The SPM Eco Week: Week of 04 – 10 February 2019

Economic indicators due this week: (Consensus estimates from Bloomberg)

Date	ECO Release	Period	Consensus		Previous	
04 Feb Mon	SA SACCI Business Confidence	Jan	-		95.2 pts	
05 Feb Tue	SA Standard Bank PMI	Jan	-		49.0 pts	
06 Feb Wed	US Balance of Trade	Nov	-$54,0bn		-$55.5bn	
07 Feb Thu	SA Forex Reserves (Gross/Net)	Jan	-	-	$51.64bn	$43.09bn
	China Foreign Exchange Reserves	Jan	$3.081 trillion		$3.072 trillion	

Abcap forecasts: SA Standard Bank PMI 49.5 pts

Last week

ECO Release	Period	Actual		Consensus		Previous	
SA M3 Money Supply	Dec	5.6% y/y		5.8% y/y		5.7% y/y	
SA Private Sector Credit	Dec	5.1% y/y		5.4% y/y		5.6% y/y	
SA PPI	Dec	-0.9% m/m	5.2% y/y	-0.5% m/m	5.8% y/y	0.4% m/m	6.8% y/y
SA Main Budget Balance	Dec	R14.5bn		-		-R16.9bn	
SA Absa Manufacturing PMI	Jan	49.9 pts		50.7 pts		50.7 pts	
SA NAAMSA New Vehicle sales	Jan	-7.4% y/y		0.1% y/y		-1,9% y/y	
US Average Hourly Earnings	Jan	0.1% m/m	3.2% y/y	0.3% m/m	3.2% y/y	0.4% m/m	3.2% y/y
US Nonfarm Payroll	Jan	304k		160k		222k (revised 312k)	
US Unemployment	Jan	4.0%		3.9%		3.9%	

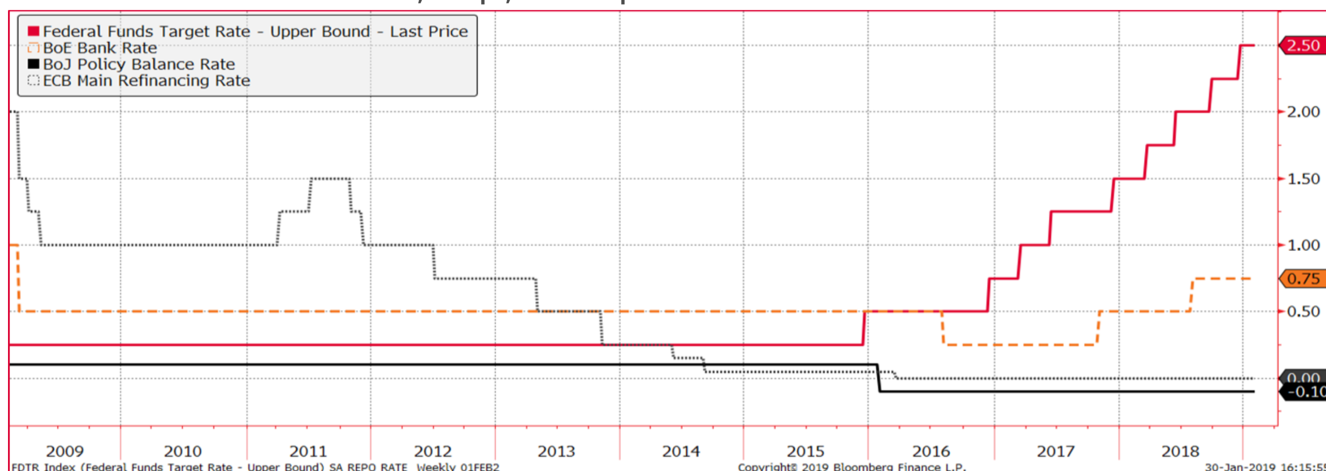
Discussion point 1: Policy uncertainty keeps the markets guessing

Early in 2018 the path of the central bank policy of the world's biggest economies seemed to be fairly well laid out (or at least it seems so with hindsight). The Fed was well into its rate-tightening programme and there was good visibility on rate hikes for the duration of 2018. The ECB had communicated well on its bond-buying tapering strategy and there was little uncertainty around what the Bank of England or the Bank of Japan were planning. Policy at the People's Bank of China was not that certain but it was evident that the monetary authorities had their finger on the pulse of the economy and stood ready to act as and when required. The chart on developed market central banks overleaf reflects the ongoing policy tightening in the US, the 25bp rate hike from the Bank of England and the flat rates that prevailed in Europe and Japan for the duration of 2018. While the European Central Bank (ECB) kept rates unchanged, they continued the process of tapering their monthly bond buying to zero by the end of 2018 – not a tightening of policy per se but a reduction in the accommodation of monetary policy.

Fast forward to 2019 and the policy horizon looks a lot more clouded. The next move according to the central bank monetary policy text book should be for the ECB to raise rates but when? 2018 GDP data for Europe turned out to be softer than expected and the Italian economy has entered a recession (negative growth in Q3 and Q4 2018). The German economy is also softer and so it's not quite clear when Mario Draghi and his team will start raising interest rates again. From an expectation of a first rate hike sometime this year, markets have started to price in a first hike only in June 2020. The Brexit conundrum has also clouded the outlook for monetary policy in the UK. The big question though stems around the path of interest rates in the US. Not too long ago the Fed was poised to increase rates in the US three times in 2019. The Fed hiked in December for the ninth time in this cycle but since then has adopted the phraseology of "being patient" about future rate hikes (which will remain dependant on the health of the economy as presented in key metrics such as job creation and the unemployment rate each month). The

"dot plot" of the Federal Open Market Committee still points to 50bp of tightening this year but market interest rates are suggesting no adjustment to the target of the Fed Funds rate in 2019.

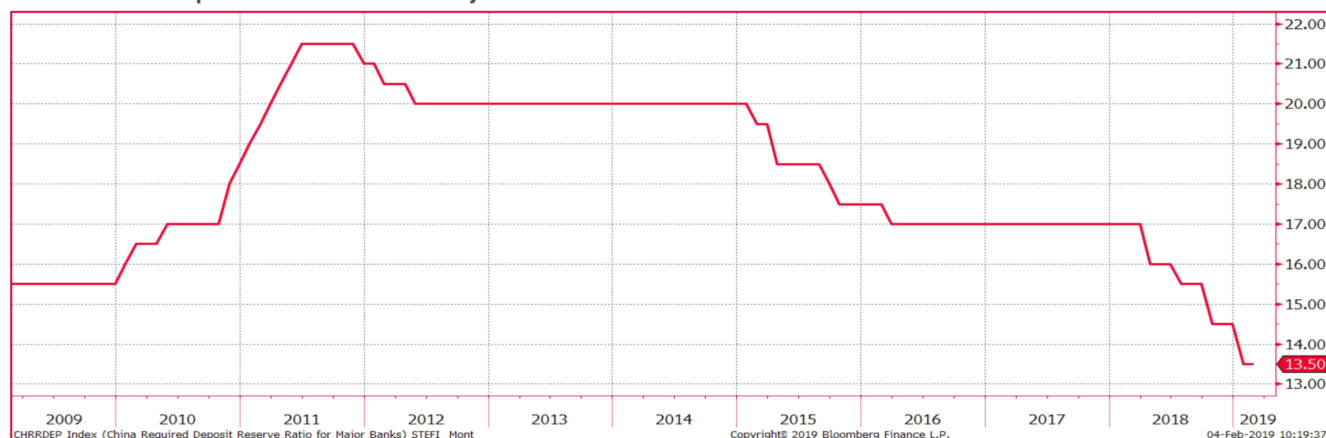
Central Bank Interest Rates for the US, Europe, UK and Japan: 2009 – 2010



Source: Bloomberg

In managing the Chinese economy, the PBoC has been concerned about lending by the shadow banking industry, the property market and general liquidity concerns. To that end, the central bank has cut the reserve requirement ratio (RRR) at the banks a number of times in 2018. The path of the RRR for major banks is reflected in the chart below and shows how that rate was eased substantially in 2018 and early 2019 already. The basic premise is that banks use the freed up funds to pay down their (high) debt levels and also lend more into the economy. These moves are designed to improve the integrity of the banking system but also to help keep growth above 6,0% and closer to government's 6,5% GDP growth target. To avoid a harder economic landing and keep growth up, the PBoC may have to act a number of additional times in 2019 but the extent and timing of that policy is uncertain.

PBoC Reserve Requirement Ratio of the major banks: 2009 – 2019



Source: Bloomberg

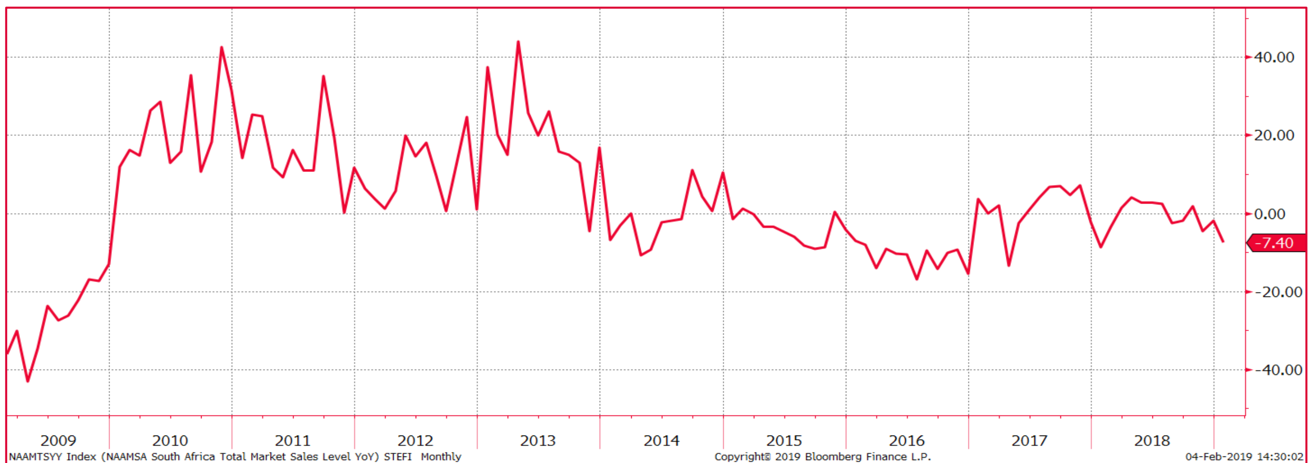
The Bank of Japan (BoJ) has continued to keep rates marginally negative whilst targeting 10-year bond yields at around zero percent. A programme of quantitative easing has been in place for some time but the negative interest rates have hurt Japanese Banks and reduced their profitability. No change to the monetary policy status quo is expected soon but the BoJ has to contend with trying to get inflation up to the target of 2% and get growth up to the same benchmark while simultaneously maintaining the integrity of the banking system – just another unknown to throw into the central bank policy pot.

A delay in tightening US interest rates should add some pressure to the US dollar, underpin equity markets and the "risk-on" trade. That should benefit emerging markets and emerging market currencies – and our own. With concerns over a 2020 US recession it seems likely that the Fed will act with caution to avoid strangling their growing economy and that should be positive for the global economy and global sentiment. Policy uncertainty coupled with Brexit and US-China trade negotiations are enough though to ensure that market volatility continues. As always, watching the Fed, is the main game in town.

Discussion point 2: New vehicle sales slump and add further colour to the current state of the consumer

The recent Consumer Confidence Index released for Q4 2018 showed that consumers were generally happy with the direction of the economy and their own finances but they still considered it an inopportune time to be buying durable goods. This is corroborated by the latest new vehicle sales data published last week. Total vehicles sales declined by 7,4% y/y in January (December: -1,8% y/y) as the chunkiest category, new passenger car sales, recorded their sixth consecutive monthly decline of 10,8% y/y (December: -0,2% y/y). The contraction in passenger car sales reflects slowing demand for new cars as households opt to hold onto their cars for a little while longer rather than replace them. The slow growth in private sector credit extension paints a similar picture of consumers sitting on their hands. GDP forecasts for 2019 are concentrated around 1,7% y/y from an estimated 0,7% y/y in 2018 but that is predicated on a stronger household sector and that in turn will be driven by confidence. There are numerous events on the horizon that can impact confidence positively or negatively and we don't have long to wait: The State of the Nation address and the National Budget loom large this month while the General Election and ratings agency outcomes will follow thereafter. The rand will be the confidence barometer for all of those events.

NAAMSA Total new vehicle sales (% change y/y): 2009 – 2019

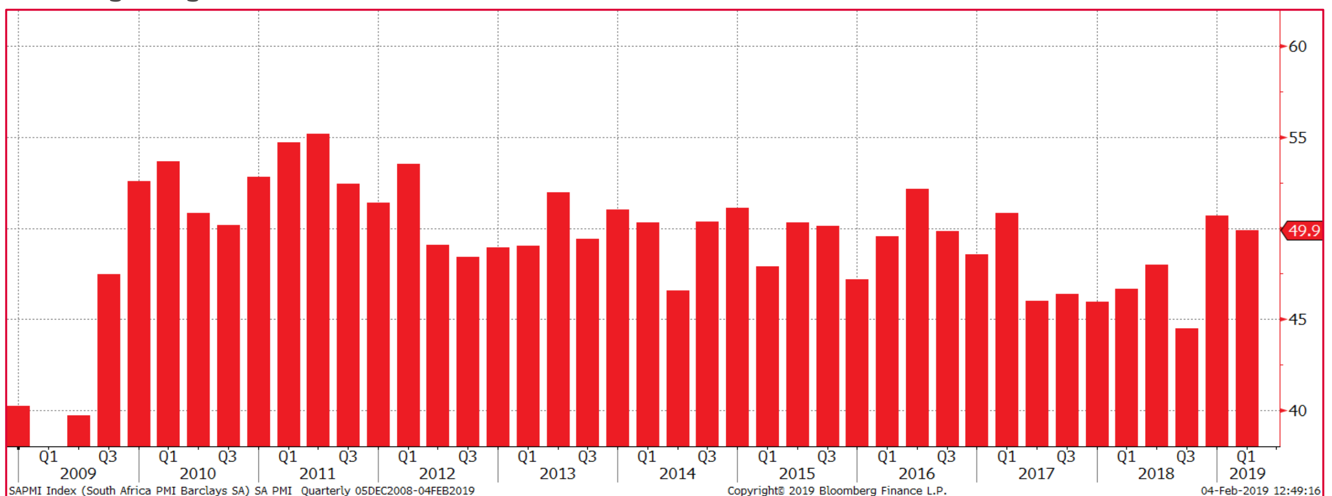


Source: Bloomberg

Quick chart: The South African Purchasing Managers Index (PMI)

The Absa PMI dipped marginally below the neutral level in January after the sharp rebound in December. The PMI and actual manufacturing data have been a little out of synch of late but the PMI does talk to the volatility of actual production and the swing between growth and contraction and positive contribution to domestic GDP. For now we're on the cusp of just stagnating.

Purchasing Managers Index (PMI) 2008 – 2019



Source: Bloomberg

Quick catch-up on the SPM Global Equity Portfolio (GEP)

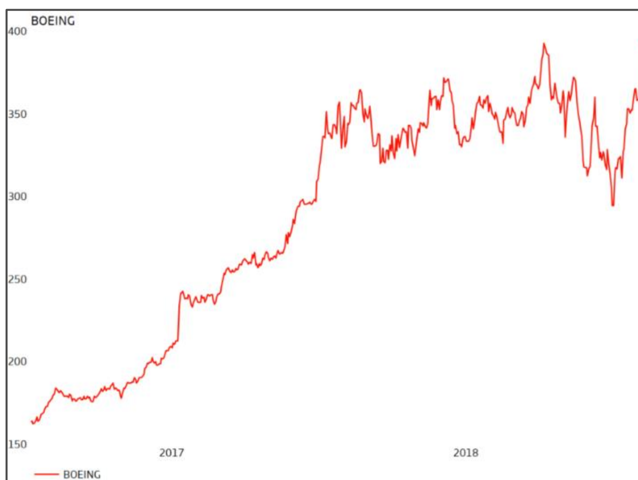
The GEP currently houses the shares of around 24 different companies listed in the US and Europe and the fortunes of these international mega-cap companies are mostly all linked to the global economy. The GEP, which is available to investors via SPM as a direct offshore investment with their externalised funds is also available in the form of a JSE-listed, rand-denominated note which provides local investors with access to the GEP for as little as R1000. Earnings season in the US is in full swing and below we highlight the quarterly earnings of five GEP companies that have reported over the past fortnight.

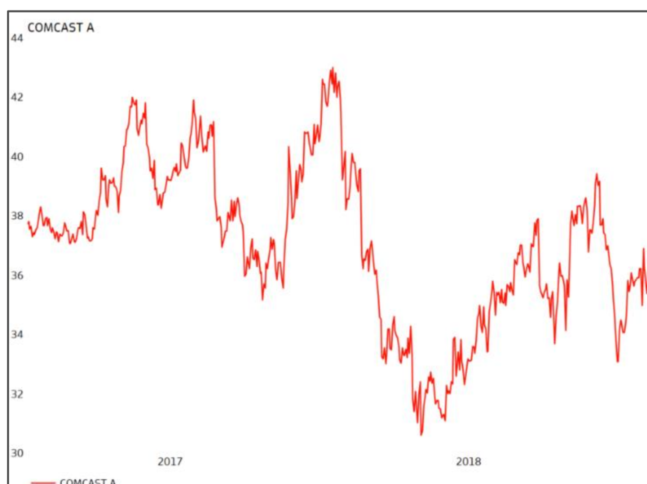
The Boeing Company

Period of reporting: Q4 2018

Revenue increased by 11% y/y to $28,3bn. Growth was driven by record commercial airplane deliveries and higher defence and service volumes. Revenue by segment: Commercial Airplanes +14%; Defence, Space & Security +16%; Global Services +29%. Operating margin increased about 310bp y to 13.6%, while EBITDA increased 36% to $4,8bn

Interesting fact: Boeing delivered a record 806 commercial airplanes in 2018 (+6% on the 763 in 2017). Q4 2018 238 airplanes (Q3: 209)





Comcast Corp

Period of reporting: Q4 2018

Comcast reported 29k video subscriber losses (lower than the consensus of -62k) and 351k broadband additions (higher than consensus of +356k). Consolidated revenue of $27,846bn (including Sky) was above consensus of $27,55bn; High-speed Internet grew 351k (consensus: 356k) and Voice added 2k beating the 34k consensus loss. The company lost fewer video subscribers than expected and grew its broadcast television and theme park businesses. EBITDA of $8,191bn was above consensus of $7,78bn. Adjusted EPS which improved during the period to $0,64 was attributed to better EBITDA and a 15,8% tax rate.

Interesting fact: Disney outbid Comcast for 21st Century Fox in 2018 but then after a long bidding war with 21st Century Fox, Comcast purchased the majority stake of UK media business Sky for $39bn.

Facebook

Period of reporting: Q4 2018

Revenue increased by 30% to $16,9Bbn with mobile advertising revenue contributing 93% of ad revenue (89% in the prior year). Net income shot up by 61% to $6,88bn. Income from operations increased 6%, to $7,82bn, while operating margin fell from 57% to 46%. The company's effective tax rate dropped to 14% from 43% the year prior. Daily active users were up 9% y/y in December, to 1.52bn on average. Monthly active users were also up 9%, to 2,32bn.

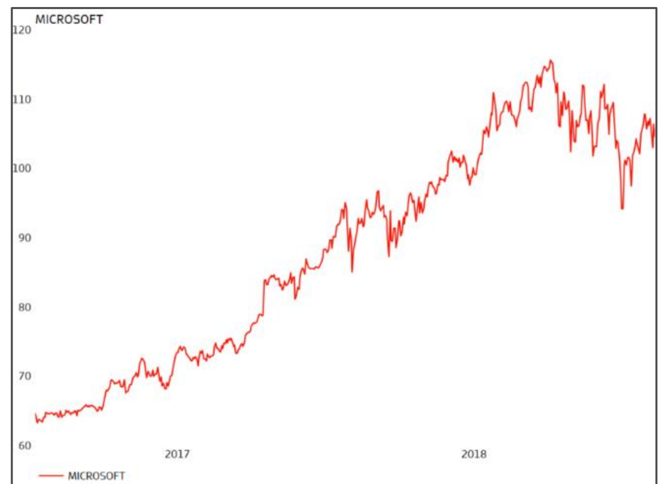
Interesting fact: The company estimates 2,7bn people use the company's service "family" each month (Facebook, Instagram, WhatsApp or Facebook Messenger), with at least 2bn using at least one of the family every day on average.

Microsoft

Period of reporting: Q2 2018

Revenue increased by 12% from the year prior to $32,47bn, below markets expectations of $32,51bn. Diluted EPS came in at $1,10, marginally above market expectations of $1,09. GAAP Net Income was $8,4bn. Intelligent Cloud revenue was up 20% to $9,4bn. Productivity and Business Processes rose by 13% to $10,1bn, and More Personal Computing rose with the lowest single digit growth of 7% to $13bn. The Azure business, which competes against Amazon Web Services and other players including Google Cloud Platform, increased by 76%. LinkedIn revenue increased 29% with record levels of engagement highlighted by LinkedIn sessions growth of 30%.

Interesting fact: Gaming revenue grew to $4,2bn ($3,9bn a year ago) with Xbox Live monthly active users of 64m (59m).

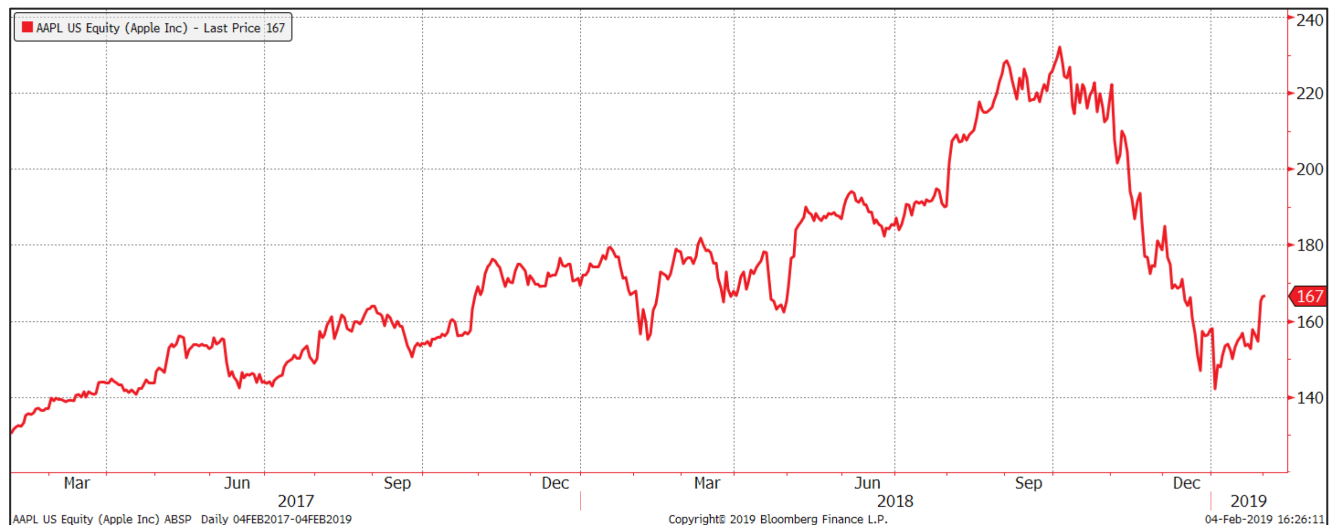


Apple

Period of reporting: Q1 2019

GAAP diluted EPS came in at $4,18 beating market expectations by $0,01, Revenue was down 4.5% y/y at $84,3bn but still above expectations. Revenue from Greater China which accounts for about 15,6% of total quarterly revenue declined by 26,6% to $13,2bn. Apple disclosed services margins for the first time at 62,8%, operating cash flow came in at $26,7bn and Apple returned $13bn to investors during the quarter. Revenue breakdown: iPhone, $52bn (-15% y/y); Mac, $7,4bn (+9% y/y); Wearables, Home and Accessories, $7,3bn (+33% y/y); iPad, $6,7bn (+17% y/y); Services, $10,9bn (+19% y/y).

Interesting fact: Berkshire Hathaway (another of the GEP holdings) owns 5,48% of Apple.



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