



ECONOMIC OVERVIEW AND OUTLOOK

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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.

KEY TAKEOUTS

- THE IMPACT OF THE PROLONGED AND RAPIDLY ESCALATING TRADE WAR HAS DAMPENED THE GLOBAL ECONOMY.
- EFFORTS TO STABILISE BUSINESS SENTIMENT HAVE RESULTED IN POLICY EASING BY CENTRAL BANKS ACROSS THE GLOBE.
- THE WEAKER-THAN-EXPECTED LOCAL ECONOMY HAS MEANT A HUGE GAP IN NATIONAL TREASURY'S TAX REVENUE.
- POSITIVE LOCAL GDP GROWTH IS EXPECTED IN THE NEXT FIVE YEARS.



GLOBAL ECONOMY

It may not be quite accurate to describe the third quarter of 2019 as dismal, at least not as far as the global economy is concerned. However, for a South African thinking back to the confluence of global and local bad news over the past quarter, that description is probably spot on. While global events certainly contributed to this significantly depressed sentiment, it has not been quite as downbeat as in South Africa.

The global economy can no longer be expected to be “more balanced and more synchronised” as per my base case outlook at the start of the year. The impact of the prolonged and rapidly escalating trade war (based on the rhetoric during the past few months) put an end to that expectation. As we discussed previously, the actual higher trade tariffs have a relatively limited impact on growth. It is rather the damage to business sentiment that hurts growth through lower business spending. It seems the impact on goods producing industries (manufacturing purchasing manager indices (PMIs) having slipped substantially) has started to spill over into slower job growth. Now, while this is risky for the outlook – as it could impact on consumer spending – at least it also seems that manufacturing output is stabilising at these lower levels, rather than weakening further.

One factor helping to stabilise business sentiment has been the further policy easing by central banks across the globe. The second quarter saw an easing policy bias steadily building across the world and this trend extended to more rate cuts in the third quarter. There have now been 31 rate cuts since April – with 22 of those in the third quarter. These include multiple cuts in some countries, namely Australia, New Zealand, India, the Philippines, Indonesia, Brazil and Chile. Apart from the two cuts in the USA, the European Central Bank also cut rates deeper into negative territory and restarted their QE policy. While China has not yet cut the main policy interest rate, some interest rate liberalisation and reserve ratio requirement rate cuts have been added to some fiscal easing to support the economy.

A large part of this policy action – at least in terms of messaging – was the two rate cuts in the USA. While the Federal Reserve Board (the Fed) initially labelled their July interest rate cut a “mid-cycle policy adjustment” and “not the start of an easing cycle”, the evolving data and events through the third quarter changed this in the minds of the members of the Federal Open Market Committee (FOMC) and they cut rates again in September. Another cut is likely before the end of this year, while incoming economic data and events around the trade war will determine if there will be further cuts.

While easier policy will certainly help the global economy, it will not be enough on its own to engineer a stronger economic recovery. Confidence will only recover sufficiently once the trade war has been resolved. Despite the volatile messaging around the trade war, it still seems that both sides want a deal.

Outlook for the global economy: Recession risks have heightened over the past quarter, but a recession is still unlikely. Ongoing policy support should help to stabilise sentiment and growth prospects. However, a trade deal is needed to lift growth prospects.

SA ECONOMY

As I hinted at in the first paragraph of this overview, most South Africans have probably felt a lot of despair recently. Not only has the world economy become riskier – as a reminder, it's very difficult for South Africa to do well when the global economy is not supportive – but local events have not exactly turned out the way we would have wanted. In fact, most local events have been downright nasty.

Many of us assumed – perhaps unrealistically – that policy reform would happen far quicker after the May elections than has been the case. In actuality, we have not seen any significant structural policy adjustment. On the contrary, most policy changes have been perceived as negative – i.e. the National Health Insurance scheme, debt relief regulations and the prescribed asset talks come to mind.

The weaker-than-expected economy has also meant a huge gap in National Treasury's tax revenue, while the financial challenges at Eskom were found to be bigger than even the worst-case scenarios and therefore needed even more money from Treasury to survive. Consequently, the outlook for the budget deficit is now significantly worse than expected. A deficit of around 6% of GDP is now likely as opposed to the 4.5% estimated at the time of the February Budget.

This, combined with the lack of growth-enhancing policies and no news on a restructuring plan for Eskom and its debt, has raised fears that Moody's could potentially downgrade its outlook statement from stable to negative this November. Equities, bonds, the rand and business confidence seem to have priced a large portion of these risks.

There has been some positive news – albeit mostly obscured by the bad. This includes a stronger-than-expected rebound in the second quarter GDP growth; a rate cut by the South African Reserve Bank (SARB) in July; the publication of Treasury's economic plan to lift growth (while not implemented yet, it has crucially restarted the policy debate); Treasury's instruction to government departments to cut expenditure in the medium-term expenditure plans by 5% in 2020/21, 6% in 2021/22 and 7% in 2022/23; stronger mortgage credit

extended to households over the last few months; continued strong car exports; a stronger leading indicator in the latest reading; some early indications of a tentative profit growth recovery in the manufacturing, finance and retail sectors and the latest wholesale sales data, which could perhaps indicate some early signs of inventory rebuilding.

We should also not forget that the slow process of rebuilding the state under the new administration, the corruption fight and the strengthening of SA's institutions are ongoing. The lights have remained on over the last several months, growth has picked up from the dismal first quarter, inflation remains low and interest rates could potentially be lowered again later this year. So, despite all the despair and uncertainty, I still believe the "Winds of Change" investment theme is on track. Thus, the next five years are very likely to be better than the past five (average growth from 2015 to 2019 will end up at less than 1% per annum). While we are unlikely to experience the 5.2% average annual growth SA registered from 2004 to 2007 again anytime soon, a more sustainable growth uplift towards 2.5% (even 3%) is very likely by 2022/2023.

Inflation remains muted, with almost no evidence of second-round price pressures despite significant cost increases in areas such as electricity and petrol. A

more dovish global monetary policy stance, combined with local growth downside surprises and muted inflation, has led to an easier policy stance at the SARB and they duly cut rates in July (a reversal of the policy error that was the November 2018 rate hike). The Bank did not cut rates at the September policy meeting due to the risks around Eskom, the Budget and a potential Moody's outlook change. Should these risks unfold in a positive manner, a rate cut in November seems likely.

Outlook for the SA economy:

While a general sense of despair has set in over the last few months, I still believe that the renewal and rebuilding of the state, the corruption fight, the strengthening of SA's institutions, the policy debate and other smaller changes will gather momentum and get some traction with respect to building confidence and lifting growth. Given all the changes of the last 20 months, I expect the next five years to be better than the past five.

