NO MORE US RATE HIKES THIS YEAR, SAYS MARKET

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ABOUT **THE AUTHOR**

Tinyiko is our young, up-and-coming and dynamic economist, working alongside Johann Els and Rian le Roux. It is her fresh take on everything to do with economics that adds original insight to our macroeconomic analysis.

KEY TAKEOUTS:

- MARKET JITTERS AS NORTH KOREAN SABRE-RATTLING INTENSIFIES
- GDP GROWTH IN MOST REGIONS EXCEEDS EXPECTATIONS
- MARKET POINTS TO US FED HOLDING OFF ON RATE HIKES
- EUROZONE RECOVERY SUGGESTS PULLING THE PLUG ON MONETARY STIMULUS

While growing tensions between the US and North Korea have been causing some market jitters, particularly across Asia, the primary focus has been more on the global economy and central banks than on politics. It's not so much that the market is being complacent and discounting the possibility of the tensions escalating into war, but rather because investors cannot ignore just how well the global economy has been performing over the past 18 months – and hence wonder whether Trump's focus on imposing sanctions is temporarily distracting him from focusing on implementing key fiscal measures to drive US growth.

On the economic front, second quarter global GDP growth was an annualised 3.8%, with most regions outperforming expectations. Notable mentions are the US, the Eurozone, Japan and Canada where growth rose to 3.0%, 2.2%, 4.0% and 4.5%, respectively. Nonetheless, emerging markets grew at 4.8% – with some economies (including Brazil) coming out of a recession.

THE RIGHT INGREDIENTS FOR SUSTAINED GROWTH

It's currently a "Goldilocks" economy, not too hot to cause inflation and not too cold to cause a recession. We cannot mention inflation without focusing on central banks…

At its July meeting, the US Federal Reserve (Fed)'s major concern was inflation, or rather the lack thereof. It stated that it was now expecting US inflation to remain below the 2% target in the medium term. Following weaker than expected employment data in August, the fed fund futures market is not expecting a rate hike in September and now places only a 47% probability for a December hike. This means the market appears to be discounting another rate hike in 2017, and that the focus will be on the US Fed's expected announcement at its next meeting to start unwinding its US$4.5 trillion balance sheet. Of course, a less hawkish Fed, as we mentioned in last month's review, means that the key lever for a stronger US dollar (i.e. rising interest rates) falls away.

JAPAN CAUTIONS ON RECENT GROWTH SPURT

Japan's second quarter GDP growth of 4% came off strong private consumption and a pickup in business investment – giving the market some hope that it will generate sustained inflation. However, in a statement from the Economic Policy Symposium in Jackson Hole, the Bank of Japan (BoJ) cautioned that the growth spurt was an anomaly. With July's inflation of 0.4% being far from the 2% target, we continue to hold our view that the BOJ will keep monetary policy extremely accommodative.

EUROPE EXPECTED TO PARE BACK ON BOND PURCHASING

The Eurozone's economic recovery makes it more difficult for the European Central Bank (ECB) to justify buying more bonds in its quantitative easing programme – which is why the market is growing increasingly confident that the ECB will announce plans to pare back the monetary stimulus in January 2018. This is expected to be debated at its September meeting, with a decision likely to be made at its October meeting. However, the strong euro – which breached the US$1.20 mark in August – is likely to keep inflation low (by driving import costs down) and hence pushing out the likelihood of lifting interest rates at all in 2018.

With global monetary policy remaining largely accommodative, global growth should remain solid in the third quarter. August's Manufacturing PMI data and a set of confidence surveys are already pointing to a strong start to the quarter. This, along with a weaker US dollar, continues to create a sweet spot for emerging markets.

All data sourced from FactSet