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By Andrew Duvenage and Paul Marais

ECONOMY

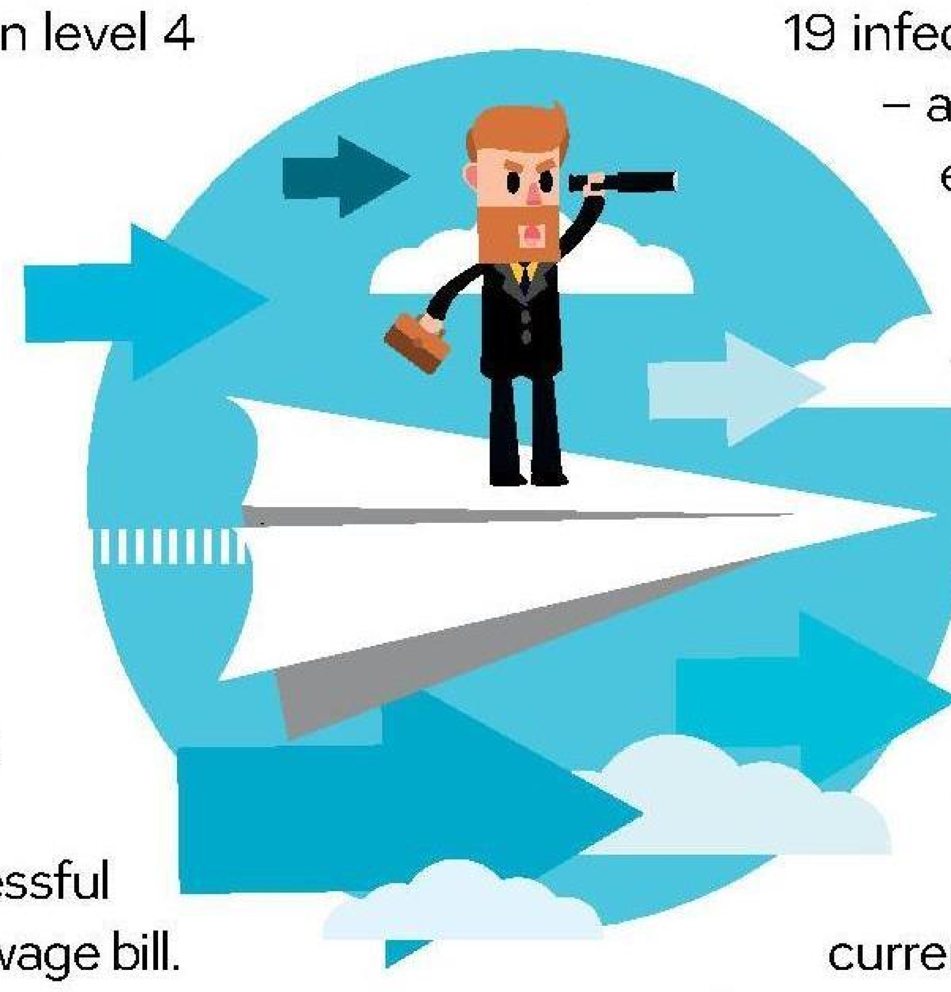
Economic outlook: The trends to be watching out for

There is a big question mark over whether South Africa's recent better-than-expected economic growth can be maintained in the latter half of 2021.

The recent growth in South Africa's economy, which defied IMF predictions, can be attributed to global demand for resources linked to infrastructure-led recoveries and pandemic-related decompressions around the world which have led to high commodity prices. This, coupled with a bumper agricultural export performance and the added benefit of Covid-19 relief grants, have helped the economy recover off what was arguably a low base. It is important to understand that this growth is partly the result of pent-up demand which accumulated during 2020.

The big question in the next few months is whether this short-term growth can be translated into long-term sustainable momentum. One of the most significant risks to the country's economic recovery continues to be the Covid-19 pandemic, including the Delta variant currently driving SA's third wave of infections which resulted in government moving the country back to lockdown level 4 and stricter restrictions in late June.

Whether the recent economic growth levels can be maintained will largely depend on how quickly and effectively the government can roll out its vaccination programme – which to date has been far too slow – the extent to which commodity prices will hold up, whether inflation will result in the SA Reserve Bank (SARB) and other central banks increasing interest rates, how quickly SA's infrastructure programme gains traction, the extent to which consumer confidence will be impacted by the end of the Covid-19 relief grants, and how successful National Treasury is in containing the public sector wage bill.



The concerns

Recent reports indicate that National Treasury is not managing to be as successful in containing the public sector wage bill as it had hoped to be. Paradoxically, the improvement in economic performance might work against Treasury when it comes to wage negotiations.

Another concern is that although corporate tax collections are back to levels before the Covid-19 pandemic, a large part of which is being driven by the strong performance of the miners, personal tax collections have not recovered to the same extent. The latter constitutes most of tax revenue. The fact that personal tax collections have not recovered to the same extent indicates that pandemic-led retrenchments may turn into permanent job losses. Unemployment is likely to be further exacerbated by the recent level 4 restrictions on alcohol sales and in-restaurant dining.

While the commodity rally is good news for the economy, the question must be asked whether mining companies will be reinvesting their elevated profits into expanding supply side capacity or will pass the benefits on in the form of dividends. The latter augers well for tax collections and National Treasury but is not as positive for long-term economic growth.

The outlook for inflation, interest rates and the rand

Inflation is expected to continue to rise and to an extent this has already been priced into the market. Contingent on the uptick in inflation, expect one or two 0.25 percentage point increases in interest rates before the end of the year. Given the fragile state of the economy, the SARB will be acting cautiously so as not to tighten interest rates too quickly.

Uncertainty arises should inflation rise more than or faster than expected. In the case of the latter, expect markets to come off to some extent, off the back of an increase in interest rates or even faster than expected withdrawals from central bank bond-buying programmes. However, if the future is deflationary then markets are likely to do better.

The recent strength of the rand has been a boon for importers. Local factors likely to influence the currency in the remainder of the year include the local elections, the impact of the third wave of Covid-19 infections – which is likely to be worse than the first wave – and an expectation that the level 4 restrictions will be extended. Recent court judgements against those implicated in corruption, and the trade surplus are both encouraging factors in the rand's favour.

However, myopically focusing only on local factors where rand movement is concerned is a mistake given the extent to which international factors play a role. The market will be watching the inflation trajectory in the US with interest given that US rates have a significant impact on the movement of the local currency.

The rand continues to be an extremely volatile currency and its recent strength is not an indicator that the economy is through the quagmire. In fact, it's a good idea to protect risks inside a portfolio and not be carried away by currency movements, particularly given the anticipated long-term trend of rand weakness and higher inflation than SA's trading partners.

Can confidence be restored?

An economic recovery is inextricably linked to confidence. Consumer confidence is currently low and business confidence will likely follow suit, which does not auger well for a sustained economic recovery.

There is no quick fix to rebuilding confidence but a concerted effort at rooting out corruption, stopping fruitless and wasteful expenditure at local government level, removing barriers to business such as policy and regulatory uncertainty and releasing spectrum would go some way to restoring faith in the government's handling of the economy. Ultimately, the focal point of government's effort needs to be on becoming an enabler of growth given that this is the only solution to most of SA's challenges. ■

editorial@finweek.co.za

Andrew Duvenage is the managing director of NFB Private Wealth Management and **Paul Marais** is the managing director of NFB Asset Management.

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