SYGNALS

FEBRUARY 2015

KEY INDICATORS

		1 MONTH	3 MONTHS	6 MONTHS	1 YEAR	2 YEARS	3 YEARS	5 YEARS
J203T	FTSE/JSE All Share Index	4.1%	7.1%	5.9%	16.1%	19.4%	19.4%	18.2%
J200T	FTSE/JSE Top 40 Index	4.5%	6.8%	4.5%	13.6%	19.1%	19.0%	17.7%
J210T	FTSE/JSE Resources 20 Index	8.7%	3.4%	-17.7%	-16.0%	-1.0%	-2.4%	2.1%
J211T	FTSE/JSE Industrials 25 index	3.2%	7.7%	12.6%	24.9%	29.0%	32.3%	28.9%
J212T	FTSE/JSE Financials 15 Index	3.4%	8.3%	17.2%	37.3%	27.1%	27.0%	22.3%
J403T	FTSE/JSE SWIX Index	2.6%	7.0%	8.0%	21.4%	21.7%	21.3%	19.7%
J303T	FTSE/JSE CAPI Index	4.1%	7.1%	6.0%	16.4%	19.6%	19.5%	18.4%
J253T	SA Listed Property Index	3.2%	12.0%	25.7%	44.3%	20.0%	25.0%	22.6%
ALBI	BEASSA All Bond Index	-2.8%	1.9%	6.2%	15.1%	6.7%	9.2%	10.2%
STeFI	STeFI Index	0.5%	1.5%	3.1%	6.1%	5.6%	5.6%	5.8%
	MSCI World Index in SA Rands	6.1%	8.0%	11.7%	16.9%	30.2%	31.4%	21.4%
	Rand/US Dollar Exchange Rate	0.2%	5.6%	9.4%	8.4%	13.6%	16.0%	8.7%
	Rand/Euro Exchange Rate	-0.6%	-5.3%	-6.7%	-12.0%	5.2%	9.5%	4.5%
	Headline CPI	-0.2%	-0.4%	0.2%	4.4%	5.1%	5.2%	5.1%
	PPI	-1.1%	-1.3%	-1.0%	3.5%	5.3%	5.4%	6.1%

"Exit from the euro does not even enter into our plans, quite simply because the euro is fragile. It is like a house of cards. If you pull away the Greek card, they all come down. Do we really want Europe to break apart? Anybody who is tempted to think it possible to amputate Greece strategically from Europe should be careful. It is very dangerous. Who would be hit after us? Portugal? What would happen to Italy when it discovers that it is impossible to stay within the austerity strait-jacket?"

Greece's newly appointed finance minister Yanis Varoufakis, February 2015

MARKET OVERVIEW

Statesmanship came to the fore in February as German Chancellor Angela Merkel and French President Francois Hollande brokered a ceasefire between Russia and the Ukraine, and averted an imminent Greek tragedy. Stock markets reacted well to what may well be only temporary resolutions to the dual political crises. Economic data releases, on the other hand, were mixed, with the US showing some weakness, the eurozone surprising on the upside and China continuing on its “new normal” lower growth path.

The US released a disappointing annualised 2.2% GDP growth figure for the fourth quarter of 2014, a sharp slowdown from the 5.0% growth registered in the third quarter. Overall growth for 2014 came in at 2.4%. Lower growth was a function of weaker business spending, a wider trade deficit and a slowdown in consumer spending. A slowdown was also evident in data releases in the first quarter of 2015. Significantly, the ISM manufacturing index slowed to 53.5% in January from 55.1% in December, its worst performance in a year, while unemployment rose to 5.7%. On the upside, the slowdown is expected to be short-lived given the enormous tail-wind provided by lower oil prices.

China also started 2015 on a weak note with the official manufacturing PMI contracting and January inflation slowing to 0.8% year-on-year, a five year low. In response, the central bank reduced the amount of cash commercial banks must set aside as reserves by 50 basis points.

The eurozone, on the other hand, surprised the markets with a fourth quarter growth estimate of 0.3% quarter-on-quarter and 0.9% year-on-year after Germany expanded by 0.7% on the back of robust domestic demand after two quarters of near zero growth. Germany grew by 1.6% in 2014. The numbers were less rosy for the rest of the eurozone. France grew by just 0.1% quarter-on-quarter, and 0.4% in 2014. Italy outright stagnated, marking its 14th consecutive quarter without any growth. The Italian economy contracted by 0.4% in 2014, after contracting by 1.9% in 2013 and 2.3% in 2012. Spain was a bright light with 0.7% quarter-on-quarter growth, its fastest pace in seven years. The eurozone’s fourth-largest economy thus grew by 1.4% in 2014, after contracting by 1.2% in 2013. And the Greek economy contracted by 0.2% after three consecutive quarters of growth, bringing 2014 growth to 1.7%.

Eurozone inflation came in at a negative 0.6% year-on-year in January. The Markit/HSBC manufacturing PMI rose to 51.0 from December’s reading of 50.6, while the composite PMI rose to a six-month high of 52.6.

The markets remained volatile throughout the month as Greece’s new government tried to negotiate its way out of repaying debts and complying with austerity measures imposed in exchange for its €240 billion bail-out in 2010. The demands started at a partial debt write-off level, morphing into a bond swap, linking future interest payments to economic growth. With Greece’s current bail-out due to expire at the end of the month, and the Greek government refusing to ask for an extension, concerns rose that without a deal the country may exit the eurozone.

Predictably, a four-month reprieve deal with its creditors, the EC, the IMF and the ECB, secured at the eleventh hour, headed off an imminent default. The arrangement gives Greece breathing room to draw up its own reform plans and relaxes the fiscal targets imposed by the troika. It also gives the new government bridging finance at a time when Greece was likely to exhaust the emergency liquidity provided by the ECB. In reality, Greece needs to plan for the repayment of €6.7 billion to the ECB in July and August, an impossible task without a fresh EU-IMF programme in place. In return, Greece undertook to honour its financial obligations and to refrain from any rollback of measures and unilateral changes to the policies and structural reforms that would negatively impact fiscal targets, economic recovery or financial stability. On paper, Greece has lost this battle.

However, the Greek government continues to insist that Greece will not abide by the terms of the bail-out program agreed to by the previous Greek government. In fairness, the program is widely recognised to have failed, imposing unreasonable austerity on the economy.

The deal was finally brokered after Merkel and Hollande pledged to uphold the sanctity of the monetary union. In reality a Greek exit would have destabilised the strategically important Balkans, pushing them towards closer ties with Russia, a possibility abhorred by both the US and NATO.

Apart from the news flow surrounding Greece, market volatility was further exacerbated by continuing political tensions with Russia over the Ukraine. A mid-month ceasefire agreement, again brokered by Germany and France, buoyed sentiment.

In an important move, US Federal Reserve Chair, Janet Yellen, signalled to Congress that an increase in interest rates was unlikely for at least the next couple of meetings given continuing weakness in the labour market and lower inflation.

However, within days of her testimony, the US data for durable goods orders came in much stronger than expected, while US core CPI remained unchanged from December at 1.6% year-on-year, putting the prospect of a mid-year rate rise back on the table.

The oil price rallied to above US$60 a barrel on short-term supply issues. In particular, Brent Crude rose by over 15% from its January close, helped by positive eurozone and Chinese data, as well as supply disruptions in Libya and Iraq. US crude showed a more modest gain of 1.9%.

The low oil prices are taking their toll on OPEC and its associates. The US EIA estimates that the group's export revenue will drop by about 37% this year. Venezuela is expected to suffer an economic contraction of 7%, while Iran will lose out on US$48 billion of revenues over the next two years.

After an initial uptick the gold price fell below US$1 200 an ounce, from its US$1 300 high in January, on news that Greece had secured a rescue deal, and on speculation of earlier US interest rate increases. However, the bullion found support at around US$1 200 thanks to demand from China which is a firm buyer at that level.

360 DEGREES ROUND THE WORLD

EUROPE: The EC struck an upbeat tone in its latest projections for the eurozone, raising its forecast for GDP expansion to 1.3% in 2015, up from 1.1%. The EU is expected to grow by 1.7%.

UK: Consumer price inflation slowed to 0.3% in January, the lowest annual rate since March 1960. The Bank of England kept interest rates at a record low.

GERMANY: The yields on German 10-year bonds have fallen below their Japanese equivalents for the first time in history, a possible indication that investors believe the eurozone is set for the combination of low growth and deflation similar to the conditions suffered by Japan over the past couple of decades.

SWEDEN: Sweden's central bank was forced to take unprecedented steps to shore up falling inflation by cutting interest rates into negative territory while announcing its intention of buying government bonds. Critics say the Riksbank started raising interest rates too soon, and then cut rates too slowly even though the economy plunged into deflation. Sweden is now being used as an example of what can happen if policymakers raise interest rates too soon. This happened against a background of a soaring currency as Sweden announced a 1.1% growth rate in the last quarter of 2014.

DENMARK: As the euro weakened, money has flooded into "safe haven" currencies such as the Swiss franc and the Danish krone. Denmark, similarly to Switzerland, has maintained a krone peg to the euro. Switzerland gave up on their peg in January, allowing the franc to surge in value. Many are speculating that Denmark will do the same. In the meantime, however, the central bank cut its key interest rate for the fourth time in three weeks to -0.75% and restated its commitment to keeping the krone in a tight trading range against the euro. Denmark's borrowing cost, the yield on 10-year government bonds, has dropped to the second lowest in the world after Switzerland.

RUSSIA: Russia's central bank cut its benchmark interest rate by 2.0% to 15% as the ruble continued to lose value.

CROATIA: Thousands of Croats had their debts written-off as part of an attempt to boost the economy by helping households to regain access to basic facilities including bank accounts. The scheme, which has been dubbed "fresh start", will see the debts of around 60 000 citizens erased by banks, telecoms and utilities operators as part of a deal with the government.

GREECE: S&P downgraded Greece to B-, one notch above default, and kept the outlook on the nation at "negative".

AUSTRALIA: The Reserve Bank of Australia cut interest rates to a record low of 2.25%, joining a global wave of monetary easing. The central bank cited lower commodity prices and an overvalued local currency putting pressure on Australia's economy as justification. Unemployment climbed to a 12 year high of 6.4%.

JAPAN: Japan exited recession after its GDP increased at an annualised 2.2% in the three months ended December 2014 after two quarters of contractions. The Bank of Japan maintained its quantitative easing programme at an annual pace of US$670 billion. The Nikkei 225 Index closed above 18 000 for the first time since 2007.

CHINA: In yet another sign that China's economy is stuttering, the country's inflation slowed to a five-year low of 0.8% year-on-year in January, sparking worries that the People's Bank of China will be next to devalue its currency. A combination of muted money growth, depressed real estate prices, and sluggish economic growth fuelled fears of possible deflation.

INDIA: India has changed the method of calculating its GDP, with the result showing Asia's third-largest economy in much better shape than expected. The revision lifted the 2013/14 GDP growth from 4.7% to 6.9%. The economy is expected to grow by 7.4% in the 2014/15 fiscal year. As a result, and in contrast to other BRICS, India is emerging as one of the few hopes for global growth. India is benefitting from a raft of new business-friendly policies instituted by Prime Minister Narendra Modi, who came to power last year.

SOUTH AFRICA

A chaotic preamble to President Jacob Zuma's state of the nation address shamed the country. The most significant announcement in the address was that foreigners will not be allowed to own agricultural land in South Africa, and that individual ownership will be limited to 12 000 ha. Interestingly, this is not an unusual arrangement in many other countries with 30 year leases being the common term, and is likely to have a marginal impact.

Data releases pointed to a subdued economy. There is now a far greater awareness of the uncoupling of performance of the markets from the domestic economic situation, as well as the appreciation of the downside risks involved.

The economy expanded by a seasonally adjusted and annualised 4.1% in the fourth quarter of 2014 compared with a revised 2.1% in the third quarter. This meant that the economy grew by a meagre 1.5% in 2014 as strikes in mining and manufacturing crippled production. 2015 is not looking much different, with tax increases, electricity rate hikes and rolling blackouts impacting on growth. The leading indicator of economic activity released by the Reserve Bank already suggested that economic growth will be weak over the next few months.

On the positive side, the Kagiso manufacturing PMI rose by four points to 54.2 in January, surprising on the upside. Unemployment fell to 24.3% in the fourth quarter of last year from 25.4% in the third quarter. It is the lowest level since the fourth quarter of 2013.

The CPI slowed significantly to 4.4% year-on-year in January, largely as a result of the petrol price decrease.

At month-end the news of a staggering trade balance deficit of R24.2 billion in January, after a revised R6.7 billion surplus in December, knocked the rand to R11.61 to the US dollar.

The 2015/16 budget has been rated as conservative enough to avoid credit rating downgrades, but disappointing in its lack of politically controversial decisions. The focus, unsurprisingly, was on how to use taxes to supplement revenues. However, the politically sensitive VAT remained unchanged for now. The main tax changes were:

- The fuel levy increased by 80.5c/litre, a combination of an outright increase and an increase in the funding of the Road Accident Fund. The National Treasury missed an opportunity to link the fuel levy to e-tolling collection.
- The 1% increase in marginal personal income tax rates was almost entirely offset by the bracket creep adjustments that have been made.
- There is a clear attack on wealth with the increase in transfer duty for properties above R2.25 million from 8% to 11%.
- Corporate taxes, which comprise less than 20% of total tax, were left unchanged, in recognition of the fact that companies are already under pressure from slow growth and electricity constraints.

Foreign exchange controls have been relaxed further, with the annual investment allowance rising from R4 million to R10 million, and the R1 million travel allowance relaxation in terms of how it is spent.

In terms of economic forecasts the highlights were:

- Inflation is expected to average 4.5% in 2015, 5.9% in 2016 and 5.7% in 2017.
- Government debt is to peak at 43.7% in 2017/18 after rising to 42.5% in 2015/16.
- Budget deficit for FY15/16 is worse than expected at 3.9% of GDP, partially due to lower expectations for nominal GDP. Deficit numbers in FY16/17 and FY17/18 were kept at 2.6% and 2.5% respectively.
- Economic growth has been forecast at 2.0% in 2015, 2.4% in 2016 and 3.0% in 2017.

ODDS AND ENDS

WORLD IS IN DEBT

Since the start of the global financial crisis at the end of 2007, the total debt worldwide has increased by US$57 trillion, rising to a massive

286% of global economic output. The ratio of total debt to economic output has declined in only a handful of smaller countries, such as Romania, Saudi Arabia and Israel. In all of the world's economic powerhouses, total debt has risen. While some of the places with the steepest increases are European countries that were enmeshed in that continent's debt crisis like Ireland, Greece and Portugal, with Spain and Italy just behind, the other significant one is China which has seen its ratio of debt to economic output rise by 83% since 2007 to 217% of GDP.

WHAT DOES THE GREEK EXTENSION DEAL REALLY MEAN?

The eurozone politicians have kicked the can down the road by granting Greece a four month extension to come up with an alternative reform plan to the current austerity measures. If Greece had exited the bail-out programme at the end of February without a follow-up arrangement, as it threatened to do, it would have forfeited its final bail-out payment of €1.8 billion, as well as €1.9 billion in ECB profits on Greek bond holdings. The IMF also has €3.5 billion in aid on hold, pending reform pledges from Athens. If the rescue package expires, Athens could also lose access to €10.9 billion worth of extra assistance put aside in 2010 to recapitalise its banking sector. In the meantime the ECB piled pressure on the country by announcing that it will no longer accept Greek government bonds as security for loans.

The Greek government insists that it does not want more money. However, in reality, it has to continue meeting its debt interest payments, government spending commitments and two large ECB bond repayments due later this year.

HOW UNREASONABLE ARE THE GREEKS BEING?

The Greek government has focused its negotiations on one key measure of austerity, the target for primary surplus. Primary surplus is the excess of what government earns in taxes less what it spends on everything excluding debt interest payments, expressed as a percentage of GDP.

Over the past four years, Greece has turned its 10% primary deficit to a 3% surplus at a great cost to jobs and the economy. In terms of the bail-out plan, however, it has to reach a primary surplus of 4.5% and then maintain it for a period of time. In addition, Greece has to reduce its debt to the eurozone's standard of 60% of GDP. The IMF estimates that to achieve that Greece would need to maintain its primary surplus at 7.2% between 2020 and 2030.

As a comparison, the aggregate primary surplus for all the eurozone countries is currently below 0%. It peaked at 3.6% in 2000. Over the past 30 years only three countries have managed to maintain a primary surplus of 5% or more for a decade; Singapore, Norway and Belgium. So maybe they have a point?

DISCLOSURE