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Global growth is downgraded

Global economic update: October 2010

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It is not yet clear whether the loss of momentum in economic growth in recent months is temporary or whether it signals greater underlying weaknesses in private spending.

During September the OECD (the Organization for Economic Co-operation and Development) revised down its projections for world growth, especially for the Group of Seven (G7) countries - the largest developed economies.

Growth in the major economies is now expected to be around 1.5% on an annualised basis in the second half of 2010 compared with the previous estimate of around 1.8%, which was compiled in May 2010.

Consumers pay off debt

The OECD argues that consumer growth may be constrained by households choosing to pay off debt rather than spending. In addition, uncertainty about unemployment could hold back growth in consumer spending.

Company profits stabilised

While consumer spending is set to remain weak, a combination of robust corporate profits and low business investment suggest that capital spending by companies is unlikely to weaken further. Because inventories are now close to desired levels, a renewed depletion of stocks is also unlikely. Overall it also appears that financial conditions have stabilised.

Uncertainty around growth recovery

According to the OECD, if the ongoing slowdown is temporary, the appropriate policy response would be to postpone the withdrawal of monetary support for a few months, while maintaining planned government budget cuts to address unsustainable fiscal positions. On the other hand, if the slowdown reflects longer lasting factors impacting growth, additional monetary stimulus might be warranted.

Emerging markets receive lion’s share of investment flows

In terms of recent global investment flows, three fund types have been clear winners. These are developed market bond funds, emerging market bond funds and emerging market equity funds. The big losers have been developed market money market funds as well as developed market equity funds.

In total almost $80 billion year-to-date has gone into emerging market fixed income ($39.3bn) and equity funds. This, as we know, has been driven by extremely low global yields and some recovery of risk appetite. In contrast investors have withdrawn a massive $373 billion from US money market funds this year, which is on top of the $466 billion withdrawn last year. US equity mutual funds continue to see outflows, whereas inflows into US bonds mutual funds are up around $300 billion since the beginning of 2009.

Strong inflows strengthen the Rand

South Africa has received its share of the investment flows into emerging markets. Year-to-date foreign inflows into the SA bond and equity markets combined are around R100 billion, with a record R70 billion going into the bond market. It is therefore no surprise that the local bond market has outperformed the local equity market and that the Rand has strengthened.

Year-to-date the Rand has appreciated by around 4% against the Dollar. Interestingly, unlike 2009 when the Rand was the second-best performing emerging market currency, or 2008 when the Rand was the worst-performing emerging market currency, this year the Rand has performed in line with many other emerging market currencies.

Given the current general (consensus) economic expectation - that short-term rates will remain low for an extended period of time on a global scale; that global inflation is well under control and that economic growth will be modest and below trend - the current investment trends (bonds and emerging markets) remain sound.

However, any material change to these assumptions will most likely influence the global appetite for risk (either positively or negatively), causing a potentially significant change in investment flows.

Warning signs

The key economic variables to currently watch are:
Private sector employment: a decline in private sector employment at this stage would be a clear signal of a return to recession.
Increased savings: A desire by households to increase savings would imply less consumer spending (household savings rose in the second quarter of 2010).
The price of housing: A relapse in house prices would almost certainly undermine the fragile recovery.