ECONOMIC VIEWS

Volatility threatens momentum

'O, it is excellent to have a giant's strength; but it is tyrannous to use it like a giant.' – William Shakespeare

By MARIE ANTELME

THE QUICK TAKE

- The Trump administration has changed the course of history with its aggressive tariffs and protectionist stance; what happens next on the global economic stage is a guessing game
- Uncertainty will weigh on investor confidence, particularly on business confidence in the long term
- It is more likely that central banks will take a dovish stance on policy rates, notwithstanding the impact of tariffs on inflation

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IN JANUARY, US President Donald Trump started to announce the specifics of the tariffs on global trade that he had promised during his election campaign. While the world was warned, what culminated in the 2 April 'Liberation Day' announcements was, at face value, much bigger and broader than most expected. The tariff 'tit for tat' that followed narrowed into a largely bilateral spat with China, while, at the time of writing, the other announcements have been suspended for 90 days to facilitate negotiations. China is not included in this suspension, and tariffs are expected to come into effect as specified. If negotiations stall during the three-month window period, it will effectively raise the US tariff rate to almost 25% – the highest in more than a century. Retaliatory tariffs have also raised the global average.

On net, the tariffs represent a massive tax on US and global trade. But because it is not clear how this will end, it is difficult to make any confident economic predictions. Modelling scenarios by tracking the tariff supply shocks through the network of prices, marginal costs, and relative demand using an accounting framework is simple in theory. The reality is that it is very difficult to implement, given the complexities of global trade where factors like ease of substitution, price pass through, the possibility of retaliation, the responsiveness of economic stabilisers, such as the exchange rate, are all unpredictable. But 'first-pass' modelling of the shock on global trade yields some clues about how economic activity may respond.

The IMF has published its first assessment relative to the forecasts it presented in January 2025. Even if the suspension that is currently underway is upheld, the implied increase in effective US tariffs will still have a material impact on global trade. From the IMF's research, there are a number of key takeaways:

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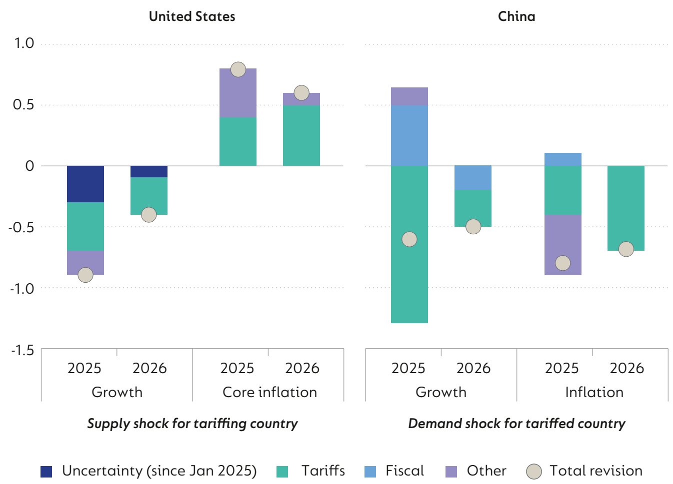
- The global trade shock will likely reduce global growth by a cumulative 0.8% over the next two yearFigure 1 shows that global growth is now expected to slow to 2.8% in 2025 and 3% in 2026 (from 3.3% in both years, previously).
- The bulk of the moderation is concentrated in the US, China, and a range of trade-exposed emerging markets. Some of the impact on China is expected to be mitigated by fresh fiscal stimulus in support of domestic demand.
- However, these global estimates mask considerable variation by country – Europe and the UK seem less vulnerable, given planned spending reform in the EU and the opportunity for monetary support in the UK.
- Tariffs will add to inflation in the US, less so in emerging markets, and will likely see disinflation in China.Globally, central banks are seen as more likely to ease policy rates should growth slow, despite some tariff-related pressure on inflation.

Figure 1

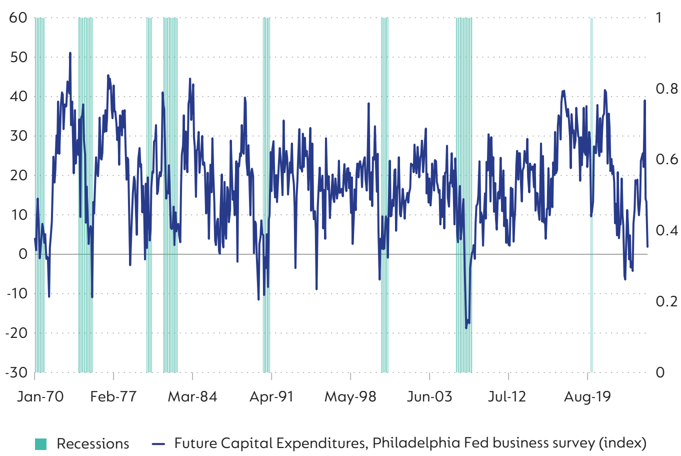
IMF FORECAST CHANGE FROM JANUARY 2025, PERCENTAGE POINTS



Source: IMF, World Economic Outlook; and IMF staff estimates

Figure 2

US MANUFACTURING SURVEY: FUTURE CAPEX (INDEX)



Source: US Federal Reserve Board

THE WORLD HAS CHANGED

The bigger challenge, though, is trying to assess the long-term growth implications of a new economic operating environment. The growth accounting exercise cannot track the shock to sentiment that the current uncertainty is creating. Business and consumer sentiment literally affects everything – from momentum in stock markets, consumption and investment decisions, to elections. The subjective nature of confidence makes it a challenging candidate in the formal analysis of economic behaviour. While it is often relegated to the camp of underlying 'animal spirits', research shows that large changes in confidence tend to signal a significant future change in output growth relative to trend.

Given that consumer spending typically accounts for about 60% of GDP in most developed economies (closer to 70% in the US) and gross fixed capital formation for another 15%-25%, the 'animal spirits' that drive decisions to spend and invest are an important consideration in an increasingly uncertain world.

Confidence is hard to measure quantitatively. Most countries survey business and consumer sentiment using simple surveys with a formulaic set of questions, which allow the respondent to judge current conditions relative to the previous period. Research done by the Organisation for Economic Co-operation and Development (OECD) suggests that business surveys, in particular, can provide valuable information for the assessment of current economic conditions for prediction purposes.[1]

We don't yet have much hard economic data that reflects the impact of recent policy announcements (which we expect will only become visible later in the year when underlying economic resilience and the effects of front-loading fade), but there is some data for April that provides insight into the possible impact on business confidence. The Federal Reserve Bank of Philadelphia's survey of manufacturers' future capital expenditure (capex) shows a precipitous decline in April to a level not seen since late 2023 and a deterioration consistent with previous recessions (Figure 2). Similar retrenchment is likely elsewhere.

[1] Santero, T. and N. Westerlund (1996), "Confidence Indicators and Their Relationship to Changes in Economic Activity", OECD Economics Department Working Papers, No. 170, OECD Publishing, Paris, https://doi.org/10.1787/537052766455.

A SHOCK TO THE SYSTEM

What drives confidence? Research done by the CFA Institute[2] suggests that the traditional drivers of both business and consumer confidence have changed over time. Key economic variables, which would reasonably be assumed to influence sentiment, have narrowed in the past four decades. Regressing variables, including real GDP growth, interest rates, unemployment, inflation, and stock market returns against consumer confidence indices, shows that their influence, especially on consumer confidence in the US, has shifted. Now, they only include inflation and equity market returns.

Business confidence is less fickle. This is possibly due to the more complex and enduring nature of business decision-making, as well as a broader sensitivity to the winds of economic change. However, it is still significantly influenced by interest rates, changes in GDP, levels of unemployment, and equity performance.

Figures 3a and 3b illustrate the regression results described above. A '+' denotes a coefficient which is both significant and directionally correct. A 'x' denotes a coefficient which was either insignificant or in the incorrect direction.

Taken together, this suggests that a shock that has negative repercussions for profitability and equity market performance, or could lead to a spike in inflation, will have a negative impact on consumer sentiment, dampening household spending and further undermining growth momentum. In this environment, we would expect to see weakness in labour markets emerge and for rising unemployment to become more pronounced than it was in the first trade-related assessment.

Business decisions will also be affected by deteriorating consumer sentiment. However, should decisions to invest be affected by longer-term uncertainty, reinforced by growth dynamics, the implications for production costs, supply disruptions, and profitability will be more enduring. Overall, this analysis suggests that uncertainty poses further downside risk to longer-term growth.

SOUTH AFRICA – BRINGING IT HOME

Even before the tariff announcements, South Africa (SA)'s starting position for growth was low. GDP only grew 0.6% in 2024, as capex collapsed and the recovery in consumption was anaemic. Tracking data suggests flat growth in the first quarter of 2025, which, even before weaker global trade assumptions, makes achieving much more than 1% real GDP growth in 2025 challenging. In addition to lowering the GDP forecasts of SA's main trading partners and adjusting at the margin for a rise in tariffs, home-grown political uncertainty will most likely undermine recent gains in consumer and business confidence. This will weigh on consumption and investment more than would have been the case before the US trade tariff meltdown.

Figure 3a

US CCI REGRESSION SUMMARY, CFA INSTITUTE ANALYSIS*

US CCI	1990s	2000s	2010s	2020s
Interest rate	x	x	x	x
Change in real GDP	+	+	x	x
CPI	+	+	+	+
Unemployment rate	x	x	+	x
Equity performance (S&P 500)	x	+	+	+

*CCI=Consumer Confidence Index
Source: CFA Institute

Figure 3b

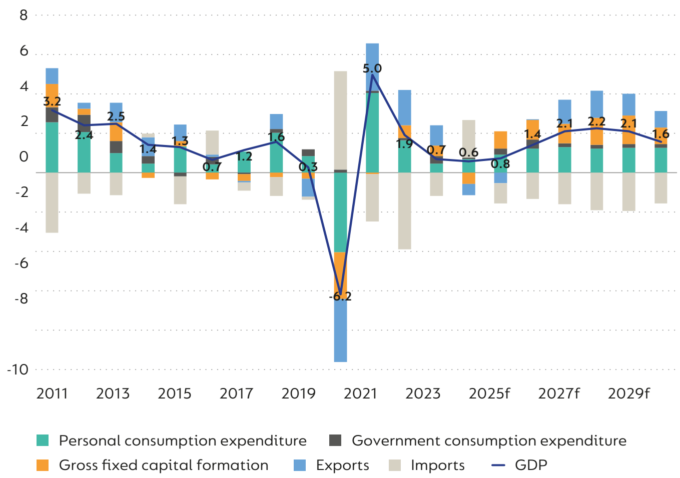
US BCI REGRESSION SUMMARY, CFA INSTITUTE ANALYSIS*

US BCI	1990s	2000s	2010s	2020s
Interest rate	x	x	+	+
Change in real GDP	+	+	x	+
CPI	+	x	x	x
Unemployment rate	x	x	x	+
Equity performance (S&P 500)	x	+	+	+

*BCI = Business Confidence Index
Source: CFA Institute

Figure 4

SA: CONTRIBUTIONS TO REAL GDP, PERCENTAGE POINTS

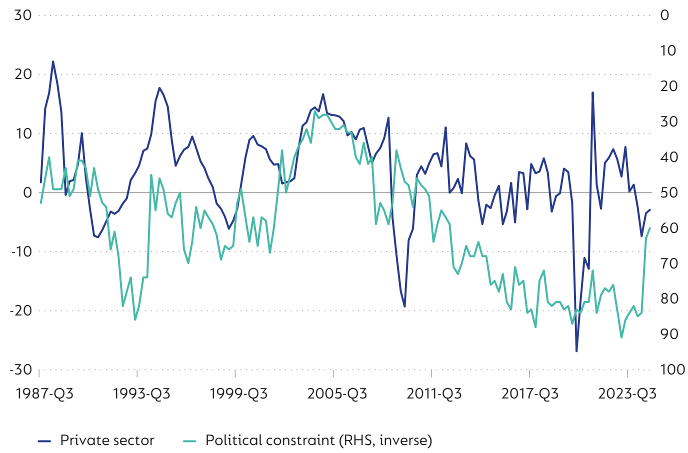


Source: StatsSA and Coronation

[2] https://blogs.cfainstitute.org/investor/2024/10/01/what-determines-consumer-sentiment-and-business-confidence/

Figure 5

BUSINESS CONFIDENCE AND PRIVATE CAPEX



Source: BER, StatsSA

Figure 6a

DRIVERS OF SENTIMENT IN SA - BER CCI*

SA BER CCI	1990s	2000s	2010s	2020s
Interest rate	×	×	×	×
Change in real GDP	+	×	×	+
CPI	×	+	+	+
BER 'Political constraint'	+	+	+	+
Change in formal employment	NA	×	×	×
Equity performance (Top 40)	NA	+	+	×

*CCI = Consumer Confidence Index
Source: BER, Coronation

Figure 6b

DRIVERS OF SENTIMENT IN SA - BER BCI*

SA BER BCI	1990s	2000s	2010s	2020s
Interest rate	+	+	×	×
Change in real GDP	+	×	+	+
CPI	+	+	+	×
BER 'Political constraint'	+	+	+	×
Change in formal employment	NA	×	×	×
Equity performance (Top 40)	NA	+	+	+

*BCI = Business Confidence Index
Source: BER, Coronation

The year started with expectations that the economy would see relatively buoyant growth of about 1.5%, as reform combined with more positive sentiment. This is now revised to 0.8% for 2025 and 1.4% in 2026 (Figure 4). The implementation (albeit again delayed) of planned energy and logistics spending should still see real growth at c. 2% in 2027 and 2028, even without additional regulatory reform.

These forecasts are also vulnerable to a change in sentiment. The post-election formation of a coalition government buoyed both business and consumer confidence, raising expectations of an accelerated reform agenda. But recent political developments increased uncertainty. The fraught passage of the VAT-focused 2025 Budget is testing the commitment of members of the Government of National Unity and has opened the door for its critics to challenge its efficacy. As is the case globally, the economic impact of qualitative factors like sentiment is hard to measure but may yet be significant in terms of growth.

Bureau for Economic Research (BER) consumer and business confidence data (Figure 5) suggests a reasonably good 'fit' to consumer spending and private investment over time, especially business confidence, which is a little less volatile. Encouragingly, confidence recovered in late-2024 (albeit still below the 'neutral' level of 50), and private CAPEX showed tentative signs of recovery. Interestingly, the BER includes a direct question about whether or not the current political environment is a constraint on investment decisions in its business confidence survey. Figure 6 shows that here, too, the improvement in perceptions about the political environment improved in late 2024.

Using the Chartered Financial Analyst (CFA) framework for SA's confidence measures shows that consumers are sensitive to changes in growth rates (Figure 6a), inflation and domestic political dynamics. On the other hand, businesses have become less sensitive to interest rates, inflation (as it has moderated over time) and – over the past five years – political dynamics (Figure 6b). GDP growth and equity performance remain important. Looking ahead, this suggests that lacklustre growth outcomes may become reinforcing, and a deterioration in political perceptions may exacerbate this dynamic.

CONCLUSION

Early estimates based on volatile and uncertain assumptions point to weaker global growth after the US tariff announcements than before. Weakness, for now, is likely to be concentrated in China and the US, but small emerging markets that are exposed to global trade are also likely to suffer. The longer the uncertainty persists, the greater the downside risk to longer-term growth.

In SA, a weak starting position materially raises the growth vulnerability in the coming year.

We expect real GDP to again fall shy of 1%, with downside risk rising, should domestic political uncertainty increase.

Globally, policymakers are expected to respond to lower growth by cutting interest rates, even if they remain cautious about the possible impact of tariffs on inflation. In SA, where growth prospects continue to deteriorate and inflation remains historically low, we see scope for the South African Reserve Bank to resume its easing cycle in the second half of 2025. This is despite elevated uncertainty, and provided there is no further intensification of perceived risk, low inflation and dismal growth warrant policy support in the form of lower interest rates. +

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