Truffle
Asset Management

Economic Commentary
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Signs of slowing in US

The US economy was buoyant through the second quarter; however negative economic surprises are revealing cracks. Historic payroll numbers are being revised down and the unemployment rate has risen to 4.1%. Consumers appear to have spent excess savings, built up over the pandemic period and the savings rate at 3.6% is now below pre-Covid levels. Higher rates on floating debt and tighter lending standards are creating a more challenging environment for borrowers, evident in rising credit card and auto loan delinquencies. Fixed long term mortgages remain shielded from the impact of tight monetary policy but higher rates on new mortgages remains a headwind for new property owners. Similarly, many corporates that are rolling debt will experience much higher rates.

Subdued private capex intentions, a high base of government spending (related to the Inflation Reduction Act) and lower emigration will also likely weigh on GDP growth next year. Although inflation has been sticky, on balance it appears to be declining which should give the Fed room to start its cutting cycle. Hence, bond rates are more likely to drift lower from here. Earnings revisions continue to drift up, although this is due to large capitalisation shares. These two factors could support what is a relatively expensive market in the short term.

The higher likelihood of a Trump presidency increases global geopolitical and economic risk. The worrying long-term trajectory of US debt may well result in Republicans restricting his ability to engage in meaningful stimulus measures that were done during his prior term.

China remains in the doldrums

Chinese equity markets rebounded in the second quarter, boosted by investor sentiment and government initiatives to support the real estate sector. However, a People's Bank of China survey in Q1 2024 showed that the percentage of people expecting home prices to fall further reached a record high (22%). Property rental yields remain low relative to the rest of the world. Although household completions are at reasonable levels, new starts continue to fall which will weigh on future GDP growth.

China consumer confidence remains low albeit stable. Chinese economic growth is supported by exports and manufacturing capex. Exports remain at risk from escalating trade tensions. As economic growth is still in an acceptable range, it seems unlikely that any significant stimulus would be forthcoming at the upcoming Third Plenum.

China's manufacturing activity remains resilient and emerging market manufacturing PMIs are in expansionary territory. This should provide support for commodities.

Momentum stalling in Europe

The ECB met market expectations with a June rate cut, however, core inflation appears to be coming down slower than expected, held up by services inflation. Consumption is low relative to pre-Covid levels and capital expenditure remains depressed. Although this could present an opportunity, the PMI is now only marginally in expansionary territory and looking weaker than in the first quarter. Given Trump's isolationist stance, the equity risk premium in Europe could increase.

South Africa's new political dawn

The recent elections were a watershed moment for South Africa and its democracy. The collapse in ANC support left the ruling party in unchartered territory with the task of not only finding a new leadership solution, but also including far larger opposition parties than initially thought.

Following two weeks of uncertainty and volatility as markets grappled with potential leadership outcomes, the formation of a Government of National Unity (GNU) was formally announced. The GNU, comprising the ANC, DA, IFP, GOOD, PA, PAC and recently the FF parties, will hold 70% of the National Assembly seats under the presidency of Cyril Ramaphosa. Markets have welcomed the outcome given the centrist anchor, policy stability, and the potential for greater commitment to economic reform and growth. The ALSI gained over 5% in two days of trading following the public announcement while the Rand strengthened to just below R18 to the USD.

Summary and outlook

Globally, inflationary pressures remain evident, but inflation does appear to be slowly gliding down. European policymakers have signaled divergence from the US with rate cuts at the start of June, but any significant shift in rates is unlikely to materialise until further signs of inflation being well under control are evident. Growth data for the US remains buoyant with reported GDP growth of 1.6% in Q1 2024 (annualized), however numerous factors are signaling a slowdown for the US economy.

Geopolitical risks across a number of regions remain elevated and continue to drive global economic uncertainty.

While the election fears have settled in South Africa, the new leadership structure and GNU dynamics still need to be bedded down following the recent formation of a new Cabinet. The GNU parties are committed to a workable approach and frankly need each other. While challenges will occur it remains important to distinguish between market noise driving volatility vs fundamental changes which could impact the longer-term outlook. From a macroeconomic perspective, continued improvement to energy security, reform of rail logistics, water and infrastructure remain critical to longer term economic growth in SA.

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Morningstar Awards were awarded to Truffle Asset Management (Pty) Ltd on 23 March 2022, 22 March 2023, and on 14 March 2024. Details available on request.

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