# SA OPTIMISM SURGES, BUT ACTUAL CONDITIONS REMAIN WEAK

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## ABOUT **THE AUTHOR**

As Sake Economist of the Year, Rian's insight into and forecasts of how macroeconomic developments impact financial markets inform our top-down views.

Following a few months of euphoria after the ascendance of Cyril Ramaphosa as the President of South Africa, the past month saw, at least in some areas, a return to reality.

Perhaps the most outstanding feature of the past month was the rather sharp weakening of the rand from around R11.60 to the US dollar late in March to R12.60/US$ by early May. While the rand's weakness was largely driven by renewed US dollar strength, it was indeed more than just greenback strength, as it also weakened against the euro from R14.50/€ to over R15.00/€ over the same period. Apart from the firmer US dollar, there were no obvious reasons for the rand's slide, other than the fact that it had notably outperformed its emerging market peers over the past few months. This was on account of optimism over SA's economic prospects under new leadership, and the currency was entering overvalued territory – a comment also made by the South African Reserve Bank (SARB) shortly before the rand's decline.

## KEY TAKEOUTS

- THE EUPHORIA FADES AS SA RETURNS TO REALITY
- A FIRMER US DOLLAR DRIVES THE RAND WEAKER
- TAXES AND THE RAND WILL DRIVE INFLATION HIGHER
- RISING INFLATION WILL DAMPEN RATE CUT PROSPECTS
- PRESIDENT TAKES ACTIVE STEPS TO BOOST GROWTH

## SARB SETS THE BAR HIGH

While the weaker rand is actually welcome from the perspective of local exporters and companies competing with imports, it has unquestionably cast a cloud over prospects of the SARB following up the interest rate cut late in March with more rate cuts later in the year. While justified by the earlier firmer rand and continued downside surprises in inflation, the cut by the SARB still came as a surprise to most commentators. Although the Bank did make it clear that it was not committing to a "cutting cycle", as it is clearly honing in on ensuring that inflation, and especially inflation expectations, settle closer to the middle of the 3% - 6% inflation target range. As a result, the bar for another cut(s) later in the year is now clearly pretty high.

Indeed, inflation, while again surprising materially to the downside in March as it reached a four-year low of 3.8%, has now likely bottomed and will be moving up from here. Significant petrol price hikes (the result of a fuel tax increase, the higher oil price and the weaker rand), the VAT hike and the weaker rand will likely cause inflation to drift up closer to 5% by year-end, so, in all probability, ruling out any further rate cuts this year.

## FASTER GROWTH AND MORE JOBS

Meanwhile, President Ramaphosa has been active on various fronts, in an effort to restore business and investor confidence as a prerequisite for faster economic growth and job creation. Apart from ongoing changes at board and management levels in a number of key state-owned enterprises, the President also announced that he had appointed four “investment envoys” to market SA as an investment destination, called an investment conference later in the year and set a target of U$1billion (R1.2 trillion) of new investment in the economy over the next five years.

While this plan is indeed commendable, it will require hard work in terms of business-friendly structural reforms, including, most importantly, policy stability and predictability – especially as the public sector is unlikely to materially contribute to the investment drive, owing to the constrained fiscal situation. Should Ramaphosa indeed be successful in his plan, fixed investment as a ratio of GDP, currently at 19%, could reach 25% by 2023, making a material contribution to faster overall economic growth and job creation.

## THE GOOD VIBES ARE YET TO REFLECT IN THE NUMBERS

While the growth and investment goals are commendable, incoming data on the current state of the economy is less so. Admittedly, business and consumer confidence readings have risen strongly in the last few surveys, but actual hard data for the first quarter points to the economy stagnating again after the 3.1% annualised growth surprise in the fourth quarter of last year. Weakness was specifically evident in mining and manufacturing production, electricity generation and retail sales. Still, quarterly interruptions in a broader improving trend is quite common, so we do not regard the latest data as indicative of a stalled, or even failed, recovery. Consequently, we hold to our view that GDP growth will accelerate to little over 2% in 2018, up from the 1.3% recorded in 2017. However, this still falls far short of the 3%+ required at a minimum to accommodate the growing labour force.

As a result, we look forward to progress with the President’s plan to put the economy on a higher structural growth path. Leadership change without clear economic growth and employment benefits will indeed be a deep disappointment and risk social and financial instability. ■