## YOU CAN BREATHE OUT NOW

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Some calm and stability have returned following the intense sell-off of emerging market assets over the past few weeks. Perhaps the 10-year anniversary of the Lehman Brothers collapse reminded investors what a real crisis looks like. In contrast, the recent troubles of emerging markets are very manageable – although clearly tough times lie ahead for Argentina and Turkey, in particular.

Argentina's government needs to borrow dollars to manage its cash flow needs (including rolling over maturing loans), even though its currency has halved in the last eight months. Turkey's dollar denominated debt amounts to 70% of GDP (more than double South Africa's ratio). Both Argentina and Turkey have a long road ahead in regaining the trust of investors, but they have taken steps. Argentina's central bank hiked rates to 60% with little impact a few weeks ago, but Turkey's central bank hiked by 6.25% to 24% on Thursday, for once delivering more than what the market expected. While Turkey's President Erdogan has in the past pressured the central bank to keep rates unsustainably low, this time round his options for containing the crisis were limited: it was either hiking rates, imposing capital controls or turning to the International Monetary Fund. As a result of the central bank's actions, the lira rallied and with it other emerging market currencies including the rand.

Also removing pressure on emerging markets was softer-than-expected US inflation numbers. Core consumer inflation was 2.2% in August against 2.4% expected. While this doesn't change the outlook of further gradual interest rate increases by the US Federal Reserve, it does reduce the risk of aggressive rate increases in the near term. Meanwhile, the European Central Bank confirmed that it was sticking to its plans to steadily remove stimulus. It will cut its bond buying programme from €30 billion per month to €15 billion in October. It plans to stop completely after December, and then start the long journey of raising interest rates to more normal levels around the middle of next year.

The rand appreciated below R15 to the dollar last week. This provides some breathing room for the Reserve Bank's monetary policy committee (MPC) meeting this week. The slightly firmer currency buys it time to assess how the growth and inflation outlook evolves, without being forced into emergency rate hikes, as in early 2014 at the height of the "Fragile Five" sell-off.

### CREDIBILITY IS NOT FREE

Credibility is not cheap, but it is immensely valuable. The SARB bought its credibility by maintaining high real interest rates over time. Given the weak economy and subdued inflation, the real repo rate is probably too high. But at least it's not 24%, and the risk of a 6% jump in one go is limited. The SARB might need to tweak rates higher, but it doesn't have to take out a sledgehammer.

South Africa's biggest challenge is the lack of local economic growth, not its dollar liabilities or balance of payments constraint. The dollar liabilities are under control and the free-floating rand takes care of the latter. But the lack of growth places huge pressure on government's finances (both by reducing tax revenue growth and increasing social spending demands) and increases the risk of a further credit ratings downgrade. Encouragingly, a Moody's analyst noted at a conference last week that they did not expect a ratings change in the next eight months, and believe the worst is behind as far as the economic slowdown is concerned. They also expect a broad-based recovery, supported by strong global growth.

### MIXED SIGNALS

We agree with this view. However, the recent signposts of such a recovery are still mixed. Business confidence declined in the third quarter, unsurprisingly given the emerging market turmoil, the lack of domestic demand and continued policy uncertainty, especially around land reform. The RMB/BER Business Confidence Index fell to 39 index points, and remains well into net negative territory. The BER surveyed 1 700 businesses across five sectors – retail, wholesale, new vehicle sales, construction and manufacturing - in August and September. Each of these sectors, chosen because of their value as cyclical indicators, was negative in the third quarter.

Stats SA released three early data points on third quarter activity. Manufacturing production was surprisingly strong in July, rising 2.9% from a year ago. Mining production, on the other hand, was surprisingly weak with a 5% year-on-year decline. Both sectors have been volatile from month to month and this has contributed to volatile quarterly economic growth numbers. However, neither sector has a discernible positive longer-term trend. Manufacturing output has essentially flat-lined since 2014, and mining output since 2010. Within each sector there are growth areas such as food production and chromium mining, but not enough to make a big difference overall. Gold mining continues to be on a long-term downward trend.

Retail sales growth was positive in real terms. Spending at retailers rose 1.3% in July from a year ago in real terms, reflecting very low volume growth. Adding back inflation, spending growth was 3.3%. This illustrates how low inflation is at retail level. Some of this is probably still the lagged impact of a stronger rand up to the first quarter, and some of this low global goods inflation. But the tough competitive environment also means that there is a clear reluctance to raise prices for fear of losing market share. This is likely to dampen the impact on overall inflation of the rand's weakness from April onwards.

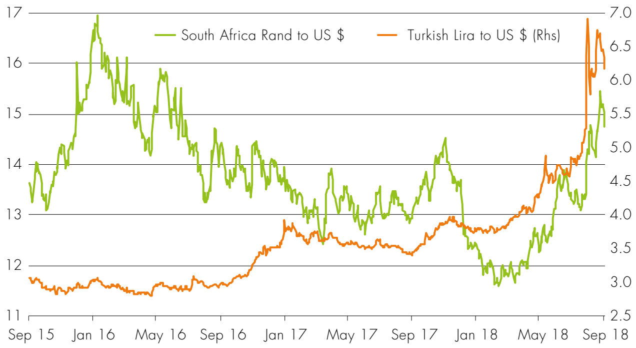
In other words, what is good for consumers is bad for retailers' margins. And of course the weakness in retail sales extends beyond the large retailers themselves, most of whom are listed on the JSE. Food producers, for instance, are also battling not just with growing the value of sales (pricing power), but also volumes. Similarly, the SA listed property sector also faces the squeeze from retail spending. The JSE All Property Index is around half locally and half globally exposed. Of the local component, around 60% is retail which faces not only weak consumer demand, but also pressure on the supply side with the rapid growth in shopping mall space in recent years. Having said that, the foreign component of the ALPI, heavily skewed to British retail, is not faring much better. The London (sterling) prices of the dual-listed Intu is down 40% year-to-date, Hammerson 15% and Capital & Counties 22%.The UK economy also suffers from policy uncertainty ahead of its exit from the European Union and low growth.

## LITTLE CHEER, BUT DON'T FEAR

In fact, the JSE had little cheer recently, apart from some of the resource companies. The domestically-focused companies are unsurprisingly struggling in the tough local economy. The most disappointing area has been the big industrial rand hedges where company-specific issues have overwhelmed the impact of a weaker rand. Naspers for instance has been held back by the 20% year-to-date decline in the Tencent share price, while British American Tobacco's London share price is down 27% in pounds. Aspen is down 32% in 2018. And of course MTN had its run-ins with Nigerian authorities. These four shares alone account for 18% of the JSE Capped Swix Index and 25% of the JSE All Share Index.

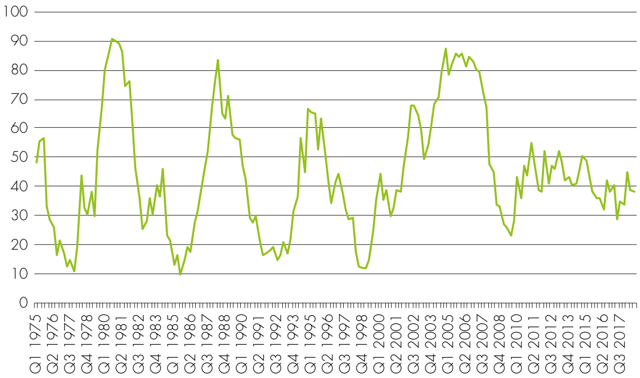
The flip-side of the underperformance of local equities is that valuations have improved and along with them, prospective returns. We've had a long period of disappointing returns from the JSE and this is still the main asset class in most portfolios. Investors are understandably worried. But remember that waiting for the market to recover before investing invariably means missing out. The best thing to do in tough, volatile and uncertain times is not to chop and change your portfolio, but to stick to your investment strategy.

**CHART 1:** RAND AND TURKISH LIRA AGAINST THE US DOLLAR



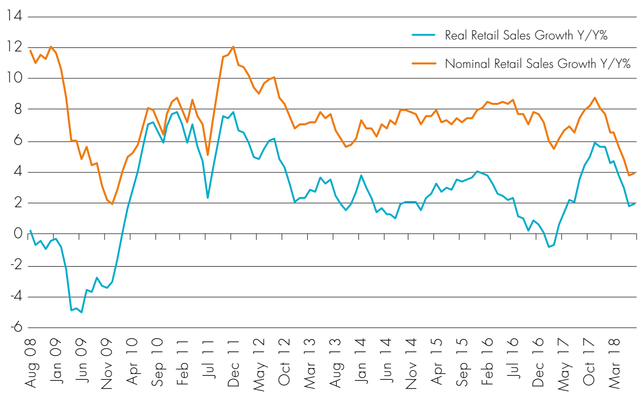

Source: Thomson Reuters Datastream

**CHART 2:** RMB/BER BUSINESS CONFIDENCE INDEX




Source: Bureau for Economic Research

**CHART 3:** SA RETAIL SALES GROWTH, SMOOTHED




Source: StatsSA

# INDICATORS

### EQUITIES - GLOBAL

| DESCRIPTION | INDEX | CURRENCY | INDEX VALUE | WEEK | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|---|---|---|---|---|---|---|---|
| Global | MSCI World | US$ | 2 163.0 | 1.17% | -0.55% | 2.85% | 9.08% |
| United States | S&P 500 | US$ | 2 905.0 | 1.15% | 0.10% | 8.64% | 16.39% |
| Europe | MSCI Europe | US$ | 1 686.0 | 1.57% | -1.11% | -6.18% | -3.21% |
| Britain | FTSE 100 | US$ | 9 546.0 | 1.53% | -0.89% | -8.22% | -2.33% |
| Germany | DAX | US$ | 1 346.0 | 1.74% | -1.97% | -4.08% | -2.89% |
| Japan | Nikkei 225 | US$ | 206.1 | 2.60% | 0.13% | 1.97% | 14.31% |
| Emerging Markets | MSCI Emerging Markets | US$ | 1 018.0 | -0.49% | -3.60% | -12.09% | -7.45% |
| Brazil | MSCI Brazil | US$ | 1 563.0 | -4.75% | -3.46% | -22.74% | -26.06% |
| China | MSCI China | US$ | 76.6 | -0.22% | -4.59% | -13.46% | -7.67% |
| India | MSCI India | US$ | 573.4 | -2.71% | -4.44% | -6.16% | -0.63% |
| South Africa | MSCI South Africa | US$ | 452.0 | 1.12% | -5.24% | -25.29% | -13.41% |

### 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 | 56 582.0 | -0.85% | -3.56% | -4.91% | 1.31% |
| All Share | All Share (Total Return) | Rand | 8 225.0 | -0.65% | -3.01% | -2.66% | 4.39% |
| TOP 40/Large Caps | Top 40 | Rand | 7 319.0 | -0.56% | -3.24% | -1.73% | 4.86% |
| Mid Caps | Mid Cap | Rand | 15 008.0 | -1.90% | -3.14% | -11.59% | -3.24% |
| Small Companies | Small Cap | Rand | 19 474.0 | -1.15% | -1.22% | -7.36% | -3.22% |
| Resources | Resource 20 | Rand | 2 805.8 | 0.94% | -0.66% | 22.73% | 26.54% |
| Industrials | Industrial 25 | Rand | 13 823.0 | -1.35% | -4.64% | -8.55% | -4.17% |
| Financials | Financial 15 | Rand | 9 263.0 | -0.57% | -2.79% | -4.57% | 13.17% |
| Listed Property | SA Listed Property | Rand | 1 913.3 | -2.01% | -2.83% | -22.35% | -15.64% |

### FIXED INTEREST - GLOBAL

| DESCRIPTION | INDEX | CURRENCY | INDEX VALUE | WEEK | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|---|---|---|---|---|---|---|---|
| Global Government Bonds | Citi Group WGBI | US$ | 930.8 | -0.19% | -0.62% | -1.82% | -2.10% |

### FIXED INTEREST - SOUTH AFRICA

| DESCRIPTION | INDEX | CURRENCY | INDEX VALUE | WEEK | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|---|---|---|---|---|---|---|---|
| All Bond | BESA ALBI | Rand | 606.5 | -0.24% | -1.28% | 3.21% | 5.34% |
| Government Bonds | BESA GOVI | Rand | 600.8 | -0.27% | -1.41% | 2.47% | 4.57% |
| Corporate Bonds | SB JSE Credit Indices | Rand | 115.3 | 0.09% | -0.11% | -8.59% | -16.38% |
| Inflation Linked Bonds | BESA CILI | Rand | 252.4 | 0.43% | 0.38% | -0.10% | 1.50% |
| Cash | STEFI Composite | Rand | 402.4 | 0.13% | 0.27% | 5.09% | 7.28% |

### COMMODITIES

| DESCRIPTION | INDEX | CURRENCY | INDEX VALUE | WEEK | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|---|---|---|---|---|---|---|---|
| Brent Crude Oil | Brent Crude ICE | US$ | 78.1 | 1.42% | 0.10% | 16.54% | 41.96% |
| Gold | Gold Spot | US$ | 1 194.0 | -0.25% | -0.67% | -7.94% | -10.23% |
| Platinum | Platinum Spot | US$ | 793.0 | 1.41% | 1.02% | -14.73% | -19.41% |

### CURRENCIES

| DESCRIPTION | INDEX | CURRENCY | INDEX VALUE | WEEK | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|---|---|---|---|---|---|---|---|
| ZAR/Dollar | ZAR/USD | Rand | 14.93 | 1.98% | -1.67% | -17.10% | -12.08% |
| ZAR/Pound | ZAR/GBP | Rand | 19.52 | 0.92% | -2.51% | -14.24% | -9.94% |
| ZAR/Euro | ZAR/EUR | Rand | 17.36 | 1.36% | -1.86% | -14.42% | -9.87% |
| Dollar/Euro | USD/EUR | US$ | 1.16 | 0.00% | 0.00% | 3.53% | 2.59% |
| Dollar/Pound | USD/GBP | US$ | 1.31 | -1.16% | -0.54% | 3.29% | 2.52% |
| Dollar/Yen | USD/JPY | US$ | 0.01 | 0.91% | 0.87% | -0.52% | 2.00% |

Source: I-Net, figures as at 14 September 2018

# ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

# THE WEEK AHEAD

## SOUTH AFRICA

- Consumer confidence
- Consumer inflation
- Monetary Policy Committee meeting

## US

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

## EUROPE

- Eurozone Inflation
- Eurozone Flash Markit Purchasing Managers' Index

## JAPAN

- Inflation

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