



SA ON THE **SLOW MEND**

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ABOUT **THE AUTHOR**

As Chief Economist, Johann is responsible for all local and global macroeconomic research. Specific focus areas include the rand, inflation, interest rates and fiscal matters.

After experiencing increasingly volatile markets during the latter months of 2018 – mostly on the back of recession fear, worries about a full-scale trade war, the Chinese economic slowdown and uncertainty around the US interest rate cycle – some measure of calm returned late in December and into January 2019. This was thanks to the prospect of some trade agreement between the US and China as talks got under way, more Chinese policy measures to stimulate their economy, and the increasing likelihood that the US Federal Reserve Board (Fed) will pause their interest rate hiking cycle.

US-CHINA TRADE TALKS GET SERIOUS

Following agreement between Presidents Trump and Xi at the G20 meetings in Argentina in December that a US/China trade deal will be pursued, a first round of talks has taken place. There seems to be a real willingness to get a deal done as realisation of the potential damage of a trade war to the global economy seems to have focused the minds. Also, in the wake of slowing Chinese data, the Chinese authorities have continued with policy measures to stabilise the economy, including another cut in the reserve requirement ratio (RRR) rate – the ratio of bank reserves that must be held at the central bank, the People's Bank of China (PBoC). Reducing this rate essentially injects more money into the economy. Further policy stimulation is set to come from more RRR cuts, VAT rate cuts and increased government spending by expanding the fiscal deficit – through a combination of tax cuts and increased spending, as well as frontloading municipal infrastructure spending.

FED TAKES A PATIENT APPROACH

Another factor that eased some of the extreme fears was the increased sense that the US Fed might not raise interest rates at the same pace as they did during 2018 (that is, four hikes of 25 basis points each). The Fed's monetary policy committee, the Federal Open Market Committee (FOMC), communicated a somewhat more dovish message after their December meeting. Not only was

KEY TAKEOUTS

- **STRONG LABOUR MARKET AND RESTRAINED FED EASE US RECESSION FEARS**
- **CHINA TAKES STEPS TO REVIVE GROWTH**
- **RECENT DATA BRINGS HOPE THAT SA ECONOMY IS IMPROVING**
- **SA RATES TO REMAIN ON HOLD IN 2019**



the number of possible rate increases for 2019 reduced in the so-called “dot plot” (essentially the forecast of the FOMC members), but Fed chairman Jerome Powell has since stated that they can afford to be patient in an environment where inflation remains muted. He even indicated that the Fed might be willing to rethink the pace of balance sheet adjustment.

The minutes of the December FOMC meeting also highlighted this willingness to be patient – especially in an environment where global risks could potentially influence the US economy. While a patient Fed will be a positive in terms of reducing recession fears, the latest US employment data also restored some calm, highlighting that the economy is still robust and the labour market strong.

I remain of the opinion that recession risk remains low and that growth rotation from the US to elsewhere should mean better balanced and more synchronised growth – albeit at a slower pace. With the end of the US rate hiking cycle in sight, I expect a weaker US dollar during 2019 – around US\$1.25 to US\$1.30 per euro by end of 2019, from a level of US\$1.15/€ at the time of writing, is not far-fetched at all. This will be a good environment for emerging markets in general and South Africa in particular.

GREEN SHOOTS IN SA ECONOMY

While South Africa’s economy remains stuck in a low confidence and weak growth environment with lots of risks, the data over the very short term seems to have improved a bit. The global improvement highlighted above has certainly helped – impacting the rand and petrol prices and thus the inflation outlook substantially.

The latest growth data points to a positive GDP number in the fourth quarter of 2018. While a full data set is not yet available, preliminary numbers show that mining and manufacturing production should be up nicely from the third quarter (Q3) average. Mining production for October was up 18% on an annualised basis from Q3 and manufacturing production for October and November was up 4% on the same basis. While electricity production for October and November was up close to 3% on this basis, the load shedding impact will likely shave a large portion off this number in December. In addition, the latest leading indicator, as calculated by the South African Reserve Bank (SARB), also ticked higher after a number of months of decline.

LOWER CPI TO KEEP RATES IN CHECK

Following several months of large petrol price increases during 2018, the fall in international oil prices and the more stable rand exchange rate led to significant petrol price declines in December and January. Underlying inflationary pressures have been weak – as evidenced by the core inflation rate (4.4% in November 2018), inflation excluding administered prices (3.8% in November) and the retail sales price deflator (2.3% in October 2018). As explained before, in a weak growth environment, businesses find it difficult to pass on price increases to consumers, hence the very weak pass-through of rand weakness into final consumer prices. Following the 5.2% headline inflation rate in November last year, the large petrol price declines will likely see headline inflation falling to 4.5% in December and 4.2% in January 2019. I maintain my below-consensus forecast of a 4.8% CPI inflation average for 2019.

While I still believe, as explained last month, that the Reserve Bank did not need to hike interest rates in November 2018 (given the weak growth environment and prospects for continued low inflation), I expect rates to remain on hold throughout 2019, for the same reasons. Both the market consensus and the Reserve Bank’s forecast for inflation are too high and will need to be revised lower. While I expect some growth improvement, the bulk of this will likely only occur after the elections, that is, during the second half of the year. The potential impact of stronger growth on pricing ability and thus inflation is therefore likely only to manifest during 2020.

My expectations for a better balanced global growth outlook, a slower US Fed and weaker US dollar, combined with a post-election confidence improvement in South Africa, should lead to a stronger rand exchange rate during 2019. This will aid confidence and the inflation trajectory.

A better global environment, including an improved environment for emerging economies, should help SA through a stronger rand exchange rate. Some growth and balance of payments benefits should also follow. Despite risks around growth, a cyclical uptick should continue during 2019, aided by improved post-election confidence. Growth should improve from below 1% in 2018 to around 2% in 2019. Low inflation should lead to unchanged interest rates this year. ■