market expectations. Headline inflation has returned to the Fed’s 2% target.

Eurozone

European equity markets retreated in May, as political risk in Europe returned to haunt investors. Political events in Italy and Spain produced high volatility in financial markets which spurred a sharp correction in the second half of the month. In Italy, new Prime Minister, Guiseppe Conte, has been sworn in, bringing months of uncertainty to an end. While in Spain, Mariano Rajoy was ousted as prime minister in a vote of no confidence. Pedro Sánchez, leader of the socialist PSOE party that tabled the motion, will replace him. The Eurozone posted a GDP growth rate of 0.4% in the first quarter of 2018. This was in-line with expectations but slightly below the growth rate attained in the previous quarter, as private sector activity growth normalised from very resistant levels at the end of 2017.

United Kingdom

UK equity markets continued their positive run over the month, despite a sell-off on concerns over contagion from the political situation in Italy. This was mainly driven by a spike in the price of Brent crude oil. Performance was also reinforced by the pound's continued weakness against the US dollar, which bolstered the returns of the market's many international constituents. The Bank of England's Monetary Policy Committee (MPC) voted to keep the central bank interest rate on hold at 0.5%, citing weaker than expected domestic growth for first quarter 2018. The decision was in line with consensus expectations following unseasonably cold weather in March, which had kept consumers and builders at home.

Spot Rates	31 May 2016	31 May 2017	31 May 2018
EUR/USD	**1.11**	**1.12**	**1.18**
GBP/USD	**1.44**	**1.28**	**1.35**
USD/JPY	**110.74**	**110.86**	**110.77**

Sources: SA Reserve Bank, Statistics SA, I-Net, BER, Trading Economics, MorningStar, Reuters

Emerging Markets

Emerging markets registered negative returns in May, underperforming its developed markets counterpart. This was largely due to the strength of the US dollar and rising risk aversion. Other factors such as the renewal of US sanctions on Iran, increased political uncertainty in Italy and the prospect of a trade war between America and its key allies also provided headwinds.

GLOBAL RETURNS IN ZAR				
2017	March 2018	April 2018	May 2018	Year-to-date
MSCI EM 24.28%	GLOBAL PROPERTY 3.61%	FTSE 100 10.52%	S&P 500 3.90%	S&P 500 4.37%
EURO STOXX 50 12.50%	GLOBAL BONDS 1.45%	EURO STOXX 50 9.51%	GLOBAL PROPERTY 3.75%	MSCI WORLD 2.79%
FTSE 100 10.95%	FTSE 100 0.13%	GLOBAL PROPERTY 7.04%	MSCI WORLD 2.09%	FTSE 100 2.55%
MSCI WORLD 10.81%	EURO STOXX 50 -0.98%	MSCI WORLD 6.57%	FTSE 100 0.75%	GLOBAL BONDS 1.26%
S&P 500 10.29%	SHANGHAI STOCK EXCHANGE -1.37%	S&P 500 5.76%	GLOBAL BONDS 0.68%	GLOBAL PROPERTY 0.91%
SHANGHAI STOCK EXCHANGE 4.78%	MSCI EM -1.49%	MSCI EM 4.89%	SHANGHAI STOCK EXCHANGE 0.68%	MSCI EM -0.37%
GLOBAL PROPERTY -0.98%	MSCI WORLD -1.81%	GLOBAL BONDS 3.67%	MSCI EM -2.14%	EURO STOXX 50 -1.33%
GLOBAL BONDS -2.78%	S&P 500 -2.17%	SHANGHAI STOCK EXCHANGE 1.26%	EURO STOXX 50 -4.45%	SHANGHAI STOCK EXCHANGE -3.15%