CENTRAL BANK OVERLOAD

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It was a big week for global monetary policy. The three main central banks met to decide on interest rates, and as usual the impacts are felt far and wide, very much including South Africa. With our large, open and liquid financial markets, decisions made in the world's financial capitals influence the returns of local investors.

It kicked off with the US Federal Reserve (the Fed), which is also by far the most important central bank in the world as it effectively sets the cost of the US dollar. While the US accounts for only 20% of global economic activity, around half of global equity and bond market capitalisation is denominated in dollars, while the greenback is one side of 80% of currency trades. Most commodities are priced in dollars and it remains the preferred currency for invoicing exports and imports in many countries.

Unlike most other central banks, the Fed sets a target range for its policy interest rate, and this was shifted up by 0.25% from 1.75% to 2% as expected. The more interesting part of the meeting was the assessment of the US economy and guidance about the future path of interest rates. The Fed statement described the US economy as "solid", but in his press conference, Chair Jerome Powell went a step further and described the economy as doing "very well" and "great".

Emergency-level interest rates are therefore not needed since the emergency (the 2008/9 recession and its lingering after effects) has now well and truly passed. Interest rates are being hiked to return them to more normal levels and not because of runaway inflation. Inflation is around 2% (depending which measure you use), while the Fed's policy rate is not even in positive territory in real terms yet. This should happen in the coming months, as meeting participants' own projections (displayed in the so-called dot plots) suggest two more hikes in 2018. These same projections suggest policy will only turn restrictive in 2020, rising above the long-run expected rate. But even then, the interest rate is only expected to be around 3.4%. The previous cycles saw rates peak closer to 6%.

DRAGHI'S **DOVISH TAPER**

Across the Atlantic, the European Central Bank (ECB) held its policy meeting not at its headquarters in Frankfurt, but in the Latvian capital of Riga. What investors wanted to get out of the ECB meeting was not whether rates would change – they didn't, as expected – but when the ECB would end its bond buying programme (quantitative easing). This will now happen by year-end, with the current pace of purchases slowing down in September before ending in December. It will reinvest maturing bonds beyond December, maintaining the size of its balance sheet.

The decision to cut quantitative easing (QE) comes amid a slowdown in Eurozone growth since the start of the year, while inflation remains stubbornly low (aside from the impact of the higher oil price). The end of QE therefore reflects an optimism on the part of the ECB that growth will not slow further. While its own 2018 forecast was cut to 2.1%, the 2019 forecast remains unchanged at 1.9%. This is still above the longer-term average of 1.5%. However, unlike the Fed, the ECB is also running out of bonds to buy, while the programme was wildly unpopular in certain influential corners to begin with (most notably at the German central bank, the largest member of the ECB system). Importantly though, the guidance that interest rates will remain at current levels until at least mid-2019 reflects ECB President Mario Draghi's view that "significant monetary stimulus" was still needed to get Eurozone inflation to the 2% target on a sustained basis. Core consumer inflation was only 1.1% in May.

The Bank of Japan's monetary policy meeting did not deliver any news, apart from yet another downgrade in its expectation for future inflation. Despite negative interest rates and the largest QE programme in the world (relative to the size of its economy), the Bank sees inflation in a range of 0.5% to 1%, still a long way off its 2% target. If anyone still clings on to the idea that central banks can generate inflation at will, they should look at the experience of Japan. It is much easier to fight inflation (by inducing an economic slowdown) than to cause it. This asymmetry argues for continued caution as the Fed and ECB continue along the path of gradually tightening policy.

Over time, changes in interest rates affect the borrowing decisions of companies and individuals. The shorter-term impact is often felt in currency markets – if one country's interest rates are rising faster than that of another, capital should follow the higher rates. In practice, people are buying and selling currencies for any number of reasons at the rate of trillions of dollars per day. In this instance, the US dollar rose to a seven-month high against peer currencies, buoyed by the prospects for continued rate increases in the US – at a faster pace than other major economies – amid a strong US economy. This in turn placed further pressure on emerging market currencies, including the rand.

SA RESERVE BANK **STILL UNLIKELY TO FOLLOW**

The weaker rand is likely to put some upward pressure on inflation by raising imported prices. Most notably, it is likely to result in another petrol price increase next month, despite the somewhat softer oil price. But inflation is expected to remain within the 3% to 6% target range, and the SA Reserve Bank (SARB) need not raise rates. If capital flows out of emerging markets accelerate, its hand might be forced, especially if its peer central banks are hiking. At the very least, rate cuts can now most likely be ruled out.

Unfortunately, the economy could use lower rates. Data from Stats SA last week showed a sharp slowdown in retail sales growth in April. While many consumers would have brought forward major purchases to avoid the April VAT increase, the slowdown was pretty broad-based across retail categories. Prices aren't the problem, with retail inflation slowing to 1.7%, well below the overall rate of consumer inflation (which includes services and transport costs).

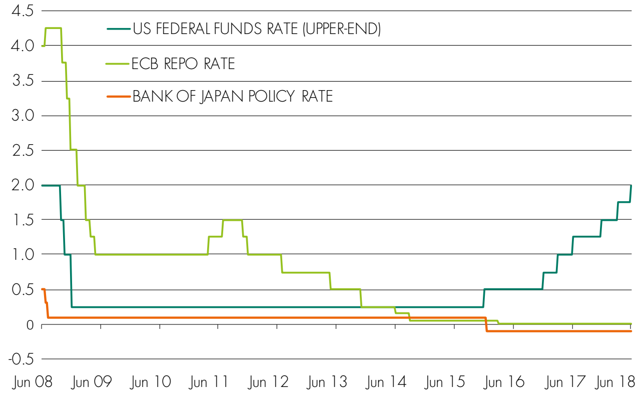
Business sentiment is also not picking up, according to the Bureau for Economic Research's long-running survey. The BER/RMB Business Confidence Index fell back to 39 index points in the second quarter. The index covers the five most cyclically sensitive sectors, and four of them (retail, new vehicle dealers, manufacturing and construction) declined. Only wholesale registered an improvement above the neutral level.

The survey doesn't cover mining, which is just as well since confidence would be very low. Mining production fell further in April, led down by gold and platinum output in particular. Gold and platinum mining shares on the JSE reflect the sorry state of affairs. Regulatory uncertainty is often cited as a constraint on mining, and this is indeed one area where the government can act quickly to improve confidence. The new draft Mining Charter, released on Friday, addresses some of the industry's concerns with the previous iteration, but not all. Mostly, it doesn't help that the rand price of gold and platinum has fallen around 15% over the past two years, while costs have escalated. The return of load-shedding last week will put further pressure on the electricity-intensive mining and manufacturing sector if sustained.

PUTTING IT **TOGETHER**

A weaker rand will certainly be welcomed by mining bosses. For ordinary investors, it is also not a bad thing as long as inflation remains relatively well behaved. South African individuals and companies have built up a large foreign asset base that should benefit from a depreciating currency. The other thing to remember is that, while market commentators have often tied themselves in knots trying to figure out the expected path of US interest rates, the bottom line is that the Fed is raising rates because the US economy is strong, and this is ultimately good for the global economy.

CHART 1: POLICY INTEREST RATES IN THE US, EUROZONE AND JAPAN



Source: Thomson Reuters Datastream

CHART 2: US DOLLARS PER EURO EXCHANGE RATE

Source: Thomson Reuters Datastream

CHART 3: RANDS PER US DOLLAR EXCHANGE RATE

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$	2 142.0	0.19%	2.34%	1.85%	11.74%
United States	S&P 500	US$	2 780.0	0.04%	2.77%	3.96%	14.31%
Europe	MSCI Europe	US$	1 756.0	0.98%	2.27%	-2.28%	6.10%
Britain	FTSE 100	US$	10 135.0	-1.60%	-0.71%	-2.56%	7.06%
Germany	DAX	US$	1 425.0	0.35%	2.22%	0.76%	9.78%
Japan	Nikkei 225	US$	206.6	-0.30%	1.26%	2.24%	15.74%
Emerging Markets	MSCI Emerging Markets	US$	1 126.0	-0.79%	0.45%	-2.76%	12.15%
Brazil	MSCI Brazil	US$	1 678.0	-0.18%	-6.73%	-17.05%	-1.00%
China	MSCI China	US$	93.5	-0.45%	2.39%	5.71%	31.18%
India	MSCI India	US$	575.0	0.45%	1.23%	-5.89%	6.48%
South Africa	MSCI South Africa	US$	524.0	-1.13%	-0.95%	-13.39%	7.38%

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	57 661.0	-0.97%	2.68%	-3.10%	13.43%
All Share	All Share (Total Return)	Rand	8 302.0	-0.94%	2.73%	-1.75%	16.86%
TOP 40/Large Caps	Top 40	Rand	7 373.0	-1.06%	3.10%	-1.01%	18.65%
Mid Caps	Mid Cap	Rand	15 613.0	-0.27%	0.60%	-8.02%	5.93%
Small Companies	Small Cap	Rand	20 252.0	-0.11%	-1.20%	-3.66%	0.57%
Resources	Resource 20	Rand	2 653.1	-2.64%	4.20%	16.05%	46.45%
Industrials	Industrial 25	Rand	14 491.0	-0.24%	4.64%	-4.13%	10.84%
Financials	Financial 15	Rand	9 069.0	-1.10%	-1.72%	-6.57%	19.02%
Listed Property	SA Listed Property	Rand	1 988.1	-1.48%	-0.94%	-19.32%	-7.92%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	938.4	-0.16%	-0.16%	-1.02%	1.30%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	601.0	-0.21%	-2.83%	2.27%	6.87%
Government Bonds	BESA GOVI	Rand	595.9	-0.23%	-3.03%	1.64%	6.21%
Corporate Bonds	SB JSE Credit Indices	Rand	115.7	-0.50%	-3.03%	-8.31%	-18.20%
Inflation Linked Bonds	BESA CILI	Rand	252.9	-0.31%	-1.38%	0.11%	1.93%
Cash	STEFI Composite	Rand	395.5	0.13%	0.29%	3.29%	7.37%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	73.1	-4.35%	-6.32%	9.06%	55.47%
Gold	Gold Spot	US$	1 279.0	-1.54%	-1.99%	-1.39%	1.99%
Platinum	Platinum Spot	US$	885.0	-2.32%	-3.07%	-4.84%	-4.12%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.43	-2.71%	-5.47%	-7.85%	-4.20%
ZAR/Pound	ZAR/GBP	Rand	17.84	-1.85%	-5.33%	-6.17%	-7.96%
ZAR/Euro	ZAR/EUR	Rand	15.60	-1.37%	-4.83%	-4.76%	-8.03%
Dollar/Euro	USD/EUR	US$	1.16	1.72%	0.78%	3.53%	-4.31%
Dollar/Pound	USD/GBP	US$	1.33	1.01%	0.18%	1.69%	-3.59%
Dollar/Yen	USD/JPY	US$	0.01	1.00%	1.65%	-1.81%	-0.44%

Source: I-Net, figures as at 15 June 2018

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Consumer inflation
- Current account balance

US

- Building permits and housing starts
- Existing home sales
- Flash Markit Manufacturing Purchasing Managers' Index

EUROPE

- Consumer confidence
- Flash Markit Eurozone Manufacturing Purchasing Managers' Index

JAPAN

- Inflation
- Flash Markit Manufacturing Purchasing Managers' Index

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