

Monthly Economics Pack

Presented by:
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March 2012



OLD MUTUAL

Investment Group

Macro Strategy
Investments

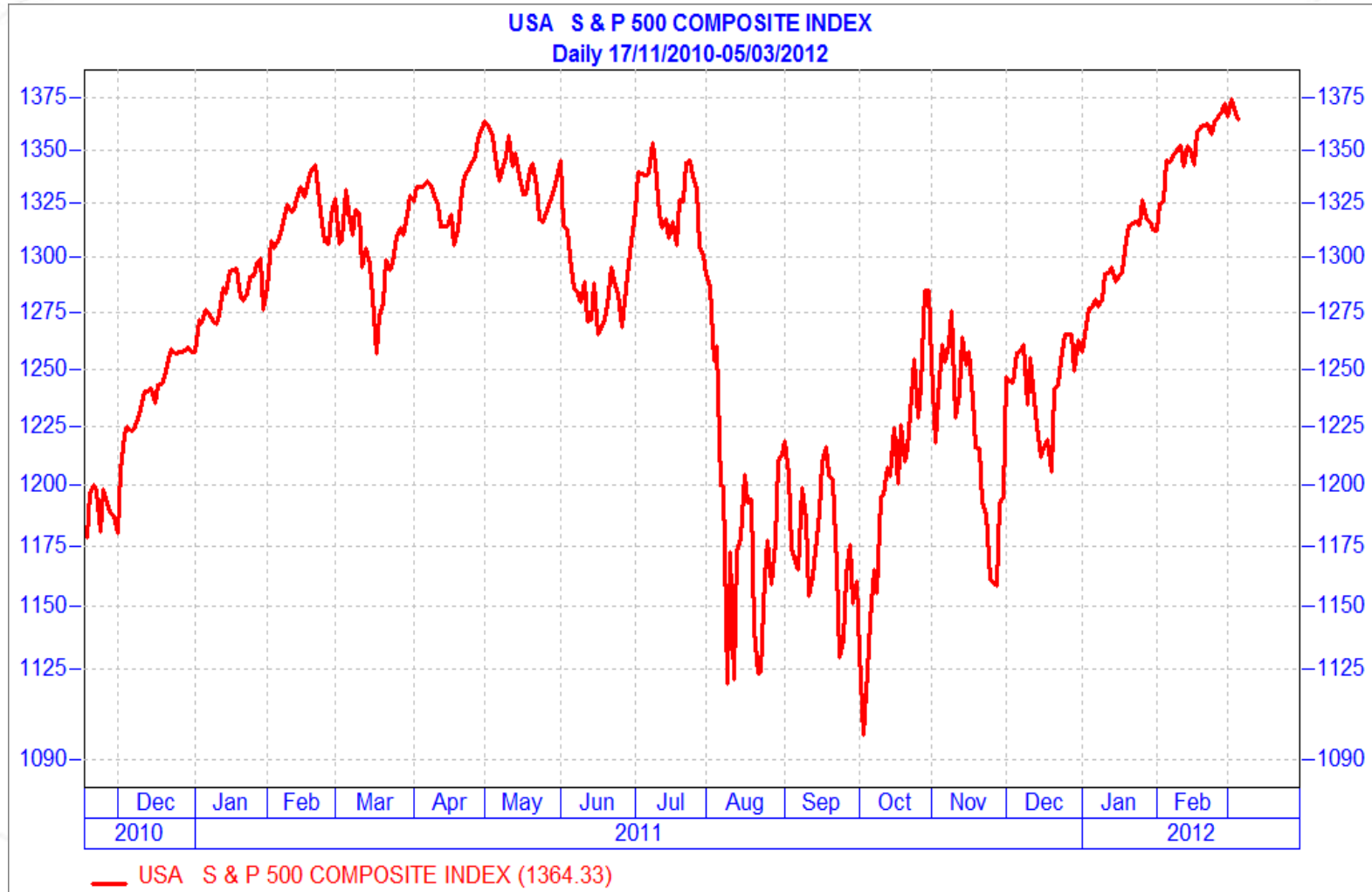


Contents

- **Recent global market events relative to our expectations**
- **Where to from here? 5 issues on the global watch list:**
 - Growth outlook
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 - Earnings developments & outlook
 - Central Bank policy actions
 - Wild Cards: oil/Iran in focus
- **Global Macro Scenarios 2012/4**
- **Global Summary**
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- **Latest macro data pictures**
- **Interest rates:** Will they rise? If so, when and, more importantly, why?
- **Appendices**
 - Forecast sheet (*with explanation of forecast changes, if any*)
 - Global macro graphics pictures
 - Oil & global growth: How serious the hit?



A solid rally since October (but runs out of momentum past little while)



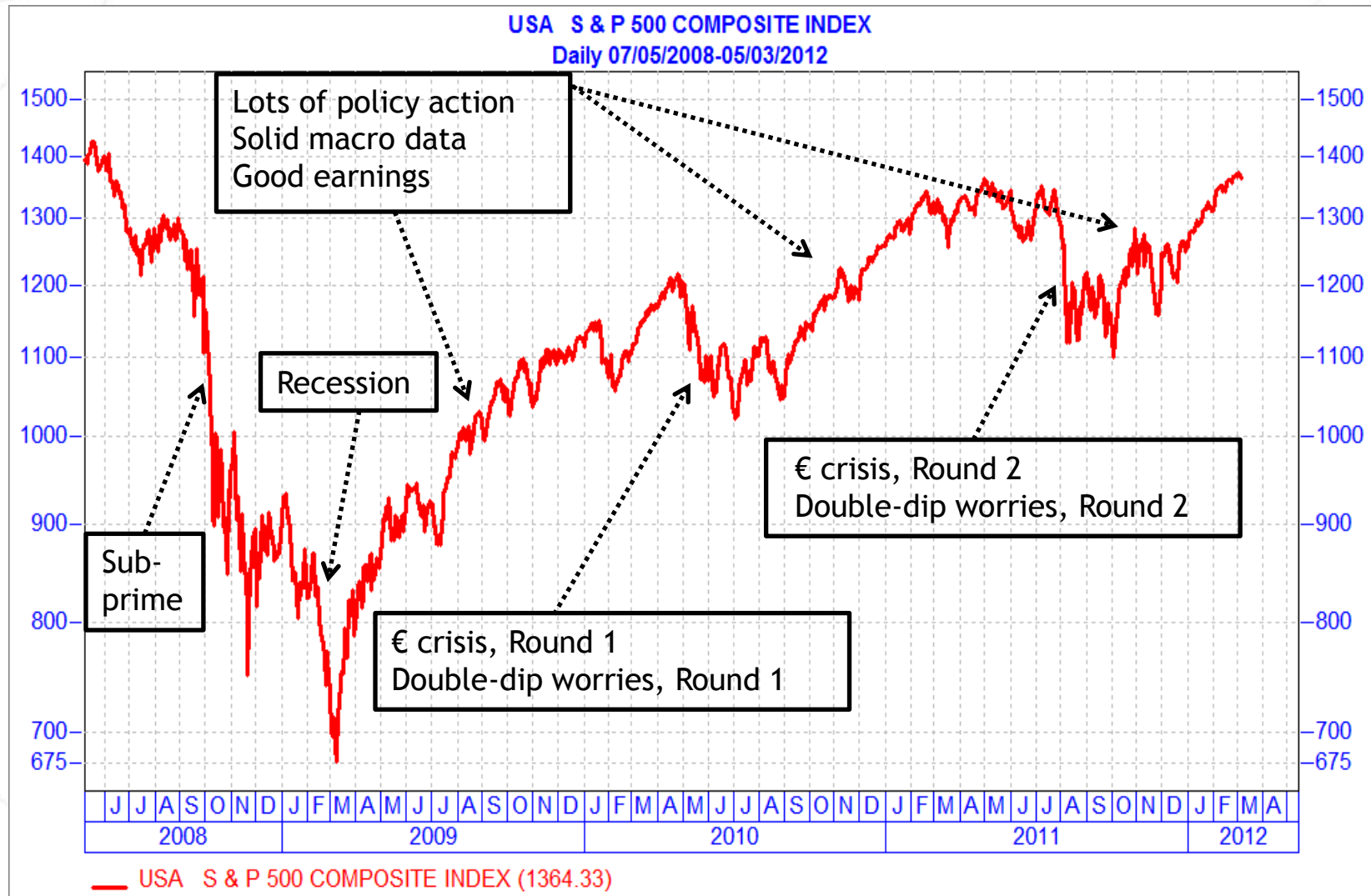


Interruptions since October were all macro-driven



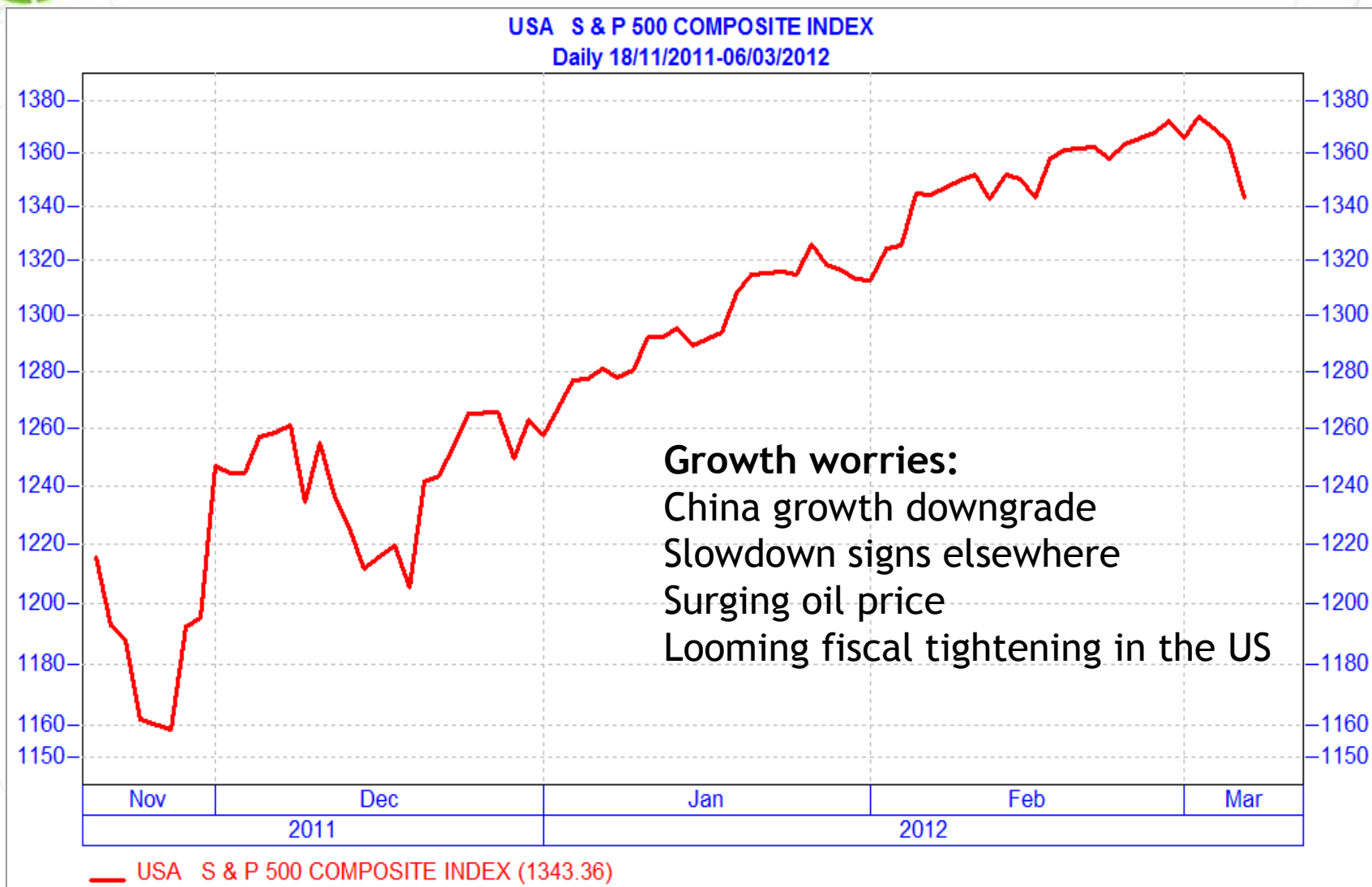


Actually, since 2008, it's really all about macro





The past week's panic was also all about Macro





Macro & markets have played out pretty much as I profiled in October 2011 ERU presentation:

See next slide from October 2011



The case for 'Out-of-the-Woods': From Oct 2011

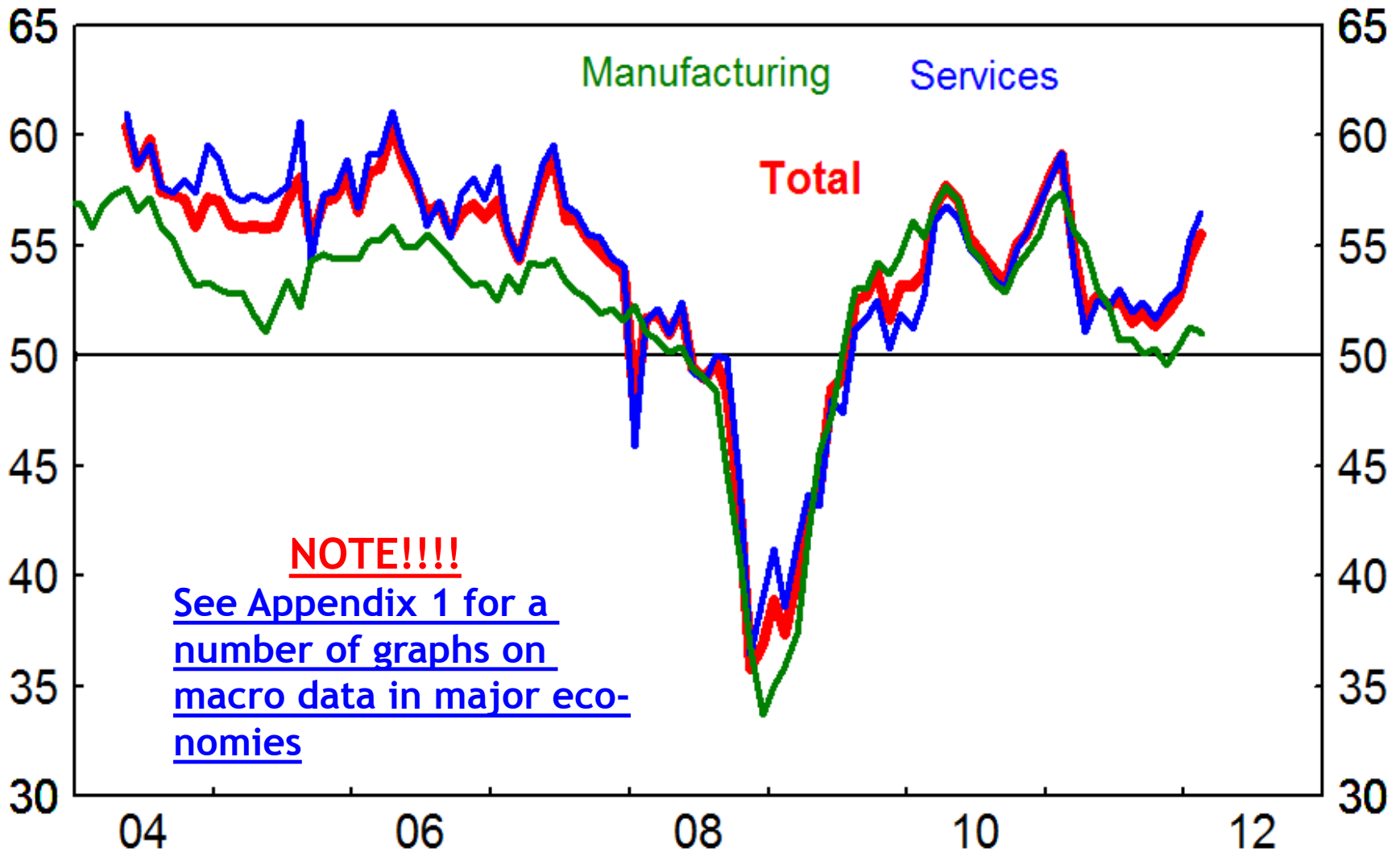
This pretty much played out, except for the S & P downgrade of EU

- **Growth: outlook not as bad as bearish investors are pricing**
 - Double-dip worries (ex EU) have faded (slow growth, not recession)
 - Maybe no acceleration soon, but worst fears may be exaggerated
- **EU debt: they *are* getting their act together, although it's a 4 x 4 track**
 - Pressure from markets, RoW, Rating Agencies leave no choice
 - Problem won't 'just disappear', but chances are it will gradually fade
- **Earnings: still elevated, pessimism may be overdone**
 - If growth pessimism is overdone, so earnings fears likely too
- **Monetary policy: lots of money printing & now rate cutting too**
 - DM remains super expansionary, EM's cutting, China easing
- **Wild Cards: have most now occurred?**
 - EU agreement could prevent actual S & P downgrade
 - Message to the USA is equally clear
 - Iran (oil) risks on the rise
- **My view: Case for 'Out-of-the-Woods' is strengthening, although there will be more setbacks, volatility & bouts of panic**



JPM Global all-industry PMI

Global PMI shows why double-dip fears have faded

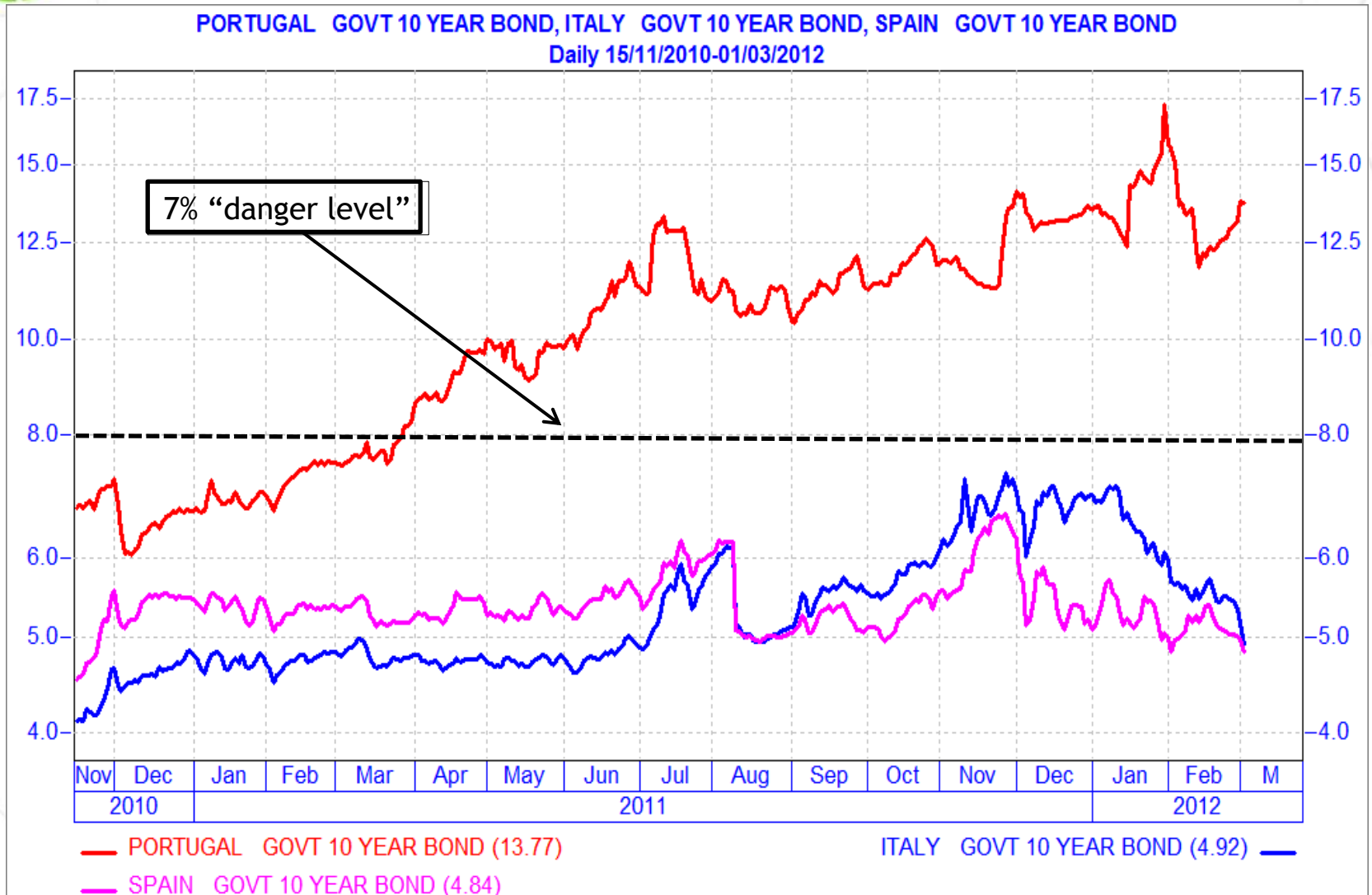


NOTE!!!!

[See Appendix 1 for a number of graphs on macro data in major economies](#)

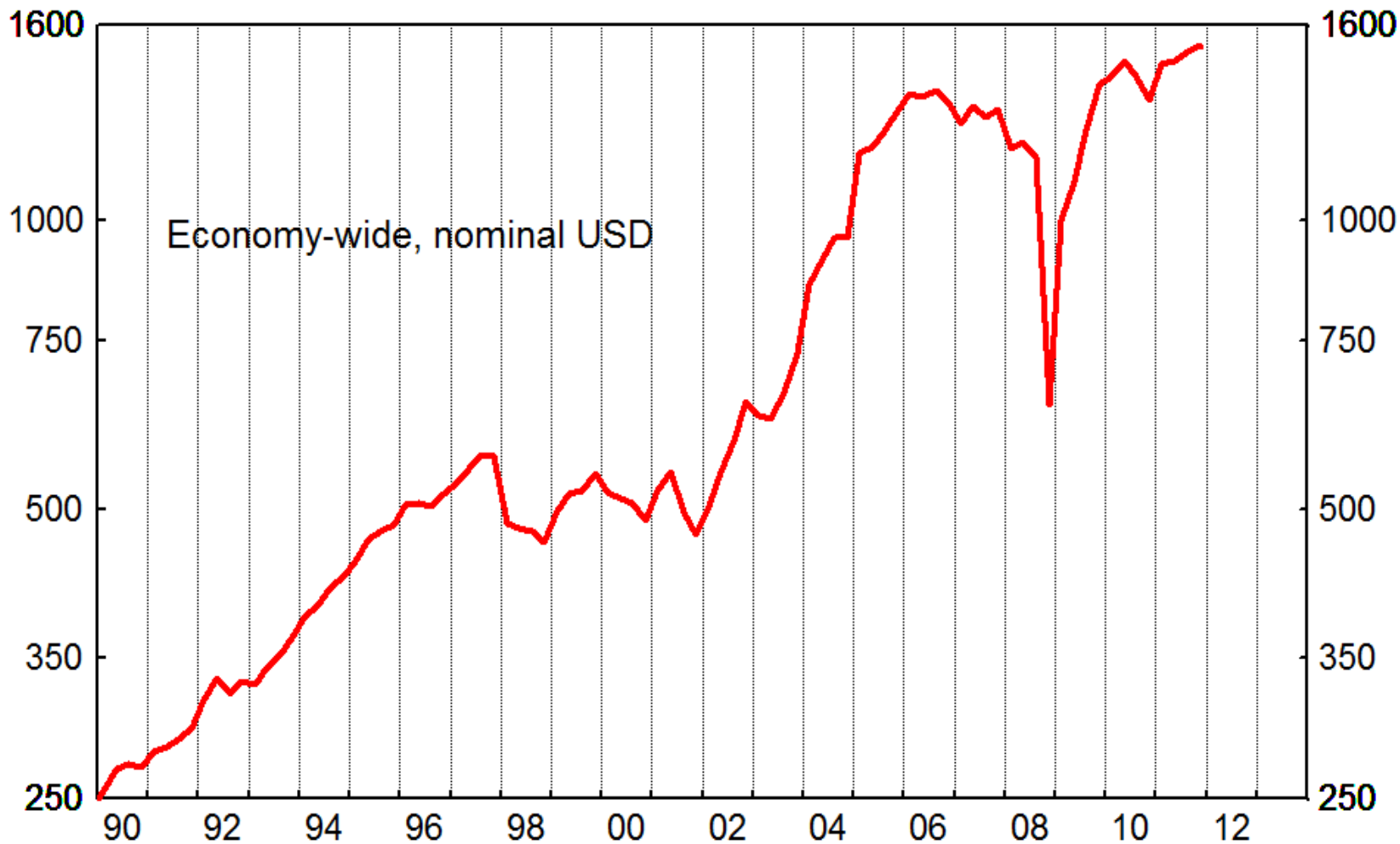


EU panic has faded sharply since late 2011



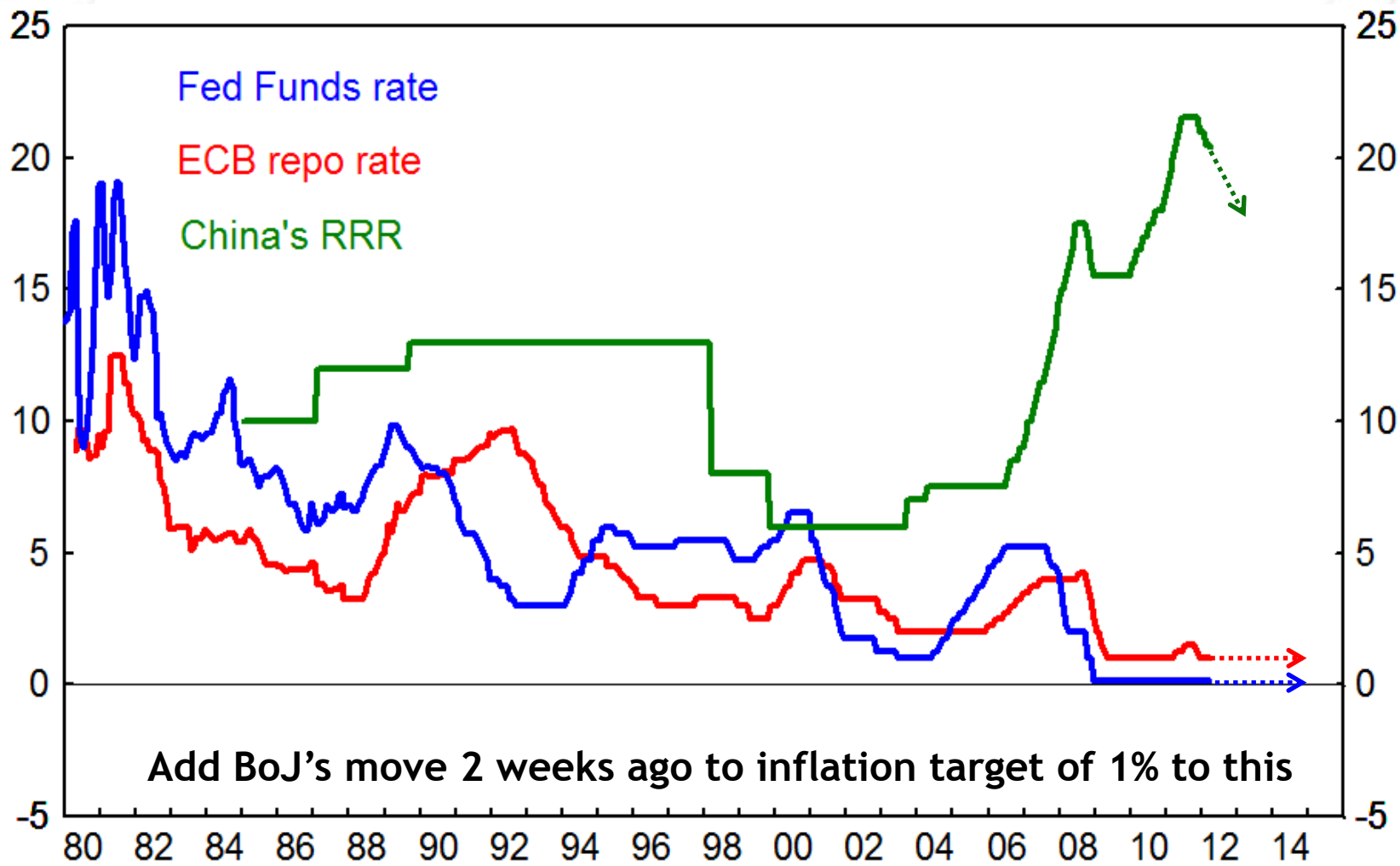


US profits



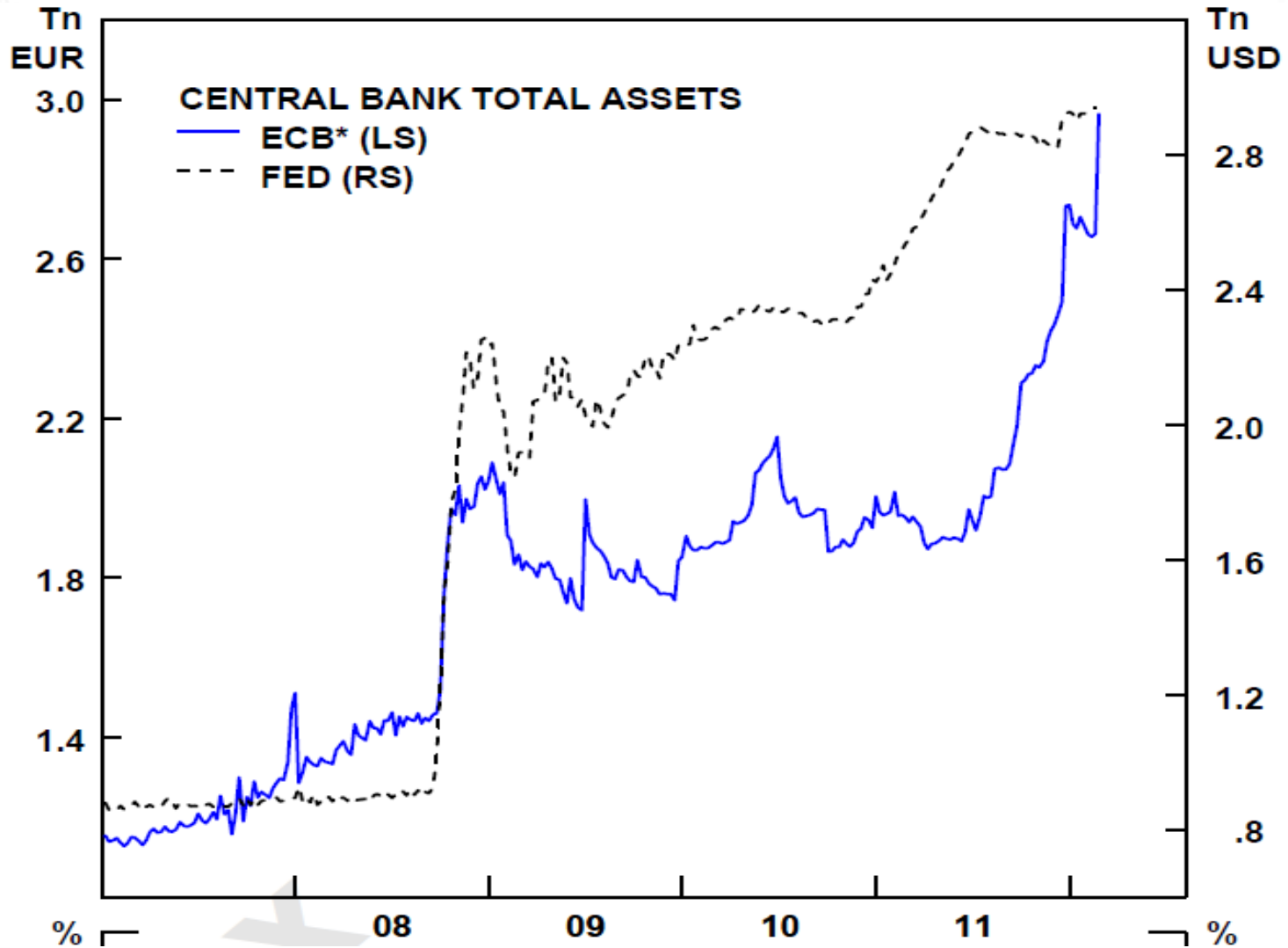


CB's feet flat on the accelerator





Monetary Reflation





**So, where to from
here?**



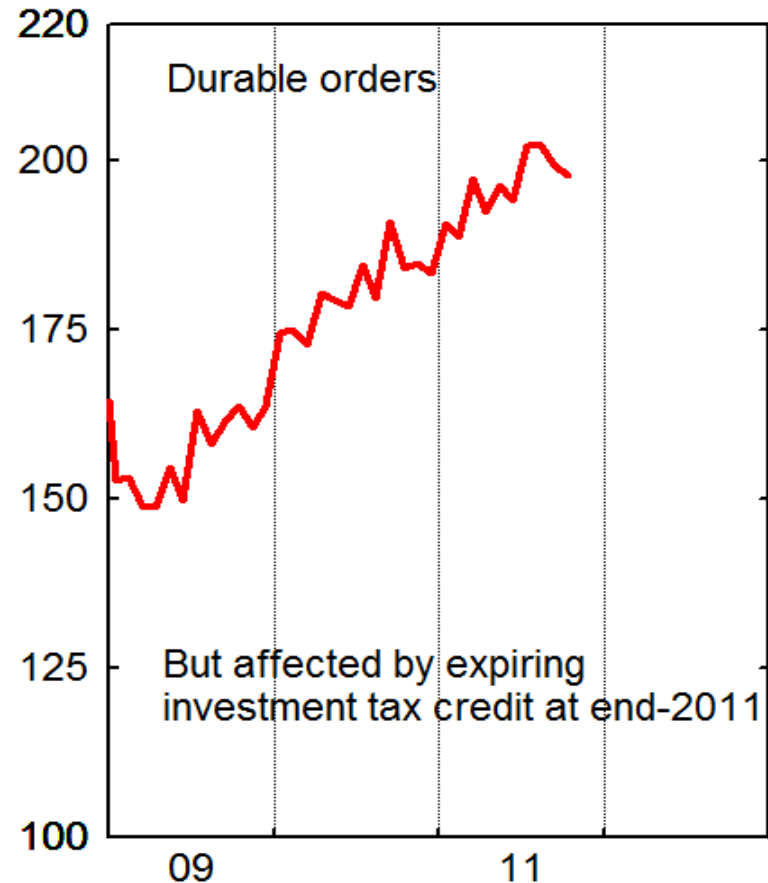
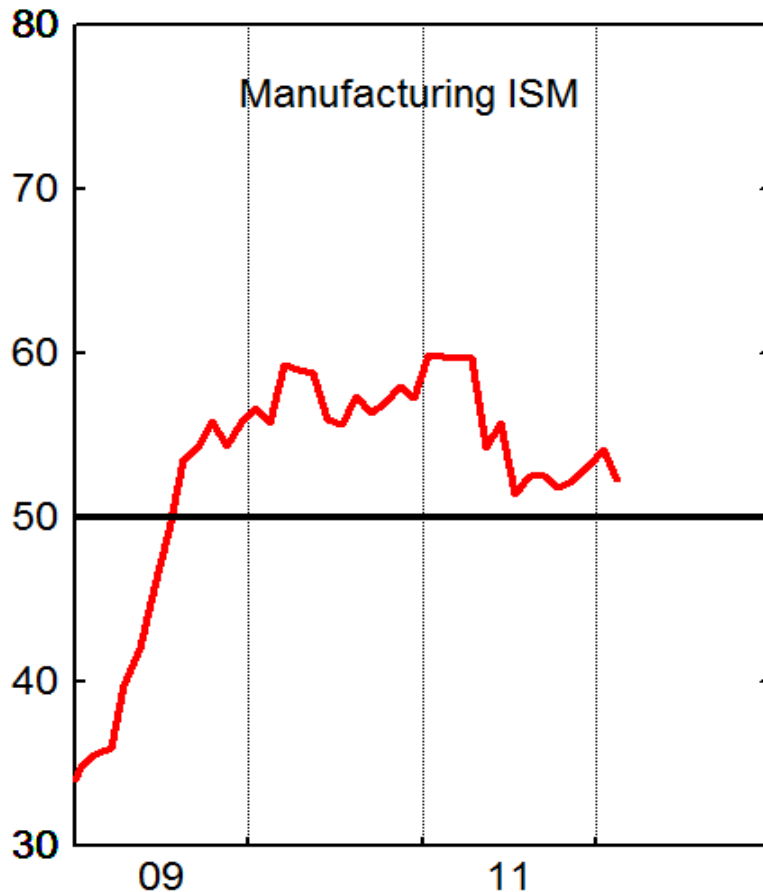
Still 5 key areas to watch

- ❖ **Economic data & outlook changes:** Slower growth & uncertainty ahead
 - *Growth has been better than expected, but will slow in H2 on EU slump, fading policy stimulus, higher oil (see appendix) & China slowdown*
 - Also, US fiscal tightening coming closer, causing macro uncertainty
- ❖ **EU debt developments:** Quiet for now, but worries will resurface
 - Worst fears have faded, *but the problem has by no means disappeared*
- ❖ **Earnings:** Slower economic growth means slower earnings growth
 - Have been firm, but losing momentum, downside surprises a growing risk
- ❖ **Policy actions:** CB's have done their bit, at least for now
 - Fed & ECB have done their bit for now, *China will ease further*
 - Fiscal tightening under way in EU, looming in the US
- ❖ **Wild cards**
 - Main risk seems oil & Israel/Iran conflict
- ❖ **A less constructive period ahead for risk assets as tail winds die down**
- ❖ **However, still no serious macro head winds in sight**



USA data has been mostly very firm recently (see appendix 1), *but these 2 weaker releases got some attention*

USA: 2 soft releases recently gets some attention





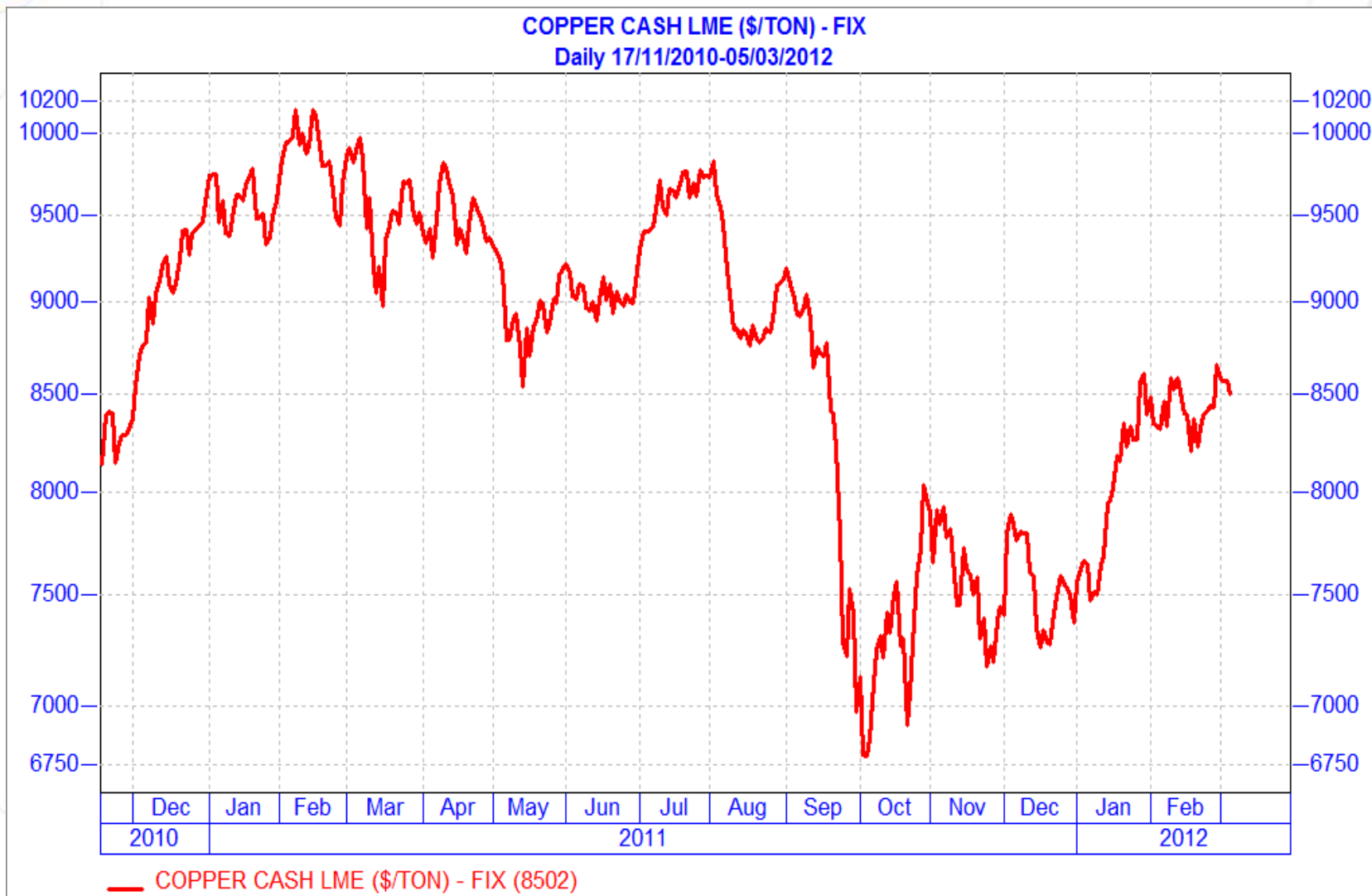
And China lowered its' 2012 growth target from 8.0% to 7½%
This caused some market concerns over severity of China's slowdown

Should China's "growth target" be seen as the "lower acceptable bound" for policy makers, rather than a "real forecast"?





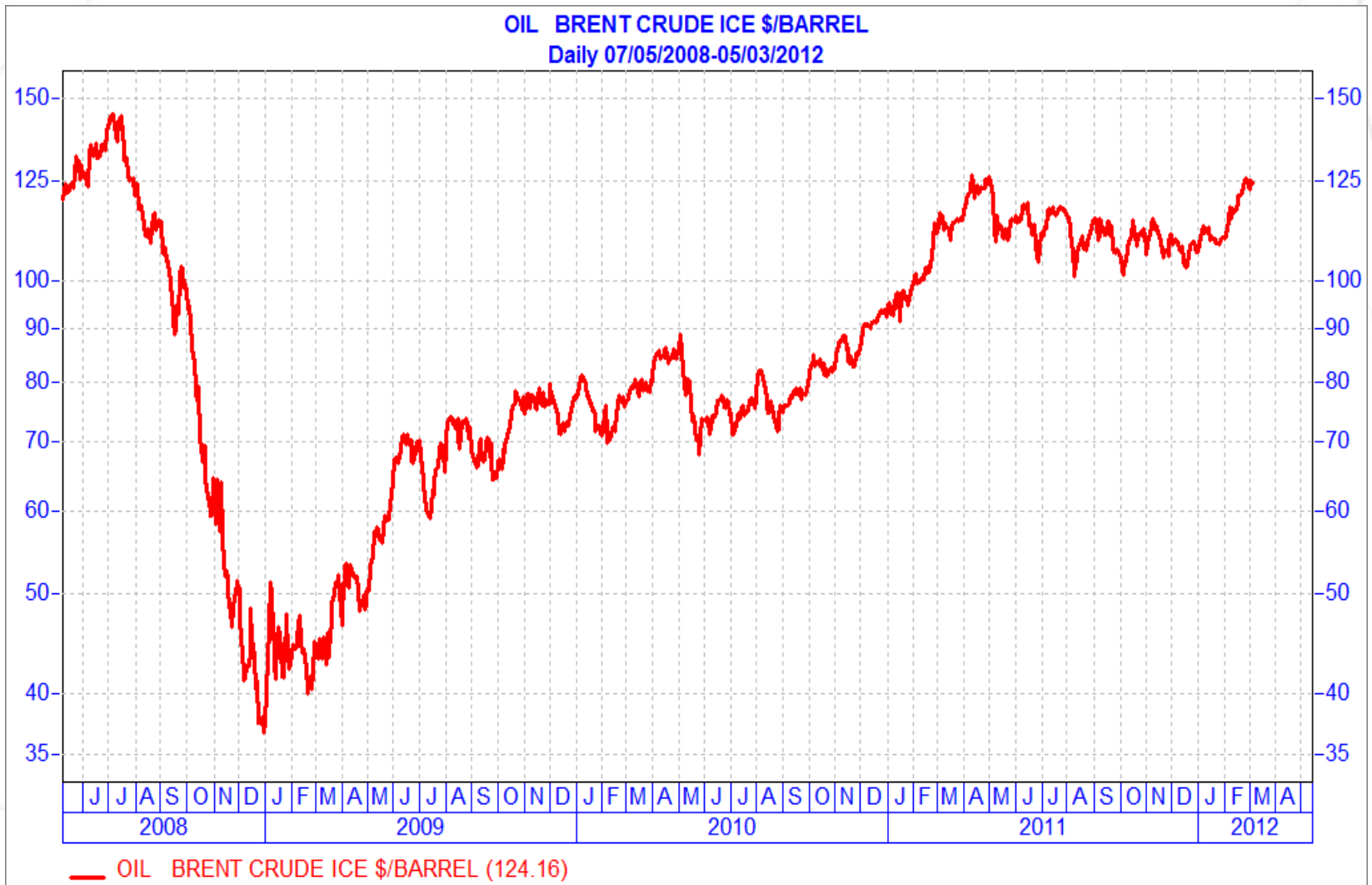
Dr Copper has run out of momentum





And oil is a threat

See Appendix 2 for brief analysis





USA: Worries mount over potential post-election fiscal shocks

Payroll tax	\$120bn
Extended unemployment	\$40bn
Debt ceiling deal part I	\$40bn
Debt ceiling deal part II	\$110bn
Bush tax cuts expire	\$240bn
Other	\$150bn
Total	\$700bn
% of GDP	4.6%

Highly unlikely these will all be allowed to occur simultaneously, but as long as these issues are unresolved, markets will be concerned



So, has the macro environment for markets changed for the worse?

❖ **Macro tail winds may have faded, but no serious headwinds ahead**

- Global growth slowdown yes, hard landing no (assuming oil 'behaves')
- Monetary policy to remain super-expansionary; China to join, Ditto Japan
- Earnings growth will slow, but unlikely to hard land
- EU problem by no means solved, but ECB's LTRO has significantly de-risked it

❖ **Nevertheless, tail risks & headwinds undeniably still exist**

- EU downturn, growth momentum loss elsewhere
- Middle East conflict and/or further oil surge
- Renewed flare-up of EU debt crisis (on fiscal slippage risk)
- Fiscal tightening in the US: "how" must wait for Nov election
- Commodity prices fall – they can easily fall on growth slowdown

❖ **I maintain my "Getting out of the woods" view as far as macro is concerned, but with markets notably higher, tail winds fading & growth slowing again, expect much more market volatility**





Global Scenarios: 2012/2014

- **Base Case: Gradual healing & normalisation (with volatility) 55%**
 - EU & US debt issues sufficiently addressed to prevent renewed full-blown crisis
 - Slow global recovery continues; slowdown in H2 '12, little better in 2013
 - Monetary accommodation while fiscal tightening continues (= low rates, QE)
 - Inflation takes back seat to growth focus, but will anyway not become *major* problem
 - EM's continue to fare better than DM's
 - Favour risk assets over interest bearing & cash (as long as fiscal tightening/monetary easing in place)
- **Alternative 1: Fairly strong cyclical rebound 20%**
 - Growth surprises on the upside esp in the US, Japan & EM's, EU in '13
 - Focus turns back to inflation given low rates and as commodities rebound
 - Focus shifts to need for reversal of recent EM policy easing
 - Fiscal troubles in DM fade as growth & tax revenues accelerate
 - Initially favour risk assets over interest bearing & cash, but beware CB's later on
- **Alternative 2: Growth slump (or full-blown global crisis) 25%**
 - Growth slowdown turns to outright double-dip or debt problems turn to crisis
 - Commodities & EM currencies tumble, global recession, deflation fears return
 - Fiscal crises everywhere
 - QE3, 4, 5...
 - Awful for risk assets



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 - EM's continue to fare better than DM's
 - Favour risk assets over interest bearing & cash (as long as fiscal tightening/monetary easing in place)
- **Past week has seen flare-up in concerns over Scenario 3**
 - Growth surprises on the upside esp in the US, Japan & EM's, EU in '13
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Global summary

- **Despite market hiccup of the past week, Base Case view of gradual healing & macro normalisation remains in tact**
 - Still, after period of good macro data & lots of policy action, a 'quieter' period ahead as growth slows again & policy makers (except China) moves to the side lines, at least for a while
- **Where's the focus the next few weeks/months?**
 - Developments around EU debt problems (still) & growth fall-out
 - Broader incoming macro data (slowdown fears still 'Evil no 2')
 - Monetary policy developments (QE, rates, China's RRR)
 - US fiscal outlook as 2013 looms larger
 - Iran & oil
- *Volatility & market fears to stick around for some time still*



SA scenarios for 2012/13

- **Base Case: 60% probability** (upside version: solid global recovery)
 - Global muddle through: debt & growth issues remain drags & concerns
 - Moderately growth (2.7% in '12; 3%+ in '13; It growth potential of 3½%)
 - Inflation to peak below 7% in '12, then trend lower
 - TW ZAR broadly sideways from end-'11 levels, may firm in '12
 - Rates on hold through '12, next move likely still up (moderately) in '13
- **Alternative 1: Global chaos: €-zone break-up, global recession 25%**
 - ZAR slumps
 - Inflation heads up to 10%
 - Growth slumps
 - Rates flat or lower initially, up later
- **Alternative 1: SA troubles: 15%**
 - ZAR slumps for 'SA reason' – politics or policy worries or c/a blowout
 - Inflation rises sharply (10% or higher)
 - Rates rise (assuming c/a widens because of strong demand)



Recent local developments

- ❖ ZAR firms sharply as global worries fade
 - ZAR has given up quite a bit of the competitive gains of 2011's fall
 - ZAR remains predominantly driven by global happenings
- ❖ Economy firms in Q4, but growth remains pedestrian
 - Q4 GDP growth firms to 3.1% saar, up from less than 1½% in Q2/3 2011
 - Consensus forecasts for 2012 GDP at 2.8%, we have the same
 - HCE to slow moderately this year, GFCF to accelerate a bit – [signs of life in construction activity \(see 7 slides on\)](#)
- ❖ Inflation: above target, but expected to peak soon:
 - Oil/food risks remain a short term concern
 - Softening consumer growth strongest counter-argument in 2012 & base effects from 'recent rapid risers'
 - Expect peak below 7% soon (6.3% currently), drifting lower thereafter
- ❖ Rate expectations remain benign
 - Little less than half still expect a hike(s) in 2012, but being pushed out
 - Consensus shifting mostly to H1 2013
 - Will rates rise before 2014?



From December's ERU presentation: Will 2012 be as dull as current consensus (& ERU) forecasts predict?

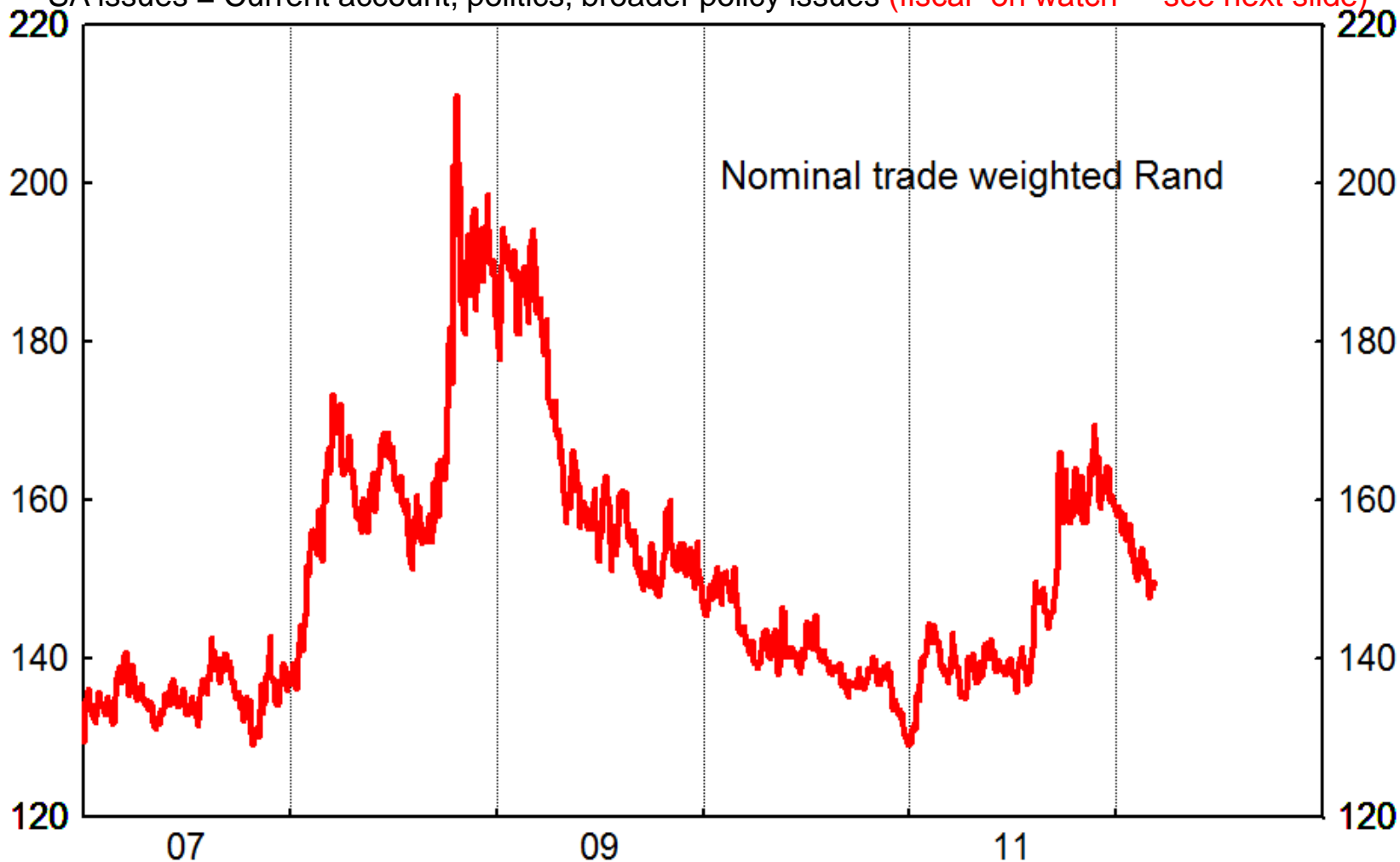
- ❖ ZAR flat to firmer
 - Few outliers, but generally a 'moderate retracement' view (happening, but more so than was generally expected)
- ❖ Growth: $\pm 2\frac{1}{2}\%$ v- 3%, sectoral rotation
 - No recession, no boom (view remains in place)
 - HCE to slow, GFCF to accelerate a bit (seems to be happening)
- ❖ Inflation: to peak 6% - 7%, ease thereafter (view remains in place)
 - Upside risks acknowledged, largely seen as temporary, cost-driven
 - Few outliers, but consensus pretty closely packed
- ❖ Current account deficit: moderately wider, no blowout (some worries)
- ❖ Rates: flat through H1, moderate rise thereafter (generally being pushed out to very late '12 or H1 '13)
 - 'Flat rates' is pretty much the broad view for middle quarters of 2012 at least



ZAR has firmed quite sharply

Still driven largely by global sentiment swings as SA 'issues'* not big at present

*SA issues = Current account, politics, broader policy issues (fiscal "on watch" – see next slide)





An issue for the ZAR is how the fiscal situation unfolds, following Moody's comments on Budget (risk of downgrade)

On the fiscal watchlist

❖ Public sector wage settlement:

- Negotiations have barely started
- Cosatu (via Vavi) says unions will demand 10%: *getting half this will be tough*
- Still, at post-Budget breakfast Treasury officials were surprisingly confident at reaching a settlement “pretty close to the 5% target” set in the Budget
- Settlement important for fiscal situation as well as private sector wage round

❖ Public sector infrastructure tender flow:

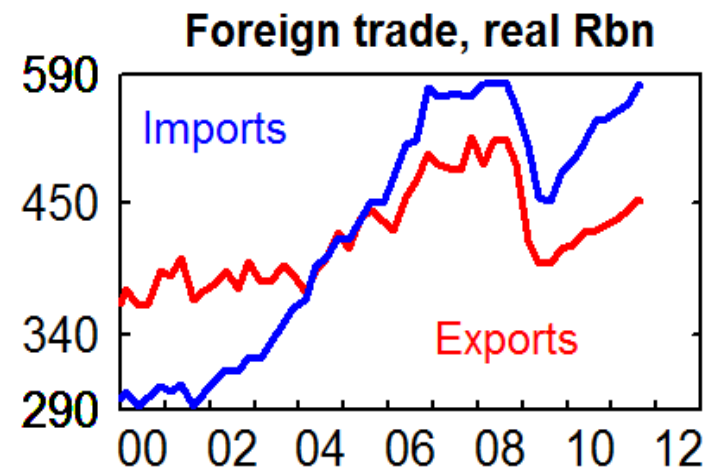
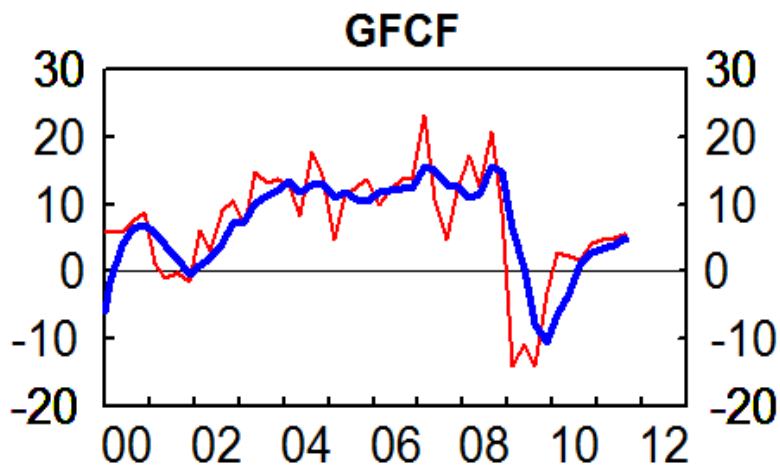
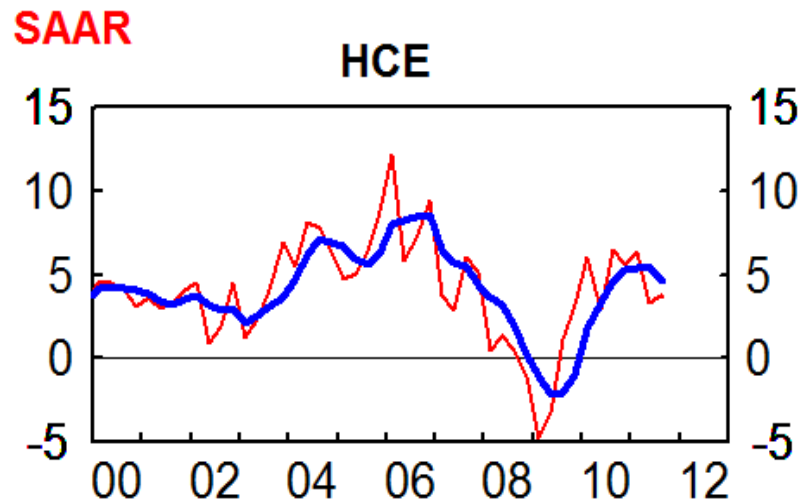
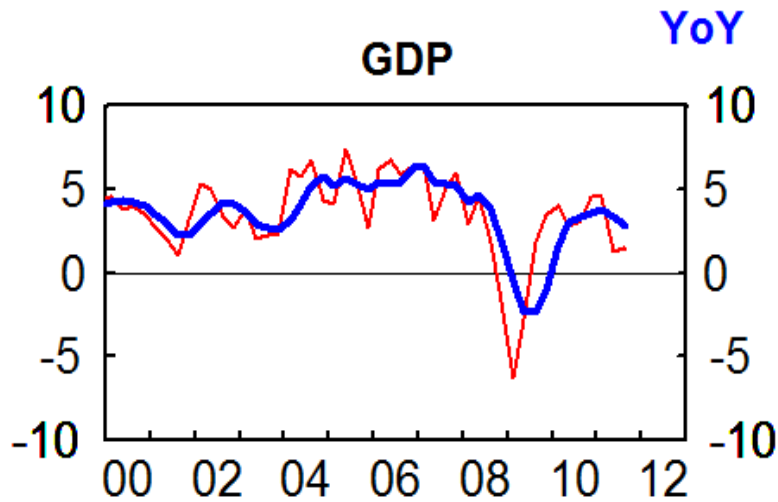
- Anecdotal evidence still points to little activity
- We will watch hard- & anecdotal evidence closely for any clues
- BER's quarterly construction sector survey should also give early clues
- Recent improvement in cement sales reportedly due to informal sector

❖ Revenue growth:

- Govt projects 9.0% increase in revenues for 2012/13 (optimistic says Moody's), after 9.7% growth in 2011/12 – *we think it is pretty do-able, though*
- Again, Treasury was pretty confident at post-Budget breakfast



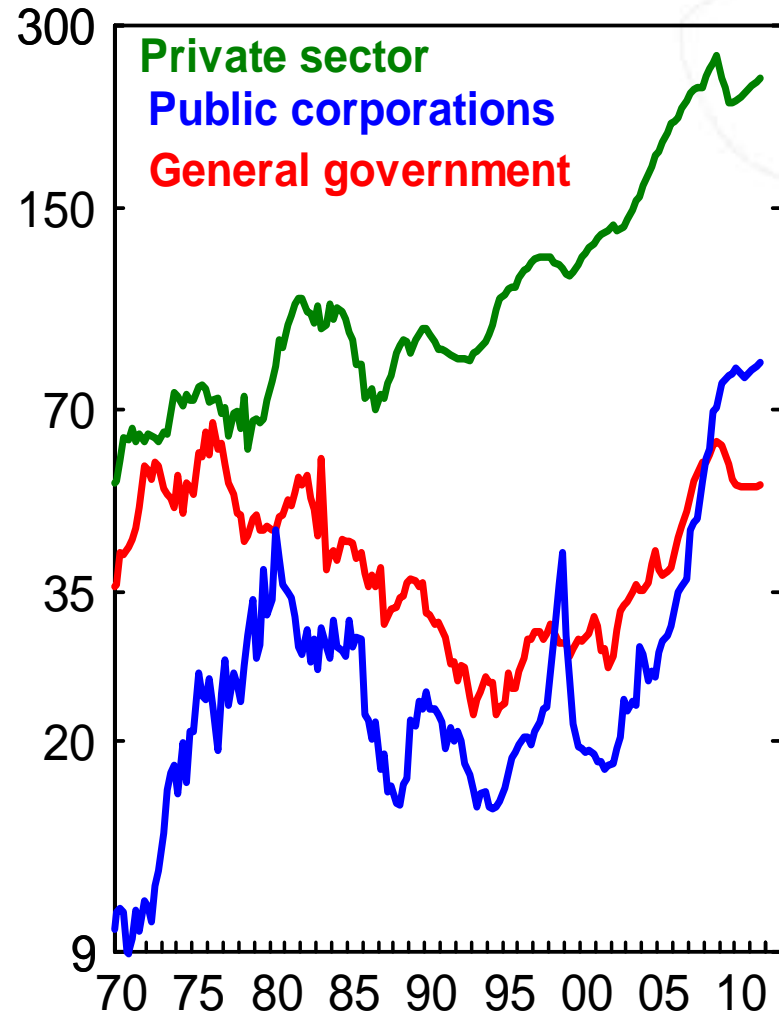
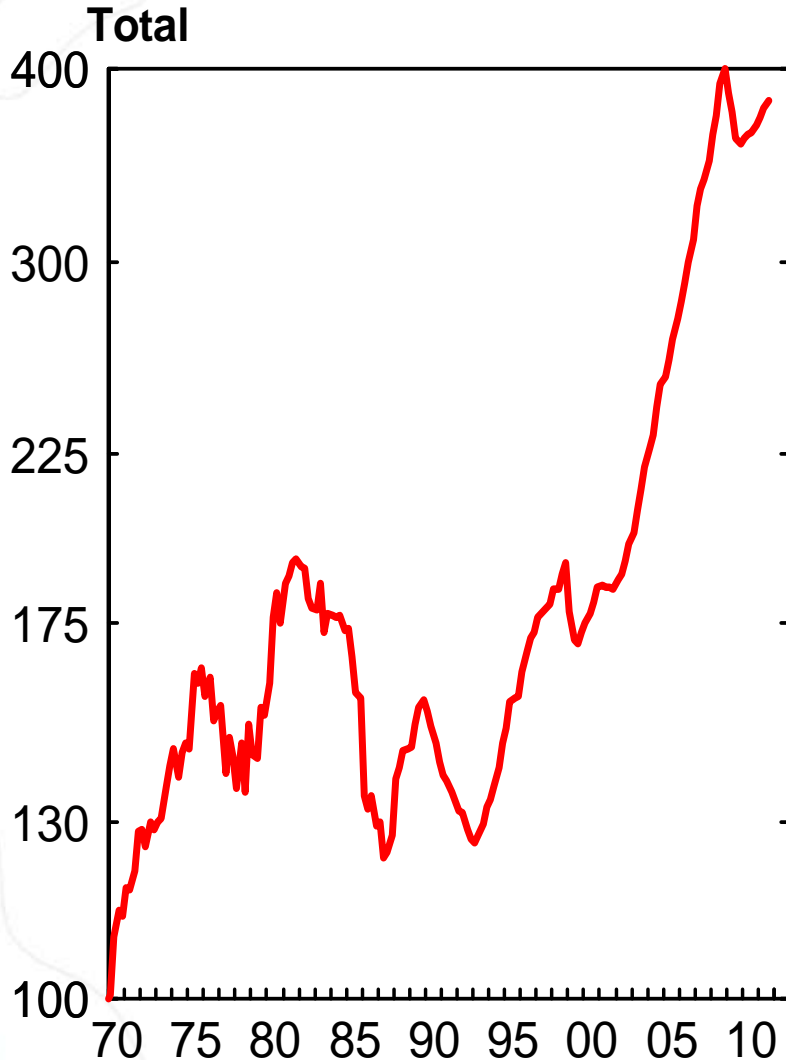
SA growth: slow, rotating, weak spots





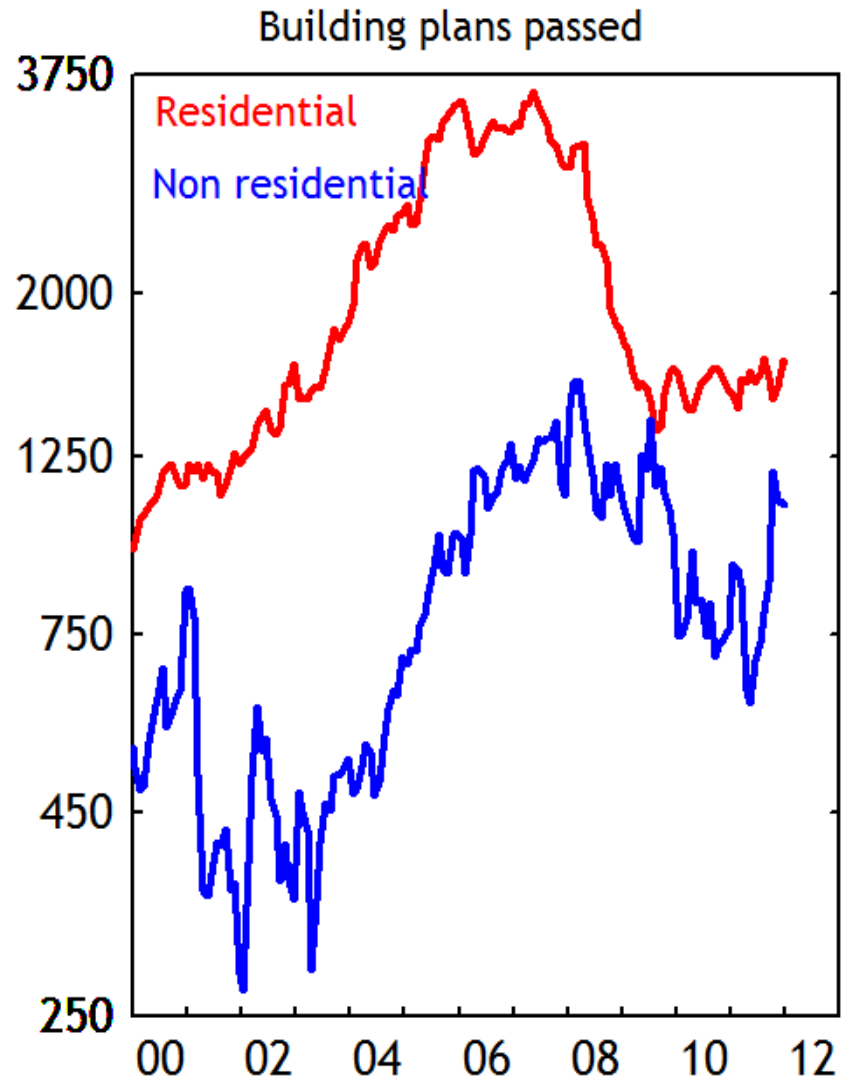
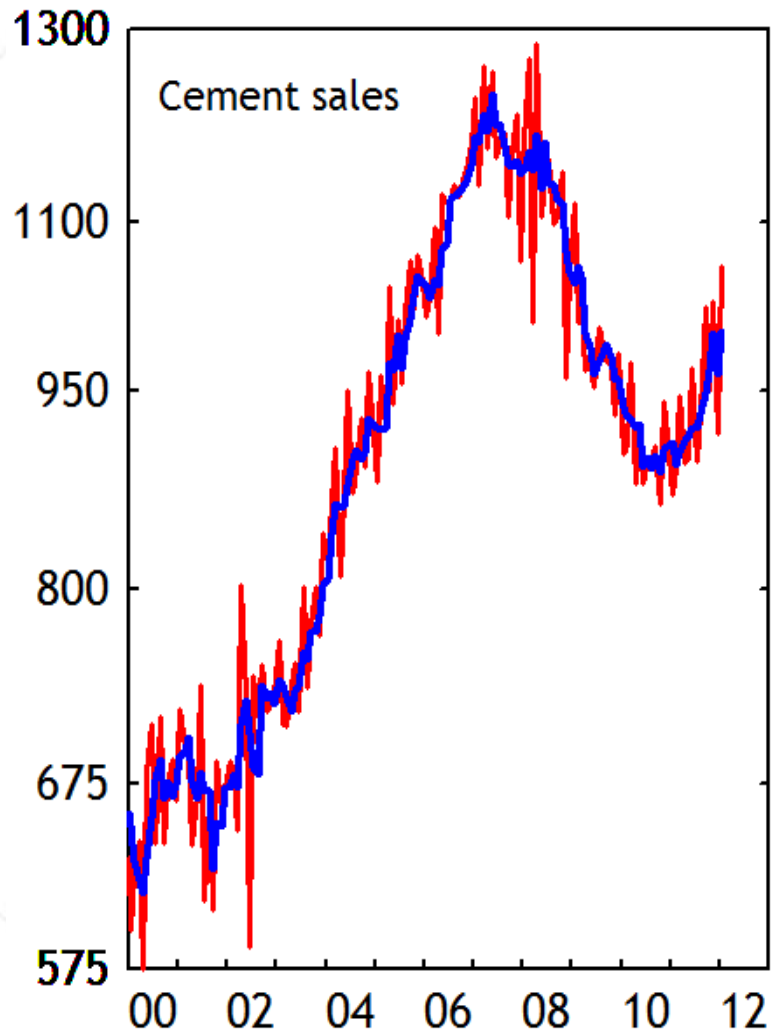
GFCF

Govt yet to recover (but under close watch following Budget focus)



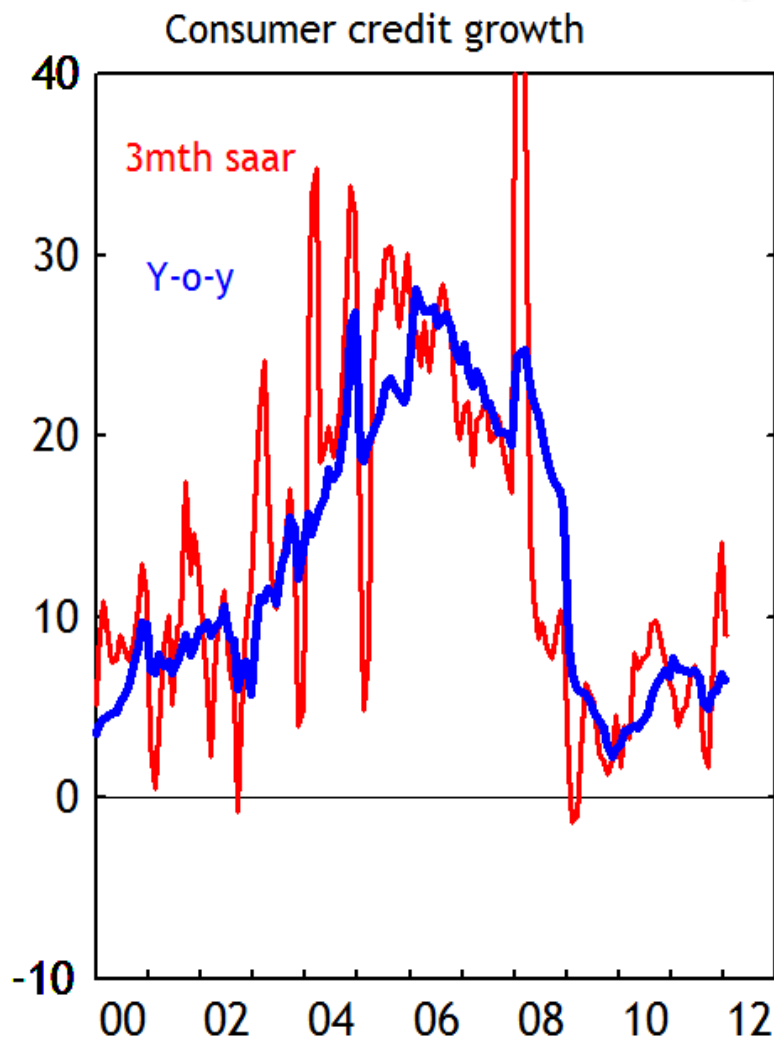
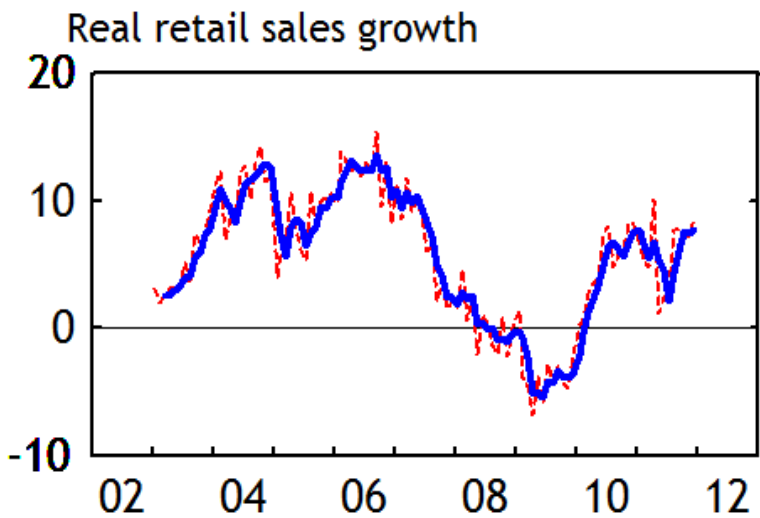
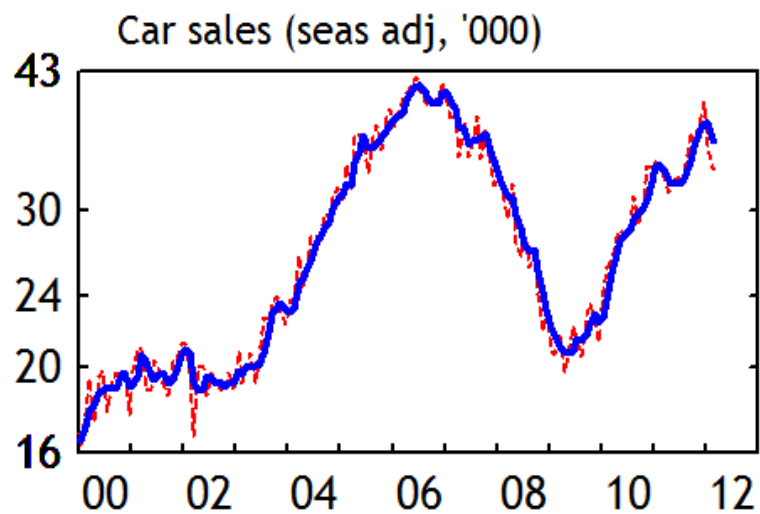


Signs of life in construction activity



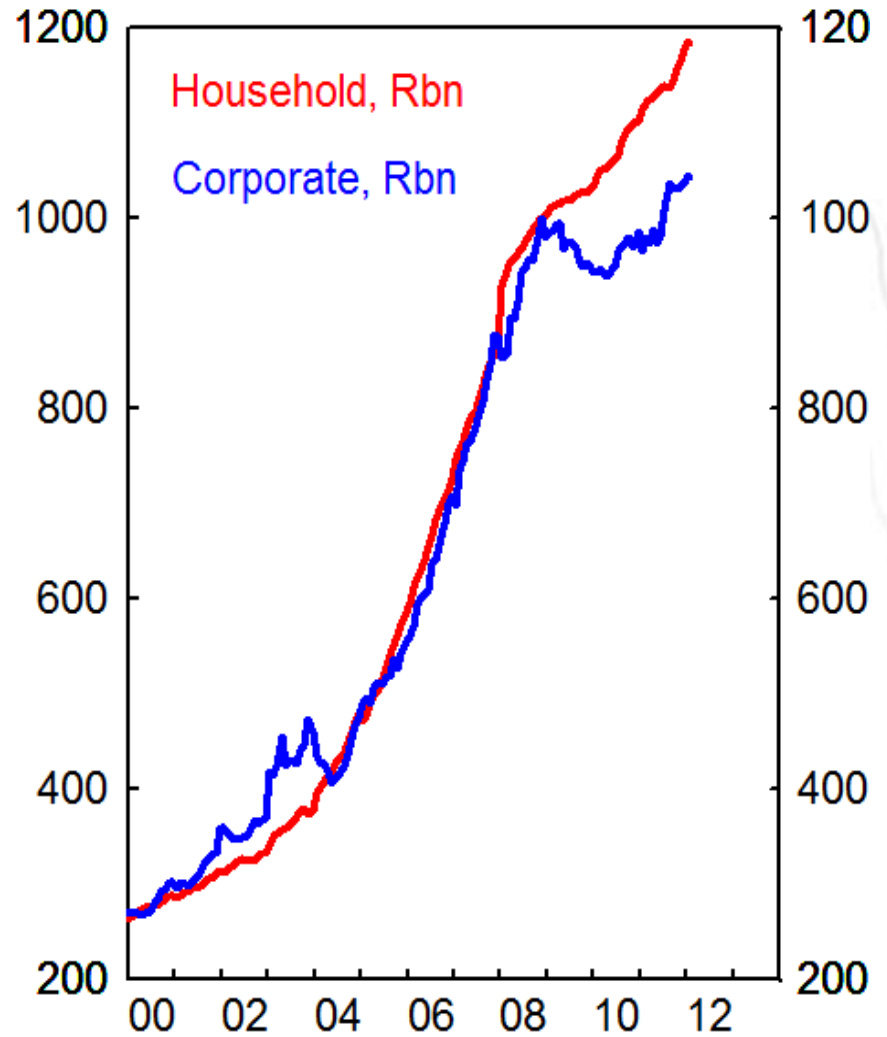
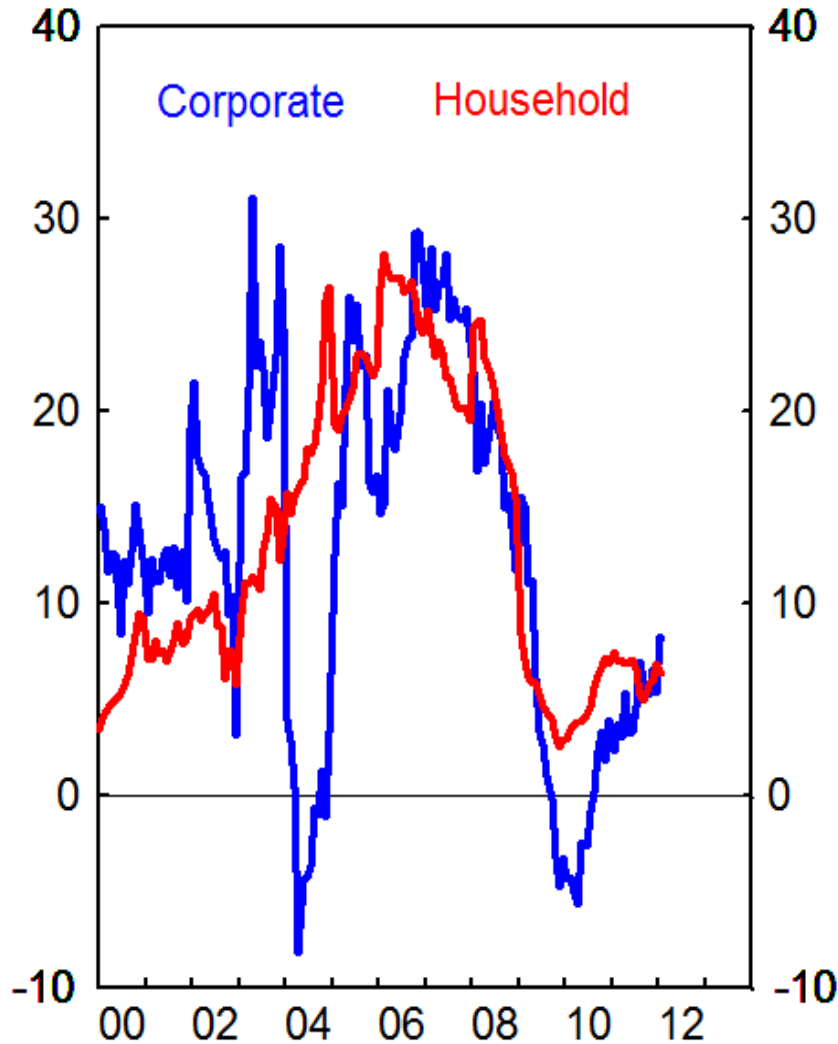


Consumption indicators





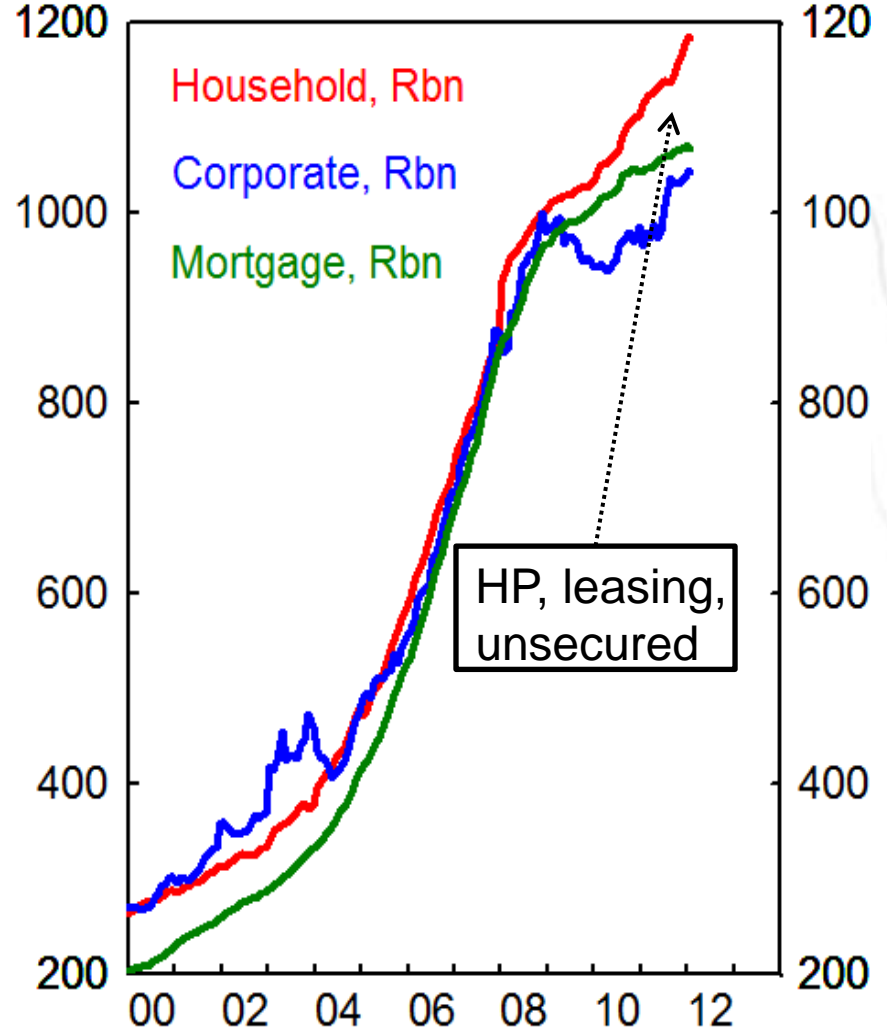
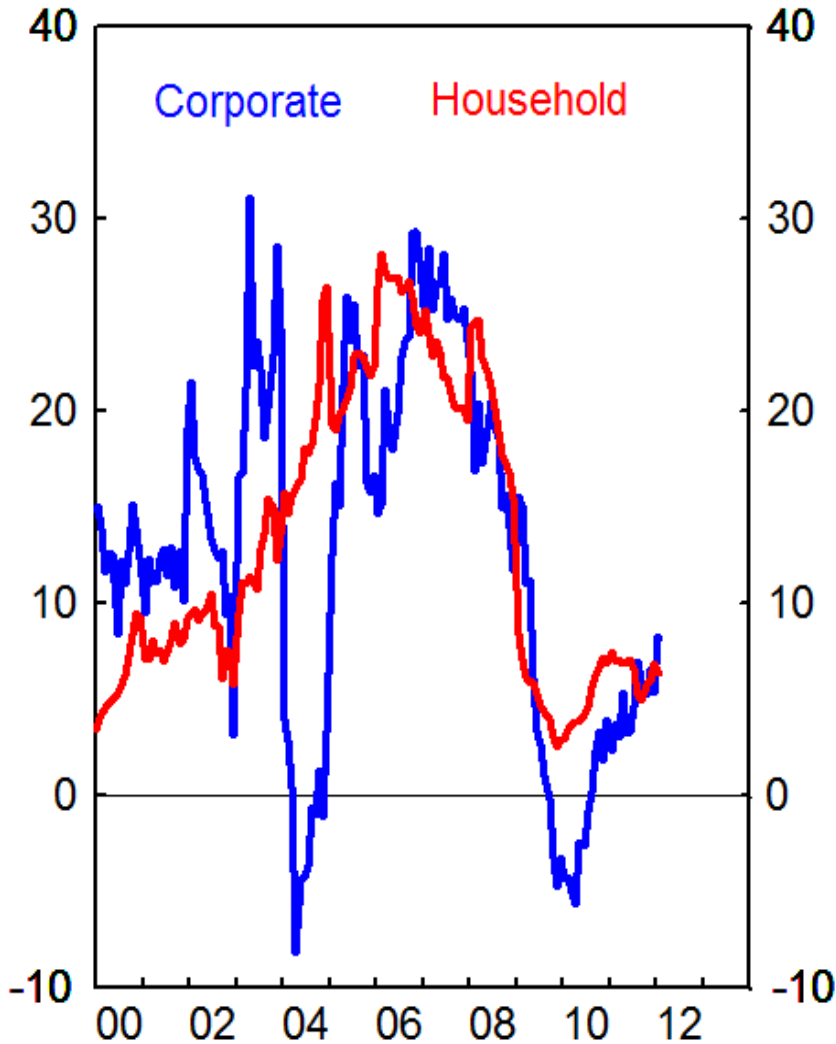
Credit gathers some pace





Credit gathers some pace

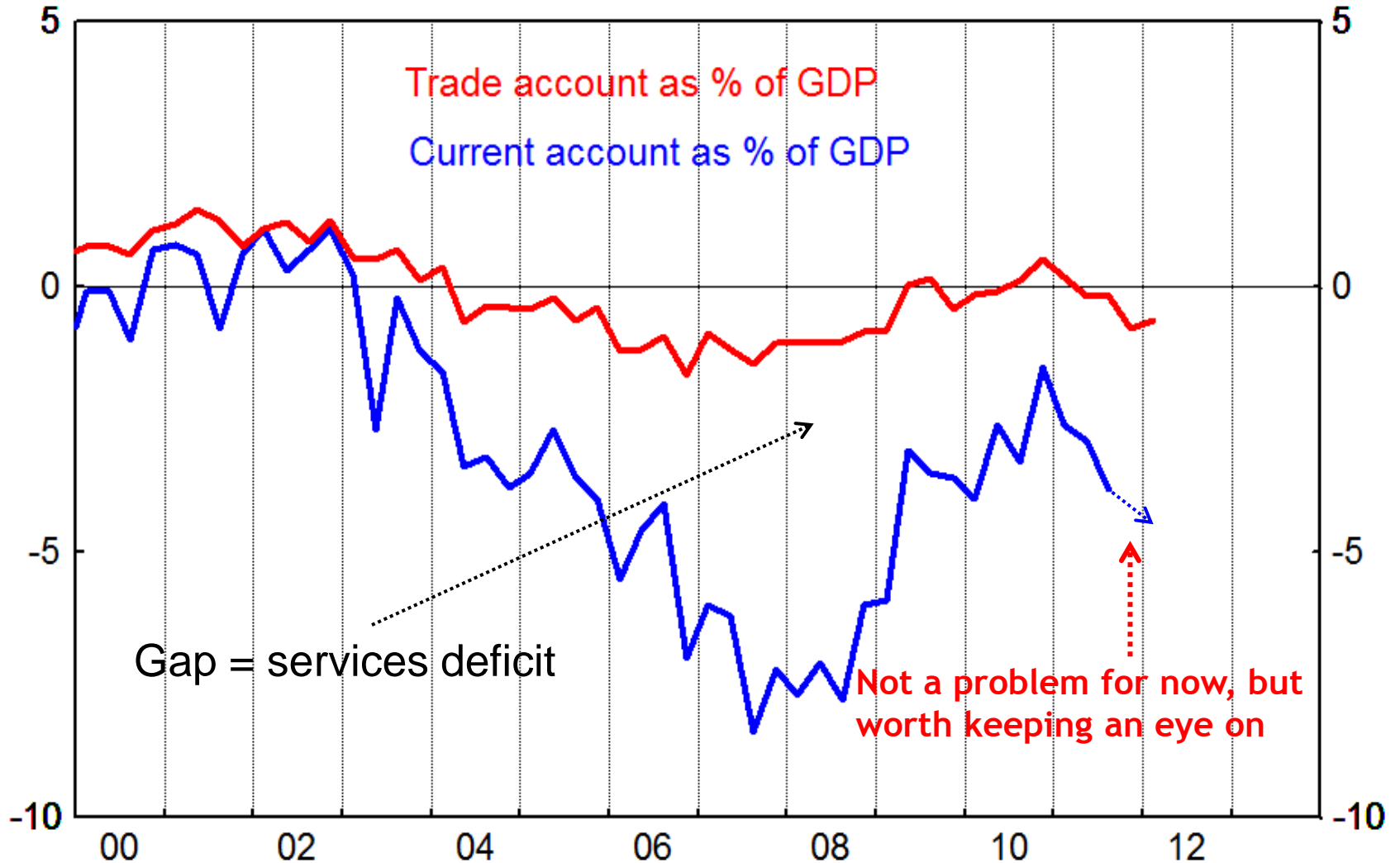
Household credit growth is largely outside of mortgages





Current account at some risk

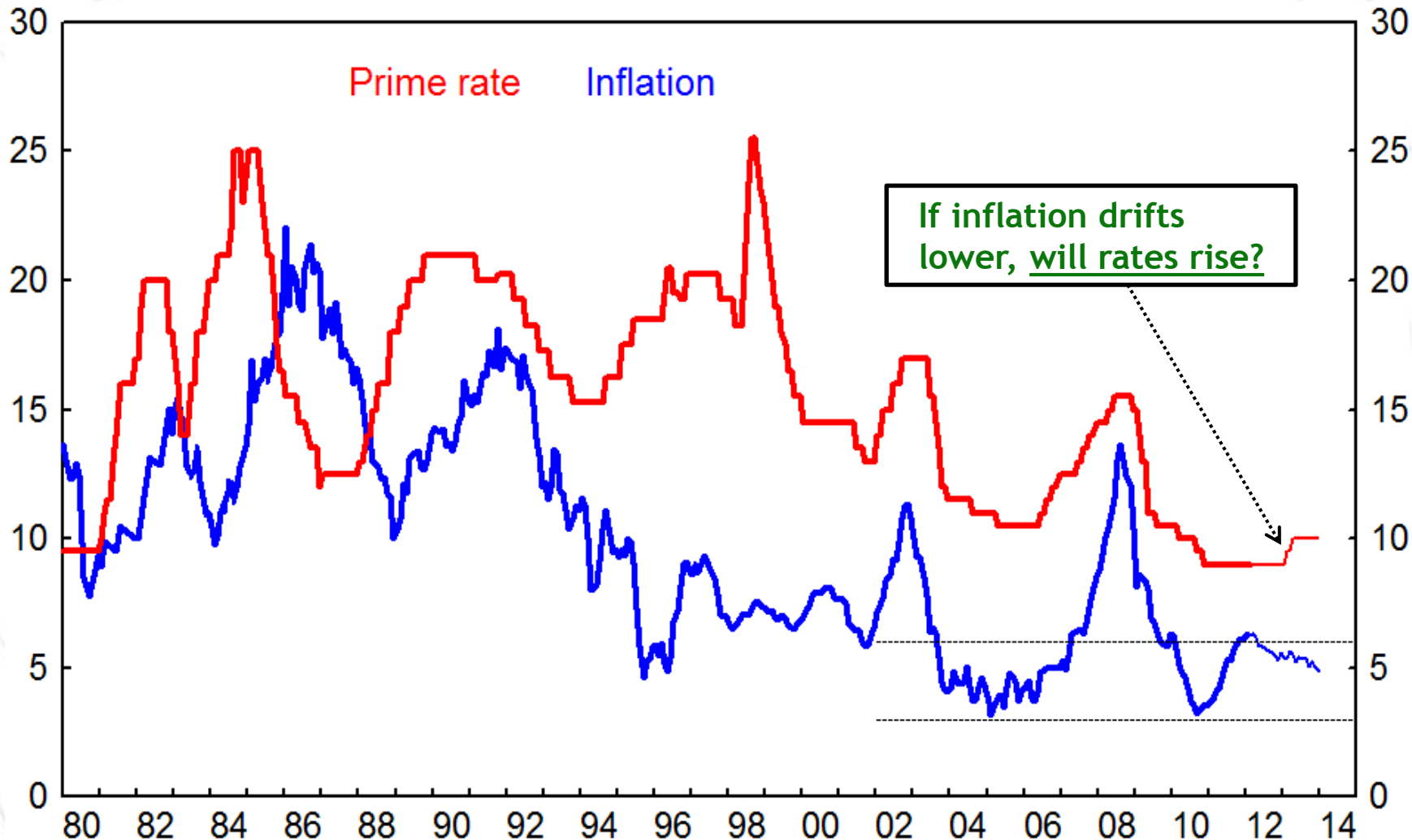
Services deficit to widen on sharp recovery in dividend payments; recent trade deficit widening also holds some C/A risk?





SA inflation & rate cycle forecasts

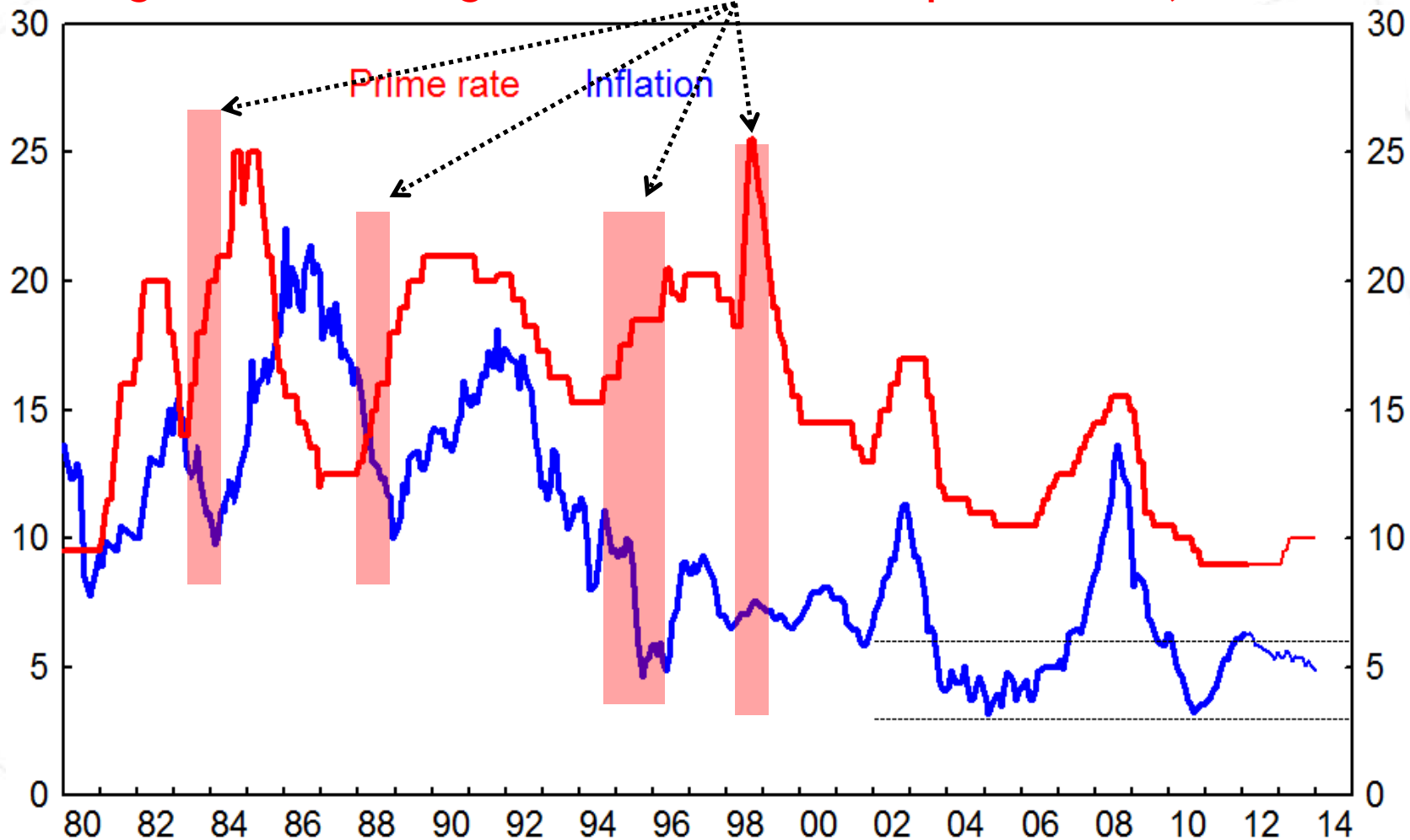
Million \$ question: next SA rate move up? If so, when?





SA inflation & rate cycle forecasts

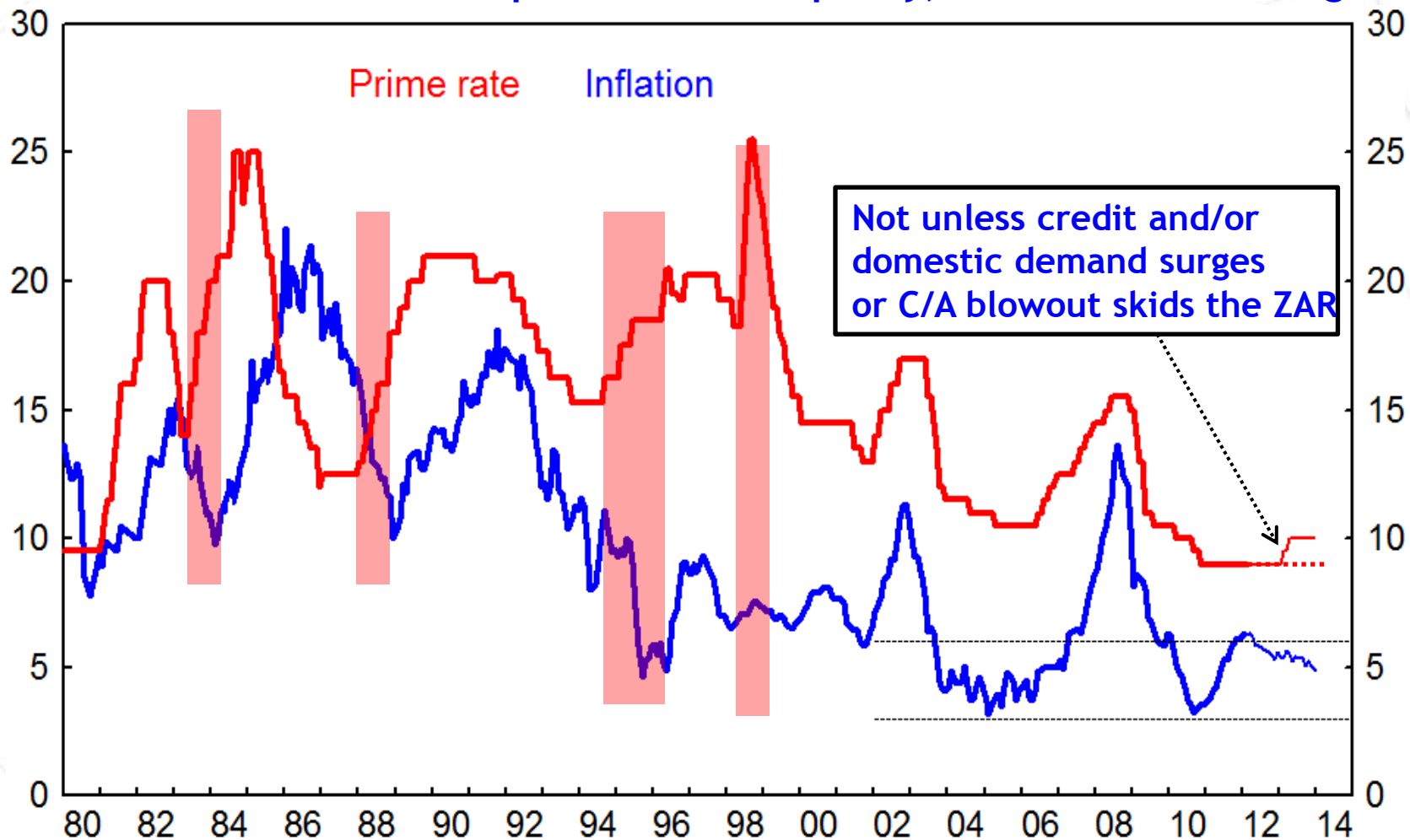
Rising rates with falling/low inflation is NOT unprecedented, of course





SA inflation & rate cycle forecasts

But that was when C/A was a prime driver of policy; now it's inflation & growth





SA Summary

- ❖ Economy in slow expansion, outlook still at risk from global situation
 - 2012 growth little under 3%, vs 3.1% in 2011 (-1.7% in 2009)
 - Moderate growth rotation in 2012: less HCE support, little more GFCF
- ❖ ZAR still at the mercy of global developments; if our Base Case view is right, should trade broadly sideways
- ❖ Inflation close to peaking; but upside risks still next few months from oil & food
- ❖ Rate outlook: no hikes soon, maybe not even in 2013
 - No urgency to cut (demand growth pretty solid, inflation rising, c/a widening)
 - No need to hike either (slow growth & downside risks, inflation to peak soon & drift lower thereafter)
 - Will likely require strong domestic demand & credit surge and/or C/A crisis to get SARB to hike
 - We push first hike out to mid-2013



Appendix slides

Appendix 1: Macro forecast sheet

Appendix 2: Global macro data pictures

Appendix 3: How serious the global growth hit from higher oil price?



APPENDIX 1

Macro forecast sheet

Changes made:

1. We change the ZAR profile slightly, seeing a moderately firmer near-term profile than before. We still expect the ZAR to drift weaker in 2013/4, although the exact profile is highly unpredictable
2. We push the first rate hike out further to mid-2013, essentially because of the declining inflation profile and likely still moderate economic growth
3. We have left the National Account forecasts (GDP, HCE, GFCF, etc) unchanged for now, as Q4 actual data is to be released within the next 2 weeks

ERU Forecasts

Annual averages, except where indicated

Economic Indicators	Historic data									Forecasts		
	avg 84 - 93	avg 94 - 03	avg 04 - 07	2006	2007	2008	2009	2010	2011	2012	2013	Medium term
Global forecasts												
USA	3.4	3.4	2.8	2.7	1.9	-0.3	-3.5	3.0	1.7	2.2	2.4	2.5
Euro area	3.3	2.2	2.5	3.3	3.0	0.3	-4.2	1.8	1.5	-0.5	0.4	1.5
Japan	4.0	0.4	1.9	1.7	2.2	-1.1	-5.5	4.5	-0.9	1.4	1.3	1.0
China	10.6	9.4	12.1	12.7	14.2	9.6	9.2	10.4	9.2	8.4	9.0	7.5
SA forecasts												
National accounts												<i>growth potential</i>
HCE	1.4	3.5	6.6	8.3	5.5	2.2	-1.6	3.7	5.0	3.4	3.5	4.0
GFCF	-2.9	5.1	12.5	12.1	14.0	13.2	-3.2	-1.6	4.0	4.5	6.0	6.0
GDE	1.0	3.2	7.2	8.6	6.3	3.5	-1.6	4.2	4.2	4.5	4.0	4.0
GDP	1.0	3.0	5.2	5.6	5.5	3.6	-1.5	2.9	3.1	2.7	3.5	4.0
Target inflation measure												
Year average	15.0	7.7	4.8	4.6	6.5	11.3	7.1	4.3	5.0	5.9	5.2	<i>5.5% annual average</i>
Year-end	15.0	7.4	5.5	5.0	8.6	10.3	6.3	3.5	6.1	5.6	5.0	
B.O.P:Current acc.												
As % of GDP	2.2	-0.7	-4.8	-5.3	-7.0	-7.2	-4.1	-2.8	-3.5	-4.0	-4.5	-4.0
Exchange rates												<i>Average annual depreciation (%)</i>
R/\$ year-end	2.54	6.36	6.46	7.04	6.85	9.39	7.40	6.63	8.09	7.70	8.10	3.0
R/£ year-end	4.10	10.15	12.28	13.78	13.62	13.68	11.96	10.35	12.57	12.24	12.96	to
R/Euro year-end	2.91	6.85	8.63	9.27	10.09	13.06	10.58	8.87	10.49	10.40	11.34	3.5%
Interest rates												
Prime overdraft at												
Quarter ends	Q1			10.50	12.50	14.50	13.00	10.00	9.00	9.00	9.00	
	Q2			11.00	13.00	15.50	11.00	10.00	9.00	9.00	9.00	
43	Q3			11.50	13.50	15.50	10.50	9.50	9.00	9.00	9.50	
	Q4	17.78	16.88	12.13	12.50	14.50	10.50	9.00	9.00	9.00	10.00	<i>4% real prime rate</i>

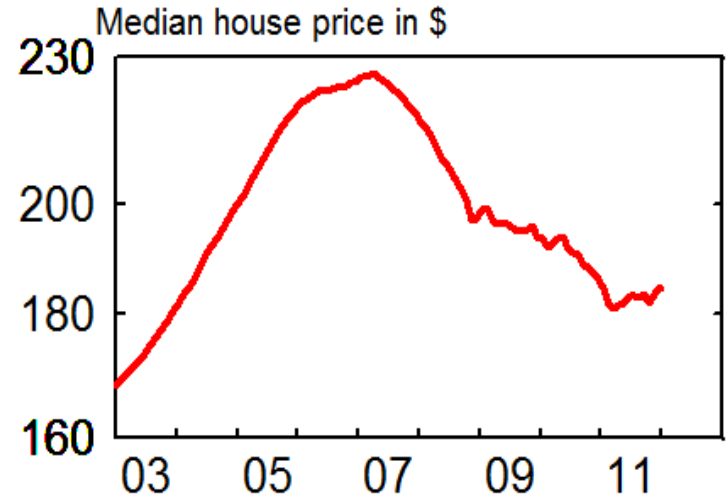
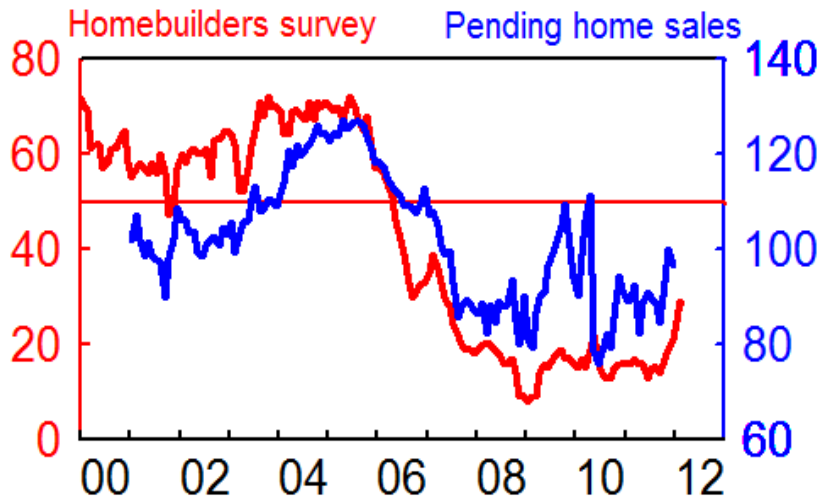
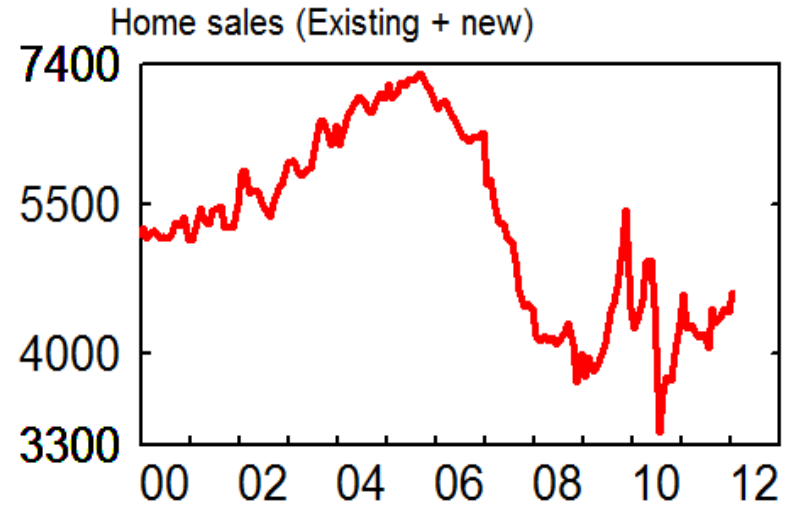
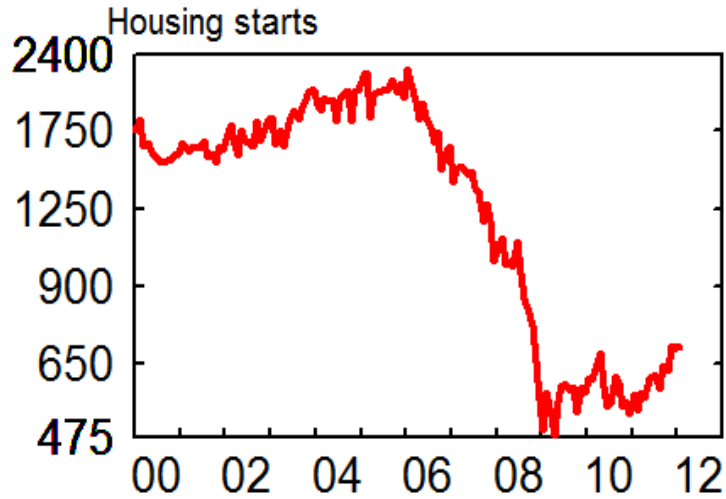


APPENDIX 2

Global macro data picture

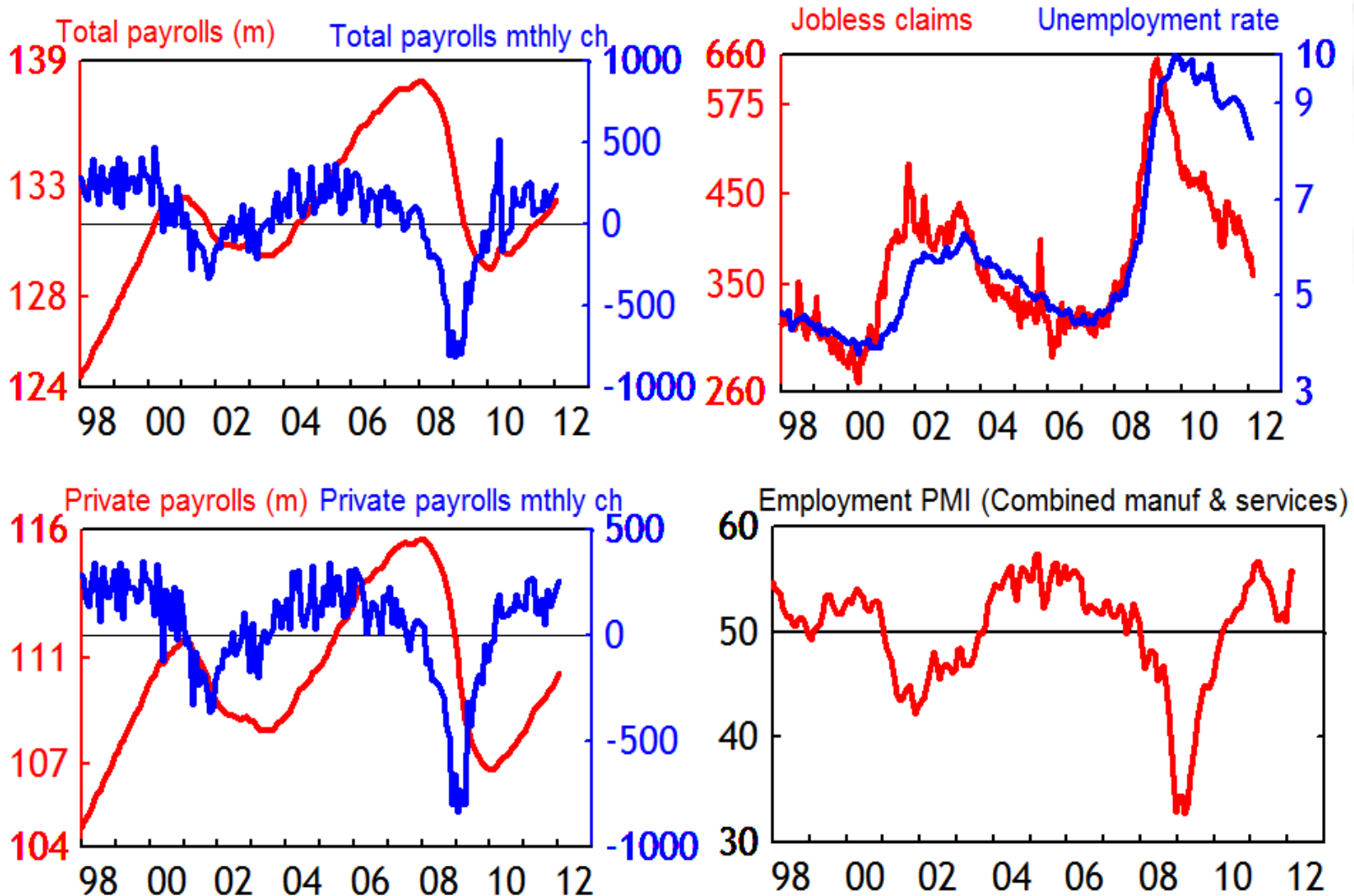


USA housing market



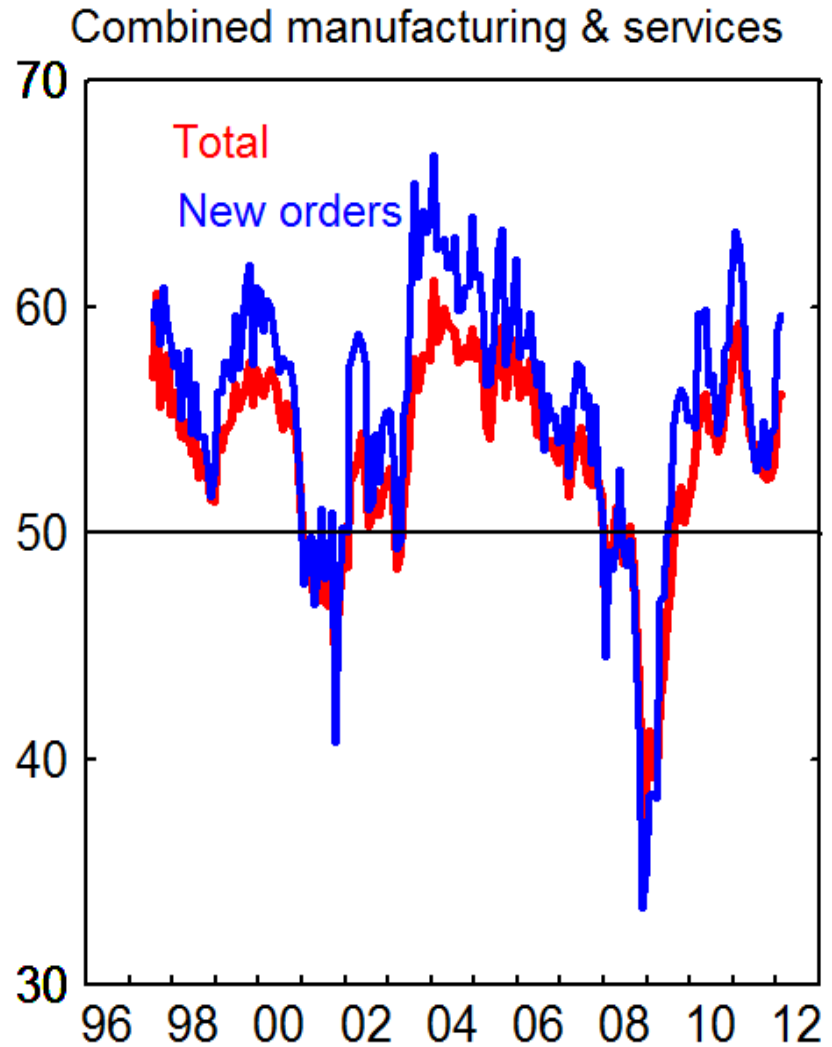
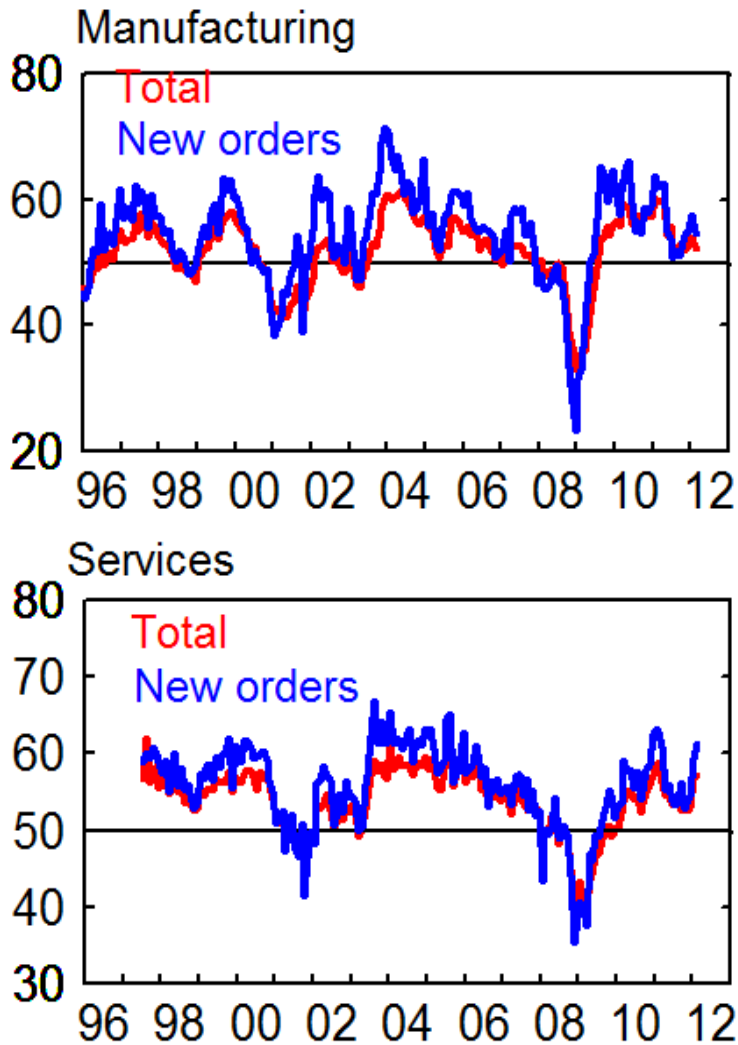


USA labour market



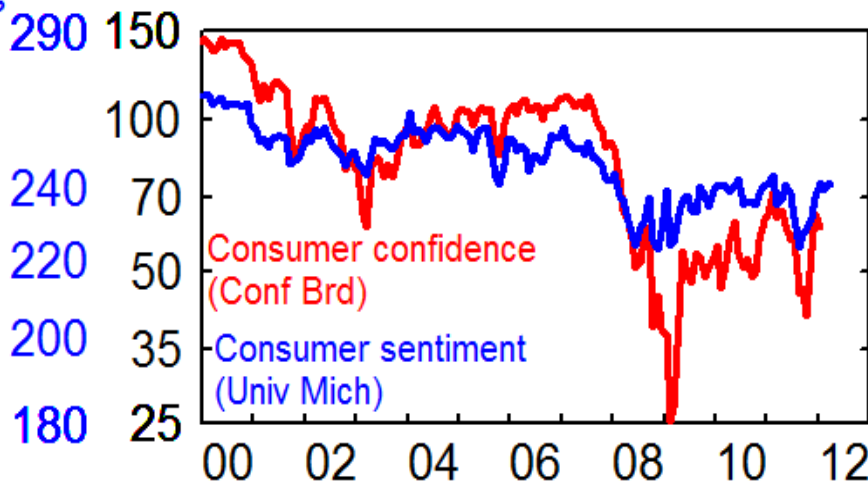
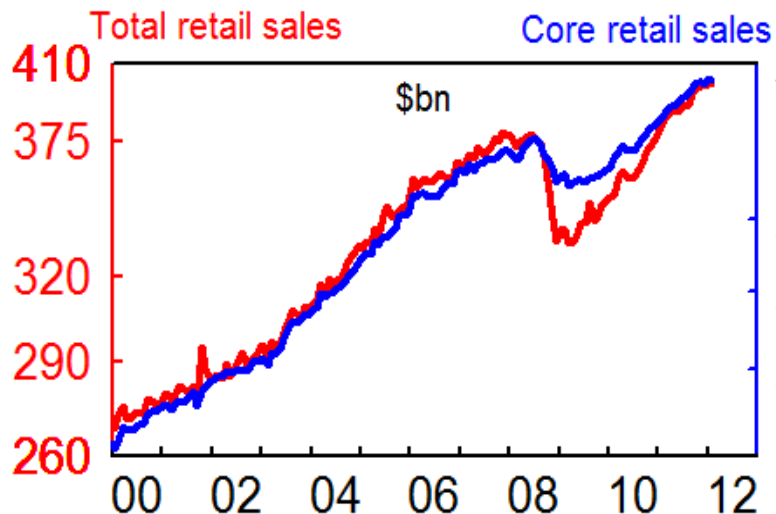
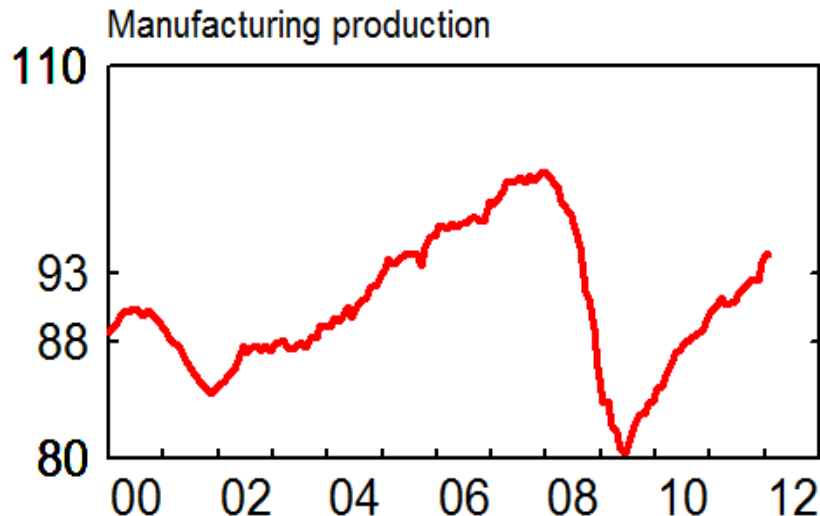
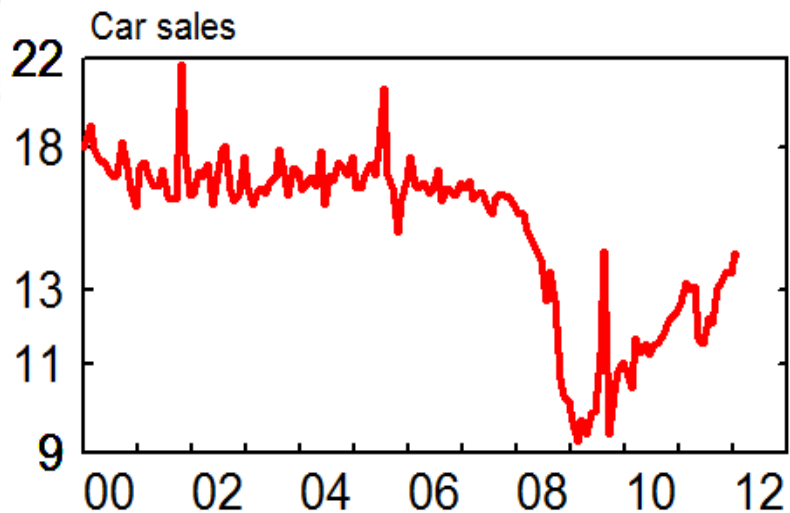


USA Manufacturing & Service PMI's



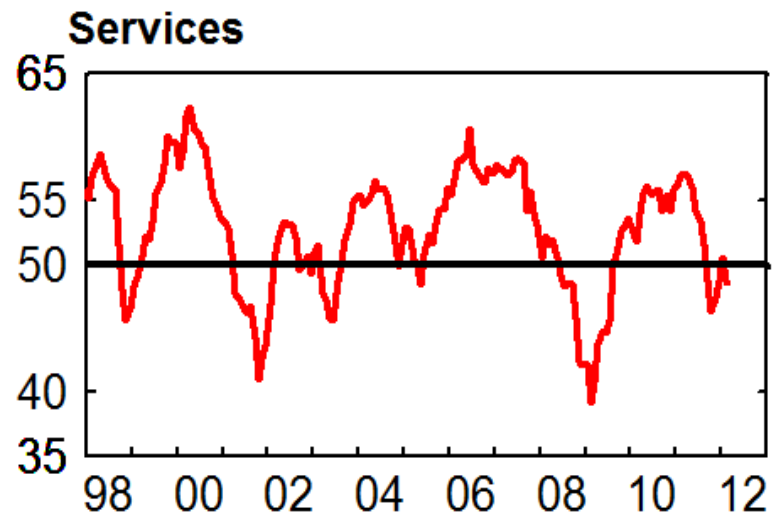
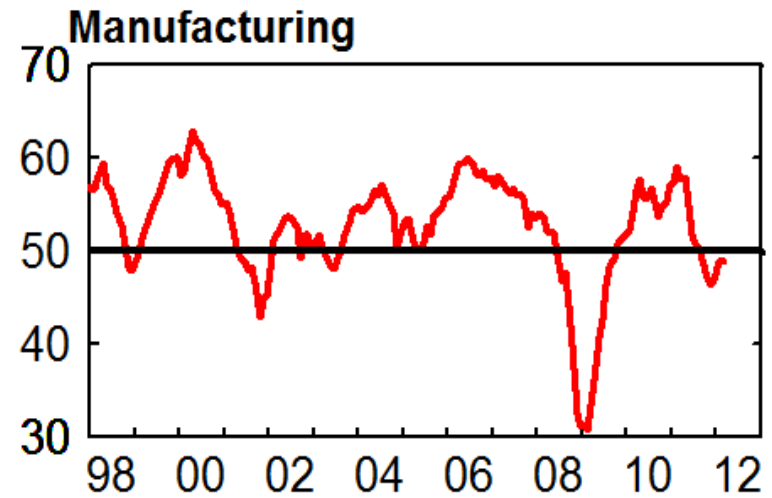
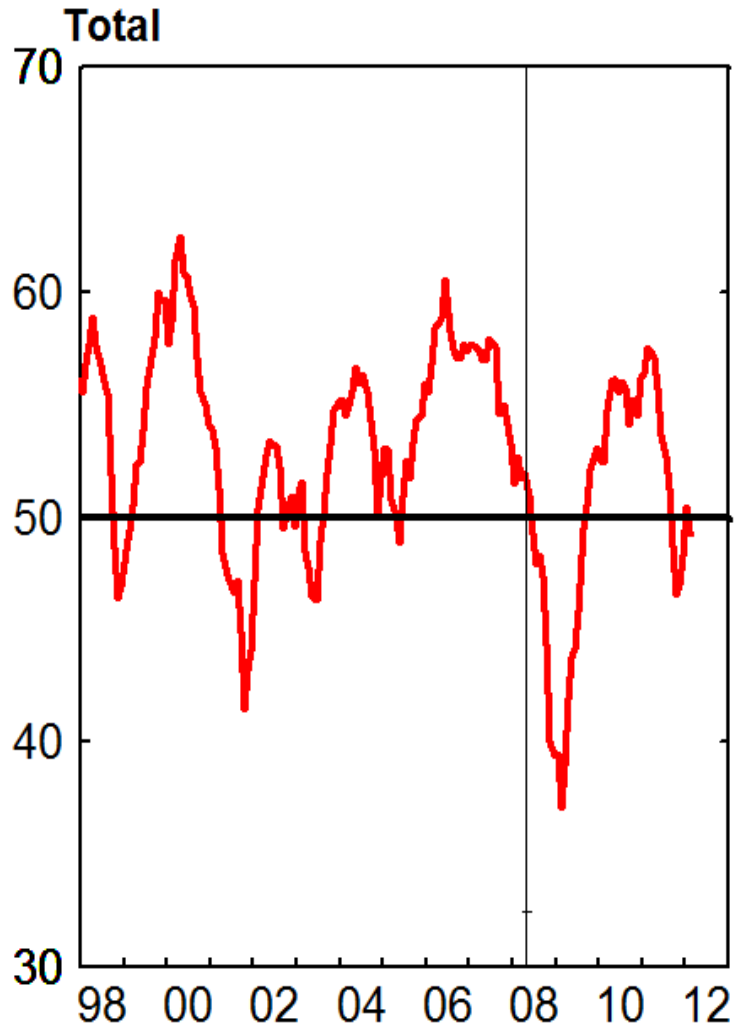


USA selected high frequency data





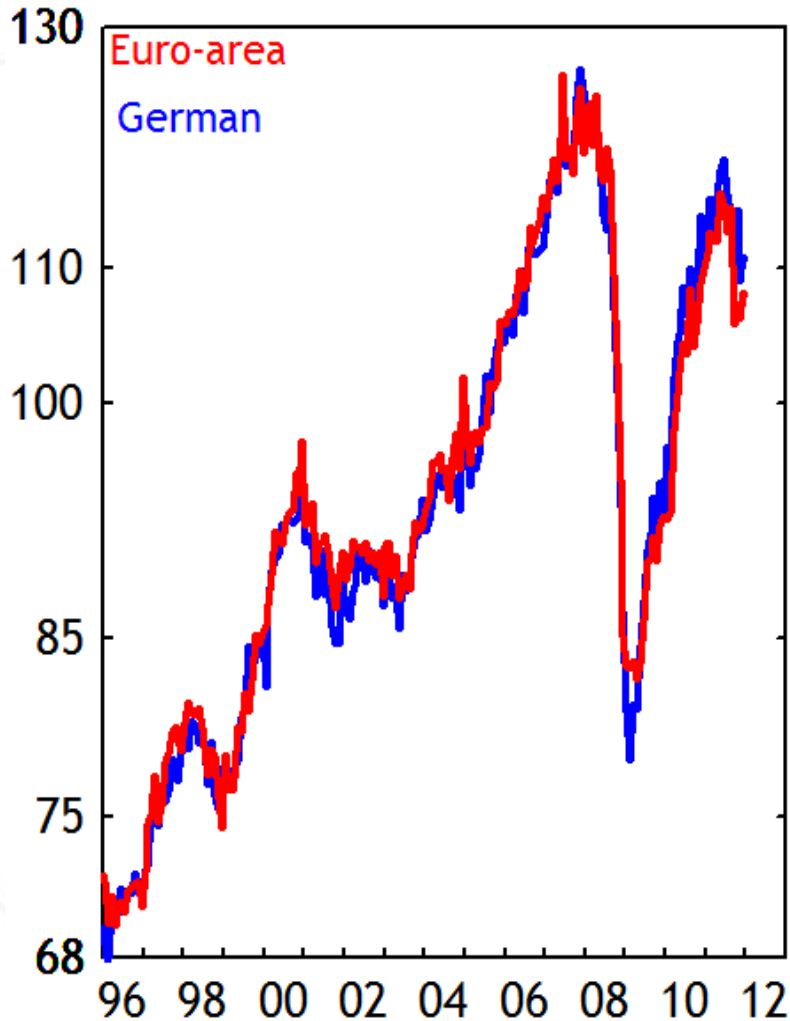
Euro-area PMI: composite



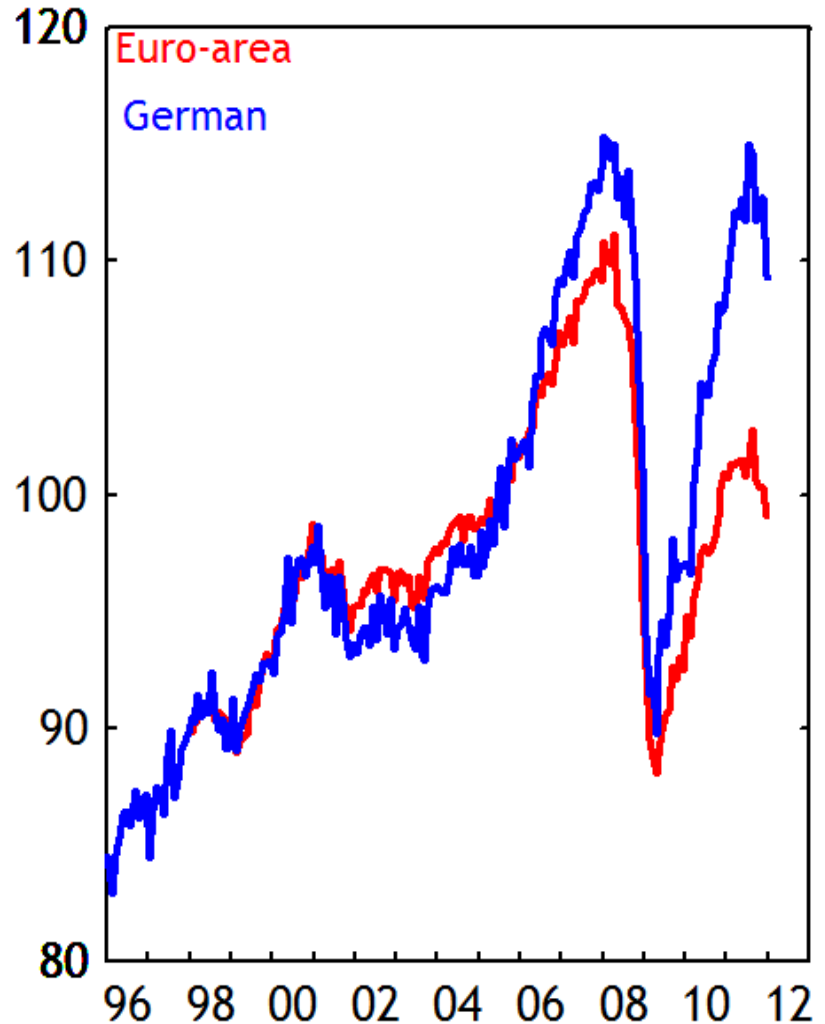


Euro-area industrial production

Industrial orders

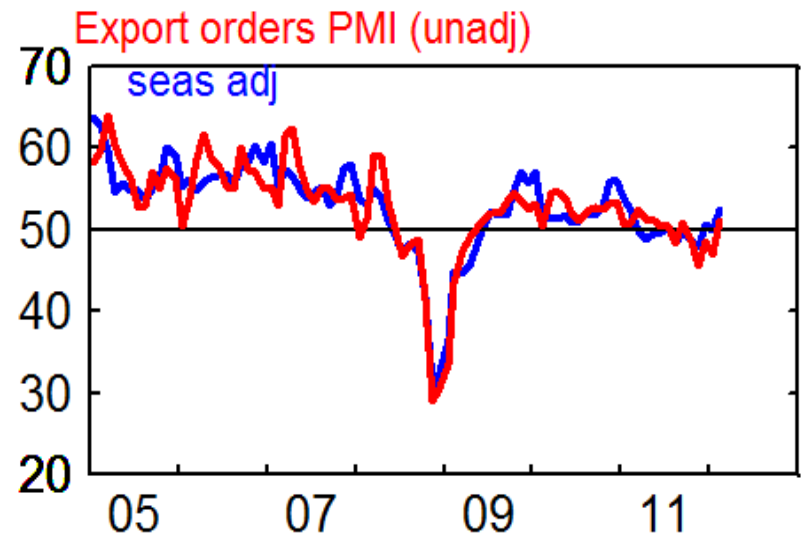
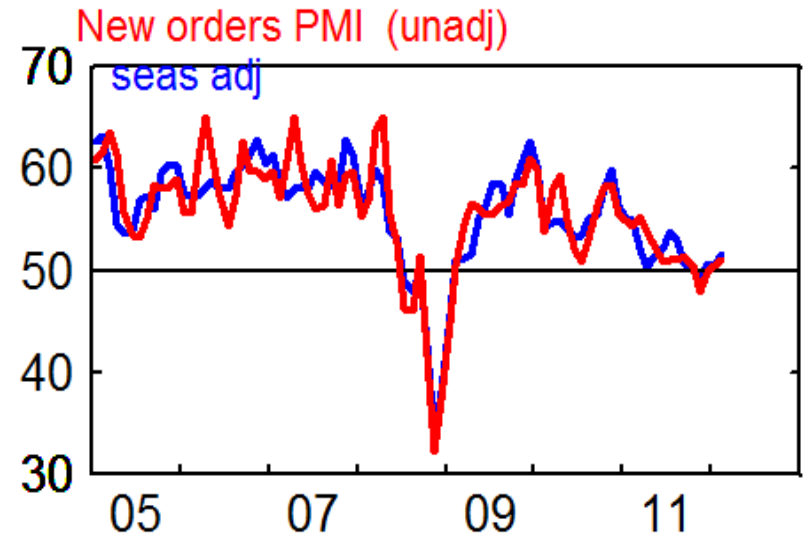
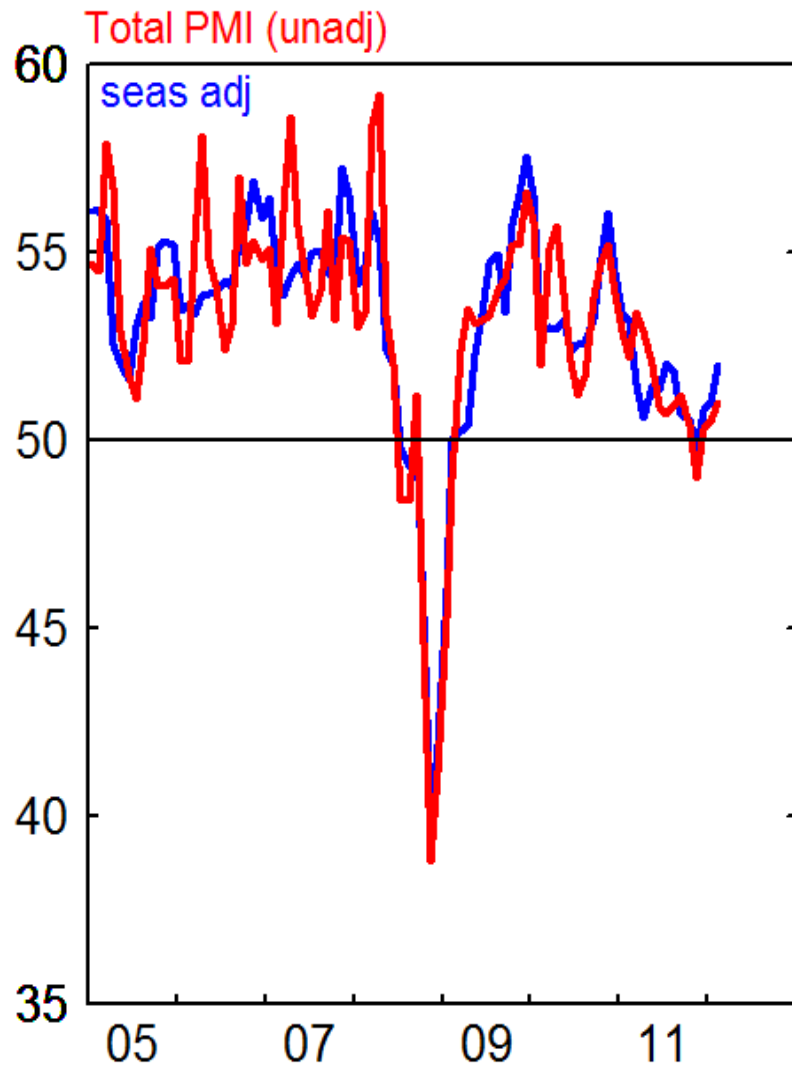


Industrial production



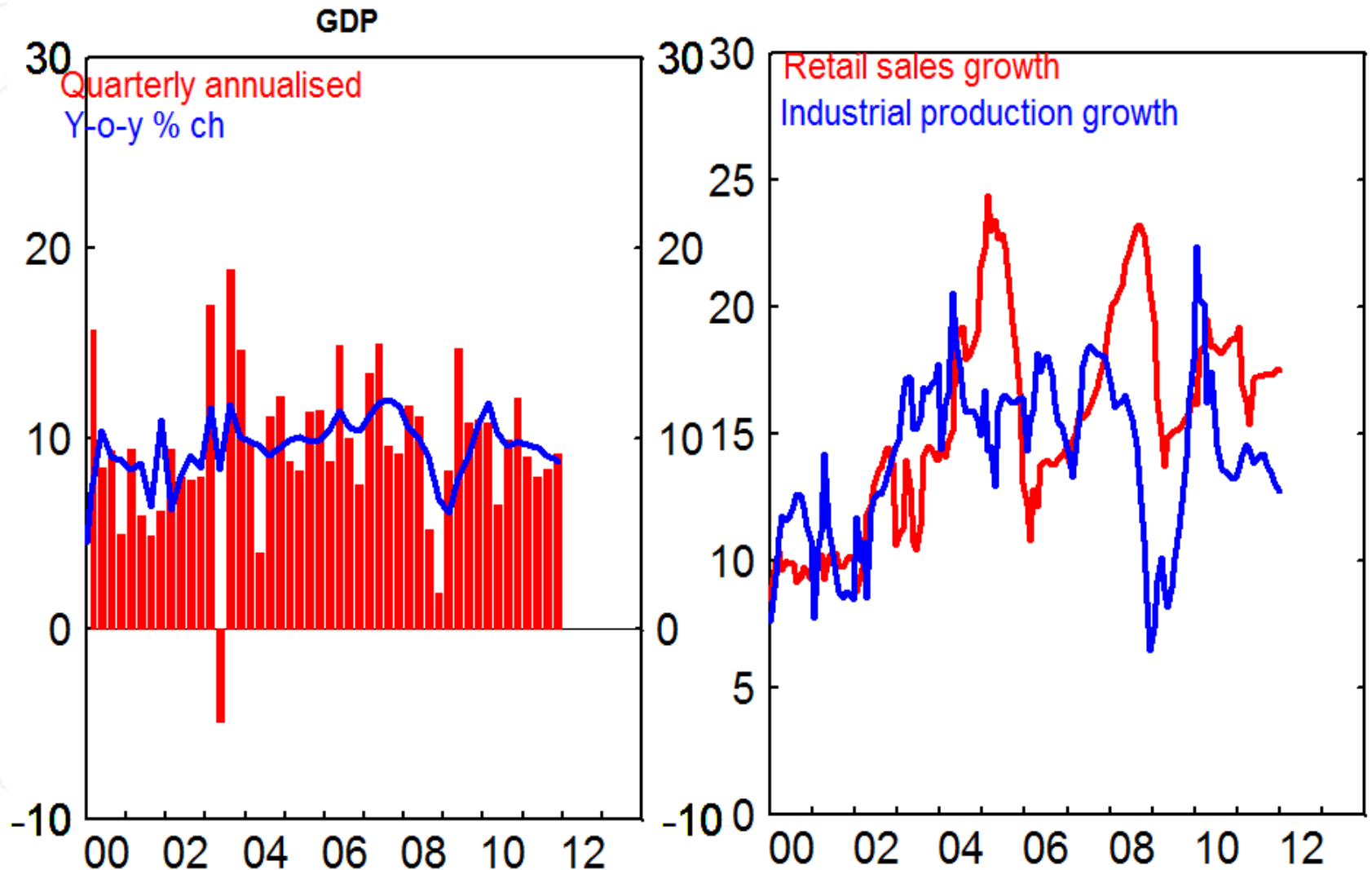


China PMI



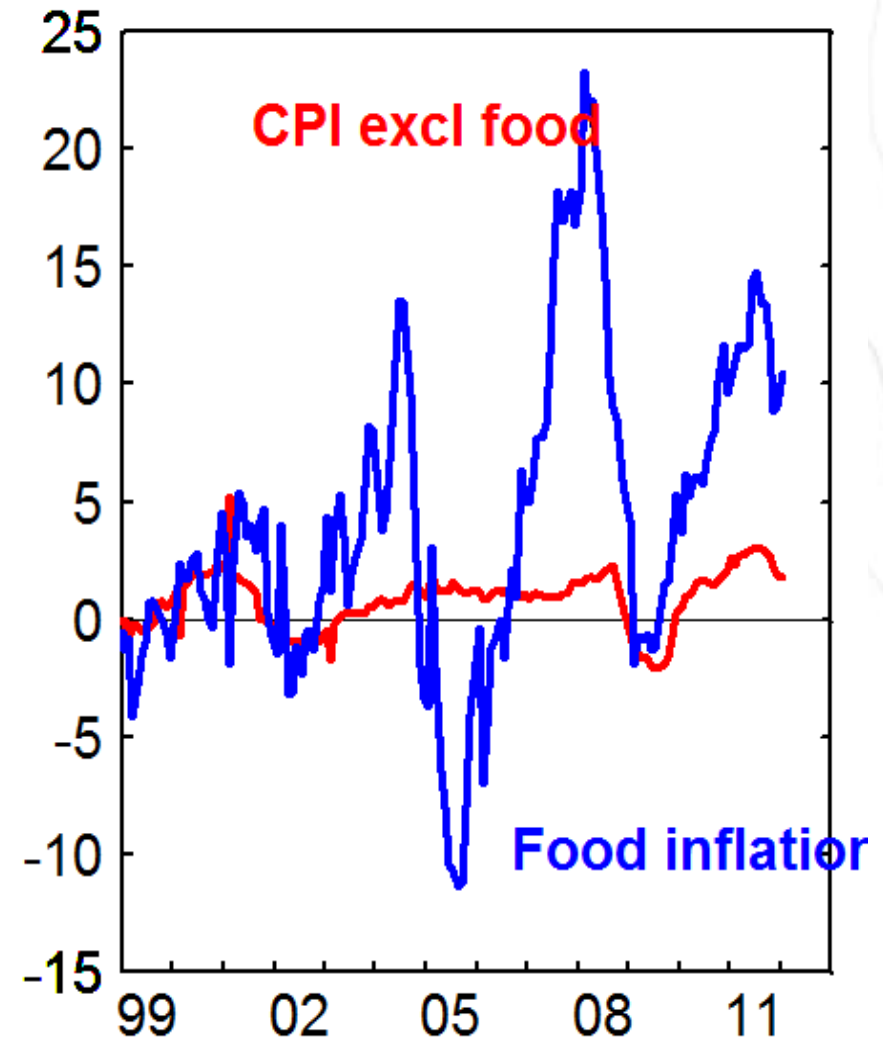
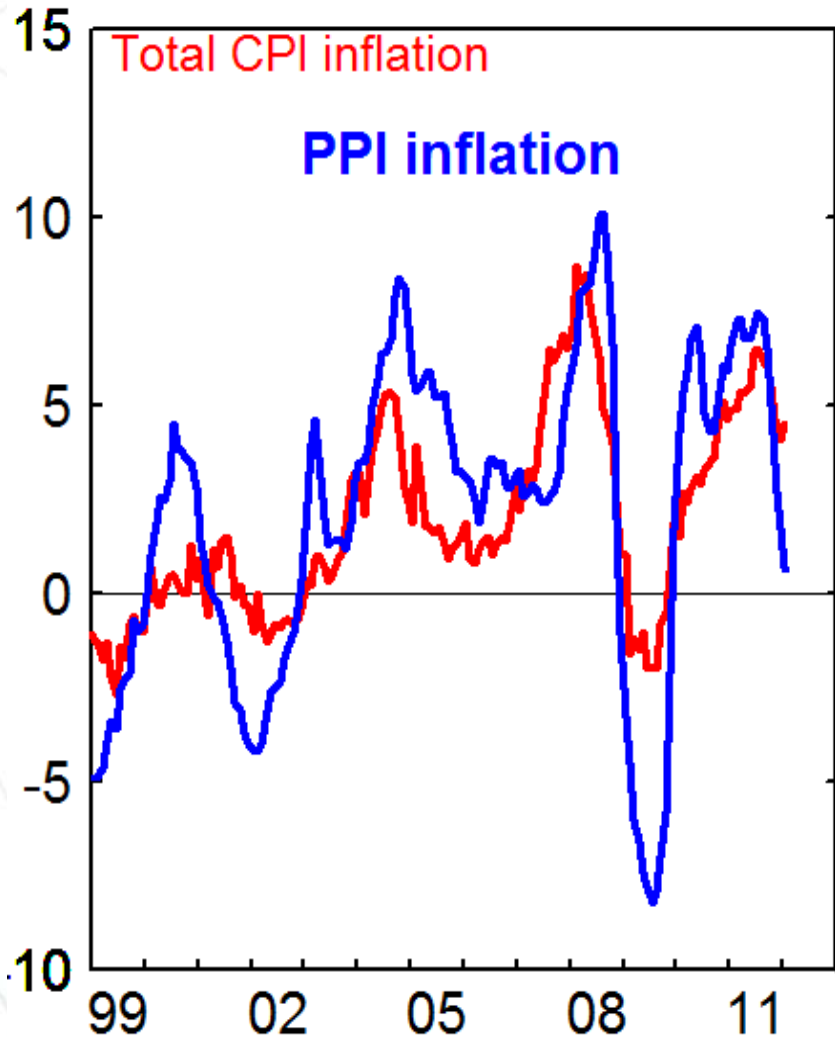


China GDP & high frequency indicators



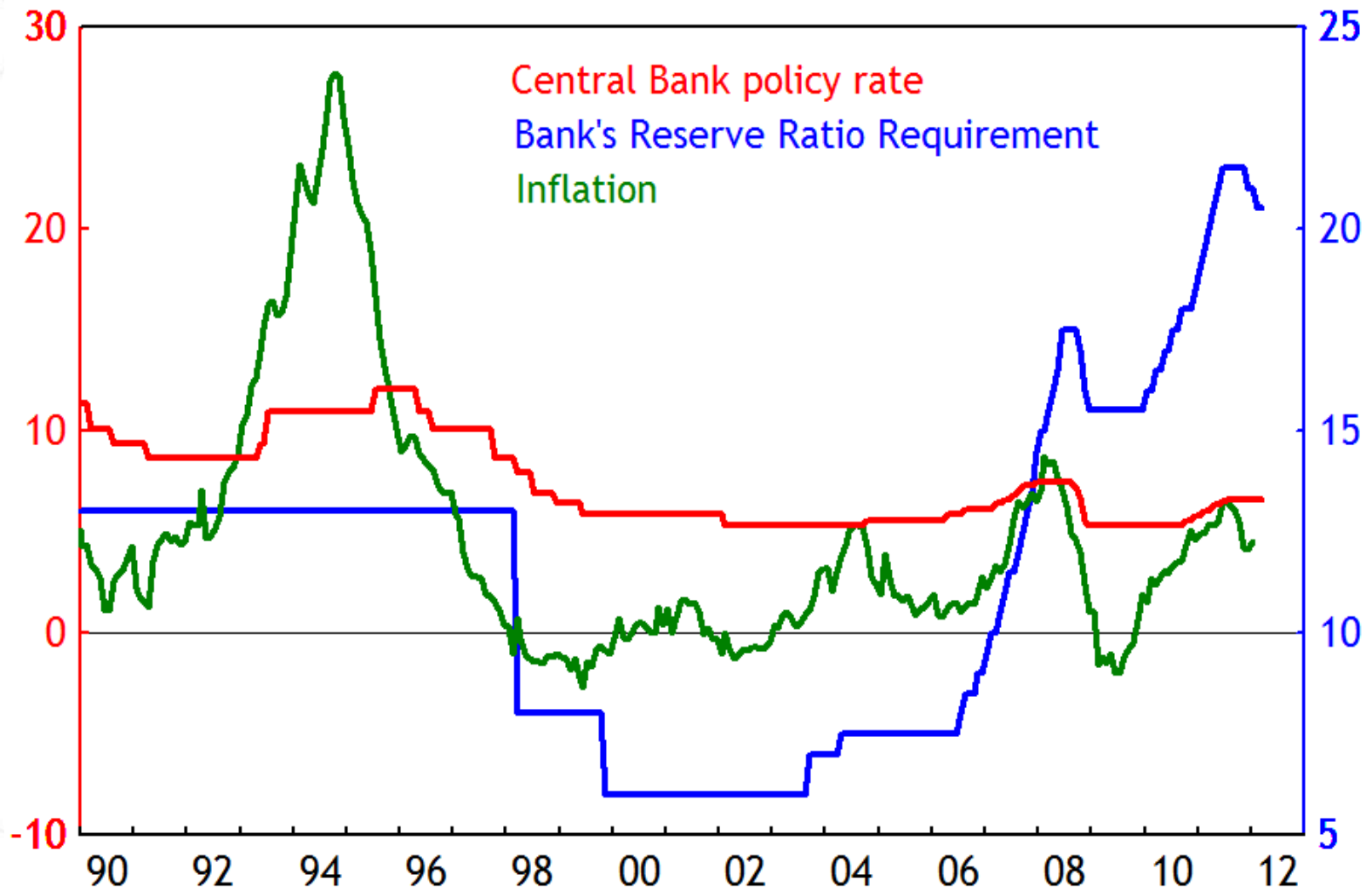


China inflation





China policy picture





APPENDIX 3

Oil & global growth: How serious the hit of the recent rise in oil prices?



Oil & global growth

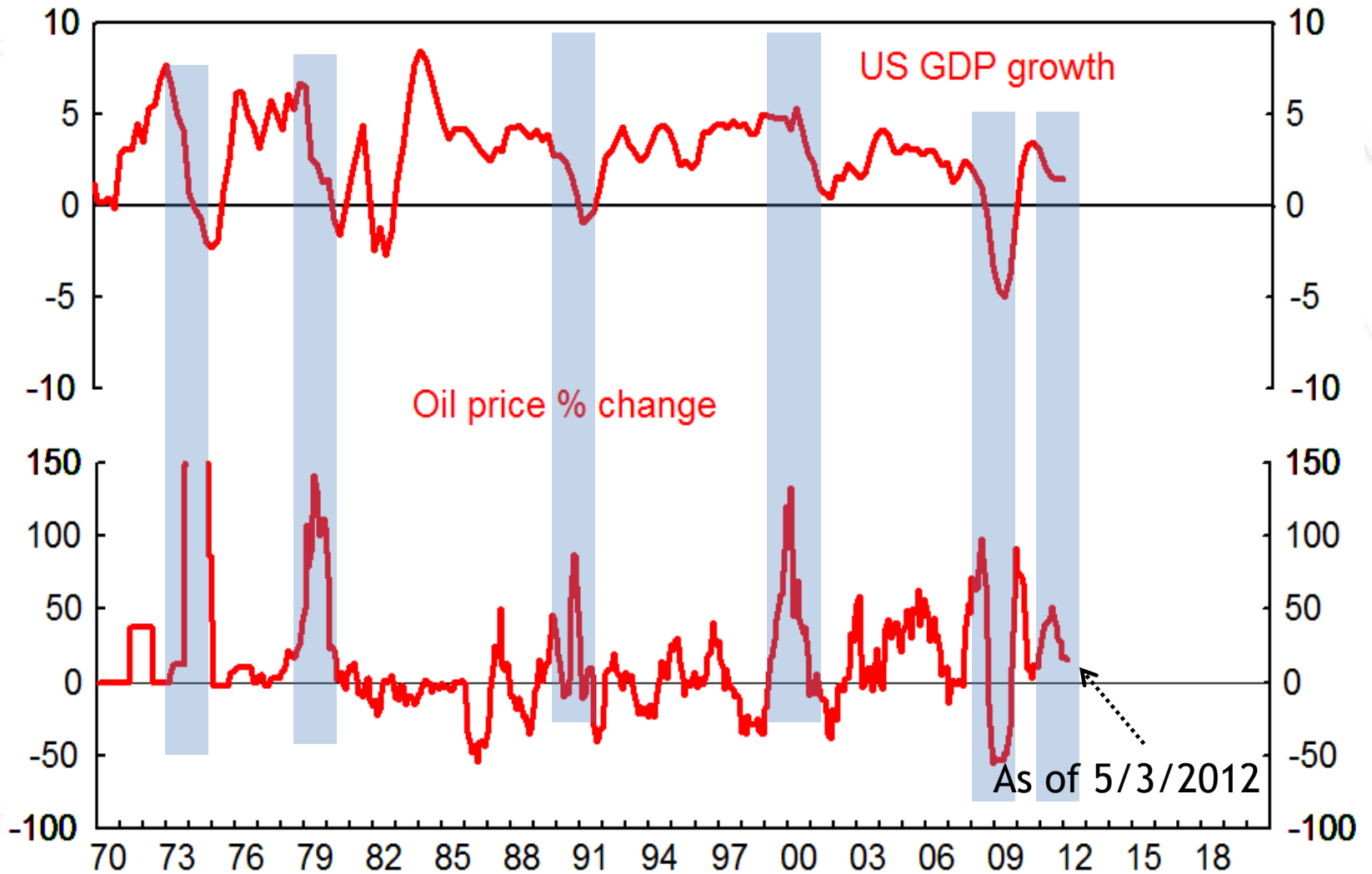
- ❖ **Lots of concerns currently over impact on global growth of recent rise in the oil price**
 - Rule-of-thumb: \$10 rise in oil price lowers global growth by 0.2% - 0.5% over a full year
 - However, this is only a very broad rule of thumb; underlying conditions & policy responses will determine actual outcomes
 - Logically, impact vastly different between producers & consumers

- ❖ **Attached are a couple of slides giving some historical perspective and come to some broad conclusions**



What risk the oil price?

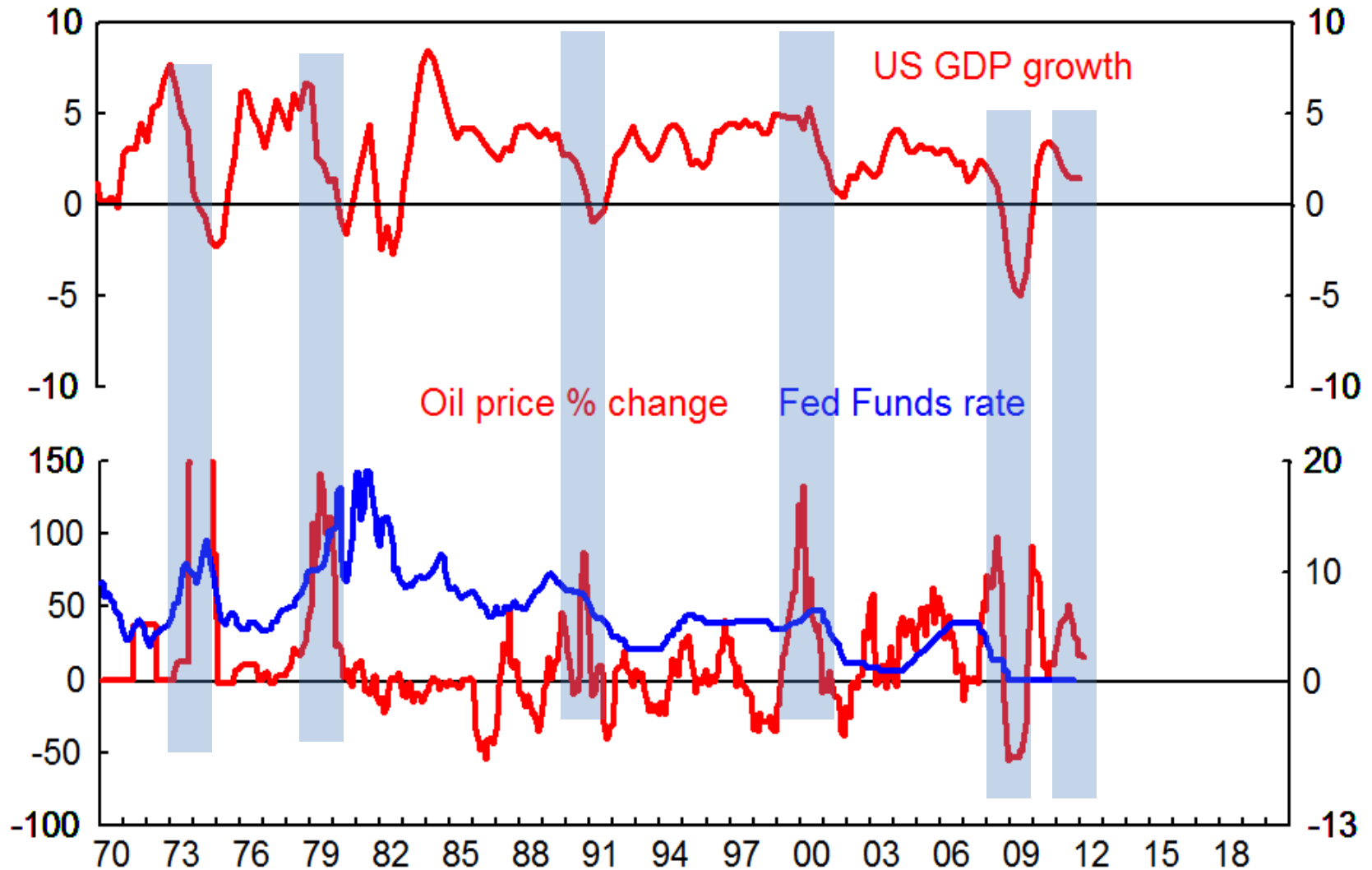
The rate of change in the oil price matters, not the level (see slide 4)





What risk the oil price?

The rate of change in the oil price matters, [also Fed reaction \(pre- or during oil rise\)](#)

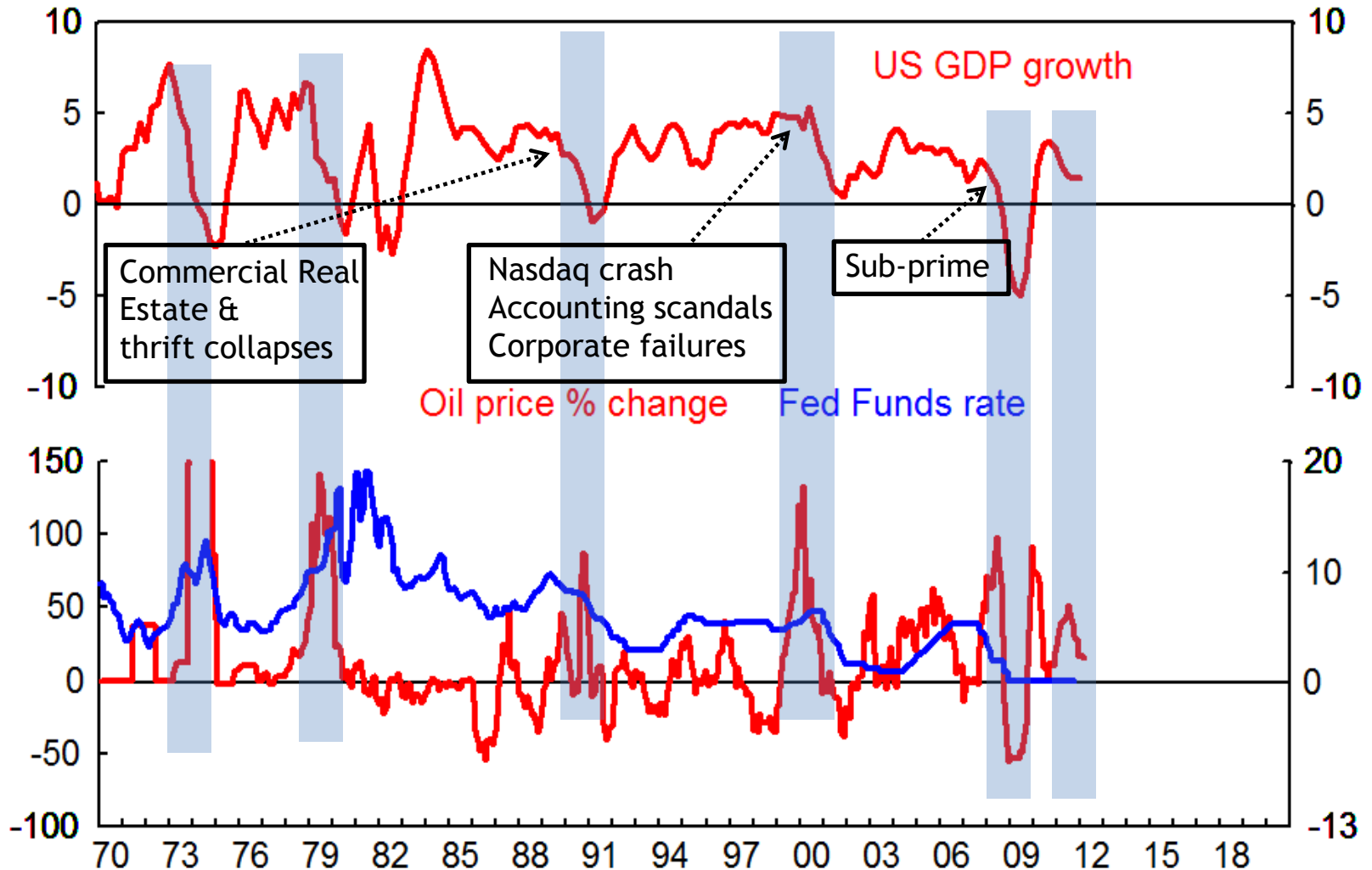




What risk the oil price?

The rate of change in the oil price matters, also Fed reaction (pre-or during oil rise)

Since 1990 oil shocks were accompanied by other troubles





Oil price vs US GDP

A growing economy can cope with a high/rising oil price

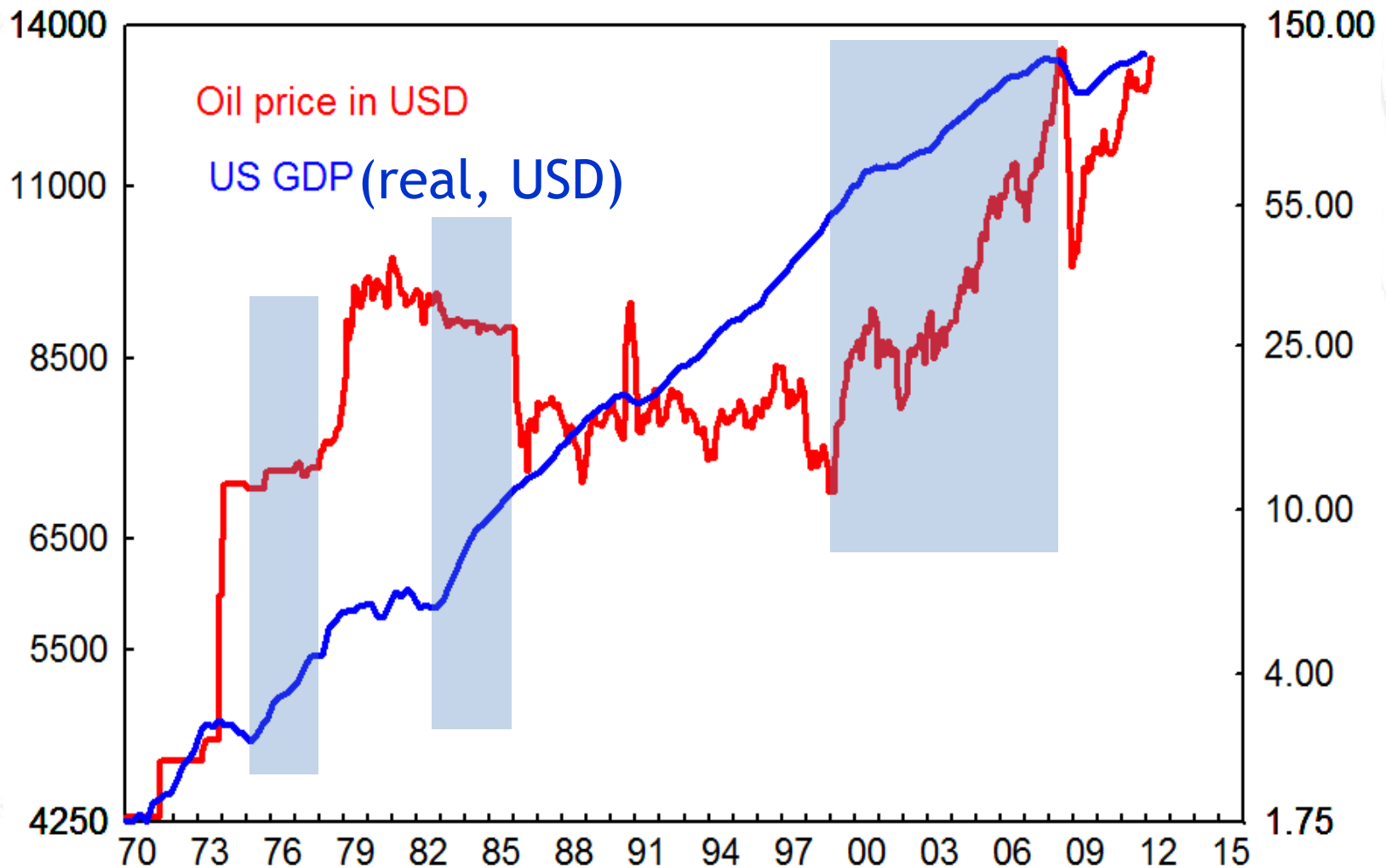




Table 1: Net Oil Export (% GDP)

Rank	Country	2012
1	Saudi Arabia	48.07
2	Kuwait	47.62
3	Nigeria	29.50
4	Venezuela	23.98
5	Iran	20.05
6	Russia	12.87
7	Norway	11.16
8	Malaysia	2.52
9	Canada	1.92
10	Mexico	0.77
11	U.K.	-0.39
12	Australia	-0.72
13	Netherlands	-0.88
14	Brazil	-1.03
15	Sweden	-1.13
16	France	-1.54
17	Indonesia	-1.79
18	US	-2.06
19	Portugal	-2.26

Rank	Country	2012
20	Italy	-2.29
21	Germany	-2.40
22	Ireland	-2.47
23	New Zealand	-2.49
24	India	-2.57
25	China	-2.73
26	Japan	-3.12
27	South Africa	-3.56
28	Spain	-3.75
29	Poland	-4.02
30	Czech Republic	-4.12
31	Taiwan	-4.50
32	Greece	-4.59
33	Singapore	-4.95
34	Philippines	-4.99
35	Hungary	-5.17
36	Turkey	-5.96
37	South Korea	-7.34
38	Thailand	-11.47

Source: IMF



Conclusion

- ❖ **History suggests that, on its own, an oil shock must be big to cause recession & must also be accompanied by monetary policy reaction and/or other shocks/drag**
- ❖ **Recent rise in the oil price small, but still holds downside risk to US & world economy because:**
 - It comes on top of already slow global (especially DM) growth
 - Some big oil importers are also face fiscal contraction (see next slide)
 - Consumers still fragile: high debt levels, slow employment
- ❖ **But, some counter-forces too**
 - Monetary policy very expansionary & will stay so
 - Corporate profits high & employment low (so unlikely to cause lay-off surge)
- ❖ **So, oil probably not at 'choking level' yet, but a rise towards \$150 will become more of an issue**
- ❖ **Markets may panic well before \$150 is reached**