GLOBAL MACRO INSIGHT

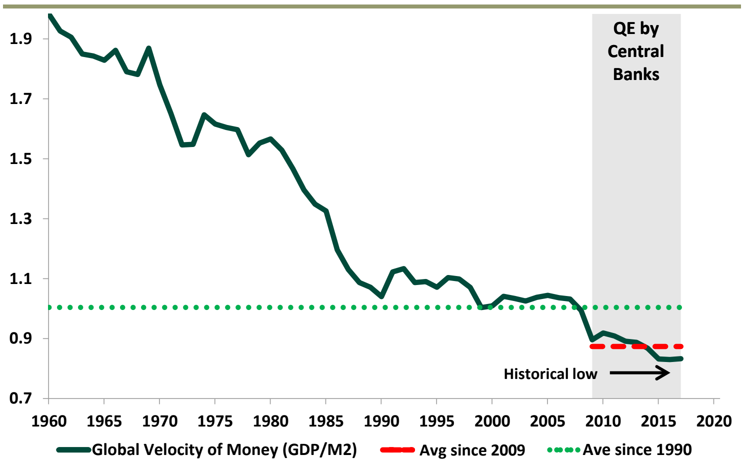
A FRAGILE GLOBAL ECONOMY: A FALLING VELOCITY OF MONEY

26 February 2019

Executive summary:

- The velocity of money has been falling for many decades. It accelerated to the downside during the 1970s as the world abandoned the gold standard and then remained stable from 1990 to 2008. Reserves (savings) held by exporting nations – for example, Japan, China, and Germany – contributed to the major savings glut since globalisation started, contributing substantially to this low velocity of money. After the global financial crisis (GFC), the velocity of money fell below 1, and central banks had no choice but to add to the monetary base to avoid deflation.
- This implies that central bank balance sheets will remain a permanent feature of monetary policy as long as velocity of money and policy rates remain this low. Even negative interest rates, which were supposed to force savers to spend, have failed to boost the velocity of money.
- As policy rates approached zero and the velocity of money moved below the important level of 1, the quantum of money and credit in the system became equally important to the price of money.
- Investment implications: If the velocity of money remains low, it would favour yielding assets over growth assets. The value of the USD would, as usual, be the real-time barometer to follow to see whether the softer tone taken by central banks would overcome the damage the contraction in the global monetary base and global trade caused last year.
- Target ranges: USD: A sustained break above 98 would indicate that the contraction in liquidity is continuing. Only a break below 92 would signal that the next major risk-on phase, similar to 2016 and 2017, is playing out.

Chart 1: Global velocity of money (growth in GDP/M2)



Source: DataStream, Nedbank CIB

Chart 1: Global velocity of money is currently below 1. This means that every dollar of monetary base and credit added to the financial system results in less than a dollar of GDP. This is a combination of weak global growth since 2009 and strong growth in the world's monetary base since then. This means that a large portion of money is either being saved (hoarded) or being used for balance sheet restoration. The world's money is trapped in the financial system, and confidence to invest in projects or to spend is low internationally; it is not just a South African story. As long as the velocity of money is below 1, the dominant threat would be deflation and not inflation. This is, therefore, an environment that favours bonds over equities.

Hence, in our view, the global velocity of money turned down in 2018 (see last chart). If the central banks want to add to GDP, which is the right side of the MV=PQ equation, they would have to cut policy rates or add to their balance sheets. The US and China are the only major economies that have room to move on interest rates.

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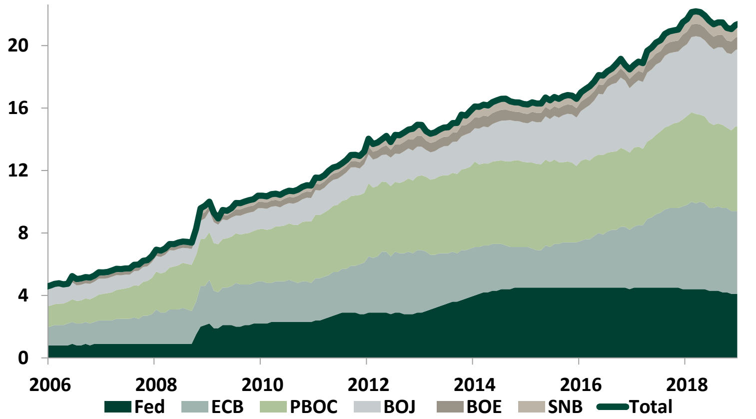
Chart 2: Stimulus by global central banks (USDtn)



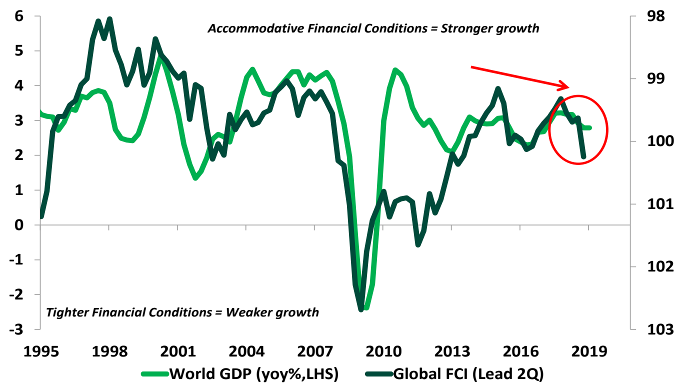
Source: DataStream, Nedbank CIB

Chart 2: Central bank balance sheets ballooned to USD21tn after the GFC. This was equivalent to a -8% policy rate for the world. This global GDP-weighted shadow rate rose rapidly last year as central banks either shrank or stopped adding to their balance sheets.

China has already started to ease financial conditions and has placed regulation of the shadow-banking system on the back burner. Its total social financing has rallied to a new all-time high on the back of easier conditions. As China added liquidity after the GFC, it triggered an extension of the commodity cycle, driving a rally in commodity prices from 2009 to 2011. These higher commodity prices added significant dollar liquidity to the global financial system, as commodities are traded in USD and the USD weakened over this period.

We believe the value of the USD would soon indicate whether the central banks can reverse the weakening global economy.

Chart 3: Global Financial conditions lead global growth



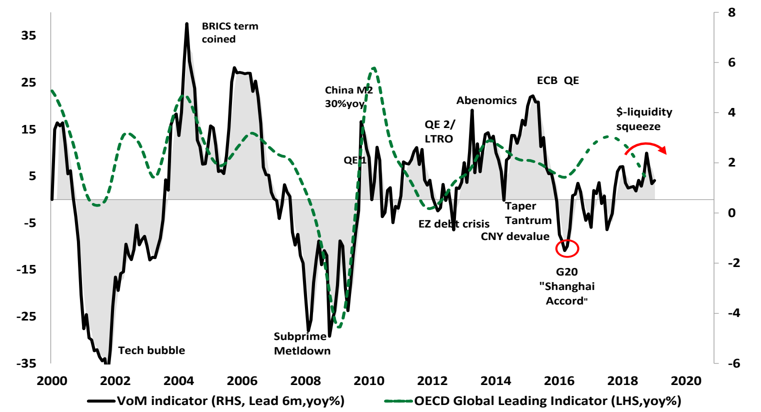
Source: DataStream, Nedbank CIB

Chart 3: As the Fed's balance sheets stopped growing in 2014, financial conditions tightened. On top of this, commodities topped out and oil, the biggest one of the lot, fell from USD100 per barrel to USD30. This contraction in liquidity forced the central banks and regulators to add liquidity in early 2016. Everything changed after the G20 meeting in Shanghai and a risk-on phase followed in 2017/18. Tighter monetary policy in 2018 – stemming from higher US policy rates and a slowdown in the global monetary base – has driven financial conditions back to 2016 lows. Many commentators are, therefore, saying it is time for Shanghai 2.0.

The equity market has already reacted as if the central banks have added liquidity, and has front-loaded a lot of the returns. Now it is a question of whether the central banks would follow through, how big the stimulus would be and whether it can overcome shrinking global trade that is leading to a contraction in global liquidity and economic growth.

The current trade negotiations between China and the US are, therefore, very important, but we must note that China's exports to the rest of the world have also slowed. The issue is more complex than just US-China tensions.

Chart 4: Nedbank's global velocity of money indicator



Source: DataStream , Nedbank CIB

Chart 4: The downside of the velocity of money number is that it is a quarterly backward-looking number. Therefore, we have developed a more real-time velocity of money indicator by which we monitor, for example, credit impulses, money multipliers and banks vs overall stock performance.

Our velocity of money indicator turned down in 2018 due to tighter financial conditions globally. The central banks will take centre stage over the coming weeks, and we will see whether the regulators are successful in turning our indicator back up again.

The long-term trend of this index, however, is a concern. Monetary policy has become more aggressive since the turn of the century, but every high in our indicator is lower, notwithstanding these massive stimulus packages. These stimulus packages have also caused the rand to become a price-taker amid these global financial conditions. If central banks flood the global system with liquidity, the carry trade (risk-on) takes centre stage and vice versa.

Key forecasts and target values

	Target values (period-end)				Broad trading range	
	3m	**6m**	**12m**	**Year-end**	**High**	**Low**
Fed funds	2.50	2.75	2.75	2.75	2.50	2.75
US 10-year bond yield	2.80	3.00	2.80	2.80	2.30	3.20
Repo rate	6.75	6.75	7.00	7.00	6.75	7.00
SA 10-year bond yield	9.20	9.60	9.40	9.40	8.60	9.70
R208 (%)	7.00	7.10	7.20	7.20	6.90	7.40
R186 (%)	8.90	9.30	9.10	9.10	8.30	9.40
R2048 (%)	10.00	10.20	10.30	10.30	9.50	10.50
EURUSD	1.16	1.12	1.14	1.14	1.16	1.12
USDZAR	13.50	14.20	14.10	14.10	14.40	13.50
EURZAR	15.66	15.96	16.00	16.00	16.19	15.66
GBPZAR	17.60	18.10	17.90	17.90	18.10	17.60
AUDZAR	9.80	10.10	10.00	10.00	10.20	9.80
Δ Global $-Liquidity	↔ to ↑	↔ to ↓	↓	↓	-	-

Nedbank CIB Markets Research/Nedbank Group Economics

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	5.00	4.90	5.30	5.40	5.30	5.20
SA core inflation	4.40	4.50	4.50	4.60	4.50	4.50
SA GDP	1.60	1.70	2.10	2.30	1.60	2.00
Current account as a % of GDP					-3.3	-3.6

South African Reserve Bank

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.60	4.70	4.80	4.80	4.80	5.30
SA core inflation	4.80	5.00	5.10	5.30	5.00	5.10
SA GDP	-	-	-	-	1.70	2.00
Current account as a % of GDP	-	-	-	-	-3.7	-4.1

National Treasury

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	-	-	-	-	5.60	5.40
SA core inflation	-	-	-	-	-	-
SA GDP	-	-	-	-	0.70	1.70
Current account as a % of GDP	-	-	-	-	-3.2	-3.7

All numbers in % unless otherwise indicated

Source: Nedbank CIB Markets Research, Nedbank Group Economics, SARB, NT

NEDBANK CIB

2019 Macro Calendar

JANUARY

Mo	Tu	We	Th	Fr	Sa	Su
31	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31	1	2	3
4	5	6	7	8	9	10

17th Jan: SA MPC
24th Jan: ECB meeting
22-25 Jan WEF Davos
30 Jan: Fed FOMC

FEBRUARY

Mo	Tu	We	Th	Fr	Sa	Su
28	29	30	31	1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	1	2	3
4	5	6	7	8	9	10

7th Feb: BoE Meeting
7th Feb: SA SONA
13th-14th Feb: UK Mps to vote on Brexit
16th Feb: Nigeria election
20th Feb: SA budget

MARCH

Mo	Tu	We	Th	Fr	Sa	Su
25	26	27	28	1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31
1	2	3	4	5	6	7

1st Mar: End of 90-day trade truce US-China
7th Mar: ECB Meeting
15th Mar: BoJ Meeting
20th Mar: FOMC Meeting
21st Mar: BoE Meeting
29th Mar: Brexit deadline (A50)

APRIL

Mo	Tu	We	Th	Fr	Sa	Su
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5
6	7	8	9	10	11	12

10th Apr: ECB Meeting
12-14th Apr: World Bank & IMF meet
17th Apr: Indonesia election
25th Apr: BoJ Meeting
April/May: India election

MAY

Mo	Tu	We	Th	Fr	Sa	Su
29	30	1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31	1	2
3	4	5	6	7	8	9

1st May: FOMC Meeting
2nd May: BoE Meeting
23-36th May: European Parlimentary election
26th May: Belguim election
May-August: South African election

JUNE

Mo	Tu	We	Th	Fr	Sa	Su
27	28	29	30	31	1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
1	2	3	4	5	6	7

6th June: ECB Meeting
19th June: FOMC Meeting
20th June: BoE and BoJ Meeting
28-29th June: G20 Summit

JULY

Mo	Tu	We	Th	Fr	Sa	Su
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31	1	2	3	4
5	6	7	8	9	10	11

18th July: SA MPC
25th July: ECB Meeting
30th July: BoJ Meeting
31st July: FOMC Meeting

AUGUST

Mo	Tu	We	Th	Fr	Sa	Su
29	30	31	1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	1
2	3	4	5	6	7	8

1st Augut: BoE Meeting
25-27th Aug: G7 Summit

SEPTEMBER

Mo	Tu	We	Th	Fr	Sa	Su
26	27	28	29	30	31	1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	1	2	3	4	5	6

12th Sep: ECB Meeting
18th Sep: FOMC Meeting
19th Sep: SA MPC
19th Sep: BoE and BoJ Meeting

OCTOBER

Mo	Tu	We	Th	Fr	Sa	Su
30	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31	1	2	3
4	5	6	7	8	9	10

18-20th Oct: World Bank and IMF meet
23rd Oct: SA MTBPS
24th Oct: ECB Meeting
27th Oct: Argentina election
30th Oct: FOMC Meeting
31st Oct: BoJ Meeting, End of term for ECG President (Draghi) and EC President (Juncker)

NOVEMBER

Mo	Tu	We	Th	Fr	Sa	Su
28	29	30	31	1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	1
2	3	4	5	6	7	8

7 Nov: BoE Meeting
22 Nov: S&P/Fitch review SA credit rating

DECEMBER

Mo	Tu	We	Th	Fr	Sa	Su
25	26	27	28	29	30	1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31	1	2	3	4	5

11th Dec: FOMC Meeting
12th Dec: ECB Meeting
19th Dec: BoJ Meeting

Central Bank Meeting
World Summit/IMF/Trade war/Political
Election

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