



Global outlook: May 2009

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Markets have rebounded since the low on 9 March 2009 as the global credit crisis appears to have subsided. However many risks still remain as the focus moves from liquidity to economic growth.

The Economic Crisis Monitor shows that the global credit/liquidity crisis is subsiding. A sustained improvement in global equity markets now probably depends more on steady economic recovery.

We will start to concentrate more on the prospects for a broad-based global economic recovery which we will monitor through our upcoming Economic Recovery Monitor.

Markets rebound

Following the low in most equity markets around the world on 9 March 2009, there has been a welcome rebound. In particular, the S&P 500* is up a massive 29.7% since March, although still down year-to-date by 2.8%.

Similarly, the SA equity market is up 13.7% locally and up 43.2% in US dollars thanks to the stronger rand. However local equities are still down 4% year-to-date in rands.

Interestingly, emerging market equity markets have outperformed developed markets since March with emerging markets up 36.6% in US dollars and developed markets up 30.8%.

** The S&P 500 - Standard and Poor's stock price index comprising the 500 largest companies in the US.*

US delivers worse-than-expected growth figures

The US released their GDP (Gross Domestic Product) figure for the first quarter of 2009. The world's largest economy contracted by 6.1% compared to annual figure in the previous quarter.

This was worse than market expectations for a decline of -4.7% compared to last quarter. Consumer spending turned positive even before tax cuts were introduced; however, fixed investment spending decreased by over 50% during the quarter! The US economy is depleting inventories at a very rapid pace but it is still technically overstocked, leading to a very low level of industrial capacity utilisation. Hence, production is falling faster than consumption.

We believe the US economy will contract by 2.9% in 2009 and recover modestly in 2010 with growth of 1.3%. For the UK, Japan and Euro area, the forecasted growth figures are as follows:

	GDP growth (2009)	GDP growth (2010)
UK	-4.2%	0.4%
Japan	-6.6%	0.9%
Euro area	-4%	0.4%

The US also released their ISM manufacturing figure (which surveys purchasing managers at 300 industrial companies) last week and this showed signs of a recovery. This spells good news for a probable economic recovery towards the end of the year.

South Africa continues to cut rates

As expected, the Monetary Policy Committee (MPC) voted to reduce the Repo rate by 100 basis points on Thursday 30 April, bringing the Repo rate to 8.5% and prime lending rate to 12%. Since December 2008 rates have decreased by 350 basis points and we believe they will drop a further 150 basis points before the end of 2009. The Reserve Bank Governor Tito Mboweni stressed that “the severe synchronized downturn in international and domestic economic conditions ...continue to tilt the balance of risks to the inflation outlook to the downside over the medium term.”

Inflation remains above target

Consumer inflation (CPI) moderated slightly in March to 8.5% from 8.6% during February. Food price inflation continued to decline but remained the largest contributor. Electricity and other fuels had the largest price increase of 30% year-on-year. We remain wary of services inflation which contributes to over 40% of SA's current inflation rate and is substantially responsible for keeping the inflation rate high. There is a real risk that inflation will not make the target range next year.

Producer inflation (PPI) continued its downward trend falling to 5.3% in March from 7.3% during February and off from its peak of 19.1% during August last year. This was mainly due to lower commodity prices and agricultural food prices.

Growth in Private Sector Credit Extension (PSCE) continued to decline in line with slowing domestic spending and tougher credit criteria applied by banks. The year-on-year figure (excluding investments) fell from 10.2% in February to 7.3% during March. Across all categories, growth will slow down further as momentum is lost, but we believe growth will not turn negative in nominal ('real') terms.

Rand does an about-turn

In 2008 the Rand was the worst-performing emerging market currency, declining by 28.5% against the US dollar. This is despite South Africa's relatively high interest rates. The depreciation of the Rand was due to a number of negative factors which prevailed during the year, the most obvious of which was increased global risk aversion associated with the global credit crisis. This resulted in foreigners selling around R55bn of SA equities during the year, highlighting South Africa's vulnerability to changes in foreign portfolio investment. The electricity outages in the early part of 2008 did not help matters.

In contrast, up until 30 April 2009 the Rand was the *best-performing* emerging market currency in 2009 with a gain of 12.2% against the US dollar. This is despite the rate cuts since December. During this time foreigners have bought a net R15.6bn of SA equities as well as a significant amount of SA bonds. The relative strength of the Rand in 2009 probably also reflects the fact that the currency was massively oversold in 2008. The technical fair-value for the Rand is around R8.50 to the USD. This does not imply that the currency will remain at these levels, but it does provide a useful indicator.

Economic Crisis Monitor

The aim of the Economic Crisis Monitor is to try and measure whether or not the unprecedented policy response to the current global economic crisis is working. This applies especially to the US, as it remains the key financial and global economy. We have selected 15 key indicators that reflect three key areas of the US economy, namely: Housing Activity, Credit Markets and the Real Economy.

Indicator	No improvement	Tentative improvement	Clear improvement
Housing activity			
1 House prices	✓		
2 Home inventories		✓	
3 Home sales		✓	
4 Housing permits		✓	
5 Mortgage applications (new)	✓		
Credit markets			
6 Mortgage rates			✓
7 Mortgage refinancing			✓
8 Corporate bond spreads		✓	
9 VIX index		✓	
10 TED spread			✓
Real economy			
11 ISM		✓	
12 Leading indicator		✓	
13 Weekly jobless claims	✓		
14 Commodity prices			✓
15 Inventories		✓	
Score			4/15

Improvement in indicators

The Economic Crisis Monitor shows that there has been further steady improvement in most indicators, especially a moderation in the weekly jobless claims, a fall in the new home inventory levels and a welcome pick-up in the ISM manufacturing index. However, the single risk to a global economic recovery remains a significant deterioration in the global labour market.

Four out of the 15 indicators selected are showing a meaningful improvement:

- US mortgage rates are at historically low levels of 4.62%
- The TED spread (the difference between the 3 month interest rate on US treasuries and the interbank lending rate) remains just below 100 basis points
- Commodity prices, which should help to keep inflation low
- Mortgage refinancing which has increased significantly in the past couple of weeks.

A further eight indicators are showing tentative signs of improvement:

- Home inventories, including now both existing and new home inventories.
- Housing permits and home sales, which appear to have turned the corner.
- Mortgage applications which have moved up but mostly in the form of refinancing.

- The ISM manufacturing index which has improved for the fourth consecutive month (the global PMI has also improved).
- The leading indicator appears to have turned, but almost exclusively only on the back of a massive increase in money supply.
- Corporate bond spreads, which are off their highs but still far from normal.
- The VIX (volatility) index which has consistently moved to below 40.