

Comment

Scale more definitively tilting to the positive side

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Introduction

The last number of weeks have seen significant developments on the domestic political front, while global financial market trends have also been noteworthy. Against that backdrop, this brief note explores how recent events are likely to impact the domestic economic landscape, in particular relative to our January forecast. From the onset, it has to be emphasised that these views may need to be tweaked again after next week's Budget.

Fast-changing political context

One of the key assumptions when we updated the forecast in January was that although then President Zuma was likely to exit the scene before his term was due to end in 2019, the process was likely to be protracted. The view was that it would probably be more of a second half 2018 event. This pushed out the timing of when we expected more policy certainty and suggested that a meaningful recovery in private fixed investment was more likely in 2019 than 2018.

Figure 1: Positive sentiment reflected in capital market yields



Source: Reuters

Update: Macro outlook

Please refer to the [glossary on the BER's website](#) for explanations of technical terms.

Clearly, with Mr Zuma resigning on 14 February, the expected change of the guard has come earlier than the January baseline assumed¹. Up to now, domestic political events have largely dominated SA financial markets, irrespective of the large moves on global markets in recent weeks. This is perhaps best illustrated in the bond market. Despite a roughly 50bps rise in the US 10-year government bond yield so far in 2018², the SA 10-year yield has declined by more or less 30bps (Figure 1). Historically, this type of divergence is rare and illustrates the prevailing positive global sentiment towards SA.

In line with this, the rand exchange rate has performed better than expected since the end of January. The local currency has found support in sustained US dollar weakness, but rand strength can at least partly also be explained by markets discounting an early Zuma exit. This has happened. So have our views changed? We now await the confirmation of Cyril Ramaphosa as the new President of the country (this afternoon), the State of the Nation Address (Friday night) and a possible cabinet reshuffle before the Budget (Wednesday, 21 February). A reshuffle will provide more clarity on the extent of possible policy changes to expect.

Possible macro implications

While the next week or so should provide more clarity, even at this stage we can say the following:

- With the caveat that the Budget remains key, it is now less likely that **Moody's** will downgrade SA's local currency credit rating when they finish their rating review after the Budget. This will ensure that SA bonds remain part of the Citibank World Government Bond Index (WGBI).
- The January forecast that the **rand exchange rate** would weaken to R12.46/\$ in 2018Q2 looks too pessimistic.
- Along with the recent sharp decline in the Brent oil price (if sustained), a stronger currency raises the likelihood that **consumer inflation** could average lower than our current forecast of 4.8% in 2018. The January forecast already assumed a lower oil price through 2018. A key risk to inflation remains a possible **VAT hike** (either a general increase, or more likely on fuel) in next week's Budget, but this is not our baseline view.
- The likelihood of a reduction in the **repo policy interest rate** at the next meeting (end March) of the Monetary Policy Committee (MPC) has increased.
- Although a bounce was expected, the recovery in **business** and **consumer confidence** in early 2018 may be more pronounced and durable.
- A reshuffle that removes underperforming / tainted ministers and a Budget that re-commits to fiscal consolidation will go some way to solidify a more positive macro environment. In particular,

¹ It has to be said that there was a lot of internal debate about this with some members of the team expecting an earlier Zuma exit.

² Higher US yields reflect a growing sense that the robust US and global growth will result in a pick-up in inflation and tighter monetary policy going forward.

this could ignite one of the key missing ingredients for growth over the last number of years (i.e. **private fixed investment**) faster than assumed in January.

While one does not want to end a positive story on a sour note, a word of caution is appropriate. In our view, a rand exchange rate that is sustained at current levels or moves even stronger, has the potential to do some damage to the productive side of the economy³. For example, employment in the loss-making platinum mining sector in particular may come under pressure. Furthermore, a combination of improved domestic demand (led by durable-goods consumption and fixed investment) and a stronger currency could see the **trade balance** of the current account deteriorate relatively quickly. This would be an important driver of our view that, despite the positive domestic narrative, the rand exchange rate could still be weaker on a 12-month view. This will especially be the case if US inflation data continues to surprise on the upside, potentially resulting in faster than expected **US policy interest rate hikes**.

As mentioned in the brief write-up of the January forecast (link [here](#)), we will formally re-assess the forecast after next week's Budget.

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³ The firm rand is of course positive for real disposable income and the broader consumer landscape.



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