



SLOWING GLOBAL GROWTH SEES CENTRAL BANKS SLIDE BACK INTO EASY MONETARY POLICY

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ABOUT THE AUTHOR

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GLOBAL ECONOMY: CENTRAL BANKS TAKE A WAIT-AND-SEE APPROACH

During the past quarter, one of the common threads in the global economy was the sustained easing in global financial conditions – thanks largely to the US Federal Reserve Board (Fed)’s so-called “policy pivot” and policy easing in China. The US Fed dropped its tightening bias at its first meeting of the year and increasingly talked about being more patient regarding policy tightening. Worries about slowing growth, subdued inflation, global trade wars and slower global growth conditions played a big role in this shift in thinking.

At its March policy meeting, the US Fed indicated (by way of its so-called dot plot) that the members of the Federal Open Market Committee (FOMC) expect interest rates to remain unchanged throughout 2019. It also announced a tapering of its balance sheet normalisation (meaning that the reversal of quantitative easing, or QE, will be slowed) from May onwards, and that it will be halted by September. This will be an important factor in a better outlook for emerging markets, which have been under pressure while QE has been reversed.

The US Fed’s easier policy stance is also promoting a broader easing in global monetary policy.

KEY TAKEOUTS



- POLICYMAKERS STEP AWAY FROM MONETARY TIGHTENING
- US FED’S U-TURN ON QE IS GOOD FOR EMERGING MARKETS
- SA GROWTH OUTLOOK IS IMPROVING (IF THE LIGHTS STAY ON)
- MOODY’S DEFERS SA RATINGS DECISION
- LIMITED PRICING POWER WILL KEEP CPI LOW

Meanwhile, China has continued on the easing path that was started last year. More policy easing is likely on the way should growth not stabilise and rebound soon.

RATE FREEZE WILL LEAD TO A WEAKER DOLLAR

All of the above has been in line with my base-case view for the world economy: slower, but better balanced and more synchronised growth (that is, slower US growth and better growth elsewhere, including the euro area and China) and a slower interest rate hiking cycle in the US (it now seems as if rates might actually stay flat, or even be lowered). Under these circumstances, the US dollar is likely to weaken. The environment for emerging markets should improve from that of 2018, when the global economy was “unbalanced” (strong US growth and weaker growth elsewhere) and higher US rates led to a strong US dollar.

The biggest risk to this view is probably sustained weak euro-area growth. While the region remained relatively weak during most of the first quarter of this year, recent signals have been slightly more positive, with some of the forward-looking indicators starting to stabilise.

Some recession risk (globally and in the US) remains, but improved conditions have lessened the probability – as most of the potential negatives have eased. Trade talks between the US and China have been ongoing and the latest news suggests that there might be a deal in the offing within the next month or so. Brexit has been an ongoing soap opera, but it seems that there is at least a willingness to try and prevent a no-deal exit.

OUTLOOK FOR THE GLOBAL ECONOMY

I remain of the opinion that recession risk is still low and that growth rotation from the US to elsewhere should mean better balanced and more synchronised growth – albeit at a somewhat slower pace than in 2018. With the US rate hiking cycle seemingly having come to an end, I expect a weaker US dollar during 2019 (this has been the outstanding item in terms of my expectations for the year). The US dollar could potentially weaken towards US\$1.25 to US\$1.30 per euro by year-end from

a level of US\$1.12 at the time of writing. This will be a far better environment for emerging markets in general, and South Africa in particular.

SA ECONOMY: WINDS OF CHANGE FAN EMBERS OF OPTIMISM

It has been an eventful start to the year for South Africa. While most attention was focused on issues around economic growth, the annual budget, credit ratings, politics and the upcoming elections, the South African Reserve Bank (SARB)’s policy shift and the inflation rate also played a prominent part in the economic discussion.

Before I discuss this in a bit more detail, I want to reiterate that I am still convinced that the South Africa of the next few years will likely be a significant improvement on the SA of the past five years. The “winds of change” investment theme is alive and well. While there has been lots of uncertainty, risks and volatility, it is a big part of my job to try to look through the current volatility and uncertainty towards the medium and longer term. I have seen more and more signs of the headwinds that have been holding us back dying down and even turning into tailwinds pushing us forward.

I still expect the election outcome to be conducive to accelerated policy reform, and the resultant return of confidence, and a better outlook for the economy. Combined with the global environment sketched above, this could lead to a substantial strengthening of the rand exchange rate.

Probably the biggest event thus far this year was the annual Budget in February. This was again a disappointment, as the budget deficit ratio, the debt ratio and the expenditure ceiling were all higher than expected. The two main factors behind this were continued slow economic growth and the cost of the Eskom bailout package. While the Budget was disappointing in terms of the numbers, the Eskom support was viewed as positive. President Ramaphosa already announced in the State of the Nation Address that Eskom would be split into separate companies, and the Budget spelled out the financial aid to Eskom. On a positive note, Government will not take on any of

Eskom's debt, but will rather give financial support over the next 10 years. Encouragingly, this will partly be financed from cutbacks in public sector wage spending. The appointment of a Chief Reorganisation Officer to oversee Eskom's separation process was also a welcome step.

Economic data at the start of the year was rather weak, confidence remains at dismal levels and the latest forward-looking indicators (the Purchasing Managers' Index and the Reserve Bank's leading indicator index) suggest downside risk. However, a slow cyclical economic recovery should gather some pace after the elections in May. Economic growth could lift somewhat from the 0.7% recorded in 2018 to 1.5% in 2019. The risk here is extended and severe load shedding that could dampen growth.

Despite risk emanating from load shedding, weak growth, the fiscal position and weak state-owned enterprises, ratings agency Moody's kept the outlook on SA's investment grade debt unchanged. In all likelihood, it will reassess the economy and policies after the May elections.

Inflation continued to surprise on the downside over the past several months. From a high of 5.2% year on year in November 2018, inflation reached 4.5% in March this year. While recent cost increases (electricity, petrol etc.) will place upward pressure on inflation, there is very little second-round pressure coming through in

this weak economy. I maintain that the current circumstances are very deflationary as there is virtually no room to pass on cost increases to consumers. My inflation forecast for this year (4.4%) is now below last year's average (4.6%). For 2020, I forecast inflation of 4.7%. If this plays out, it would be the lowest three-year average inflation rate in many decades.

In fact, should downside growth risk increase and inflation continue to decelerate, an interest rate cut(s) could come back on the cards. This brings me to the SARB's own policy pivot, which was so much larger than the US Fed's, as discussed above. The SARB has gone from a rate hike in November to a much more dovish stance in the past two policy meetings. To some extent, it was assisted by the Fed's pivot and (late last year/early this year) by a lower oil price, but to a large extent the SARB might have been too focused on potential risks that did not materialise.

OUTLOOK FOR THE SA ECONOMY

A better global environment, including an improved environment for emerging economies, should help SA this year. A good election outcome and improved post-election confidence will also help. I expect growth to slowly gather pace in the second half of the year and inflation to remain subdued. A case could be made for an interest rate cut should growth and inflation continue on the downside. For now, I expect a strong rand later this year and flat interest rates.

