A HEALTHIER WORLD EXPECTED IN 2019, SA TO BENEFIT

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Markets have become increasingly volatile recently, on the back of risks around late-cycle global growth and the concomitant possibility of a US, or even global, recession, the ongoing risks associated with a full-scale trade war and uncertainty around the US interest rate cycle into 2019.

Global growth in 2018 has indeed been far less synchronised and balanced compared with 2016 and 2017 – with the US experiencing strong growth, while the euro area, China and other emerging economies have been showing signs of slowing. This has led to a strong US dollar during 2018.

When looking forward to 2019, it is important to note that late-cycle global growth does not automatically mean recession. We expect a growth rotation away from the US – that is, somewhat slower growth in the US economy versus a bit better growth in the euro area, China and other emerging markets. While overall global growth will slow through 2019 and into 2020, growth will likely be more balanced and, once again, more synchronised – and thus healthier than during the unbalanced 2018.

A TURNING POINT FOR US RATE HIKES

The end of the US interest rate hiking cycle is in sight. This does not mean it has ended, but that there is now more visibility towards the end of the hiking cycle. Not only will the US economy likely grow at a slower pace during 2019 – interest rate sensitive sectors such as housing have already shown clear signs of slowing – but the underlying pace of consumer inflation (including the US Federal Reserve's preferred inflation measure, the core personal consumption expenditure (PCE) deflator) has started slowing recently. The strong US dollar and lower commodity prices will likely outweigh the impact of higher trade tariffs on inflation.

Increasingly, more frequent comments from US Federal Reserve (Fed) officials, including the chairman, have highlighted the fact that they are considering the impact of not only slower US growth, but also slower and unbalanced global growth, as well as the level of US policy interest rates and the fact that they might need to signal more data dependency in their policy meeting statements. We expect the US Fed to ease off their pace of four rate hikes during 2018 to only two hikes in 2019. The outcome of more balanced global growth and a tamer US Fed is likely to be a weaker US dollar during 2019. The US dollar could reach a range of US$1.25 to US$1.30 per euro by the end of 2019, from a level of US$1.14/€ at the time of writing.

While the lower oil price and the 90-day trade truce between the US and China will help, these issues remain risks for the global economy and bear close monitoring.

KEY TAKEOUTS

- MORE BALANCED GLOBAL GROWTH EXPECTED, AS US SLOWS
- FEAR OF AGGRESSIVE US RATE HIKES SUBSIDES
- CHEAPER OIL AND WEAKER US DOLLAR WILL BENEFIT EMERGING MARKETS
- SA INFLATION TO REMAIN SUBDUED, DELAYING RATE HIKES

OUTLOOK IMPROVES FOR EMERGING MARKETS

Receding global headwinds, lower oil prices, a weaker US dollar, a stable China and a better policy mix present a better overall environment for emerging economies. In turn, this will help support the rand. (More on the rand a bit later.)

While we all agree that progress towards a better growth outlook for South Africa has been painfully slow, some progress has indeed been made with respect to cabinet changes, new boards at state-owned enterprises, commissions of enquiry into state capture and SARS, finalisation of the mining charter, a new head of the National Prosecuting Authority and the President's investment plan. While many risks remain and decisive policy adjustments are delayed until after the 2019 elections, these changes should help to at least stabilise confidence amongst businesses, consumers and investors.

SA GROWTH LIKELY TO LIFT IN 2019

While economic growth remains weak even after the swing out of recession, with 2.2% annualised GDP growth in the third quarter, we expect the slow cyclical uptick in the economy to remain on track and expect better growth during 2019. From 2017's 1.3% growth, we expect a rather dismal growth rate of 0.9% in 2018, rising to 2% in 2019. While there are certainly downside growth risks (think weak confidence and electricity shortfalls), a decent global environment, low local inflation, post-election sentiment improvement and pent-up investment demand could help in elevating the cyclical growth rebound.

DEFLATIONARY ENVIRONMENT PUTS LID ON RATE HIKES

The SA Reserve Bank (SARB)'s interest rate increase in November was a close call, also reflecting to a large extent the view of the market. With weak growth, very weak pricing power by businesses and recent cost increases, the environment is indeed very deflationary. Measured inflation has continually surprised on the downside during 2018, as very little of the rand's effect was passed on to consumer prices. Similarly, the petrol price increases from April to October have limited consumer discretionary spending, further exacerbating the deflationary environment. Clearly, the SARB was in a risk-containing exercise, worried about a global slowdown, the US rates cycle and the potential impact on the rand. As highlighted above, most of these risks could turn out the other way.

I also expect this deflationary environment to continue in 2019, with the better growth only impacting price pressures more decisively in 2020. Apart from the deflationary environment, the sharp petrol price decline in December and another large decline of around 50 cents a litre expected in January 2019 (the biggest two-month decline since the R2.95/litre total price decline in December 2008 and January 2009) will markedly pull down the 2019 inflation average. With food price inflation also expected to perform relatively modestly during next year, inflation should average 4.8% in 2019 – compared with the SARB's forecast of 5.5%. To my mind, this leaves little room for further rate increases and I thus expect the Reserve Bank to pause for an extended period.

A STEADY AND STRONGER ZAR IN 2019

The likelihood of a more balanced global growth outlook and weaker US dollar (as mentioned above), combined with a confidence boost in South Africa should policy reforms return in earnest after a likely good ANC election outcome, should thus lead to a sharply stronger rand exchange rate during 2019. An exchange rate close to or around R12.00 (or even stronger) to the US dollar will not be a surprise. Although this strength will likely be short term in nature, I do expect a positive SA scenario to lead to a more stable exchange rate over the next few years. But the rand will, in all likelihood, maintain a weakening path on a medium- to long-term basis, due to inflation differentials.

From an investment perspective, it is important to note that the slower world and better SA outlook mean that SA assets should outperform global assets, and thus it could be rather dangerous to take all your money offshore. In a diversified balanced fund, this scenario should mean overweight SA assets and underweight offshore. ■