South Africa Research
SA Macroeconomics
3 August 2020

South Africa Q3 20 Quarterly Perspectives

No easy road to recovery

- **South Africa has been hit especially hard with a sharp increase in COVID-19 infections in recent months, but it appears to be nearing the peak in new infections. However, there is still considerable uncertainty about how the pandemic will evolve and, with health care facilities stretched, the human and economic costs of the pandemic will remain a problem for some time to come.**

- **We have revised our forecast for GDP contraction this year to 8.3% from 9.7% previously. This revision mostly reflects the better than expected data from Q1 and Q2. But given the recent escalation in new cases, we now believe that the economic recovery in H2 20 is likely to be slower than we previously expected amid extended lockdown measures, more localised disruptions to activity from ongoing COVID-19 outbreaks, and a large negative demand shock from job losses and the expiration of some of the government's economic relief initiatives. For 2021, we forecast a partial recovery of 2.4%.**

- **South Africa's already strained public finances will remain under immense pressure. In the Supplementary Budget presented in June, the National Treasury projected a main budget deficit of 14.6% of GDP (equivalent to a primary deficit of 9.7% of GDP) for FY2020/21. We believe the outcome is likely to be worse and project a main budget deficit of 16.6% of GDP. Finance Minister Mboweni has signalled a plan to achieve a primary balance in FY2023/24, which will require expenditure cuts worth R230bn in the next two fiscal years, over and above the planned R160bn wage bill cuts. We are doubtful that cuts of this magnitude can be achieved.**

- **Inflation is contained and will likely remain so for some time given the large negative demand shock to the economy. The current account deficit will narrow this year due to terms of trade support and weak domestic demand, but the capital account could remain under pressure in a global environment of elevated uncertainty. The rand has recovered significantly in recent months. Our baseline forecast has USDZAR at 15.75 by year-end. With respect to monetary policy, we expect another 25bp cut this year but see risks skewed in the direction of more.**

- **Given the inherent uncertainty and the magnitude of the policy challenges created by the crisis, other outcomes for the economy, relative to our baseline forecast, are possible, either for better or for worse. If the pandemic comes under control sooner than we expect, the recovery in 2021 may be stronger. Moreover, with reforms to lower the cost of doing business and lift confidence, we believe that the medium-term growth potential can be lifted to about 2.5%. However, there is an alternative scenario in which the pandemic, along with its costs, drag South Africa's macroeconomic performance down to a much weaker level.**

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Contents

COVID-19 2
GDP 3
Fiscal policy 6
External accounts 8
Inflation 10
Monetary policy 11
Exchange rate 12
Risk scenarios 13
Conclusion 15
Macro forecast and assumptions 16

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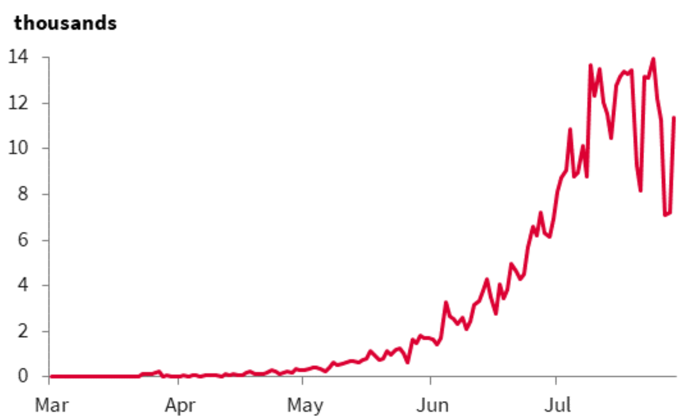
The *Quarterly Perspectives* series of reports outline our macroeconomic forecasts for South Africa with a discussion of the key themes and issues for the quarters ahead. The forecasts presented in this report are based on the output of our proprietary demand-side macroeconomic model, enlivened with supply-side constraints. The model runs off a comprehensive macro data set until Q1 20, as published by Statistics South Africa and the South African Reserve Bank's latest Quarterly Bulletin, but updated for other relevant data published more recently. Given the nature of the COVID-19 supply shock, we augment our analysis and calibrate the model output with a detailed consideration of the different productive sectors of the South African economy.

South Africa is entering peak infections, but COVID-19 will remain a problem

The COVID-19 pandemic is hitting South Africa hard, and the country now has one of the highest daily new infection rate per capita

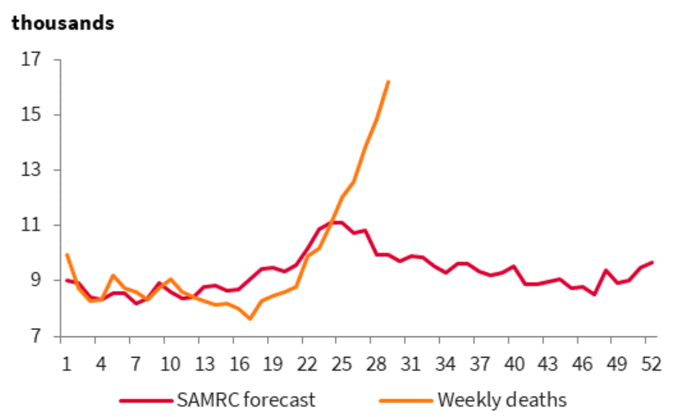
The COVID-19 pandemic is hitting South Africa hard. Daily new infections in the country as a whole have escalated sharply since the last Quarterly Perspectives, but recent data suggest that new infections are stabilising, albeit at alarmingly high levels (Figure 1), leaving South Africa with one of the highest per capita new infection rates in the world. Epidemiologists expect peak infections to occur in late August or early September. The official COVID-19-related mortality rate still looks relatively low, but recent research from the South African Medical Research Council found that between 6 May and 14 July more than 17,000 'excess' deaths from natural causes were recorded. In other words, actual deaths were 59% higher than normal for this time of the year. These excess deaths are nearly four times the official COVID-19 mortality data of 4,845 during this same period. Death rates could mount now, given that in many jurisdictions the health care systems are worryingly stretched.

Figure 1: Daily infections have risen sharply in July but may be peaking



Source: SA Department of Health, Absa Research

Figure 2: Actual reported deaths point to a bigger COVID-19 mortality rate



Source: SA Medical Research Council, Absa Research

We do not expect an effective vaccine to be available to South Africans at scale until well into the second half of 2021 at best

The unpredictability of the future course of the pandemic in South Africa is a source of tremendous uncertainty about South Africa's economic prospects in the near to medium term. We believe that even if the country passes peak infections, the virus will continue to vex, requiring inconvenient and economically costly social distancing practices and periodic localised lockdowns or closures of production facilities, as and when outbreaks occur. The science around the COVID-19 virus is expanding fast and a number of potential vaccines are currently being developed. However, it is unclear how effective they will be, but more importantly the challenge of manufacturing billions of doses of a vaccine and all the necessary equipment to administer it, and the logistical challenges of distributing around the globe are exceptionally daunting, perhaps more so than even creating the vaccine itself. Given where South Africa sits in the international pecking order of nations, we believe that investors and policy makers should not assume that a vaccine will be available in South Africa at scale until towards the end of 2021 at best.

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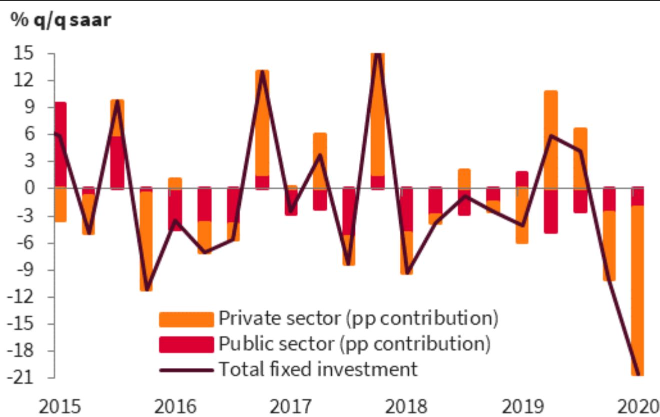
Growth recovery likely to be muted after a big Q2 collapse in GDP

Mixed economic activity data so far in Q2 20

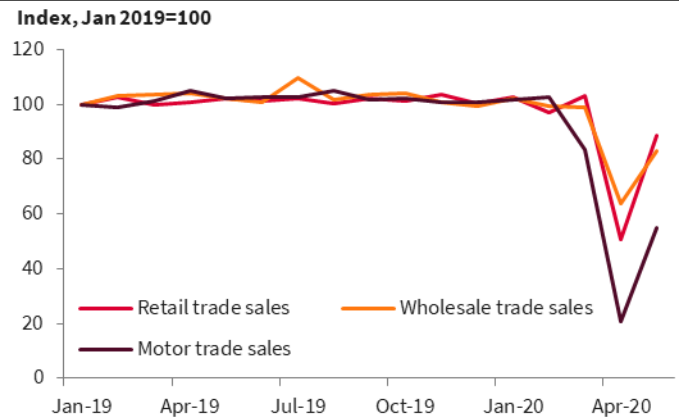
Since our last forecast update on 22 May (*Economic costs of COVID-19 mount*), a few of the activity indicators have come in a little better than we expected. For example, GDP for Q1 20 fell just 2.0% q/q saar, versus our previous forecast of -5.4%, although the demand side of the national accounts laid out an alarming collapse in fixed investment spending (Figure 3). Since then, several of StatsSA's key high frequency data – specifically mining output and wholesale and retail sales for April and May – have also performed somewhat better than expected, with a smaller than expected decline in April, and a stronger than expected bounce in May, albeit still not to the levels prevailing prior to the lockdowns (Figure 4). Other data, however, such as road and freight transport, have come in much weaker than we expected in these two months, while the motor trade and catering and accommodation data are starkly bad. Additionally, the Bureau for Economic Research's newly published survey of South Africa's services industries suggests an unprecedented collapse in its gross value added in Q2 20, with the very restrictive Level 5 lockdown in April and Level 4 in May (Figure 5).

Figure 3: Fixed investment spending collapsed in Q1 20



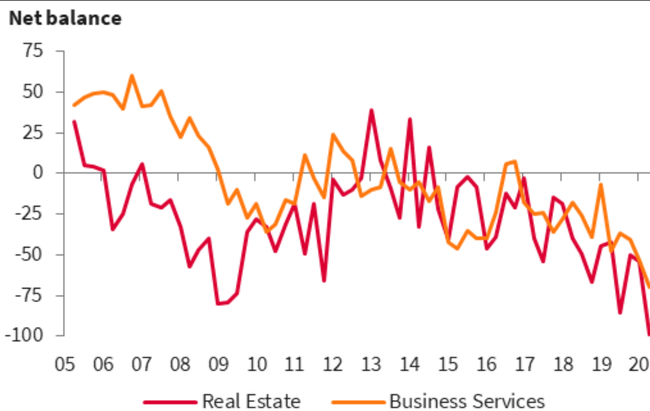
Source: StatsSA, Absa Research

Figure 4: Retail and wholesale sales have been stronger than expected



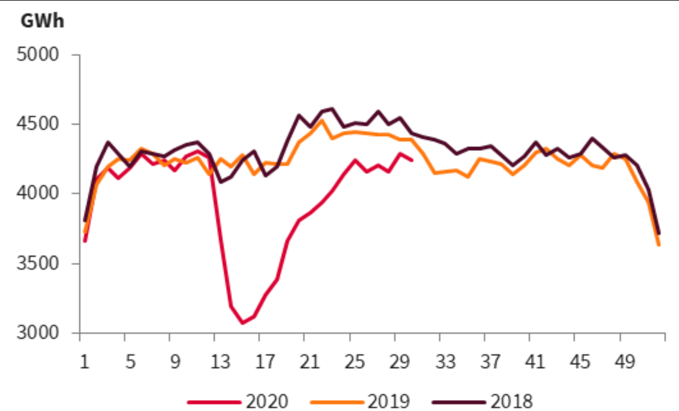
Source: StatsSA, Absa Research

Figure 5: Confidence levels in the services business have plunged



Source: Bureau for Economic Research, Absa Research

Figure 6: Electricity demand is nearly back to normal



Source: Eskom, Absa Research

GDP in the first half of 2020 will probably come in better than we expected a few months ago…

Various other data sets (including PMIs, banking transactions, electricity demand, foot traffic in economic locations, such as workplaces and shops) suggest further improvement into June and July, as the government moved to a substantially less restrictive Level 3 of lockdown (Figure 6). We analysed these and other high frequency activity data further in our recent publication, *Recent data suggest upside risk to our Q2 GDP forecast*, 27 July. Overall, we now forecast a GDP contraction in Q2 20 of 13.5% q/q seasonally adjusted but not annualised.[1] By way of comparison, flash

[1] Even though the normal way of reporting South Africa's GDP data is quarter-on-quarter seasonally adjusted and at an annualised rate (q/q saar) we choose not to annualise the quarterly growth rates here because annualising such large step changes magnifies the figures in a non-linear way, which we feel obscures understanding. A level drop of 13.5% q/q is equal to an annualised drop of 44.1% q/q saar.

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estimates show US output down by 10.0% in Q2, and Eurozone GDP down by 12.1%. Notably, both these economies had much lighter lockdowns, on average, than South Africa. Although our new Q2 GDP forecast is better than our previous call of a 19% q/q contraction, Absa Research still likely sits on the bearish side of consensus. A recent survey of 26 economists by Bloomberg put the average GDP forecast for Q2 at -39.2% q/q saar, equivalent to a level drop of 11.7%. Full Q2 national accounts data will be released only on September 8.

…but the outlook for the second half of the year has dimmed as the pandemic has escalated sharply, and Level 3 restrictions remain in place

Far more important than the specific outcome for Q2, however, is the growth outlook for H2 20 and into 2021. Unfortunately, we believe the prospects of a relatively robust recovery in the second half of this year have dimmed, given the deteriorating global growth backdrop and the escalation of the COVID-19 pandemic domestically, which will have constraining effects on confidence and economic activity. In particular, South Africa is unlikely to relax the lockdown further until the pandemic is much more under control and this is probably several months away at least. Additionally, although the current Level 3 lockdown allows a substantially broader range of economic activities than Level 5 or 4, some key parts of the economy continue to be restricted – for example, the government only announced last week that it would soon allow intra-provincial leisure travel and accommodation while inter-provincial and international travel remains banned.. Moreover, in mid-July, the government reintroduced the ban on the sale of alcohol for domestic consumption, which is a big blow to restaurants struggling to reopen in the face of sharply fewer customers anyway. Finally, although most of the important parts of the economy are now formally permitted to operate, albeit with safety precautions to maintain social distancing, even in the absence of major formal restrictions, large parts of the economy could still struggle to restart given a number of ongoing impacts of the COVID pandemic:

- the psychological shock of COVID-19 as people simply stay home to try and avoid getting infected;
- ongoing localised supply disruptions as new outbreaks lead to temporary closure of production and distribution facilities; and
- the demand shock that looms when workers lose their jobs and incomes.

The scheduled termination of the programme of expanded social grants and wage support for furloughed workers under the TERS scheme could be a big blow to household income and hence domestic demand

We believe the demand shock will be particularly significant and potentially long-lasting. For one, the R50bn temporary increase in social grants is due to expire in October. Meanwhile, the partial income support from the Unemployment Insurance Fund (UIF) under the Temporary Employee/Employer Relief Scheme (TERS) for workers furloughed without income was recently extended by six weeks, but its new termination date in mid-August will also represent a big negative blow to household spending power (although actual payments from the scheme may drag on for a bit). Employment levels in general are a lagging economic indicator and job losses could accelerate sharply now, especially if firm bankruptcies also pick up. The scale of permanent business closures and job losses in the rest of the year, and their interdependency, are critical, but exceptionally challenging to forecast. Pending further data and analysis, we assume 1.5mn job losses in Q2 and the remainder of the year.

Job losses of 1.5mn at South Africa's median wage would translate into a hit to household spending power worth about 2.4% of GDP

To put this into context, 1.5mn job losses at the average wage in the formal sector non-agricultural economy would translate to an income loss of about R405bn, about 8% of GDP. At South Africa's median wage, the job losses would translate to an income hit of about R120bn, which is perhaps a more realistic figure since job losses are likely to be concentrated at the lower end of the income distribution. Some of the hit to income from job losses might be offset by payments from the UIF, but certainly not all of it, with the UIF (post the initial phase of TERS) having only about R103bn in reserves. Additionally, consumption demand will be impaired by pay cuts at both the lower and upper income levels (i.e., reduced financial sector bonuses) and the negative wealth and confidence effects as higher income households defensively curtail what was previously optional spending. These effects will be partly mitigated by the SARB's 300bp of rate cuts so far this year, which serve to inject about R50bn per annum into consumer wallets with floating rate debt (mainly middle to high income households with mortgages and car loans).

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Different productive sectors will be differently affected by the remaining lockdown restrictions, ongoing supply chain disruptions, and the hit to both domestic and international demand

Therefore, while the Q1 and Q2 numbers may have surprised on the upside, the pace of the rebound in H2 will likely be less robust than we previously envisaged. In addition to the industries mentioned above that will remain constrained by the Level 3 restrictions, we also see construction, the motor industry and real estate as particularly vulnerable to the negative demand and confidence shocks. Additionally, some parts of manufacturing and retailing – especially those firms involved in making or selling optional consumer items – are unlikely to quickly recover to pre-COVID-19 business volumes. The spectre of ongoing load-shedding events is an additional constraint. The only production side sectors that are likely to do well this year are agriculture, given a bumper maize crop, water, communications, and those businesses that can onshore critical production of essential goods, such as PPE and pharmaceuticals (Figure 7). Overall, the GDP bounce out of Q2 (with 2 of its 3 months being locked down relatively hard) is likely be material, but thereafter in Q4 the pace of growth will probably ebb somewhat.

Figure 7: GDP will generally not recover to 2019 levels even by 2021, but some sectors suffer a more persistent knock than others

	Index 2019q4=100, levels									
	2020F				2021F				Real GDP, % y/y	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2020	2021
Agriculture, forestry and fishing	106.3	114.6	123.5	127.9	126.3	126.3	126.3	126.3	15.3	6.9
Mining and quarrying	94.1	69.4	78.0	81.6	84.5	86.6	88.7	90.8	-18.8	8.5
Manufacturing	97.8	68.8	77.4	81.8	83.8	85.8	86.9	87.9	-19.2	5.7
Electricity and water	98.6	91.3	92.3	93.4	94.5	95.6	96.8	97.9	-7.2	2.5
Electricity	98.6	88.8	90.1	91.4	92.8	94.1	95.5	96.9	-8.9	2.8
Water	98.6	98.9	99.3	99.7	100.0	100.4	100.8	101.2	-2.1	1.5
Construction	98.8	61.5	66.9	69.3	71.7	74.3	76.9	79.7	-27.5	2.1
Trade & accommodation	99.7	81.8	88.9	90.8	91.7	92.5	93.8	95.0	-9.9	3.3
Wholesale	99.7	91.2	95.4	96.1	96.6	97.1	97.8	98.5	-4.6	2.0
Retail	99.7	91.2	94.4	95.1	95.6	96.1	96.8	97.5	-5.1	1.5
Motor trade	99.7	47.1	72.2	79.9	81.8	83.8	86.8	89.9	-25.4	14.5
Catering and accommodation	99.7	26.5	40.6	47.0	50.7	54.6	58.9	63.5	-46.6	6.5
Transport and communication	100.1	93.2	97.6	98.8	99.8	100.9	101.9	103.0	-4.6	4.1
Transport	100.1	85.8	91.1	92.2	93.4	94.5	95.7	96.9	-9.6	3.0
Communication	100.1	108.9	111.5	112.9	113.8	114.6	115.4	116.3	6.1	6.1
FIRE sectors	100.9	90.1	90.7	91.4	92.0	92.6	93.3	94.0	-5.8	-0.3
Finance and insurance	100.9	94.5	94.5	94.8	95.1	95.6	96.2	96.8	-2.9	-0.3
Real estate	100.9	80.3	81.4	82.4	83.4	84.5	85.5	86.4	-12.9	-1.5
Business services	100.9	92.3	93.7	94.8	95.3	95.8	96.5	96.9	-3.7	0.7
Personal services	100.1	88.1	90.2	91.3	91.8	92.3	92.9	93.4	-7.3	0.2
General government services	100.2	101.7	101.7	101.7	101.7	101.5	101.2	100.5	1.8	-0.1
Total value added at basic prices	99.5	86.1	90.1	91.8	92.8	93.7	94.6	95.3	-8.3	2.4
GDP %y/y	-0.3	-14.4	-10.2	-8.2	-6.7	8.8	4.8	3.8	-8.3	2.4

Source: Statistics South Africa, Absa Research

We now expect GDP to contract 8.3% this year

From the expenditure side of the national accounts in 2020, we forecast a big contraction in personal household consumption expenditure, a near-term expansion of government consumption spending, weak fixed investment spending, and a contraction of imports that outweighs weaker export volumes (see our full forecast in Figure 22 on page 16). Additionally, inventory drawdown is likely to be quite a drag on growth this year. Overall, we now forecast that for 2020 as a whole GDP contracts by 8.3%. This is obviously much better than our previous forecast of -9.7%, thanks to the better-than expected foundation provided by the Q1 and Q2 data. We caution however that uncertainty is high, and both better and worse growth outcomes this year are possible, depending on how things pan out. We forecast a modest 2.4% growth in 2021. The pandemic will leave South Africa poorer, more unequal and more heavily leveraged and this is a poor foundation for economic recovery. The virus itself will continue to depress confidence and shackle economic activity, at least until an effective vaccine is available.

Without a much faster and broader programme of reforms, South Africa's long-term growth rate is probably stuck at about 1.5%

Of course, the longer term matters even more than the GDP outcome for this year or next. In other words, how fast can South Africa begin to claw back lost production levels and household welfare once the pandemic is out of the way? Given the current policy mix, the prognosis does not look particularly promising. The government is aiming at changing South Africa's institutional savings

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framework to encourage private sector investment into a major infrastructure development programme, but the implementing details are still unclear, and it may not get off the ground quickly. Similarly, a programme of growth-boosting structural reforms (including energy supply liberalisation, broadband spectrum auction, modernisation of rail, road and port transport industries and red-tape elimination) is on the agenda, but again implementation could be slow, while other key structural reforms such as labour market liberalisation do not appear to be even up for discussion. Necessary but challenging reforms are held up by both ideological contestation and also weak state capacity. Absent an accelerated and expanded reforms effort, we believe that growth will revert to about 1.5% per annum, after a slight rebound spurt in 2021. Interestingly, the National Treasury recently took a similarly conservative view on South Africa's longer term growth prospects.

Big spending cuts to be detailed in MTBPS

The COVID-19 pandemic has sent South Africa's already shaky public finances reeling

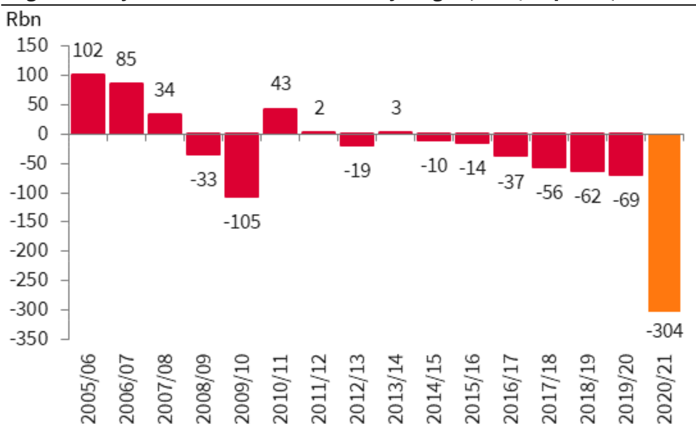
The COVID-19 pandemic is ravaging South Africa's public finances. While this is true for most countries around the world, South Africa entered into this crisis with a weaker fiscal position than most. Now, in 2020/21, the unprecedented economic contraction is causing tax collections to crater, while the immediate health interventions and economic support priorities of the authorities require a lot of upfront spending. In the Supplementary Budget unveiled on 24 June, Finance Minister Mboweni laid out a starkly revised fiscal plan, with R142bn new COVID-19-related spending (and a R3bn equity injection for Land Bank) funded by a major reprioritisation of previous budgetary allocations as well as a R36bn increase in the overall spending envelope. (See *South Africa Supplementary 20/21 Budget: No detail yet on targeted spending cuts*, 24 June, for more details, and Figure 8.)

Figure 8: Sizeable reprioritisation, but total noninterest spending still R36bn higher

Rbn	FY2020/21
Main budget non-interest expenditure (2020 Budget Review)	1536.7
Proposed upward expenditure adjustments	145.0
Proposed downward expenditure adjustments	-100.9
National departments' baseline suspensions	-54.4
Repurposing of provincial equitable share	-20.0
Provincial conditional grant suspensions	-13.8
Local government conditional grant suspensions	-12.6
Other adjustments	-8.1
National Revenue Fund payments	0.0
Downward revisions to skills development levy	-2.1
Lower skills development levy due to 4-month holiday	-6.0
Revised noninterest expenditure	1572.7
Change in non-interest expenditure from 2020 Budget	36.0

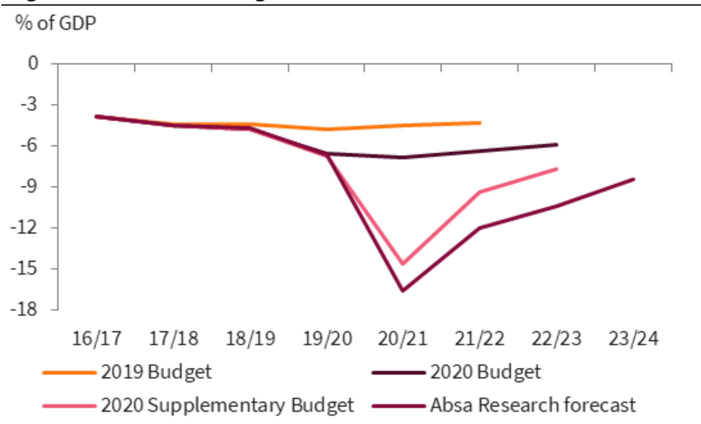
Source: National Treasury, Absa Research

Figure 9: In-year revenue versus February target (2020/21 prices)



Source: National Treasury, Absa Research

Figure 10: Govt aims for big fiscal consolidation after COVID-19 blowout



Source: National Treasury, Absa Research

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The Supplementary Budget forecasts a main budget deficit outcome of 14.6% of GDP for this year

Meanwhile, the Supplementary Budget forecast a big tax shortfall (relative to the original February 2020 Budget target for the current fiscal year) of R304bn (Figure 9). With slumping revenues and increased spending, the National Treasury now projects the main budget deficit to come in at 14.6% of GDP, equivalent to a primary deficit of 9.7% of GDP (Figure 10). Meanwhile, due to payments out of the UIF for the TERS scheme, the National Treasury forecasts the consolidated deficit at 15.7% of GDP.

We see further upside spending risks in the current fiscal year

We believe these numbers could come in even worse than the Treasury has forecast, because we have a slightly more pessimistic expectation for GDP in 2020. Also, we are of the view that the courts are more likely than not to enforce the implementation of the third year of the public sector wage deal (i.e., for FY2020/21), thus requiring an additional R37.8bn in spending this year. The announced extension and the possible expansion of the TERS/UIF scheme will have adverse cost implications at the level of the consolidated budget, which includes the social security funds such as the UIF. We also see a potential upside spending risk in that the government may find it politically and socially untenable to rescind the R50bn temporary expansion of social grants as planned in October. However, because there is uncertainty about this, we have not factored it into our forecast that the main budget deficit this year will come in at 16.6% of GDP.

Finance Minister Mboweni said that he is aiming at R230bn spending cuts in the next two fiscal years on top of R160bn cuts in public sector compensation over the three years commencing with the current one, but details will only be provided in October with the MTBPS

Weaker growth and sharply wider deficits have sent South Africa's debt dynamics lurching onto a much more adversarial trajectory, with the debt ratio projected by the National Treasury to rise from 63.5% of GDP at the end of FY2019/20 to 81.8% of GDP by the end of this fiscal year. We forecast 84.6%. In response to this growing fiscal crisis, Finance Minister Mboweni has said that big spending cuts are essential, amounting to R230bn over the next two years, on top of the R160bn of cuts to public sector compensation that he promised in the February 2020 Budget for the current and next two years (R37.8bn in the current year, and R54.9bn in FY2021/22 and R67.5bn in FY2022/23). We believe this is an enormous adjustment goal, amounting to 9% of consolidated spending over the next two fiscal years (assuming that the R37.8bn of public sector pay restraint planned for this year is forced into next year). Mboweni said that details of where these cuts may fall will only be announced in October with the Medium Term Budget Policy Statement (MTBPS), but confirmed that the government is moving to zero-based budgeting, under which all expenditure is re-examined and re-justified with each iteration of the fiscal plan to see if it provides good value for increasingly scarce money. Of course, uncertainty remains high, but we doubt that Mboweni can deliver on spending cuts of that magnitude, in the face of likely widespread opposition within the governing alliance (and society at large) to 'austerity'. Also, such large proposed cuts may have a tactical messaging element to them, softening the unions and the left up to readily accept smaller cuts. Uncertainty remains extremely high, of course, but we are minded to pencil into our forecasts an assumption that Mboweni gets about half the spending cuts that he is aiming for. This is unlikely to be sufficient to stabilise the debt to GDP ratio in the near term, unless growth from 2021 onwards surprises strongly to the upside.

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Figure 11: Absa Research forecasts a slower pace of fiscal consolidation than the active scenario laid out in the Supplementary Budget

	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24
National Treasury 2020 Supplementary Budget targets								
Nominal GDP, Rbn	4419	4699	4921	5137	4860	5329	5618	--
%y/y	7.1	6.3	4.7	4.4	-5.4	9.7	5.4	--
Revenue, Rbn	1138	1196	1275	1345	1100	1268	1379	--
% of GDP	25.7	25.5	25.9	26.2	22.6	23.8	24.5	--
Expenditure, , Rbn	1305	1405	1507	1691	1809	1764	1809	--
% of GDP	29.5	29.9	30.6	32.9	37.2	33.1	32.2	--
Noninterest expenditure, Rbn	1159	1242	1325	1486	1573	1501	1508	--
% of GDP	26.2	26.4	26.9	28.9	32.4	28.2	26.8	--
Interest costs, Rbn	146	163	182	205	236	263	301	--
% of GDP	3.3	3.5	3.7	4.0	4.9	4.9	5.4	--
Deficit, Rbn	-167.5	-208.6	-231.3	-345.3	-709.6	-495.5	-430.5	
% of GDP	-3.8	-4.4	-4.7	-6.7	-14.6	-9.3	-7.7	
Gross debt, Rbn	2233	2490	2788	3261	3974	4371	4830	--
% of GDP	50.5	53.0	56.7	63.5	81.8	82.0	86.0	--
Absa Research July 2020 Forecasts								
Macro context	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24
Real GDP, % y/y	0.8	1.6	0.4	0.1	-9.9	5.1	1.4	1.4
GDP deflator, % y/y	6.2	4.8	4.3	4.3	3.5	3.7	3.9	4.2
Nominal GDP, Rbn	4419	4699	4931	5149	4801	5235	5513	5825
% change	7.1	6.3	4.9	4.4	-6.7	9.0	5.3	5.7
Deviation from Supplementary Budget target, Rbn					-59	-94	-105	--
Revenues								
Tax elasticity	0.97	1.00	1.23	1.20	3.20	1.40	1.30	1.20
Tax hikes, Rbn	0	0	0	0	0	5	10	15
Main budget revenue, Rbn	1138	1196	1275	1345	1055	1193	1285	1388
Deviation from Supplementary Budget target, Rbn					-45	-75	-93	--
Spending								
Noninterest spending, Rbn	1159	1242	1325	1486	1611	1546	1536	1525
% y/y		7.2	6.6	12.2	8.4	-4.0	-0.6	-0.7
Interest costs, Rbn	146	163	182	205	240	275	320	350
Main budget expenditure, Rbn	1305	1405	1507	1691	1851	1821	1856	1875
Deviation from Supplementary Budget target, Rbn					41	57	46	--
Key fiscal metrics								
Deficit, Rbn	-167	-209	-231	-346	-796	-628	-570	-487
as % of GDP	-3.8	-4.4	-4.7	-6.6	-16.6	-12.0	-10.3	-8.4
Primary balance, % of GDP	-0.5	-1.0	-1.0	-2.6	-11.6	-6.7	-4.5	-2.4
Gross debt, Rbn	2233	2490	2788	3261	4060	4589	5188	5676
as % of GDP	50.5	53.0	56.5	63.5	84.6	87.7	94.1	97.4
Debt service as % of tax revenues	12.8	13.4	14.1	15.2	22.8	23.1	24.9	25.2

Source: National Treasury, Absa Research

Current account deficit narrows but capital flows are key

South Africa recorded its first current account surplus since 2003 in Q1 20, but a small deficit is likely for Q2

Some calm has returned in global financial markets in recent months, thanks in part to the unprecedented monetary and fiscal policy support that advanced economies have unleashed in response to the pandemic. However, global risk sentiment could remain volatile given the still elevated uncertainty about the global outlook. This is likely to keep South Africa's external vulnerabilities top of mind for investors, given the country's relatively open capital account. In this respect, recent data on the current account of the balance of payments have been encouraging. The current account (CA) swung from a deficit of 1.3% of GDP in Q4 19 to a surplus of 1.3% in Q1 20

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(Figure 12), the first surplus since Q1 2003. The surplus was mainly due to the merchandise trade surplus surging to 4.0% of GDP in Q2 from 0.8% of GDP in Q4 19. Meanwhile, the deficit on the 'invisibles' account narrowed from 3.3% in Q4 to 2.7% in Q1, the smallest since 2006. That said, some deterioration in the current account balance seems likely in Q2 due to the lockdown-related disruptions to domestic production and exports, especially in April. On the basis of the monthly merchandise trade data, which posted a record surplus of R46.6bn in June, we expect the current account to print a small deficit of 0.8% of GDP in Q2.

Three key determinants of the current account balance going forward

Looking ahead, we see three key determinants of the path of the current account:

- Firstly, and mostly importantly, the balance between external demand for South Africa's exports versus the strength of domestic demand that reflects in imports;
- Secondly, terms of trade, which is the ratio of South Africa's export prices to its import prices, and which is particularly important in an environment of rapidly shifting commodity prices;
- Thirdly, the degree to which the invisible account narrows further on the back of recent divestments by foreign portfolio investors.

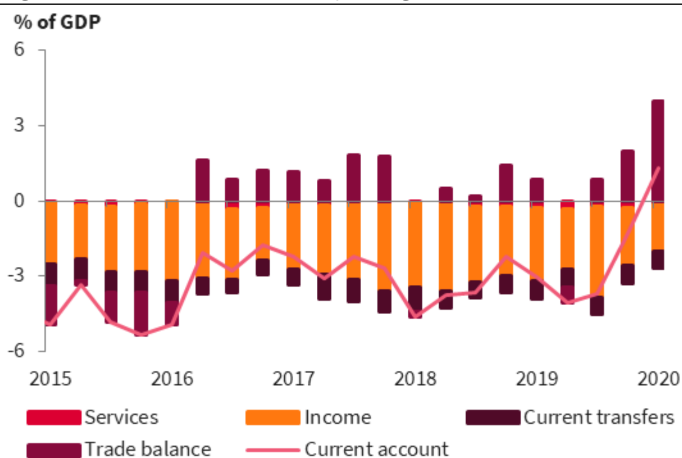
Import compression should outweigh the hit to exports

As regards export volumes, on 13 July, the WTO estimated that world trade could shrink by between 13% and 32% this year, with a sharply weaker global growth outlook recently published by the IMF. This is likely to dampen export volumes, which we see shrinking by about 11% this year. This contraction will be outweighed, however, by a contraction in imports as domestic demand shrivels (Figure 13). We forecast that domestic expenditure will fall by 9.4% in 2020, pulling import volumes down by nearly 15%.

South Africa's terms of trade have been quite favourable recently, but the oil price surge will have eroded some of this support; the gold price rally provide some offset

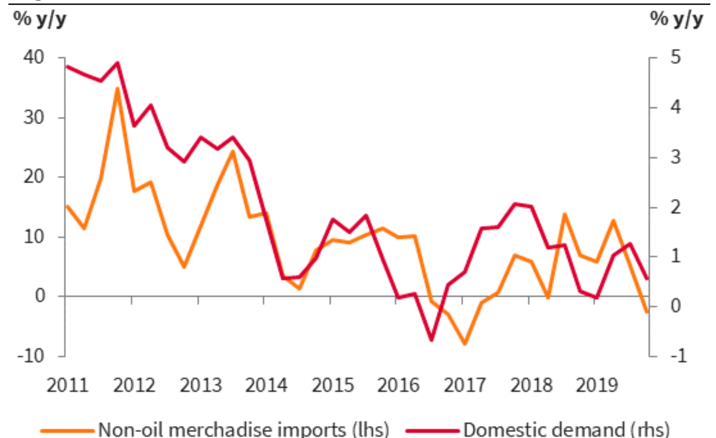
Terms of trade likely remained supportive of the merchandise trade balance in Q2, but we believe this will fade somewhat, moving forward. The Brent crude oil price, a key import, has risen sharply in recent months, averaging USD43.9/bbl in July compared to just USD28.2/bbl in Q2. Meanwhile, key export commodities showed mixed price movements in Q2. PGM and coal prices fell sharply in Q2, but gold prices have rallied strongly. Meanwhile, the structural 'invisibles' deficit could narrow further as the large portfolio outflows recently will likely lower interest and dividend repayments. Against this, we forecast the current account to hit -0.7% of GDP overall in 2020, and -1.6% in 2021.

Figure 12: The current account likely swung back to a deficit in Q2



Source: SARB, Absa Research

Figure 13: Weak domestic demand will compress imports



Source: Stats SA, SARS, Absa Research

Capital account flows remain key but South Africa's strong net international investment position is an important buffer

Given the ongoing uncertainty, the financing side of the balance of payments is critical. Net foreign direct investments were positive in Q1 20 but it is hard to see this being sustained as firms are likely to hold back on large capital outlays amid the ongoing uncertainty. Meanwhile, portfolio investment has recently recorded large net outflows (Figure 14). According to JSE data, foreigners sold R88bn of South Africa's government bonds and R53bn of South African equities in the first half of the year, although such sales have recently tapered off thanks to the improvement in the global risk appetite. Big portfolio outflows tend, however, to be offset by sizeable other capital

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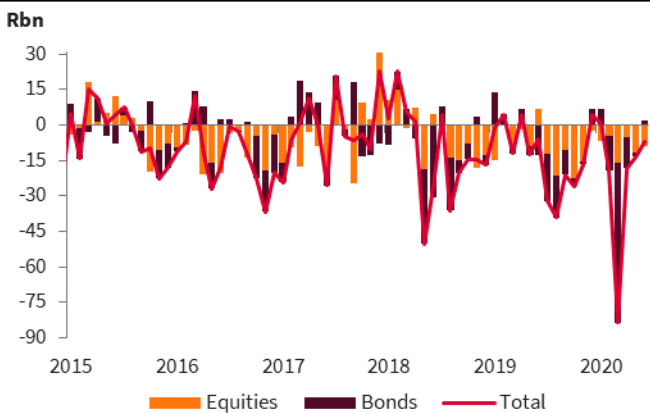
inflows. Importantly, and unusually for an emerging market, South Africa has a strong net international investment position. South Africa's net international investment position increased from R447bn in Q4 19 to R1.6 trillion in Q1 (Figure 15) due to foreign liabilities of SA falling by R378bn and foreign assets of SA rising by R750bn, helped by exchange rate movements in Q1 as well as the relative movement of South African versus foreign markets. The effect of prudential regulatory limits on offshore investments as a percentage of AUM means that some of South Africa's portfolio investment abroad will probably need to be repatriated over the coming year.

Figure 14: Foreign portfolio outflows continued to ease in Q2



Source: SARB, Absa Research

Figure 15: South Africa has a strong net international investment position

Source: SARB, Absa Research

CPI downside target breach will be brief but trajectory to remain contained

Lower fuel prices have helped to push headline CPI inflation below the target range in May…

Headline CPI inflation has been on a steady declining path for several years due to weak demand and an unusually long period of low and stable food inflation. The sharp decline in the Brent crude oil price in March and April, by more than 60%, helped push CPI inflation still lower. In May, headline CPI inflation delivered a downside breach of the target range, printing at just 2.1% y/y, its lowest level in 15 years. Core CPI inflation has also continued to soften, reaching 3.1% y/y in May from an average of 3.7% in Q1 20. It is worth noting that lockdown restrictions have presented some challenges to the statistics authorities in the measurement of these data. In April and May, nearly 25% of the CPI had to be imputed as pricing information was not available. The imputation strategy resulted in monthly declines in all the price indices for which there was no data. In our view, it is unlikely that all these prices would have fallen uniformly in the manner they have been imputed. Therefore, we see the recent CPI as having been tilted downwards by the imputation process. Nonetheless, the downside breach of the target range seems likely to be temporary.

…but the recent rebound in Brent crude oil prices will make the downside target breach temporary

Although the fuel price index has a relatively small weight (4.6%) in the CPI basket, its volatility tends to drive the overall trajectory of headline CPI inflation (Figure 16). After the collapse in March and April, Brent crude oil prices have recovered faster than we anticipated, with spot prices currently c200% higher than early May levels. While Brent crude oil prices are likely to remain volatile, for purposes of our forecast, we have assumed that prices remain broadly stable at current levels through to year-end and rising only gradually into next year. (a full list of our assumptions on key inputs to the model, including oil prices, is given in Figure 23, on page 17.) Meanwhile, recent court rulings in favour of Eskom against its challenge of NERSA tariff determinations will have no bearing in the near term, but leave tariff hikes from next year highly uncertain. We have adjusted upwards our assumed electricity tariff increase for mid-2021 to 12% from 5.3%. The outlook for food prices is also key. At this stage, there is little to suggest any significant upside pressure on food costs in the near term, especially given the prospects of a bumper maize crop. We therefore see food and non-alcoholic beverages inflation remaining contained at just over 4% over the foreseeable future.

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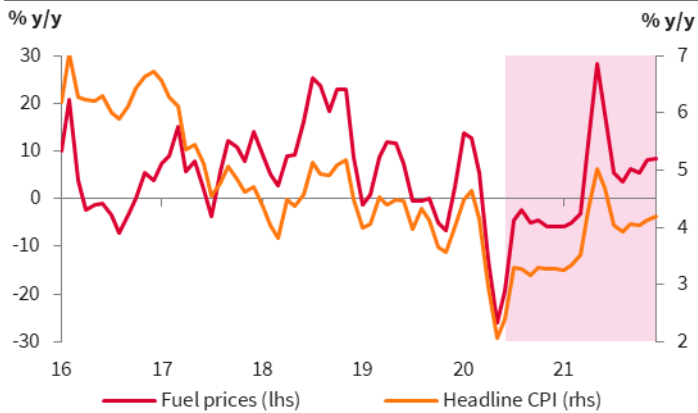
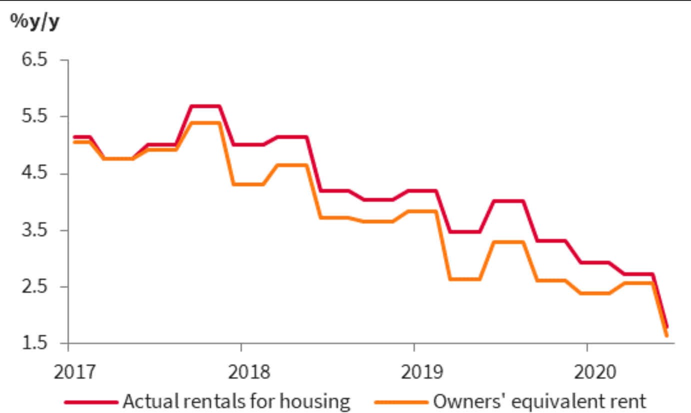
Figure 16: Brent crude oil prices are critical for the path of headline CPI



Source: Stats SA, Absa Research

Figure 17: Housing costs are under pressure and could fall further



Source: Stats SA, Absa Research

We see headline CPI inflation rising back above 3% from July and tracking around this level through to Q2 2021

Outside of these exogenous supply side factors, the large negative demand shock in the economy will likely continue to be a significant constraint for firms' pricing power. It is also likely to permanently drive some firms out of business, resulting in somewhat higher levels of market concentration. But it is too early to assess how this could affect pricing dynamics. One area that will be worth watching closely is housing costs. Excess supply and weak demand have already created significant downward pressure in rental costs and owners' equivalent rent (with a combined weight of 16.8% of the CPI basket) ahead of the current crisis. In the June CPI data, which contained the first survey of housing costs into the pandemic, actual rentals and OER inflation eased to 1.6% and 1.3% y/y, from 2.7% and 2.6%, respectively in May (Figure 17). This was somewhat higher than we had expected as various anecdotal reports had suggested more significant downward pressure on the rental market. Our baseline forecast is consistent with lower housing costs over the remainder of the year but with some upward correction into next year. But, given the risks of even lower outcomes, we have modelled a scenario where both actual rentals and OER fall by a cumulative 2% over the September and December surveys. In that scenario, headline CPI inflation would end the year just below the lower bound of the target range at 2.8% compared to our current forecast of a year-end print of 3.0%. Overall, our baseline forecast has headline CPI inflation rising back to just above 3% from July and to track around this level through to Q2 next year. Over the near term, data imputations present some uncertainties to the measurement of the CPI data, but we continue to see the risks as tilted to the downside, particularly given the recent strengthening in the exchange rate.

Monetary policy: we see scope for further modest rate cuts

The SARB MPC has cut the repo rate by 275bp since COVID-19 hit the country in March, including the 25bp at the July meeting

The SARB's efforts to counter the economic damage of the pandemic have been a critical pillar of the overall domestic economic policy response, particularly given South Africa's severe fiscal constraints. The SARB's policy interventions have been quite broad, including regulatory forbearance on banks to encourage lending, its purchase of government bonds in the secondary market to improve market functioning and of course the interest rate reductions. Since March, the SARB has cut the repo rate by 275bp, including the 25bp cut delivered at the July MPC meeting. At the current repo rate of 3.50%, the real repo rate, adjusted using average inflation expectations, is slightly negative on a forward-looking basis. However, at the July MPC meeting, the committee appeared to shift slightly to a more cautious stance with 2 of the 5-member committee preferring to keep rates on hold. This is likely to raise some concern from the market that perhaps the committee thinks that it has done enough. However, we see scope for further rate cuts.

We see weaker growth outcomes to likely open up scope for further monetary policy easing

We believe that given the magnitude of the negative shock from the pandemic, the MPC's primary concern is likely to remain economic growth. And, as we have argued, the recovery in economic growth is likely to be subdued in the second half of the year, despite the substantial relaxation of the formal lockdown restrictions, with the rapid rise in COVID-19 infections suggesting a deeper recession this year than the SARB anticipates. Moreover, the main elements of the fiscal policy response to the pandemic – i.e., tax relief on businesses and workers, the temporary employee relief scheme and social grant uplifts – all are due to expire at a time when the economy will

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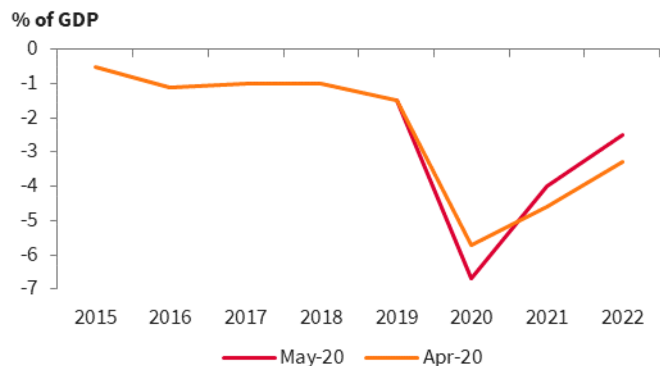
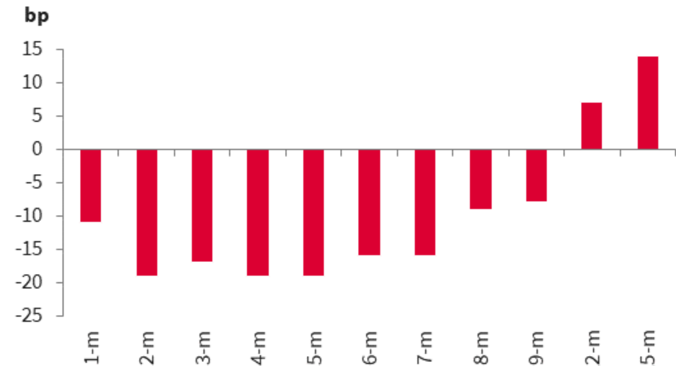
probably still need substantial policy support. The expiration of these measures thus implies a negative shock onto the economy. These factors do not necessarily form part of the QPM framework, but will have to be a part of any discussion about the near-term growth outlook. By the SARB's own current projections, the output gap could be as high at 7% of GDP this year, remaining sharply negative through to 2022 (Figure 18).

Figure 18: Output gap is likely to be large and persistent



Source: SARB, Absa Research

Figure 19: Market pricing suggests further easing in the near term



Source: Refinitiv, Absa Research

We expect the MPC to cut by a further 25bp in September with risks skewed in the direction of more easing this year

With inflation remaining generally contained, growth outcomes that are in line with our expectations ought to open up room for more rate cuts, particularly as the nominal policy rate remains some distance from the zero lower bound constraint. Additionally, the implied starting point for the exchange rate in the July model run was 17.93/USD and the current spot rate is roughly 5.5% stronger than this. If the exchange rate remains resilient over the coming months, which is what we expect, this might also tilt the QPM in the direction of more monetary policy easing. We therefore expect the SARB to cut the repo rate by a further 25bp to 3.25% at the September meeting. This is consistent with current market pricing (Figure 19). The MPC of course always stresses that it is data dependent and may want to wait to see how its earlier policy efforts are affecting economic activity. By the time of the September meeting, there will be an array of high frequency data for economic activity into Q3, and critically, the Q2 20 GDP (due out on 8 September) and the Quarterly Labour Force Survey (due out on 11 August). The latter will be key for showing the effect of the labour market damage and the extent of negative demand shock likely to come from that. Surveys of the labour market suggest that the report is likely to be sharply weak. Our baseline forecast is for rates to remain on hold after September until Q3 2021, but we see risks as somewhat skewed in the direction of more monetary policy easing over the remainder of the year.

We believe the rand will recover further into year-end

Easy global monetary policy and fiscal stimulus will likely see the undervalued rand recover further towards year end

Global risk aversion continues to wane due to the unprecedented level of global monetary and fiscal stimulus measures. These stimulus measures are supporting global commodity prices and reigniting the demand for emerging market assets in general. Firmer commodity prices should promote trade inflows, while SA's relatively high bond yields should attract capital inflows. From a valuation perspective, our Peer model implies that the ZAR remains significantly undervalued relative to other high-yielding and commodity-based currencies (Figure 20) and, from a purchasing power parity basis, the ZAR could strengthen by 8% before the exchange rate would become uncompetitive. Therefore, we still expect the local currency to strengthen to R16.00/USD by quarter-end, before reaching R15.75/USD by the end of the year – which is now the most bullish ZAR view in the market (Figure 21). A fresh wave of heightened COVID-19 fears and/or the inability of the SA authorities to bring about meaningful structural reforms pose the biggest risk to a contractive ZAR view. We expect this year's government foreign loans from multilateral financial institutions to be ZAR neutral (see *We remain constructive about ZAR during H2,* 29 June).

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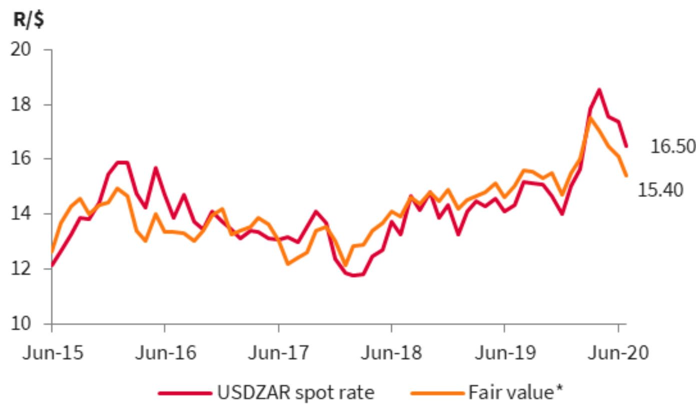
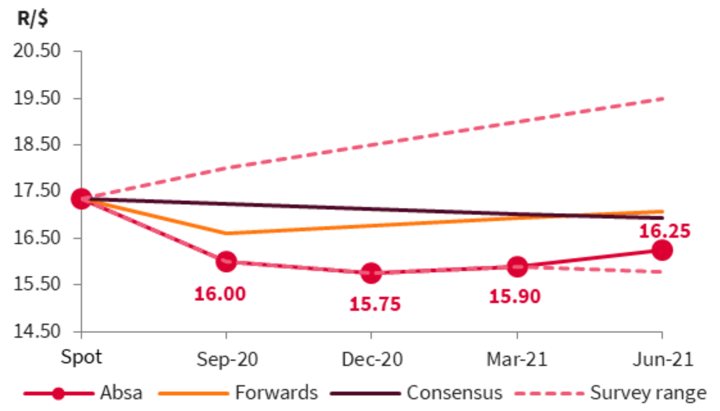
Figure 20: Historical performance of the peer model



*Note: *Fair value = α + β1 Commodity FX basket + β2 High-yield FX basket*
Source: Bloomberg, Absa Research

Figure 21: Comparative USDZAR outlook



Source: Bloomberg, Absa Research

Other outcomes are possible, either for better or for worse

Forecasts rarely materialise exactly, in part because large parts of the future are inherently unknowable

Obviously, our forecast is not guaranteed to pan out exactly. While it represents our best judgment currently on the way the economic picture is going to develop, other outcomes are possible, either for better or for worse. This is partly because no model, however sophisticated, can ever fully represent the complexity of an actual economy, and also, more fundamentally, because economic outcomes are contingent on a large number of factors that may or may not materialise in the future. The COVID-19 pandemic is a perfect example of this – a risk that people were aware of, but could not possibly factor into a macroeconomic forecast until it happened. With this in mind, we caution that investors and policymakers should not place too much weight on our single forecast and should also contemplate other possible scenarios. We discuss two possible alternative scenarios to our baseline, which we will call ‘Better and Worse’.

A variety of developments, each with varying importance and probability, could drive South Africa to a better outcome than our baseline forecast envisages

For Better to be South Africa’s future, we need to see some reasonably robust combination (though not necessarily all) of the following things happen:

- Peak infections happen soon and taper off quickly, while an effective vaccine or treatment is widely available sooner rather than later;
- Global GDP, thanks to all the advanced economy fiscal and monetary stimulus, bounces back more sharply than the IMF currently expects (-4.9% in 2020 and +5.4% in 2021);
- Lockdowns are quickly relaxed further, including border openings, and international tourism begins to recover, supporting South Africa’s catering and accommodation industry;
- Finance Minister Mboweni is able to push through something close to all of his desired fiscal adjustment package, which, although contractionary in the short run would give confidence to investors and allow South Africa’s country risk premium to ease and its savings rate to rise over the medium term;
- Market-friendly changes to South Africa’s investment regulations are introduced quickly, such that institutional savings increasingly finance vital infrastructure development across a range of sectors;
- The state auctions broadband spectrum this year, agrees to a functioning Mining Charter 3 with the industry, makes good headway rather than lip service on reforms at ports and rail, and opens up the regime for skilled immigration;
- Businesses and consumers quickly adapt to the dislocations of the new COVID-19 reality, such that activity levels recover quickly in Q3 and are sustained in Q4 and into 2021 as more of the economy comes back on line;
- Recent outbreaks of social unrest abate as the recovery offers more economic opportunities and incomes, and workers who have been furloughed or retrenched quickly find new jobs;

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- Commodity export prices stay high, but oil prices ease again;
- Load shedding is not a major problem, as Eskom rehabilitates its existing plants, and new power supply is quickly procured;
- The state takes a serious look at how it can improve its efficacy, and private and public sector corruption is brought to book;
- The COVID-19 crisis motivates all societal and political and economic stakeholders to negotiate sincerely compromises on long-standing polarised positions; workable social compacts are struck in a number of contested sectors.

Robust reforms would lift South Africa's growth rates and help stabilise public finances over the medium term

If a strong majority of these things were to happen, we believe South Africa could reasonably expect a much stronger GDP bounce in 2021 than our forecast of just +2.4% and medium term growth rates to rise back to around 2.5% or so. This would significantly strengthen the country's weak fiscal position, such that the debt burden would stabilise and eventually start to grind downwards. The rand would also likely strengthen further. Demand-pull inflationary pressures would likely pick up a bit, but inflation would still likely remain well within the target range. Nonetheless, with the economy on a sounder footing, the SARB would be likely to more quickly commence a slow process of normalising rates versus our current baseline forecast of another 25bp rate cut and then a hike only in Q3 21.

An extended pandemic and a failure to implement any fiscal and structural reform would be two big downside risks to our baseline forecast

However, South Africa's future could also be Worse, if some collection of the following developments were to materialise in force:

- Exposure to COVID-19 does not give long-lasting immunity and an effective vaccine proves elusive or wildly expensive;
- The COVID-19 pandemic does not quickly peak and wane, but instead extends well into 2021, with fitful bursts of businesses opening and closing, and possibly even the escalation of lockdown levels again;
- Finance Minister Mboweni is unable to secure strong backing from the Cabinet and the ANC for necessary spending cuts, particularly with respect to public sector wages, and adverse debt dynamics intensify;
- Firm bankruptcies and worker layoffs are very large, generating extensive downside multiplier effects;
- The escalating COVID-19 pandemic and its economic fallout cause social pressures to intensify markedly, especially after the government removes its temporary income support via the extended TERS/UIF scheme and the expanded social grants;
- Oil prices rise further, but recent gold and PGM strength fades;
- The government is slow to develop a workable framework for its goal of a privately financed infrastructure drive, especially if empowerment objectives prove hard to marry with the need for speed and efficacy;
- Eskom's unbundling process falters, while efforts to procure new power supply and rehabilitate the existing plants are unable to prevent recurring load shedding;
- Heightened demand for reduced state resources serves to embitter and entrench ideological contestation within the polity, and functional social compacts are mostly impossible to secure;
- The structural reform agenda remains more 'talk' than 'walk';
- Emigration accelerates, depriving South Africa of human and financial capital, and capital flight generally picks up.

Obviously, even some of these risk scenarios could drive South Africa to a rather dark place economically, under which GDP growth would further stagnate. The SARB would likely keep rates

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lower for longer, but at some point, the rand would likely weaken a lot and the SARB would then have to hike rates sharply. The building debt crisis would come to a boil, possibly leading the government to try to introduce asset prescription in an effort to avoid a full-fledged IMF programme with strict conditionality, for which there is no political support.

In conclusion, it will be a long hard slog to recover

The pandemic is a huge economic blow to South Africa…

As the pandemic continues to unfold, South Africa faces an unprecedented level of economic uncertainty and challenge. Despite some promising results in early vaccine testing, it is still too early to tell how long the pandemic as well as its associated health and economic costs will persist. Even if an effective vaccine is found soon, developing the capacity to manufacture and distribute the vaccine across most parts of the world is likely to take some time. For South Africa, a small developing economy that was already riddled with a host of structural challenges, including high levels of inequality, elevated joblessness, poor potential growth, long running reform inertia and depleted fiscal policy space, the pandemic will cause big economic scarring. The recovery is likely to be protracted and uneven, particularly in an environment that is likely to be characterised by much higher levels of leverage in both the private and public sectors.

…leaving the government with some very challenging policy imperatives

Thus, the policy challenges in the post-COVID-19 environment will be larger than ever. In this regard, the MTBPS in October will be a critical test of the government's resolve. But more broadly, President Ramaphosa has indicated that the government is preparing the 'third phase' of its economic policy response to the crisis, which will be focused on structural reforms and a privately financed infrastructure drive to rebuild confidence and boost medium-term growth prospects. While we would like to be optimistic about this, the government's inability to implement reforms in the past due to ideological conflicts within the polity, capacity constraints and coordination problems does not make for an especially inspiring outlook on reforms. That said, as we have argued above, there is potential for upside as well as downside developments relative to our fairly conservative baseline forecast. No doubt the next handful of months will produce a number of important developments that might point a clearer way forward.

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Figure 22: We now forecast a smaller GDP contraction in 2020, and also somewhat softer inflation

	2019		2020				2021								
	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	2019	2020F	2021F	2022F	2023F
Output (% q/q saar)															
Real GDP	-0.8	-1.4	-2.0	-44.0	20.5	7.5	4.3	3.7	3.7	3.4	0.2	-8.3	2.4	1.9	1.2
Real GDP (%y/y)	0.1	-0.6	-0.3	-14.4	-10.1	-8.2	-6.7	8.8	4.8	3.8	0.2	-8.3	2.4	1.9	1.2
Private consumption	0.3	1.4	0.7	-17.1	2.4	3.7	2.4	2.5	2.9	3.1	1.0	-2.3	1.4	1.2	1.3
Public consumption	1.4	-0.2	1.1	2.1	1.8	0.6	-2.0	-2.3	-2.3	-2.2	1.5	1.2	-0.9	-2.0	-1.9
Investment	4.1	-10.0	-20.5	-66.7	6.4	4.7	9.7	9.2	9.8	10.3	-0.9	-22.7	-0.1	1.3	1.8
Exports	3.5	2.3	-2.3	-56.4	27.5	5.3	5.4	5.7	5.9	5.9	-2.5	-11.1	2.0	1.7	1.8
Imports	-8.9	-8.5	-16.7	-54.2	43.3	4.8	3.8	2.5	2.6	2.2	-0.5	-14.7	2.1	1.9	0.9
Prices (% y/y)															
CPI inflation	4.1	3.7	4.4	2.4	3.1	3.1	3.1	4.5	4.1	4.1	4.1	3.3	4.0	4.2	4.3
Core CPI inflation	4.1	3.9	3.7	3.1	3.1	3.1	3.2	3.6	3.5	3.4	4.1	3.3	3.4	3.5	3.7
PPI inflation	4.5	2.9	4.1	0.6	2.0	3.7	4.3	6.5	5.6	4.6	4.6	2.6	5.2	4.7	4.8
External and government accounts (% of GDP)															
Current account	-3.7	-1.3	1.3	-0.8	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6	-3.0	-0.2	-2.1	-2.8	-2.9
Main budget fiscal balance*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-6.6	-16.6	-12.0	-10.3	-8.4
Main primary balance*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-2.6	-11.6	-6.7	-4.5	-2.4
Government debt*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	63.5	84.6	87.7	94.1	97.4
Interest rates and exchange rate (eop)															
Repurchase rate, %	6.50	6.50	5.25	3.75	3.25	3.25	3.25	3.25	3.50	3.50	6.50	3.25	3.50	4.25	4.75
Prime rate, %	10.00	10.00	8.75	7.25	6.75	6.75	6.75	6.75	7.00	7.00	10.00	6.75	7.00	7.75	8.25
USDZAR	15.17	13.98	17.80	17.38	16.00	15.75	15.90	16.25	16.40	16.60	13.98	15.75	16.60	17.25	18.00

*Source: Stats SA, SARB, National Treasury, Thomson Reuters, Absa Research.; * Fiscal data are for the year commencing 1 April (eg the entry in the 2019 column refers to the 2019/20 fiscal year*

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Figure 23: A few key input assumptions have shifted since our last forecast round, with much weaker global growth backdrop and higher oil prices

Variable	Absa Research assumptions (July)	SARB assumptions (July 2020 MPC meeting)	General comments and risks to our assumptions
Key Global Economic Assumptions			
Global growth	We forecast G7 GDP contraction of 5.4% for 2020 and growth of 3.8% for 2021; China GDP growth of 0.8% and 5.2% for 2020 and 2021, respectively.	Growth of SA's major trading partners is projected to be at -4.7% in 2020 and 4.3% in 2021.	The Absa Research and SARB global growth assumptions for model inputs are not strictly comparable. However, both sets of forecasts project GDP contractions in major trading partners in 2021.
Brent crude	Brent to average USD42/bbl in 2020 and USD47/bbl in 2021.	Brent to average USD40/bbl in 2020 and USD45/bbl in 2021.	Absa's crude price assumption is broadly in line with that of the SARB but there is considerable uncertainty about the outlook for international oil prices.
Non-oil commodity prices	Our commodity forecasts for 2020 and 2021 as a base: Gold in USD/oz at 1,688 and 1,736; Platinum in USD/oz at 841 and 857; Coal USD/mt at 63 and 57; Iron ore in USD/mt at 91 and 92.	The SARB does not reveal any specific commodity price assumptions. Instead, it assumes non-oil international commodity prices to rise by 9.3% and fall by 3.9% in 2020 and 2021, respectively.	The Absa Research and SARB commodity price assumptions are not strictly comparable. South Africa's key export commodity prices have remained relatively well supported despite weaker global economic activity.
Key Domestic Economy assumptions			
Food prices	We forecast food price inflation to average 4.2% in 2020 and 4.4% in 2021 and 4.5% in 2022.	The SARB did not reveal its forecast profile for food price inflation, but noted that food inflation is expected to remain contained.	The prospect of a bumper harvest this year will likely help to keep overall food price inflation relatively contained.
Fuel taxes and levies	We assume a 10c/l rise in distribution margins each December and a 30c/l increase fuel levies in April 2021.	Taxes and levies on fuel are expected to rise by 5.8% and 5.2% in 2020 and 2021, respectively.	Among other measures, the National Treasury is likely to announce a higher-than-inflation increase in the general fuel levy in the February 2021 budget as a way to lift tax revenues.
Electricity prices	We have assumed average electricity tariff increases of 10.0% for 2020 and 10.1% for 2021.	The SARB expects average electricity increases of 9.6% in 2020 and 6.7% in 2021.	Eskom's court reviews of recent NERSA decisions are an upside risk to electricity tariffs.
Growth in government consumption	We forecast real government consumption (G) growth of 1.2% in 2020 and -0.9% 2021.	The SARB no longer publishes its assumption for G.	The need to stabilise the growth of government indebtedness and the slow pace of economic growth will limit the growth of government consumption.
Potential growth	-2.2% in 2020 and 2.3% in 2021.	-2.0% in 2020 and 1.1% in 2021.	Assumptions about potential GDP growth are tricky as they cannot be directly observed, but instead estimated by using statistical techniques on recent GDP trends. We and the SARB expect the negative output gap to persist over the forecast horizon.
Neutral real interest rate	Absa's model makes no explicit assumption about the neutral real interest rate.	The neutral real interest rate is estimated to be 2.1% in 2020 and 2.2% in 2021.	Globally, there is much debate about what the neutral level of real rates is, because it cannot be directly observed. However, weaker global economic activity due to the COVID-19 pandemic has probably lowered the neutral real rates everywhere.
Exchange rate	In Absa's macro model, our exchange rate serves as an exogenous input. Our baseline forecast assumes an average NEER depreciation of 10.5% in 2020 and depreciation of 0.9% in 2021.	The SARB's QPM model endogenously determines the exchange rate path, forecasting a NEER depreciation of 14.2% in 2020 and of 0.9% in 2021.	The exchange rate is one of the key variables in any forecast, regardless of whether it is set as an exogenous assumption or endogenously determined, as with the SARB's new QPM. The volatility of the rand and the uncertainty about its path over the forecast horizon pose risk to the model's forecast.
Interest rates	We expect the SARB to cut the repo by 25bp to 3.25% in September 2020.	The SARB's QPM embedded one 25bp rate cut in Q4 of 2020. But the MPC brought this cut forward in the July MPC meeting	The FRA curve is not fully discounting any further rate moves but is still tilted slightly in the direction of more easing in the short term.

Source: SARB, Absa Research

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