



# South African Macroeconomic Outlook

## Ramaphoria fades to hard realism as recession bites

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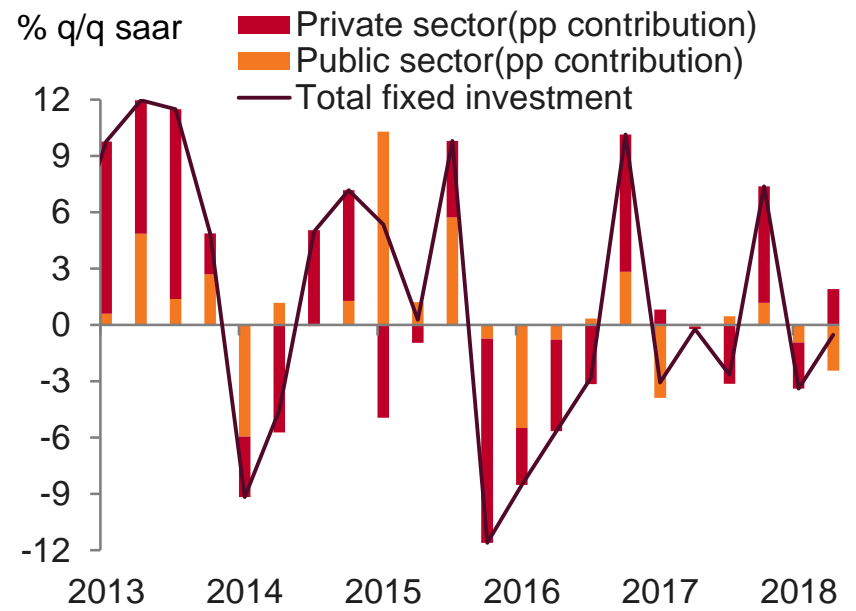
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# Recession is likely temporary – but growth momentum is weak

%q/q saar	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18
Agriculture	36.9	41.7	39.0	-33.6	-29.2
Mining and quarrying	7.8	6.2	-4.4	-10.3	4.9
<b>Primary sector</b>	13.9	13.8	5.2	-17.0	-4.6
Manufacturing	2.9	3.7	4.3	-6.7	-0.3
Electricity and water	8.1	-6.1	3.3	0.2	2.1
Construction	-0.7	-1.2	-1.4	-1.9	2.3
<b>Secondary sector</b>	2.8	1.5	3.1	-5.0	0.5
Trade & accomm.	0.9	-0.1	4.8	-3.1	-1.9
Transport comm's	2.6	0.8	2.8	0.9	-4.9
FIRE*	3.1	1.9	2.5	1.1	1.9
Personal services	1.7	1.2	1.0	1.2	0.8
General government	-1.9	1.1	1.4	1.9	-0.5
<b>Tertiary sector</b>	1.2	1.1	2.7	0.3	-0.6
<b>GDP at market prices</b>	<b>2.9</b>	<b>2.3</b>	<b>3.1</b>	<b>-2.6</b>	<b>-0.7</b>

Surprisingly, private capex grew in Q2



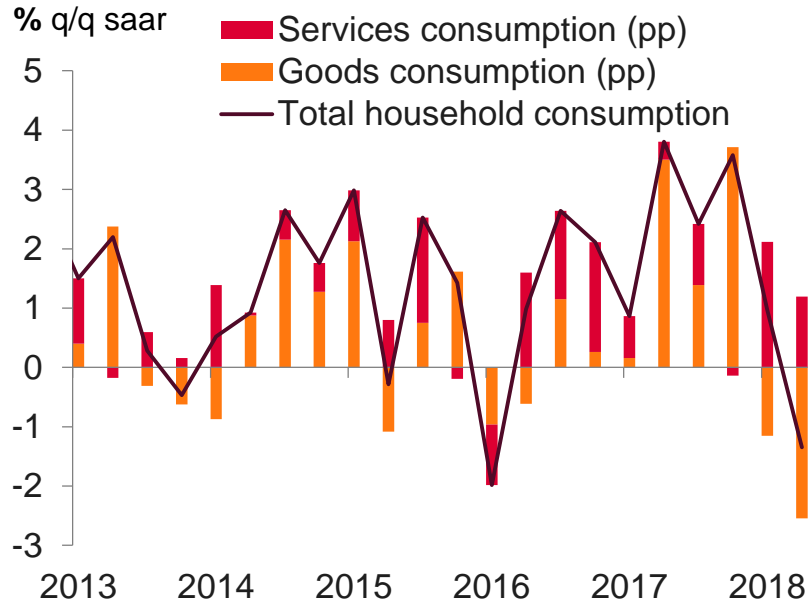
\*Finance, insurance and real estate. Source: Statistics South Africa, Absa Research

Source: Statistics South Africa, Absa Research

# Household spending contracted sharply in Q2

Household spending on goods plunged 1.3% q/q saar...

...as households curtailed spending in more optional consumption categories



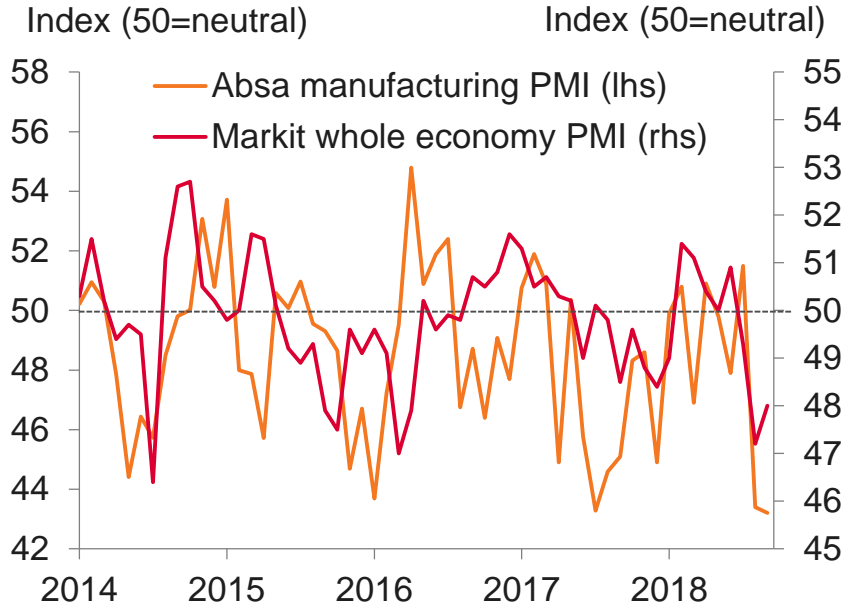
	Share of total	Growth rate, %q/q saar			
		2017	Q317	Q417	Q118
Food & NAB	21.4	-1.5	3.4	-2.0	-2.8
Clothing & footwear	5.2	2.3	20.7	-15.6	-6.8
Alcohol & tobacco	4.9	-1.5	-4.4	-1.6	-5.5
Furnishings & equip	6.7	5.9	10.8	5.4	-3.4
Housing & utilities	14.7	-0.5	0.7	2.8	0.5
Communication	2.6	3.9	-0.6	9.0	6.5
Recreation & culture	4.5	9.7	7.8	-0.8	-7.6
Health	7.2	3.6	7.6	3.9	5.2
Education	3.7	1.2	0.6	2.4	2.4
Catering & hotels	2.6	9.3	-0.2	4.4	3.2
Transport	15.2	5.7	4.1	1.0	-6.1
Miscellaneous	11.3	2.2	-3.5	5.9	5.0
<b>Total consumption</b>	<b>100.0</b>	<b>2.4</b>	<b>3.6</b>	<b>1.0</b>	<b>-1.3</b>

Source: Statistics South Africa, Absa Research

Source: Statistics South Africa, Absa Research

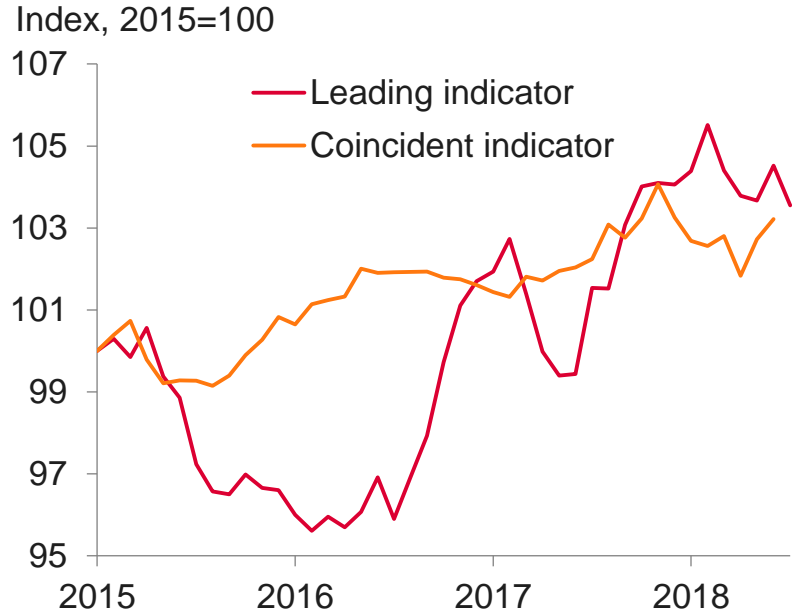
# Sentiment and leading data suggest weak momentum...

## PMIs were down sharply in Q3 18



Source: Bureau for Economic Research, Markit, Absa Research

## Business cycle indicators are softer

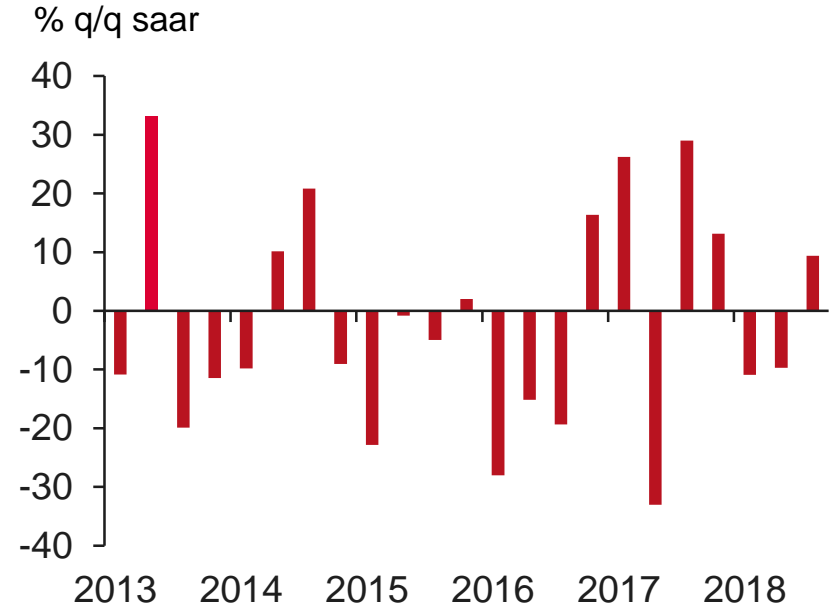
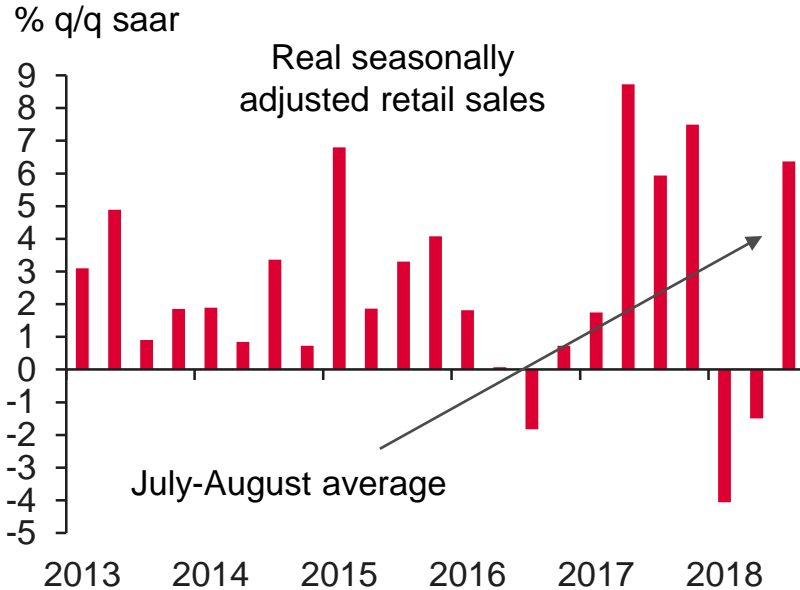


Source: SARB, Absa Research

# ...but demand-side activity prints in Q3 have been quite good

Retail sales have recovered in Q3...

...and passenger car sales are also up



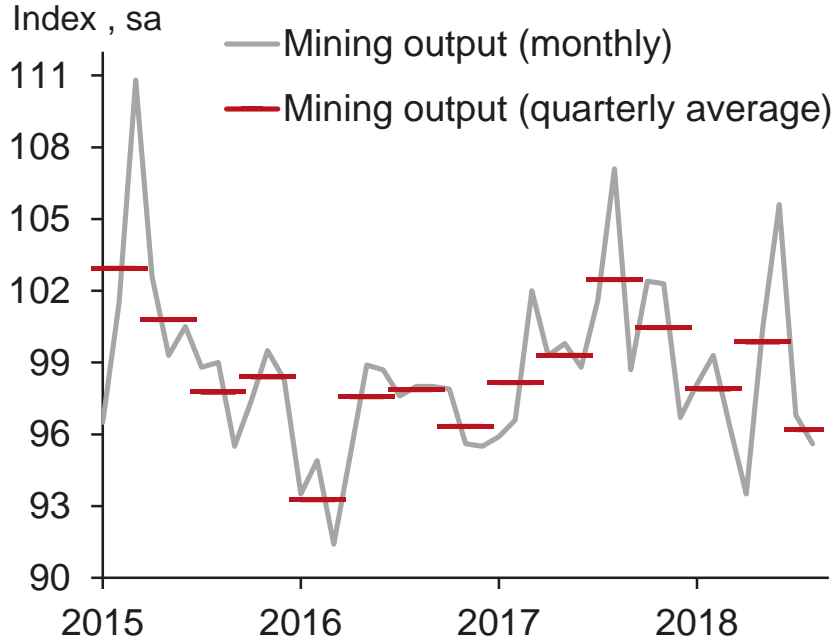
Source: StatsSA, Absa Research

Source: NAAMSA, Absa Research

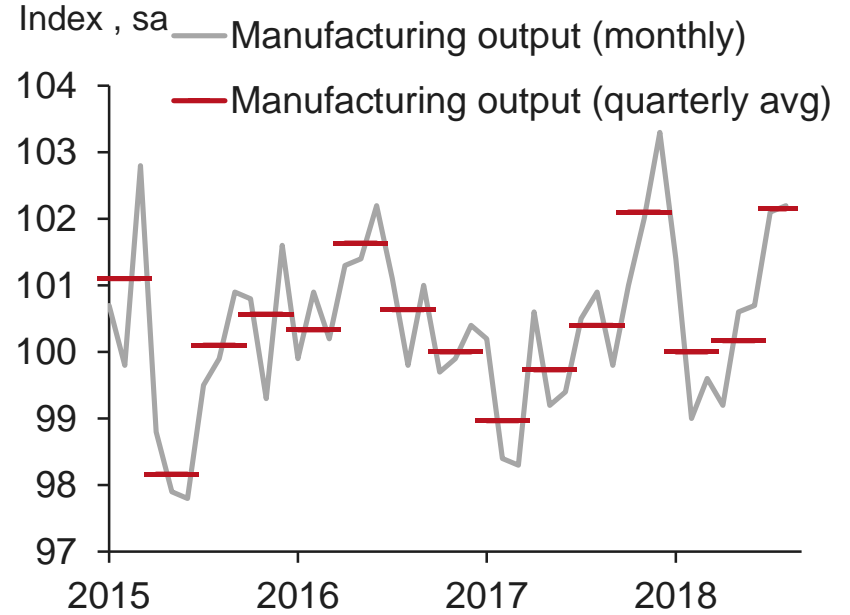
# Supply-side indicators are more mixed

Mineral production has plunged in Q3...

...but manufacturing output is up a lot



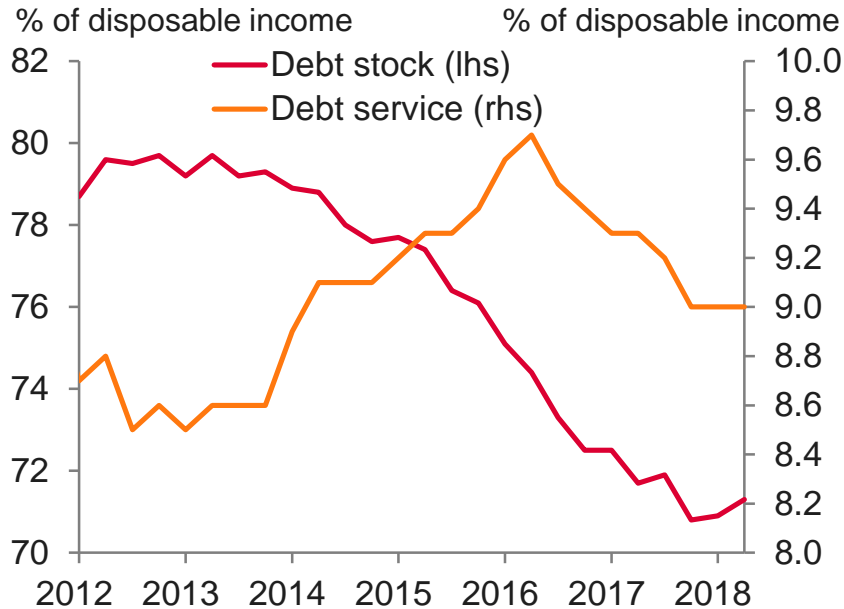
Source: StatsSA, Absa Research



Source: StatsSA, Absa Research

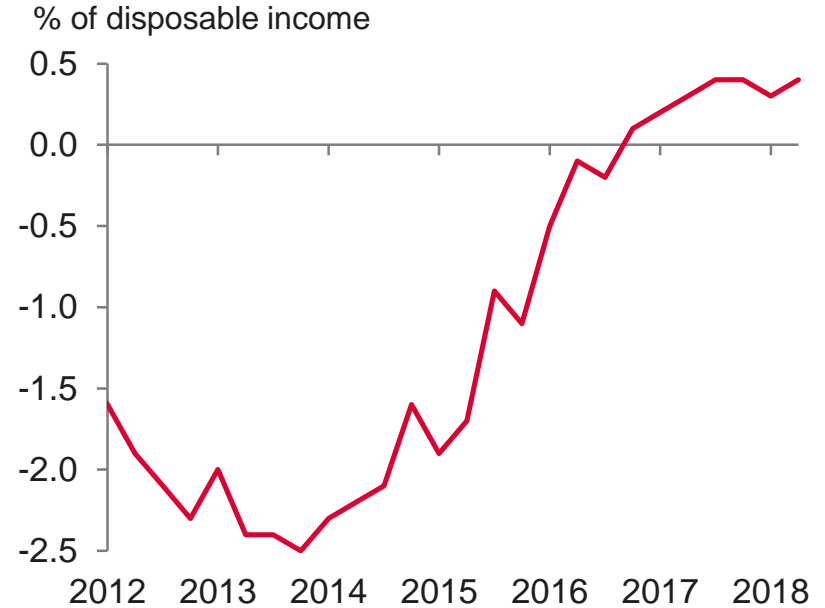
# Households have been in a defensive mindset for some time

Big household deleveraging halted in early 2018...



Source: SARB, Absa Research

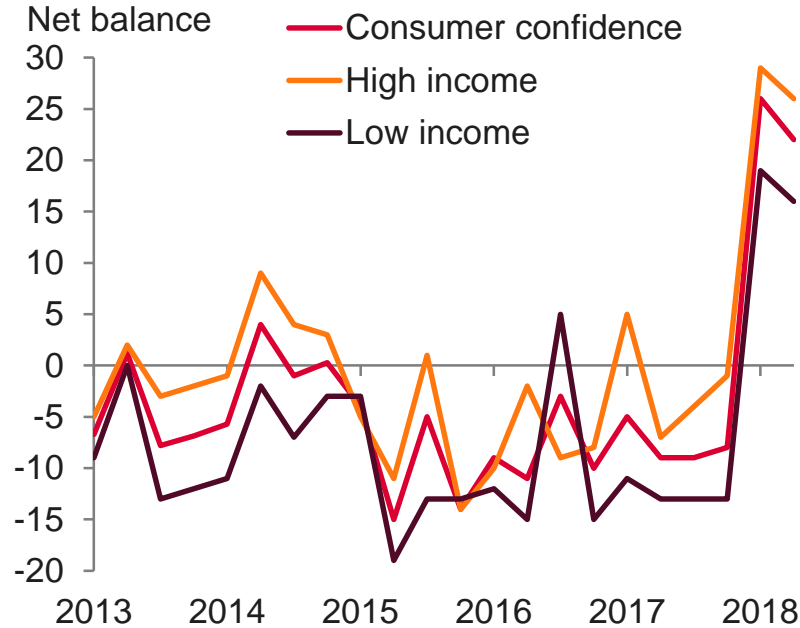
...but net household savings are back into positive territory



Source: SARB, Absa Research

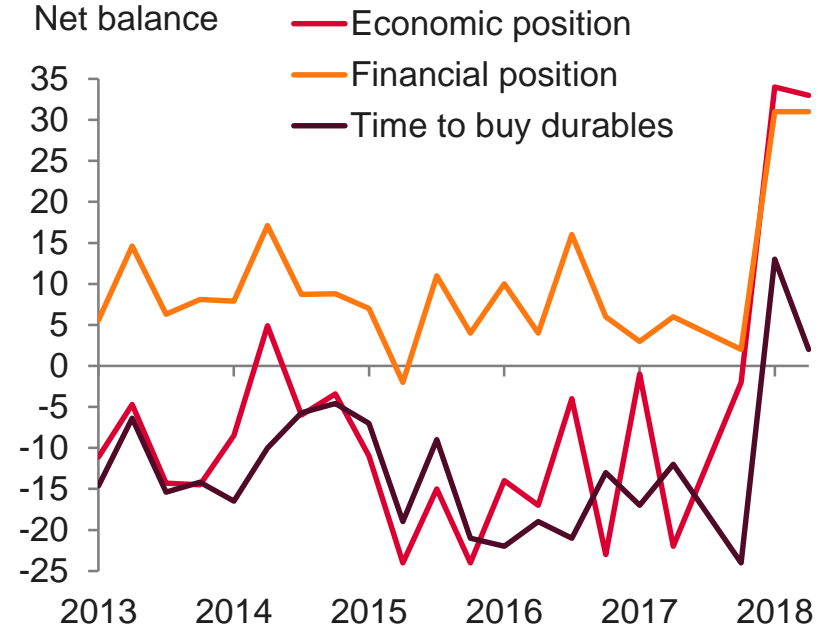
# Looking forward, consumer confidence is critical

Consumer confidence was surprisingly high in Q2 18...



Source: Bureau for Economic Research, Absa Research

...but consumers remain relatively more cautious on durables spending

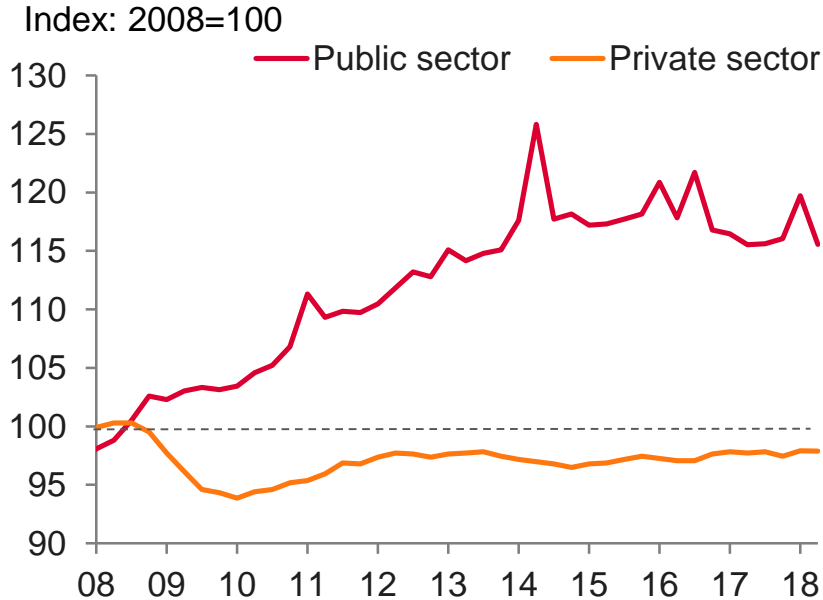


Source: Bureau for Economic Research Absa Research



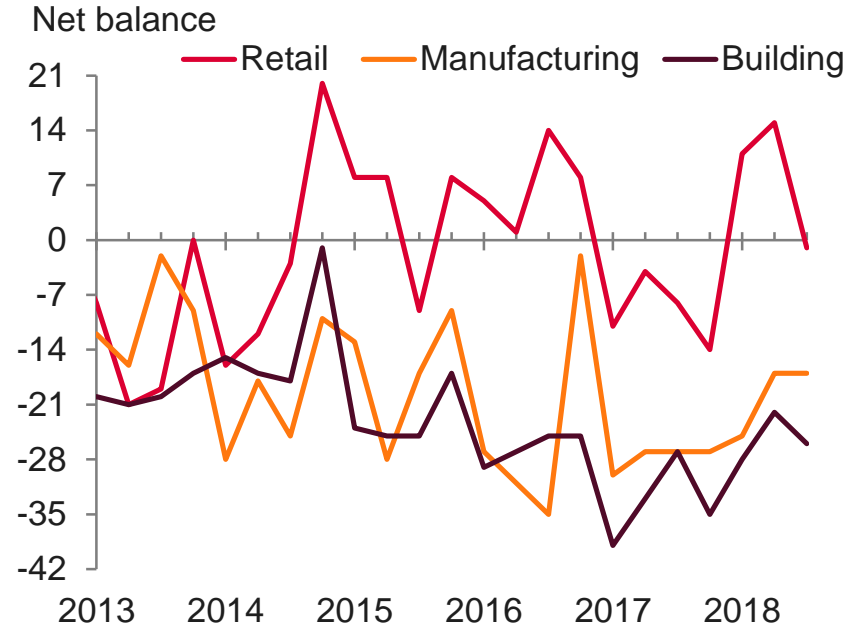
# The labour market continues to be very challenging

Formal employment growth has largely stagnated



Source: SARB, StatsSA, Absa Research

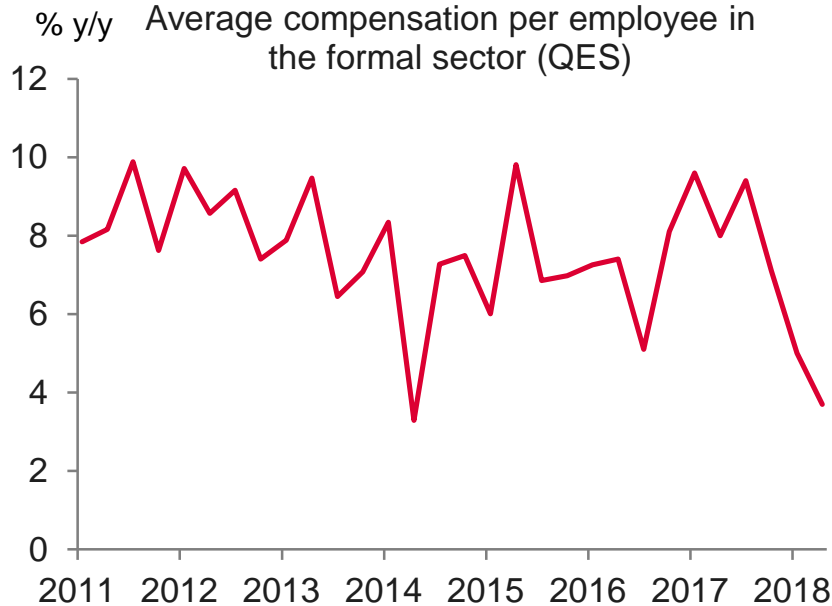
Firms' hiring intentions also reveal a soft labour market



Source: BER, Absa Research

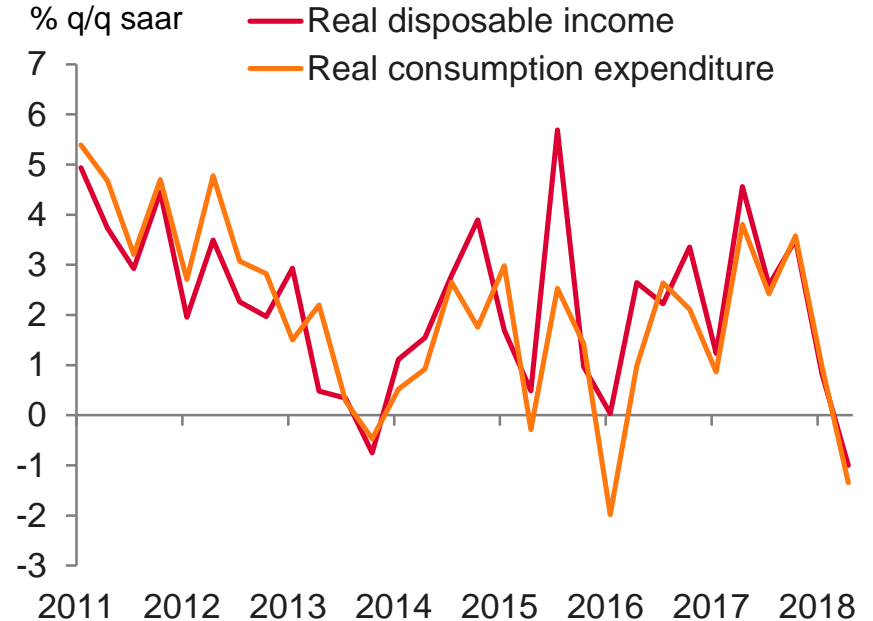
# Now, household disposable income is under pressure

Wage settlements seem to be slowing...



Source: Statistics South Africa, Absa Research

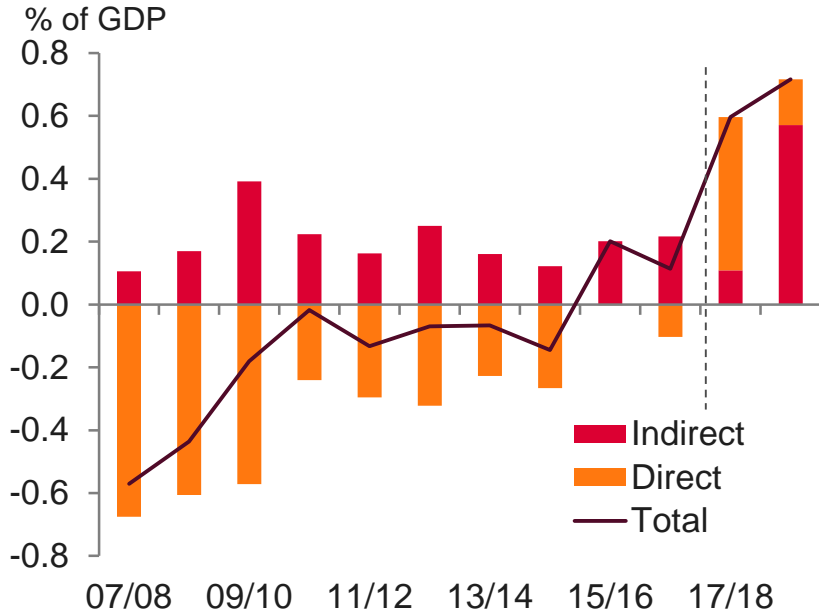
...and real household disposable income contracted in Q2 18



Source: SARB, Absa Research

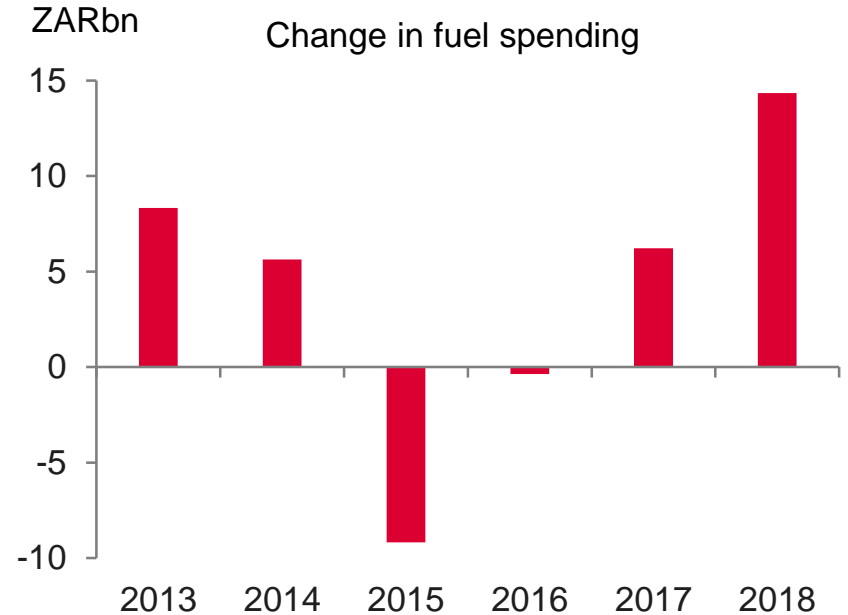
# VAT and petrol price hikes are two enormous headwinds

The taxman has not been kind in recent years...



Source: National Treasury, Absa Research

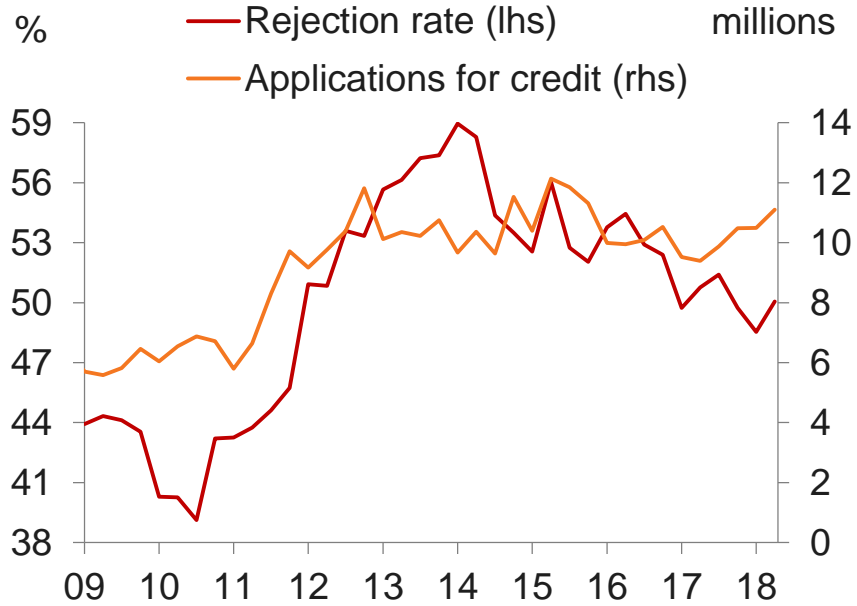
...and petrol price increases this year have will cost households a lot



Source: SARB, CEF, Absa Research

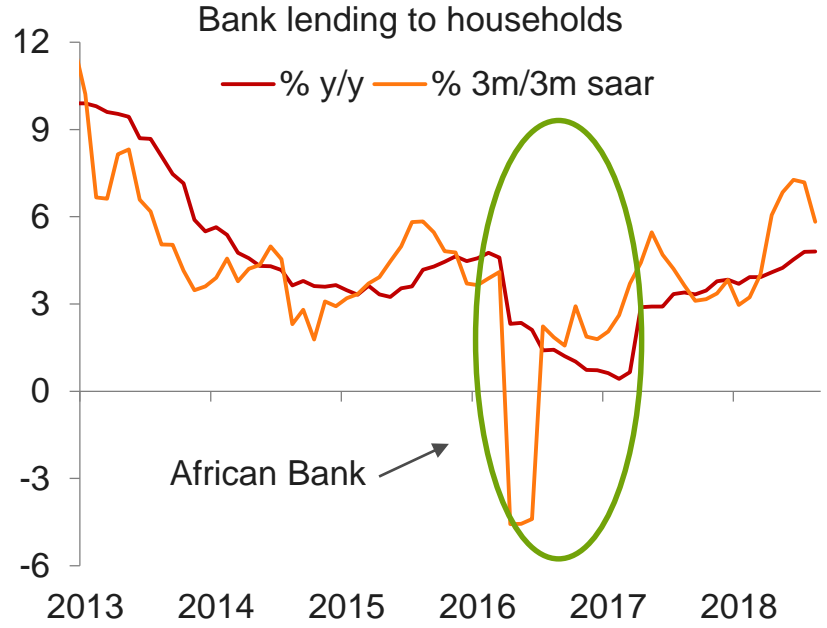
# Banks seem willing to lend but households are not borrowing

Credit availability seems to be slowly improving, but Q2 might be different



Source: NCR, Absa Research

Bank credit shows households slowly accelerating borrowing

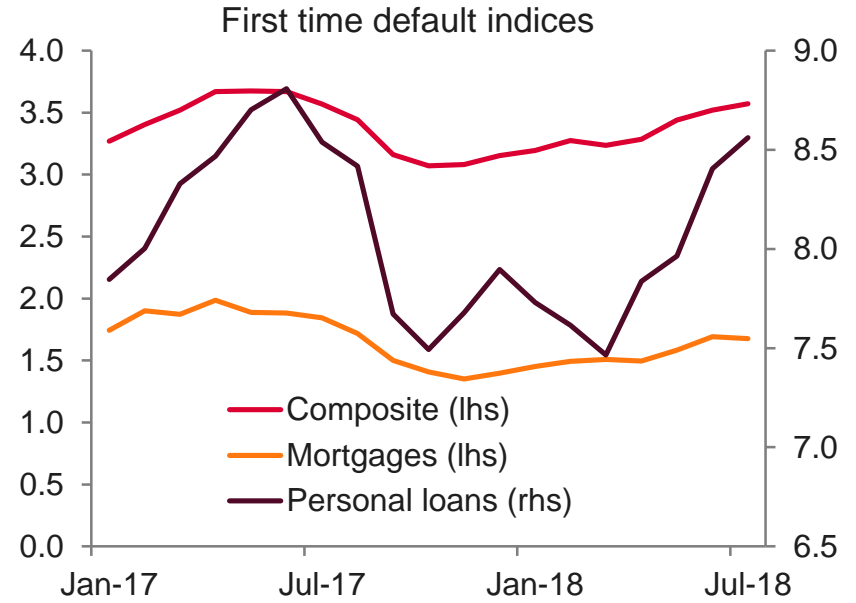
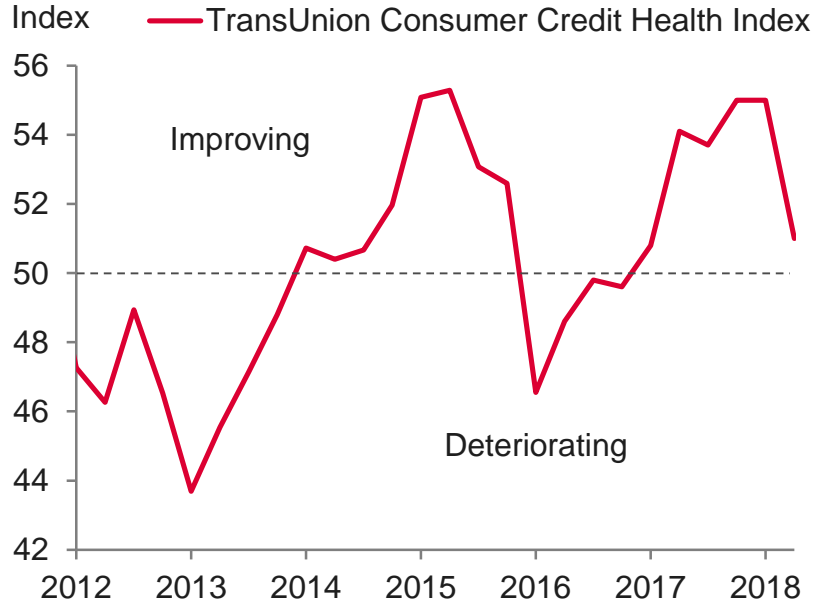


Source: SARB, Absa Research

# Household credit metrics: on the cusp of turning?

Consumer credit health deteriorated in Q2 18...

...and there are early signs of rising default behaviour



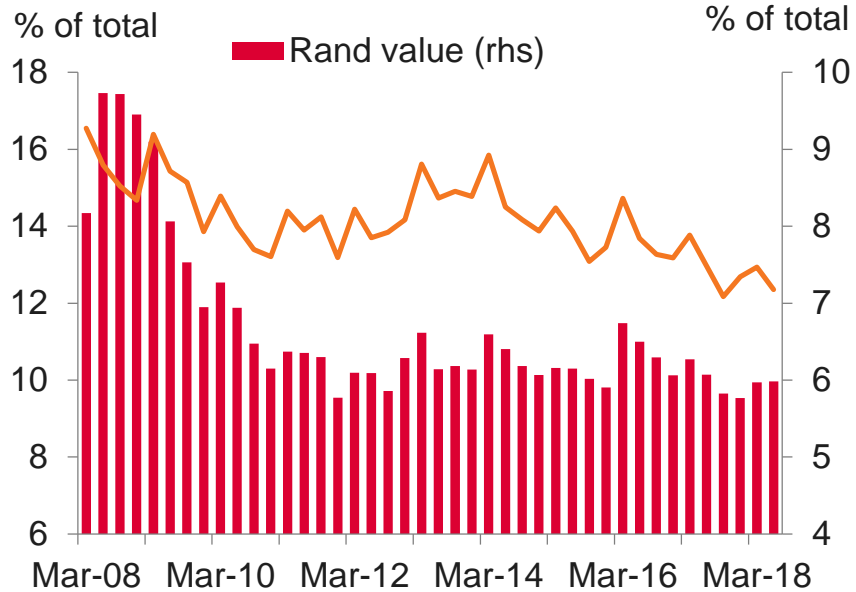
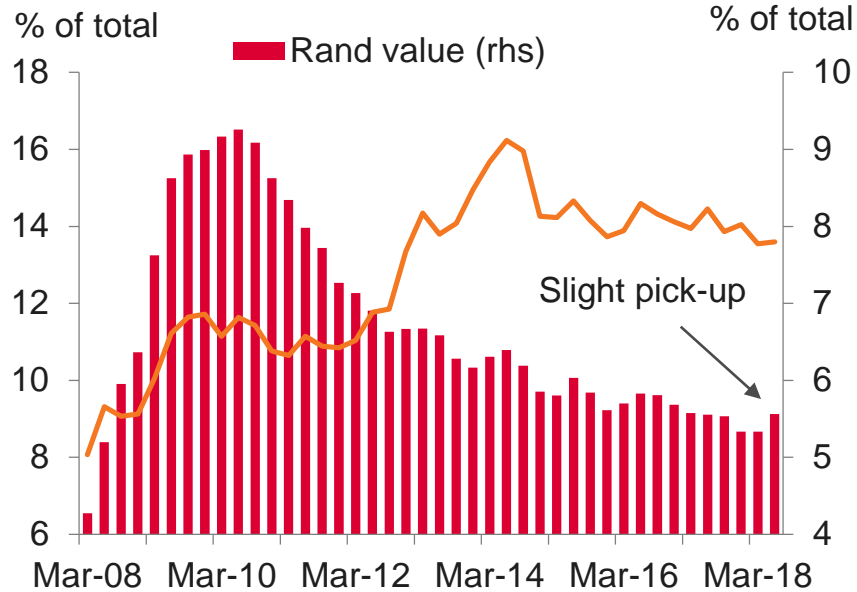
Source: TransUnion, Absa Research

Source: Experian, Absa Research

# Household credit metrics: Q2 NCR data surprisingly benign

Only a tiny pick-up in arrears in Q2...

...and no fresh overdues

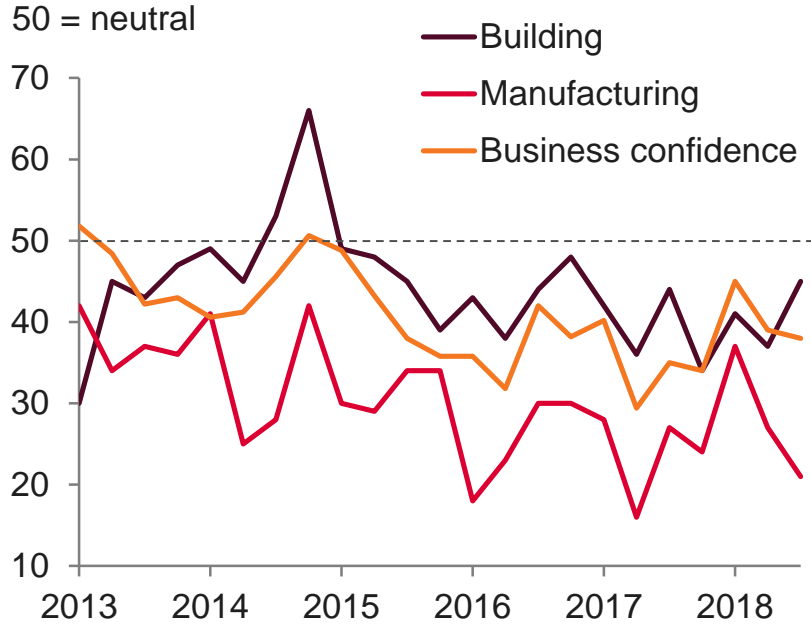


Source: NCR, Absa Research

Source: NCR, Absa Research

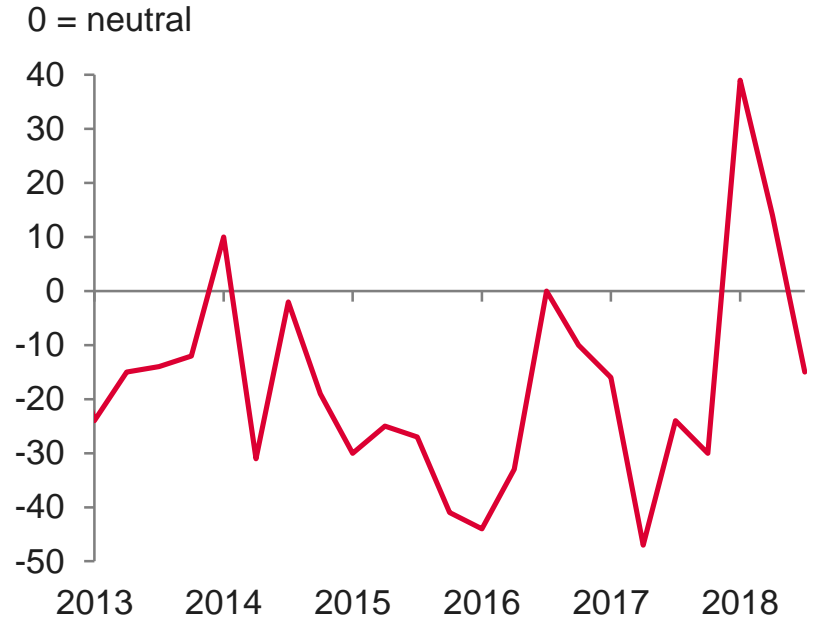
# Less than two in five businesses express confidence

Slight further Q3 fall in overall BCI, but bigger drop in manufacturing



Source: Bureau for Economic Research, Absa Research

Manufacturers' hopes about business conditions in the future have slumped



Source: Bureau for Economic Research Absa Research

# What are the prospects for real reform?

## Ramaphosa's stimulus package

Not a classic stimulus: No new spending, instead ZAR50bn reprioritisation  
ZAR400bn infrastructure fund could potentially work if quickly implemented  
Mining Charter and immigration reform are easy to do quickly  
Other microeconomic and structural reforms will take time  
Review of administered prices is good, but businesses need quick action

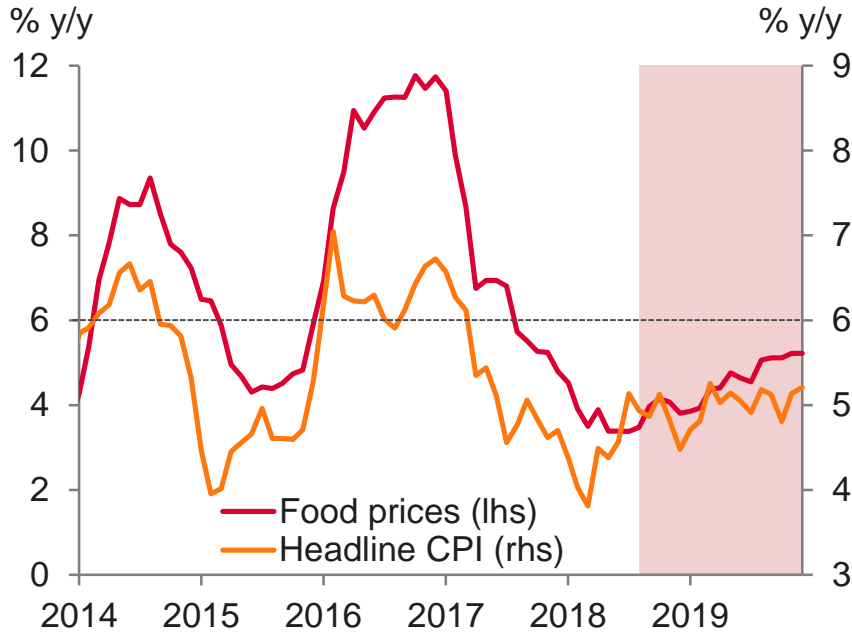
## Key reforms for after the elections?

Shrinking public sector payrolls?  
Overhauling/privatising SOCs?  
Tackling SADTU in an overhaul of the education system?  
More liberalisation of labour markets (automatic wage deal extensions)?  
Export processing zones?  
Tenure reform in communal lands?



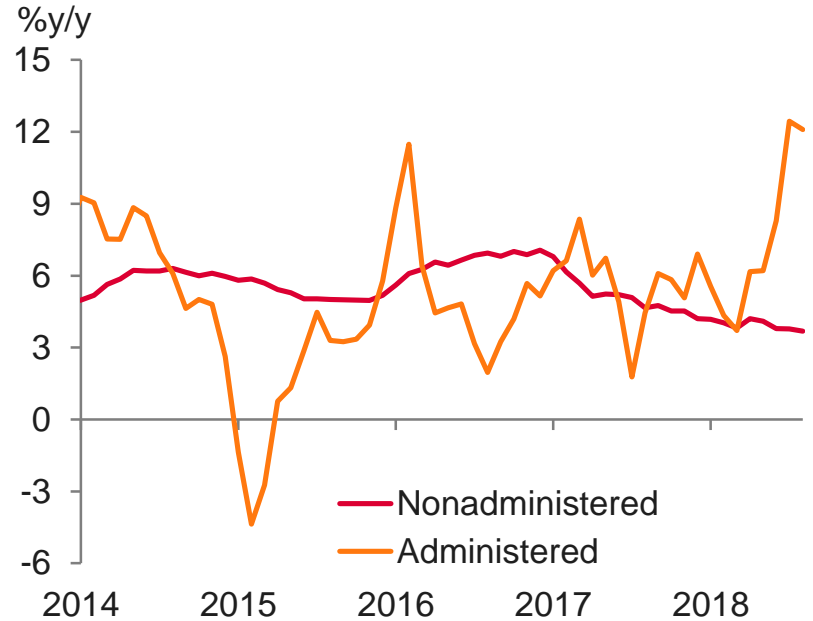
# Inflation likely to rise, but stay within target for 2018-19

Food prices are well behaved, but El Niño risk exists for 2019



Source: Statistics South Africa, Absa Research

There is no inflation – except for administered prices

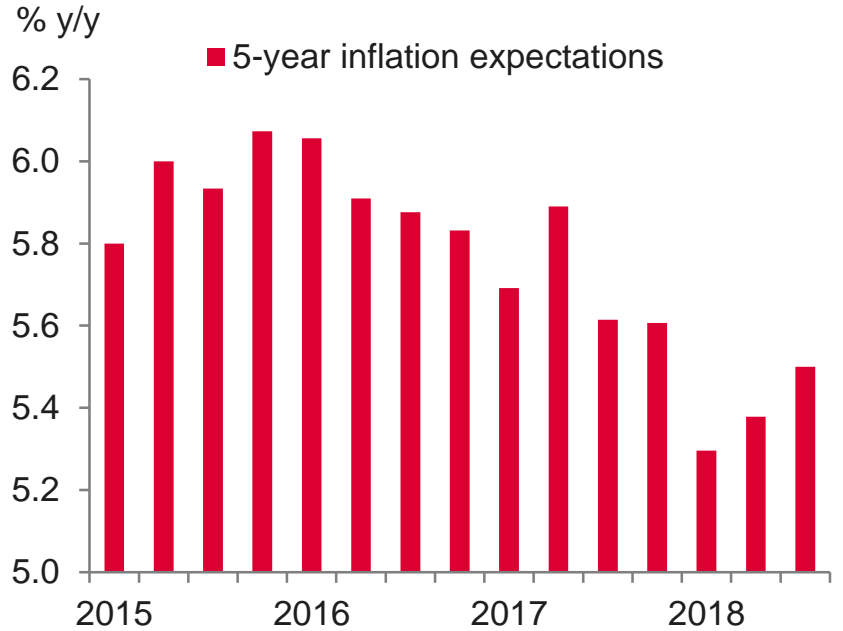
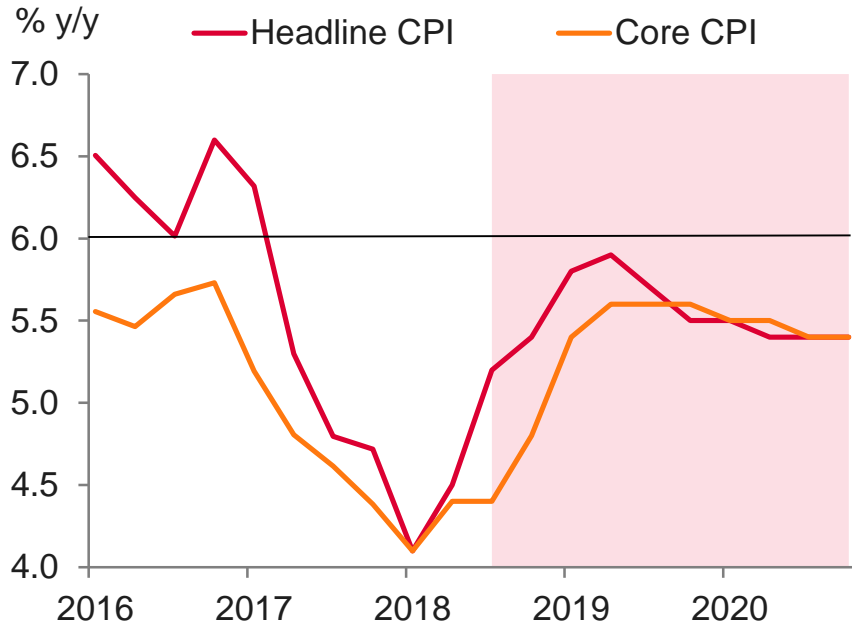


Source: Statistics South Africa, Absa Research

# Inflation likely to rise, but stays within target for 2018-19

Even the SARB itself does not forecast a breach of target...

...but inflation expectations appear to be edging up again



Source: SARB, Absa Research

Source: Bureau for Economic Research, Absa Research

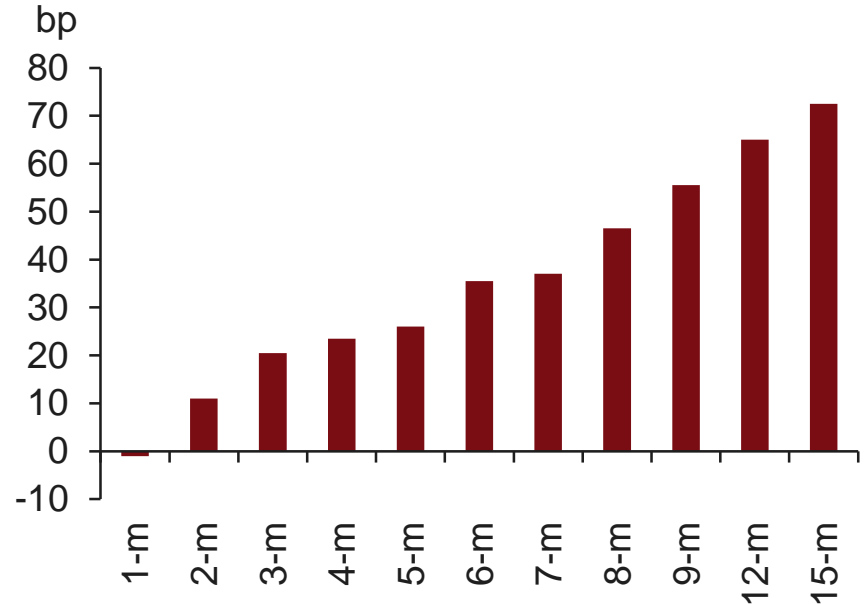
# SARB's dilemma: rising inflation but faltering growth

## Split MPC votes show a diversity of views

Sep '17	3-3	hold
Nov	6-0	hold
Jan'18	5-1	hold
Mar	3-4	25bp cut
May	7-0	hold
July	7-0	hold
Sep	4-3	hold

- MPC members who voted to hike in Sep seem to have reacted solely to the 7% weakening of the ZAR
- This is a divergence from the MPC's stated reaction function: to not react to the exchange rate per se, nor to the first-round impact of FX movements
- There are currently no second-round inflation effects; inflation for market determined prices in the CPI basket at just 3.7% y/y

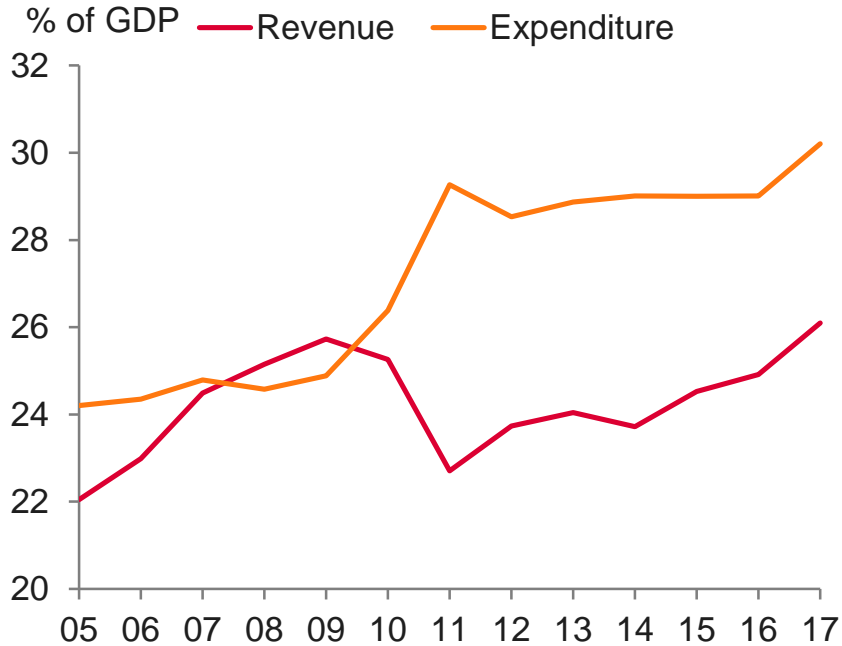
Market is pricing in a full 25bp rate hike by the March MPC



Source: Thomson Reuters, Absa Research

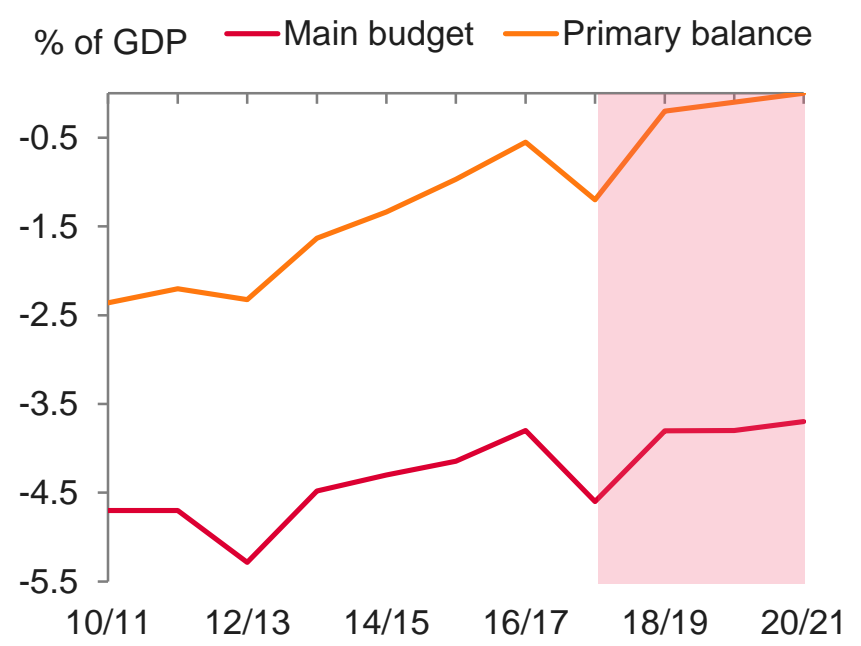
# Huge fiscal policy challenge in upcoming MTBPS

**Tax revenues have not kept pace with expenditure**



Source: National Treasury, Absa Research

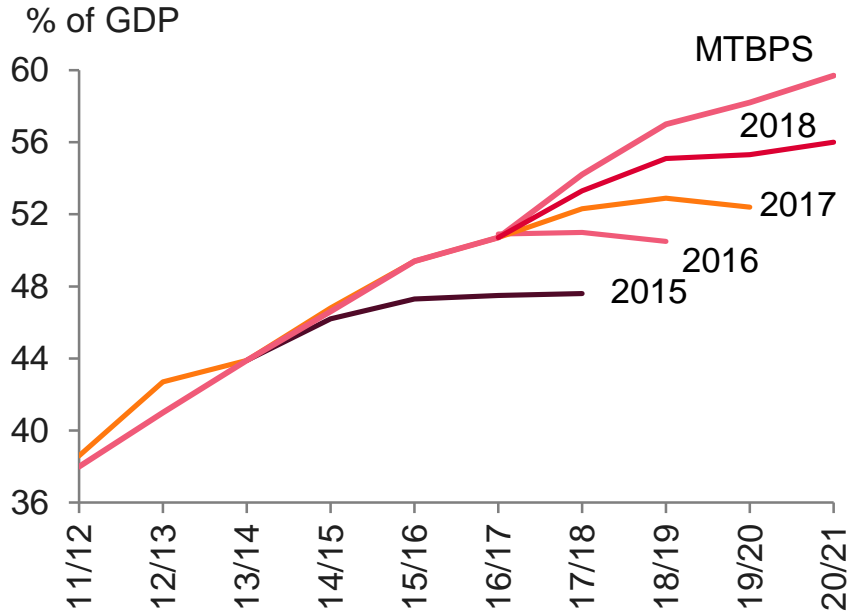
**South Africa continues to run a primary budget deficit**



Source: National Treasury, Absa Research

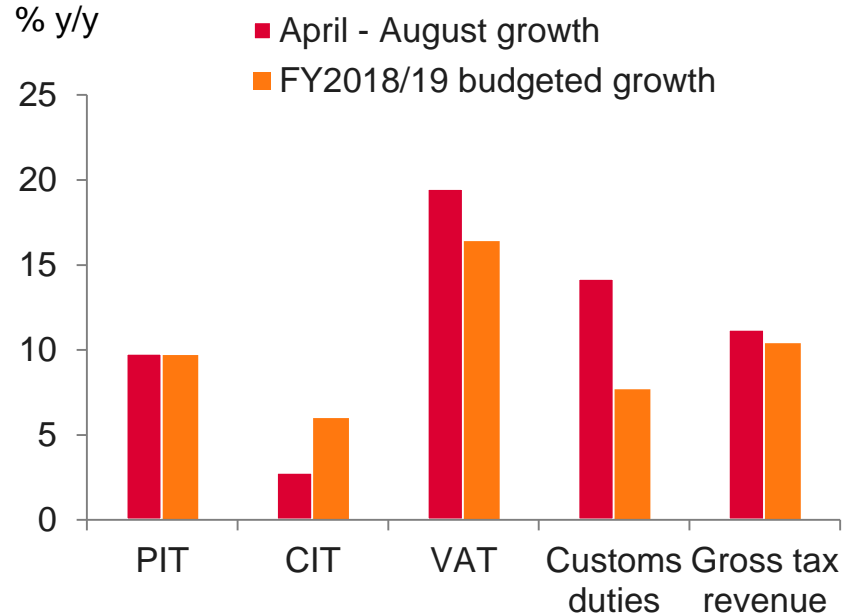
# Huge fiscal policy challenge in upcoming MTBPS

Each year, public debt – and debt service – creeps higher



Source: National Treasury, Absa Research

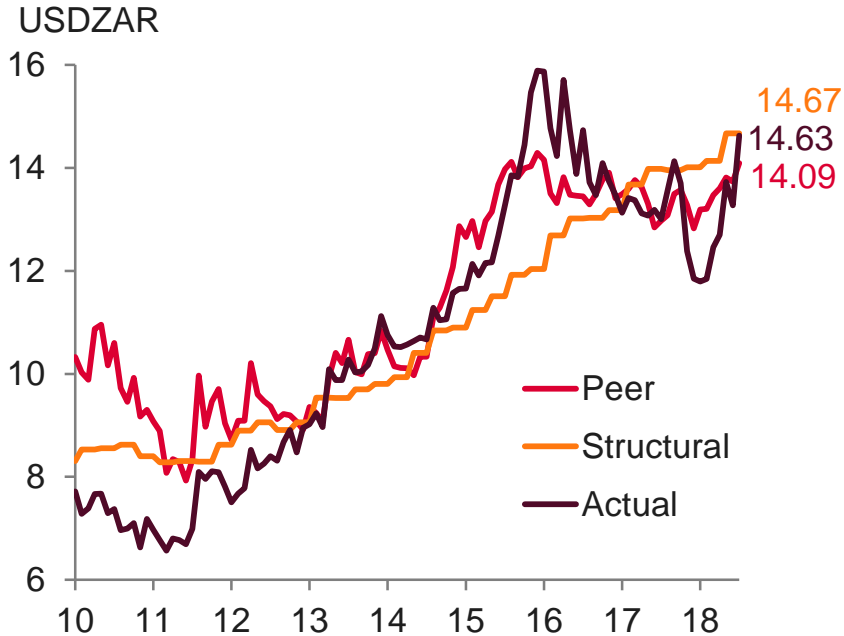
Tax receipts running slightly ahead of budget though CIT receipts are worrying



Source: National Treasury, Absa Research

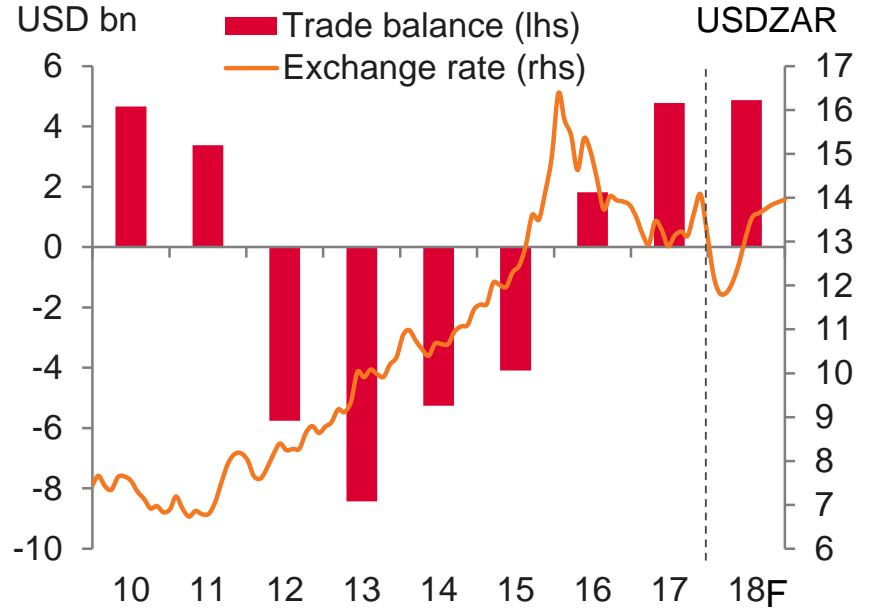
# Thinking about the rand

Our exchange rate models suggest current spot rate is very roughly right



Source: Absa Research

ZAR tends to do better in periods of merchandise trade strength



Source: Statistics South Africa, SARB, Absa Research

# Thinking about the rand

## Baseline view

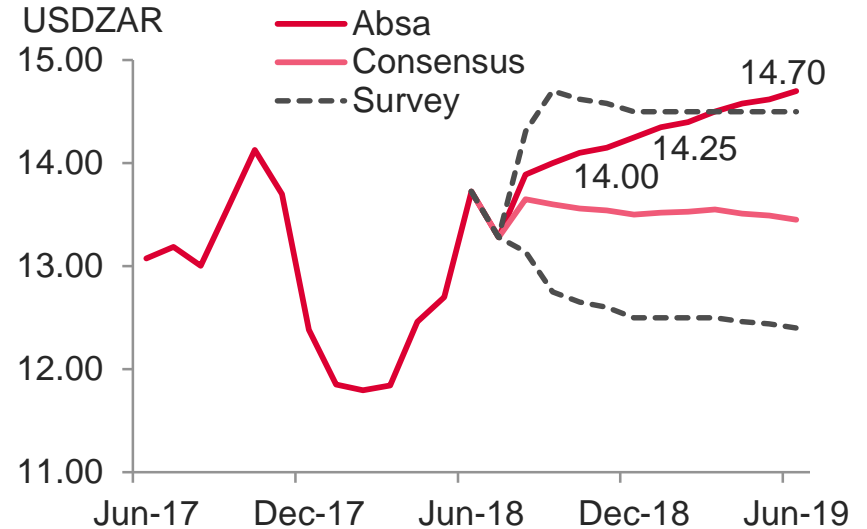
- Valuation models suggest ZAR overvalued
- Weak growth and renewed ToT deterioration
- Reduced global risk appetite

## Risks for a stronger rand

- Dollar positioning is not as stretched
- EM/DM yield differentials are at 5y highs
- Might the SARB hike rates?

## Risks for a weaker rand

- Trade wars hit global sentiment further
- EM sell-off intensifies
- SA debates deteriorate into populist policy
- Credit ratings? Moody's on 12 October



	Spot	Sep-18	Dec-18	Dec-19
<b>USDZAR</b>	14.11	14.00	14.25	15.00
<b>EURZAR</b>	16.43	16.38	16.82	18.75
<b>GBPZAR</b>	18.47	18.34	18.81	21.30

Source: Reuters, Absa Research, Spot rates as on 27 September 2018

# Key issues for the quarters ahead

## Politics

A factionalised ANC in a pre-election year, but CR is slowly gaining the upper hand  
Ramaphosa's personal popularity is a big asset in his fight against corruption  
It will be hard to handle expectations on land reform and the EFF will not help

## Economics

The chicken and egg of confidence vs growth  
The MPC's dilemma: rising CPI risks as growth slumps  
A less friendly global context: higher global rates and trade wars

## Public Finance

Public sector wage bill is a major problem  
Can new SARS leadership lift tax elasticity quickly?  
More bailout money for struggling SOCs?



# Baseline macroeconomic forecast: weaker than the last QP

	2017		2018				2019				2017	2018F	2019F	2020F	2021F	2022F
	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F						
<b>Output (% q/q saar)</b>																
Real GDP	2.3	3.1	-2.6	-0.7	1.5	1.4	1.1	1.6	1.8	2.7	1.3	0.5	1.4	2.1	2.1	2.1
Real GDP (%y/y)	1.3	1.9	1.4	0.5	0.3	-0.1	0.8	1.4	1.5	1.8	1.3	0.5	1.4	2.1	2.1	2.1
Household consumption	2.4	3.6	1.0	-1.3	1.9	1.6	1.6	2.1	2.0	2.3	2.2	1.5	1.7	2.2	2.0	2.1
Durable goods	15.2	13.1	-0.9	-11.2	5.1	2.9	1.1	2.1	2.3	2.1	6.0	3.1	1.5	2.3	3.0	3.4
Semi-durable goods	4.8	16.7	-12.1	-5.1	2.6	2.0	1.0	1.7	1.8	1.9	3.1	0.3	1.3	2.2	2.1	2.2
Non-durable goods	-1.2	2.6	0.5	-2.4	1.7	1.9	2.0	2.7	2.2	3.0	1.1	0.6	1.9	2.1	2.1	2.2
Services	2.4	-0.3	5.0	2.8	1.2	1.1	1.6	1.8	1.8	1.9	2.3	2.2	1.6	2.1	1.7	1.6
Government consumption	1.3	1.6	1.4	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.6	1.1	0.5	0.5	0.5	0.5
Investment	-2.7	7.4	-3.4	-0.5	1.1	2.1	2.7	2.7	3.1	3.3	0.4	0.3	2.3	3.0	3.2	3.3
Exports	-0.6	12.3	-17.4	13.7	4.2	2.3	1.6	1.8	2.6	2.9	-0.1	0.9	3.0	3.0	2.1	2.6
Imports	-11.4	21.6	-6.9	3.1	1.3	1.6	1.2	3.1	3.4	3.7	1.6	1.9	2.2	3.4	3.8	3.0
<b>External and government accounts (% of GDP)</b>																
Current account	-2.1	-2.9	-4.6	-3.3	-3.1	-3.5	-3.6	-3.7	-4.1	-4.0	-2.4	-3.6	-3.9	-4.1	-4.2	-4.3
Consolidated fiscal balance*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-3.5	-4.3	-3.8	-3.8	-3.7	-3.5
Consolidated primary balance*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-0.2	-0.8	-0.2	-0.2	-0.1	0.2
Government debt*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	50.6	52.7	54.6	55.9	57.3	57.0
<b>Prices (% y/y)</b>																
CPI inflation	4.8	4.7	4.1	4.5	5.0	5.0	5.2	5.4	5.3	5.1	5.3	4.6	5.2	5.2	5.3	5.3
Core CPI inflation	4.6	4.4	4.1	4.4	4.2	4.3	4.4	4.6	4.7	4.9	4.7	4.3	4.5	4.9	5.3	5.3
PPI inflation	4.3	5.1	4.3	5.0	6.1	6.0	5.9	5.9	5.5	5.6	5.5	5.4	5.7	5.7	5.6	5.6
<b>Interest rates (% eop)</b>																
Repurchase rate	6.75	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.75	6.75	6.75	6.50	6.75	7.00	7.00	7.00
Prime rate	10.25	10.25	10.25	10.00	10.00	10.00	10.00	10.00	10.25	10.25	10.25	10.00	10.25	10.50	10.50	10.50

\* Fiscal year ending 31 March. Source: Thomson Reuters, SARB, Statistics South Africa, National Treasury, Absa Research



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We, Peter Worthington and Miyelani Maluleke, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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