SA FALLS INTO RECESSION AMIDST **POLITICAL UNCERTAINTIES**

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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.

The firming of the rand during July, from R13.75 to the US dollar at the start of the month to below R13.20/US$ by month-end, proved to be only a temporary interruption, as the currency slumped badly in August. By month-end, the rand was trading around R14.75/US$, some 28% weaker than the R11.55/US$ reached at the height of "Ramaphoria" late in March. Further weakness followed after the release of weak second quarter GDP data, with the rand trading around R15.60/US$ by 5 September.

While the renewed weakness of the rand was largely driven by general concerns around emerging markets, with escalating trouble in Turkey and Argentina the focus, SA-specific issues also featured prominently. The key issues include uncertainty around land reform, concerns over the (so far) failed economic recovery and SA's sustained and fairly large twin deficits.

It has now been roughly eight months since President Ramaphosa's election and there are about another eight months to go to the general elections in 2019. Given that land reform uncertainty will still be around for some months to come, the political heat is set to increase as the election nears and global conditions are increasingly less supportive. The next eight months to the elections may prove to be characterised by considerable financial market volatility. Under such conditions, it is difficult to see the economy recovering very strongly. In short, it seems as if the long-awaited improvement in business, consumer and investor confidence, and with it the economy, will have to wait until after the 2019 general elections. And conditions will only then improve if greater policy certainty is provided on a number of key outstanding issues, and reforms are more aggressively implemented.

The negative sentiment also spilled over to the bond market, where the yield on the 10-year government bond rose back to over 9% by early September, from around 8.5% at the end of July.

KEY TAKEOUTS

- UNCERTAINTY AT HOME AND ABROAD HAMMERS THE RAND
- EXPECT FINANCIAL MARKET VOLATILITY IN THE MONTHS AHEAD
- SA SLIPS INTO RECESSION DESPITE STRONG GLOBAL ENVIRONMENT

RECESSION!

Another blow to the economy is the annualised contraction in second quarter GDP numbers of 0.7%, following a first quarter number of -2.2% (which was revised to -2.6%). Two consecutive quarters of negative GDP put us into recession. Of grave concern is that we have been unable to participate in the strong global growth environment. The main reason for our low/negative growth is the continued lack of consumer, business and investor confidence in our country – predominantly around political and policy uncertainty. Even if there's a recovery in the third and fourth quarters, we are unlikely to improve on 2017 GDP growth of 1.3% and expect, at best, around 0.7%-0.8%. We have included a more detailed note on the latest GDP data, and the implications thereof, on page 15.

INFLATION EDGES TOWARDS UPPER TARGET

As expected, inflation rose to 5.1% in July and is now well up on the 3.8% low reached in March, although still in the 3% - 6% inflation target range. Given the pressure on the rand and a persistently elevated oil price, we expect inflation to continue to drift higher towards the top end of the target range early in 2019. Should the pressure on the rand continue, inflation could actually exit the range in the months to come.

SARB FACES THE TIGHTROPE

The combination of factors I've described is complicating matters for the SA Reserve Bank (SARB). The Bank has, for some time now, been at pains to indicate that it wants to settle inflation and inflation expectations around the middle of the range, or at 4.5%. This places the SARB under pressure to start considering raising the repo rate on account of escalating underlying inflation pressures and actual inflation now more decisively moving away from the SARB's preferred 4.5% level. However, the weak economy, and the danger of higher borrowing costs doing even more damage, make a rate hike(s) a much more difficult decision.

Considering all of this, it is very likely that the period in the run-up to the 2019 elections will be characterised by economic uncertainty and financial market volatility.

Looking further out, though, we remain hopeful that the economy will eventually recover modestly, that the land reform issue will be handled with care and that the ongoing efforts of the Ramaphosa administration to place public institutions on a healthier footing and effect other much-needed economic reforms will, in due course, begin to bear positive economic fruit. ■