SIGNS OF AN IMPROVING GROWTH **OUTLOOK START TO EMERGE**

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ABOUT **THE AUTHOR**

Tinyiko is our young, up-and-coming and dynamic economist, working alongside Johann Els and Rian le Roux. It is her fresh take on everything to do with economics that adds original insight to our macroeconomic analysis.

February was an eventful month. In our previous commentary, we cautioned investors on being too optimistic about Cyril Ramaphosa's election as ANC president, as there were some key changes in Government that needed to happen in order for us to be convinced that the prospects of policy reform would indeed take hold. In a surprise statement late on the 14th of February, Jacob Zuma announced his resignation and a day later Cyril Ramaphosa was sworn in as the President of South Africa. In our view, this was a big positive for a market-friendly shift in politics.

The second key change that we were eager to witness was the replacement of the Finance Minister in order to restore

KEY TAKEOUTS

- FINALLY, A MARKET-FRIENDLY SHIFT IN POLITICS
- SARB TO CUT RATES DESPITE VAT'S IMPACT ON CPI
- CONSUMER SPENDING AND PRIVATE INVESTMENT SET TO RISE

some credibility in National Treasury. While the ratings agencies are sympathetic to our growth challenges, a deterioration in leadership at a key institution that previously contributed to our prized investment grade rating didn't help. Malusi Gigaba has now been replaced by former Finance Minister Nhlanhla Nene. Zuma axed Nene in December 2015, an act that precipitated the domino effect of multiple downgrades by ratings agencies Fitch, S&P and Moody's. The return of Nene provides the reassurance that National Treasury will continue on the path of fiscal consolidation, as outlined in the National Budget review by Rian on page 11.

Other recent ministerial changes include the appointments of Gwede Mantashe, Pravin Gordhan and Jeff Radebe in three key ministries, namely the Ministry of Mineral Resources, Ministry of Public Enterprises and the Ministry of Energy, respectively. In our view, this cabinet shake-up, along with a return of tighter fiscal policy, has removed the possibility of a Moody's downgrade in March, and with it the imminent risk of an exclusion from the Citi World Government Bond Index (WGBI). We believe that Moody's will remove their negative watch and still maintain their negative outlook on South Africa. A shift to a stable outlook by Moody's will be positive for the rand, which has already firmed sharply since Ramaphosa's win at the ANC December elective conference.

VAT-INDUCED CPI WILL NOT DETER SARB

A firm and stable rand will aid in keeping inflation pressures low. Headline inflation dropped to a low of 4.4%, which is just below the mid-point of the South African Reserve Bank (SARB)'s inflation target range of 3% to 6%. A continuation of this trend, and the combination of tighter fiscal policy, has raised the prospects of the SARB cutting the repo rate as early as March. Following the one percentage point VAT increase announcement in the Budget, we've had to revise our 2018 average inflation forecast marginally higher from 4.4% to 4.6%. However, we still believe that the SARB will look through the VAT-induced higher inflation for 2018 and still cut rates from March. We currently have two 25 basis point rate cuts in our forecast for this year.

GROWTH DRIVERS ARE STARTING TO EMERGE

Lower inflation and lower interest rates should boost consumption, which we believe will drive growth for this year through a pick-up in real disposable income. The lower income decile group should continue to benefit the most in this environment, where inflation has been averaging 2% and lower. The upside surprise to growth could very well come from a renewed boost in household credit extensions, which has been depressed for quite some time. A combination of lower interest rates and local banks that are now willing to extend credit as a result of an improved macroeconomic environment, should pave the way for a rebound in household credit extensions.

Another upside surprise to growth could come in the form of a rebound in private investment. In the Bureau of Economic Research Business Confidence survey, more than 80% of respondents pointed to politics as being a key constraint to investment. Now that we are seeing incremental improvements in the political environment, business confidence could very well return and lead to an increase in real private investment. One anecdotal event supporting our assertion is the Chamber of Mines' recent suspension of its court review of the Mining Charter, as they are now having progressive engagements with the presidency. A continuation of such engagements, and clearer policies going forward, will create a pro-investment environment and hence boost growth.

STRONG POLICY IMPLEMENTATION STILL NEEDED

While the improved political backdrop provides for a slightly more positive outlook for 2018, the long-term structural story still remains uncertain and will require some strong policy implementation to revitalise depressed sectors, such as mining and manufacturing, in order to absorb the large number of unemployed individuals in South Africa. Persistent sub-trend economic growth will do us no favours in terms of the fiscus and hence a reassertion by Government of the National Development Plan is something we will continue to watch.

Sources: Stats SA, National Treasury, FactSet