# Cytonn Q3’2018 Markets Review

## Global Markets Review

**Introduction**

According to the World Bank, the global economy grew at an estimated 3.6% in Q2’2018, compared to 3.1% in Q1’2018. Global growth is projected to stabilize at 3.1% in 2018, the same pace as last year, supported by firming investments in advanced economies, a continued recovery in commodity-exporting emerging market and developing economies (EMDEs), and a robust growth in commodity-importing economies. Global growth is projected to ease gradually over the next 2-years to 2.9% in 2020, as major Central Banks gradually depart from accommodative monetary policies that seek to stimulate growth by increasing the overall money supply in the economy. Below is the summary of the key occurrences in Q3’2018 per region:

**Unites States:**

The US economy grew by 4.2% y/y in Q2’2018, compared to 2.2% y/y in Q2’2017, making it the fastest growth rate in 4-years, attributable to strong gains in private consumption and capital spending. According to the World Bank, growth in Q3’2018 remains robust despite the trade deficit widening, amid rising fiscal stimulus and a strengthening US Dollar. The economy continued to add about 200,000 jobs per month while nominal wage growth reached 2.9% y/y in August, its highest level since 2009.

The Chicago Purchasing Manager’s Index (PMI) fell to a 5-month low of 60.4 in September, down 3.2% points from 63.6 in August. Consumer spending increased steadily in August, supporting expectations of solid economic growth in the third quarter, while a measure of underlying inflation remained within the Federal Reserve’s 2.0% target for a fourth straight month.

The annual GDP growth estimate for 2018 rose to 3.1% from 2.8%, according to the US Federal Reserve, with a projection of 2.5% in 2019, up from an earlier projection of 2.4%., before slowing to 2.0% in 2020 and 1.8% in 2021. The expected slowdown in economic growth will be attributable to the decline in impact of the recent tax cuts, heightened inflation and a rise in interest rates. Additionally, there is rising concern on U.S.’s imposed tariffs on Chinese goods and steel and aluminium imports from most countries. The turn towards protectionist trade policies, aimed at reducing the influence and competitiveness of foreign imports, threatens to slow growth and exert upward pressure on inflation.

The US Fed raised interest rates at its meeting on 26th September 2018, by lifting the benchmark rate by 25 basis points to a range of 2.0 % - 2.25% from 1.75% - 2.0% set in June 2018. The increase in rates was the third this year and the seventh in the last eight quarters, which has been observed as the end of the accommodative monetary policy era after the deep financial crisis.

The hikes were backed by the Fed’s sentiments that (i) the economy was growing at a faster-than-expected rate of 3.1% this year and would continue to expand moderately for at least 3-years from 2018, (ii) a sustained low unemployment rate that is estimated to rise in the fourth-quarter of 2018 from 3.6% to 3.7%, and (iii) stable inflation which is expected to remain close to its 2.0% target over the next 3-years. The U.S. Fed still foresees another rate hike in December, three more in 2019, and one increase in 2020.

The S&P 500 gained by 7.1% in the quarter and has gained 9.0% on a YTD basis, making it the biggest quarterly advance since the fourth quarter of 2013. This growth is tied to the tax overhaul passed last year. The changes, which included a cut to the corporate tax rate, sent corporate profits sharply higher through the first two quarters of the year, and analysts expect third-quarter earnings to be robust as well. Going forward, a strengthening U.S. economy is expected to keep the rally going and help investors look past the continuing trade tensions between the U.S. and China and other nations.

**Eurozone:**

The European Central Bank (ECB) met on 13th September 2018 and maintained the interest rate on the main refinancing operations at 0.00%, and the interest rates on the marginal lending facility and the deposit facility at 0.25% and (0.40%) respectively. The key ECB interest rates are expected to remain at their present levels through the summer of 2019 and thereafter, to ensure the continued convergence of inflation to levels that are below, but close to 2.0% over the medium term.

The Eurozone recorded a slow 0.4% growth in Q2'2018, compared to a growth of 1.5% in Q2'2017, down from an average of 2.7% in the last two quarters of 2017. According to the September 2018 European

Central Bank (ECB) macroeconomic projections, the Eurozone annual real GDP is projected to increase by 2.0% in 2018, 1.8% in 2019 and 1.7% in 2020. This is a slight downward revision from the June 2018 projections, of 2.1% in 2018 and 1.9% in 2019, reflecting the impact of weakening global trade in leading world economies, compounded by the effect of the Euro's past appreciation.

Inflation decreased to 2.0% in August 2018 from 2.1% in July, with ECB foreseeing a further decrease to 1.7% in the remainder of 2018, 2019 and 2020. Underlying inflation is expected to pick up towards the end of the year and increase gradually over the medium term, supported by the ECB's monetary policy measures, the continuing economic expansion and rising wage growth. The unemployment rate declined to 8.2% in July 2018 from 9.1% in July 2017, which is the lowest level observed since Q4'2008, attributable to strong economic growth.

The Euro Stoxx 600 gained by 1.3% in Q2'2018, but has however declined by 1.54% YTD. The index is currently on a declining trend, driven by a plunge in Italian bank equity prices, whose big sovereign bond portfolios make them sensitive to political risk. This was after the Italian Government significantly widened its budget-deficit target for 2019 to 2.4% of GDP, which is three times higher than the number that the previous government had planned. The higher public spending could spark negative market reactions, given that Rome holds the second highest debt pile in the Eurozone after Greece, totalling EUR 2.3 tn (USD 2.7 tn), accounting for 131.8% of its GDP.

The ECB confirmed it will half its asset purchases to EUR 15.0 bn from EUR 30.0 bn per month as of October this year, and it's on track to end the program by year end. Thereafter, it intends to reinvest the principal payments from maturing securities, so as to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

In the medium term, we expect continued expansion of the Eurozone economy, which will be supported by (i) ECB's very accommodative monetary policy stance, (ii) increased growth in lending to the private sector, spurred by low interest rates and favourable bank lending conditions, and (iii) lower deleveraging needs, which will drive private expenditure boosting domestic demand, the economy's main growth driver.

**China:**

China’s economy grew by 1.8% q/q and 6.7% y/y in Q2’2018 compared to a 1.4 % expansion in Q1’2018. This was driven by (i) a pick-up in the pace of industrial production, (ii) an increase in private consumption, and (iii) increased investment in infrastructure. The economy is still expected to meet this year’s growth target of 6.5%, despite escalating trade tensions with the United States that worsened in September 2018. The U.S. President Donald Trump imposed a 10.0% tariff on USD 200.0 bn of Chinese imports, set to be increased to 25.0% on 1 January 2019, and China responded with duties of its own on USD 60.0 bn of U.S. products.

China's Consumer Price Index rose to a six-month high of 2.3% y/y in August of 2018 from 2.1% in the previous month and slightly above market consensus of 2.2%. The increase was driven by higher prices of food, clothing, rent, fuel and utilities, education, culture and recreation. However, it remained well below the Chinese Government’s target of around 3.0% for 2018. Annual average growth in industrial production, edged up from 6.4% in July to 6.5% in August. Despite the slight improvement in August, growth in industrial production remains sluggish and the trend could even worsen in the coming months when spill overs from the ongoing trade dispute with the United States start to kick in.

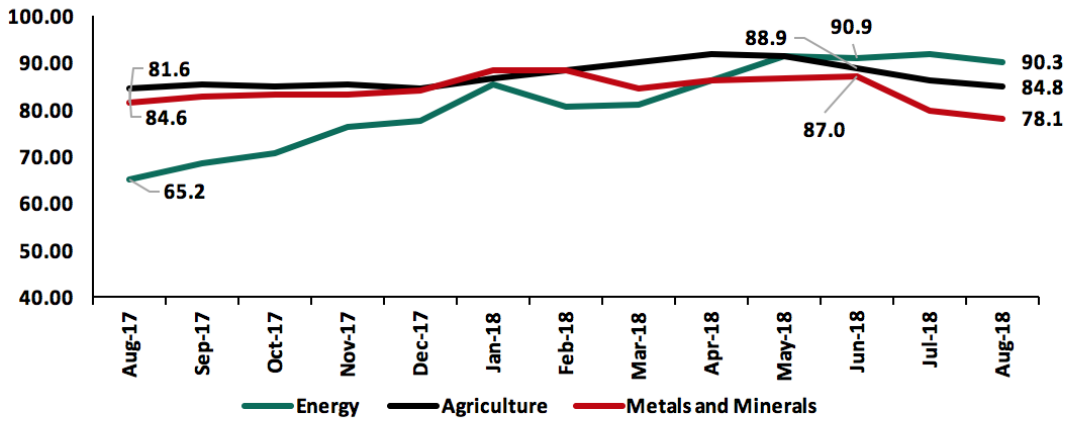
The Shanghai Composite Index retreated marginally by 0.9% during the quarter and declined by 15.6% on a YTD basis, the lowest level since 2014 amid trade policy uncertainty. This is due to the sustained effects of the ongoing trade wars with the United States. Downside risks to China’s economic outlook have increased amid escalating trade wars with the United States, a sudden slowdown in the property market and potential corporate defaults. However, the recent shift towards looser fiscal and monetary policy is expected to support domestic demand in the near term.

**Commodities:**

Global commodity prices declined by 2.5% y/y in August 2018 following July’s 7.3% decrease, representing the steepest fall in nearly 7-years. Prices for both Brent and WTI crude oil declined overall in August to USD 73.1 per barrel and USD 68.0 per barrel, respectively, from USD 74.4 per barrel and USD 70.8 per barrel, respectively, in July. This is attributable to the ongoing trade war between China and the U.S., and rising production by key producers including Russia and Saudi Arabia, after the relaxation of the agreed supply cuts. However, oil prices have risen steadily since mid-August following reports that Iranian oils exports had fallen ahead of the reintroduction of sanctions by the U.S., as well as concern regarding the adverse weather in the U.S.

Metals prices dropped throughout the summer by 3.0%, reflecting concerns about trade tensions and growth prospects in China. Agricultural prices fell in August by 1.8% due to ample supply for key commodities, including coffee and sugar. However, grains prices rose in August by 4.3%, driven by rising wheat prices, due to weather-hit harvests in Europe, Russia and some parts of Australia. Below is a chart showing the performance of select commodity price indices.

**World Bank Commodity Prices Indices**



***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.***

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