# Cytonn H1’2018 Markets Review

## A. Global Markets Review

**Introduction:**

Most global economies registered continued economic growth in the first quarter of 2018, with China, USA and the Eurozone registering growths of 6.8%, 2.0% and 0.4% y/y, compared to 6.7%, 1.1% and 0.5%, respectively, in Q1’2017. The regions begun the year with good performance but ongoing trade concerns and abrasive geopolitical stances have threatened to derail this.

Below is the summary of the key occurrences in H1’2018 per region:

**United States:**

The US Federal Open Market Committee (FOMC) hiked the Federal Funds Rate twice during the year, settling on a range of 1.75% - 2.00% in June. The decision by the FOMC to hike rates was on the back of a decline in the unemployment rate to an 18-year low of 3.8% in June from 3.9% in March 2018, below the unemployment rate target of 4.5%. The committee highlighted that economic growth has been rising at a solid rate to record a 2.0% GDP growth in Q1’2018, bolstered by tax cuts and a strong labor market. The Committee expects to raise the federal funds rate 2 more times in 2018, due to (i) a sustained GDP growth of 2.0% in Q1’2018, expected to record hit 2.7% for FY’2018, (ii) strong labor market conditions as indicated by the low unemployment rate, and (iii) inflation that is at 2.8%, which is expected to edge closer to the Committee's preferred level of 2.0% over the medium term.

The US stock market recorded a positive performance, with S&P 500 having gained by 0.8% in H1’2018, attributed to gains in the technology and financial services sectors, on optimism of pro-growth and protectionism policies from the current Trump administration, such as the corporate tax cut from 30.0% to 21.0%, which has tended to boost corporate earnings and thereby lead to rising stock prices.

We expect the US market to remain supported by a strong labor market that will spur domestic consumption and economic growth. However, the ongoing trade wars between the US and China, the Eurozone, Mexico and Canada is likely to dampen the country’s growth prospects, which could disrupt product supply chains and undercut business investment.

**Eurozone:**

In the Eurozone, the momentum in growth waned, as the GDP growth was recorded at 0.4% in Q1’2018, which was lower than the 0.7% growth recorded in both Q1’2017 and Q4’2017. The decline in the GDP growth could largely be attributed to a weak performance in the external sector, as exports declined by 0.4%, for the first time since Q4’2012. The decline in exports was largely due to a lower aggregate demand of products that could be attributed to a strong Euro currency. Moreover, there was overall reduced government spending coupled with reduced fixed investment growth. The Eurozone PMI declined by 5.9% to 55.5 from 58.8 recorded in January 2018. The decline in the PMI points to slowing economic growth in the region, as inflows from new business grew at a reduced pace.

The European Central Bank (ECB) recently met in June, maintaining the base lending rate at 0.00%, and the rates on the marginal lending facility and deposit facility at 0.25% and (0.40%), respectively. The current negative deposit rates are expected to persist in 2018 and impact growth positively by spurring domestic regional consumption. The Bank also announced an upcoming end to its Quantitative Easing (QE) program at its June meeting. The ECB will finalize its asset purchase program at the end of December 2018 and halve the pace of purchases from the current EUR 30.0 bn per month to EUR 15.0 bn per month in the final quarter of the year. This points to the beginning of the end for monetary stimulus in the Eurozone. The bank also signaled that the path of interest rates going forward, is likely to remain at the current levels through to the summer of 2019, granted inflation moves as expected.

The stock markets in Europe registered declines in the first half of 2018, with the FTSE 100 declining by 0.1%, primarily due to the healthcare and telecommunication sectors. The region's stock markets began the year with a positive performance, but were weighed down by uncertainty on the path of US interest rates and the outlook of global trade. The sectors tend to serve as "bond proxies" that offer stable returns and are much sought after when bond yields are low. However, amid rising US rates, and therefore rising bond yields, these sectors declined on account of increased capital outflows.

On the political front, growing global trade tensions are threatening the Eurozone's outlook. On 22$^{nd}$ June, US President Donald Trump threatened to escalate a trade dispute with the EU by slapping a 20.0% tariff on automobiles. This came after the EU enacted retaliatory tariffs on US goods, following the US's imposition of tariffs on steel and aluminum imports from the EU. While the US' initial tariffs on steel and aluminum are expected to have a relatively small economic effect, the automobile industry is a much larger sector and the US is the biggest market for EU car exports, meaning that the economic effect would be much more pronounced for countries such as Germany and the UK, if the tariffs are imposed. On the domestic political front, Italy and Spain have experienced political uncertainty. New, relatively unstable governments have been installed in both countries, as detailed below:

***In Italy:***

- A Coalition Government formed by the populist Five Star Movement (M5S) and right-wing League party was installed in June, ending months of political deadlock, and,
- The Coalition spelt out plans for fiscally expansionary policies, which may cause the government to clash with European bodies if they flout the expenditure guidelines.

***In Spain:***

- Pedro Sánchez was sworn in as the new Prime Minister at the start of June, after the incumbent Mariano Rajoy lost a confidence motion in parliament after a fallout from a massive corruption scandal that he had been implicated in, and,
- The newly installed government has weak political mettle, as it commands only 84 seats out of 350 in parliament, which will constrain policymaking and possibly limit its tenure.

***In Germany:***

- Political uncertainty has increased due to an internal dispute within the ruling coalition over migration policy. The dispute is seen as undermining Chancellor Angela Merkel's leadership, which is receiving opposition from the Interior Minister Horst Seehofer, who threatened to prevent immigrants registered in other European countries from gaining entry into Germany, a move that Merkel has been vocal against.

Declining GDP growth recorded in the first quarter of 2018, coupled with rising inflation and mounting political risks, led to a downgrade of the region's GDP growth estimates. According to World Bank, GDP is now projected to grow by 2.1% in FY'2018, down from last month's forecast of 2.3%. Rising inflation is likely to reduce household consumption this year. The ongoing trade tensions between the Eurozone and the US is expected to impact negatively on the external trade sector, as commodities such as automobiles, are set to be disadvantaged in the US, which is a major market for them. This, coupled with the various political problems in major member countries, is expected to hamper the regions GDP growth for the year 2018.

**China:**

China's y/y GDP in Q1'2018 increased by 6.8% to Yuan 19.9 tn (USD 3.2 tn), the same rate as Q3'2017 and Q4'2017. The steady economic growth was driven by (i) a steady growth in industrial production, (ii) an increase in private consumption, and (iii) increased investment in infrastructure by the government. New businesses and industries continued to record steady growth, as corporate profit and resident incomes steadily increased which boosted private consumption. The services sector, which accounted for 56.6% of the economy, played a key role in driving China's economic growth, with a growth rate of 7.5% y/y.

On the stock market, the Shanghai Composite Index declined by 15.0% in H1'2018. The heightened uncertainty occasioned by a prolonged trade spat between China and the US has dampened investor sentiment in the country, resulting in a generally stronger Yuan against major currencies. Corporate results for December 2017 had showed positive trends. However, stock performance within sectors was attributed to investor sentiment that was influenced by political events both domestically and globally.

The Chinese economy faces several challenges that could derail the steady growth pace recorded in the previous quarters. These include (i) increased protectionism policies (policies aimed at protecting own domestic interests) in countries such as the US, (ii) monetary policy adjustments by major economies, and (iii) financial market turbulence mainly in the Eurozone. This could lead to increased uncertainty in the international markets, which could affect the country's export business seeing as the economy is a net exporter of their domestically produced commodities. The US administration has imposed tariffs of about USD 50.0 bn on Chinese goods and, recently announced activation of denial of export privileges against leading Chinese telecom equipment maker ZTE Corp. However, the government is insistent on the capability of the economy to handle trade tensions with the United States, citing the country's increasingly domestic-led growth from local consumption, growing innovation edge, and ample room for development and policy control.

***We expect the global economy to recover and post a better growth than that recorded in FY'2017, on account of improving commodity prices, increased income levels and by extension consumption levels. However, ongoing geopolitics are likely to dampen any growth prospects.***