Private and confidential

SA macroeconomic outlook

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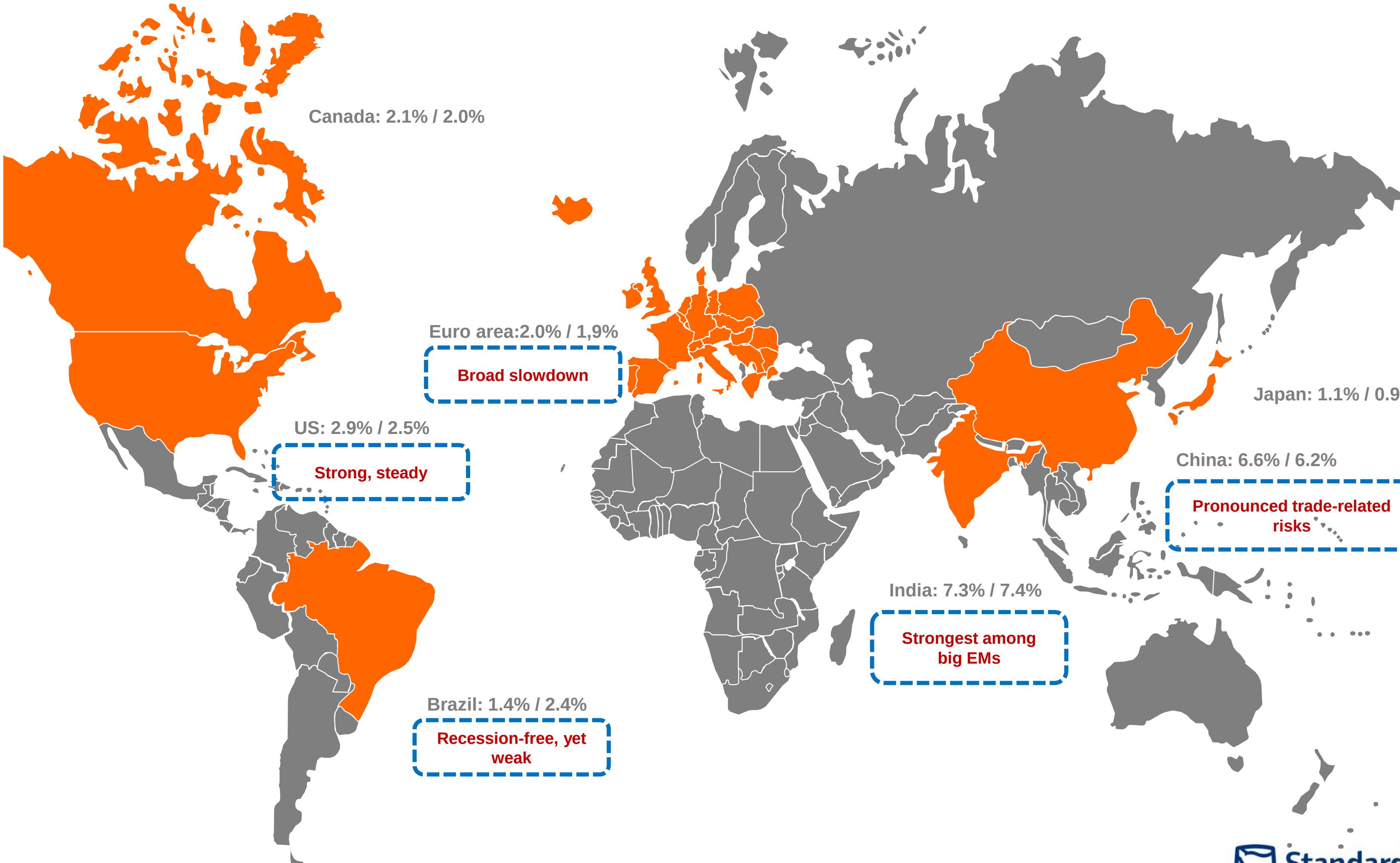
Standard Bank

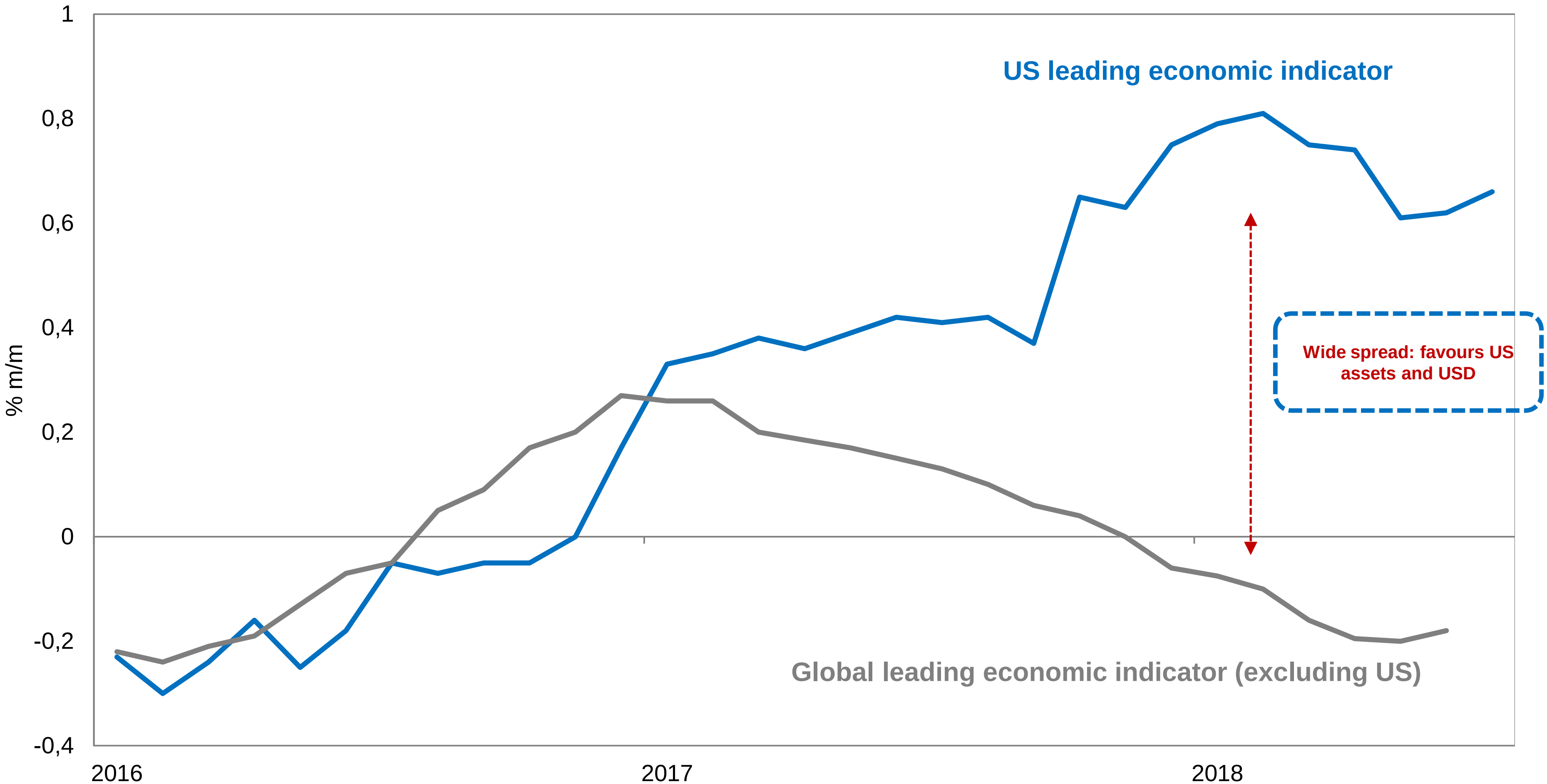
Summary of core views

Outside the US, GDP growth is moderating in key markets



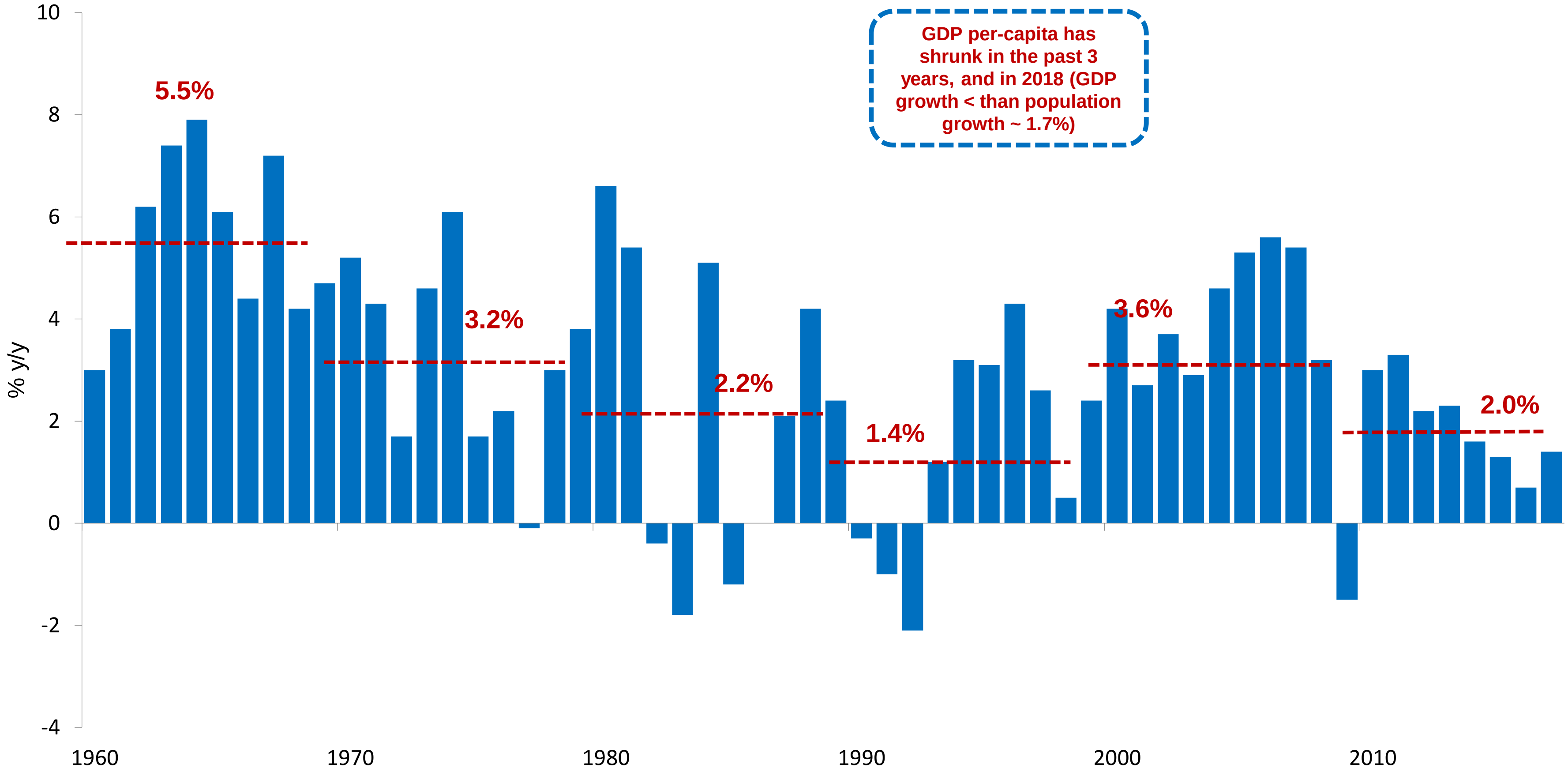
Sources for all charts: IMF (WEO, Oct 2018), Standard Bank Research estimates

Leading economic indicators



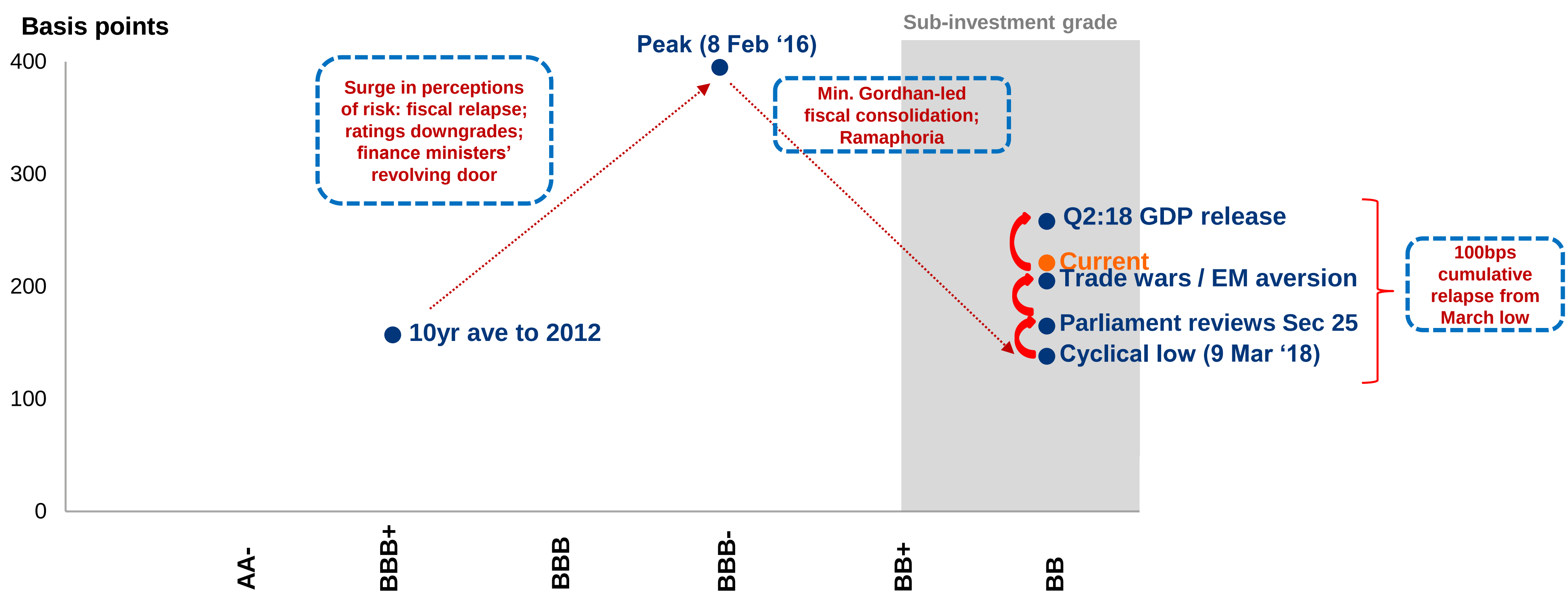
Sources for all charts: Bloomberg, Standard Bank Research

South African GDP growth since 1960 – business confidence key



Sources for all charts: SARB, Standard Bank Research estimates

Post Ramaphosa: 3-step risk reset



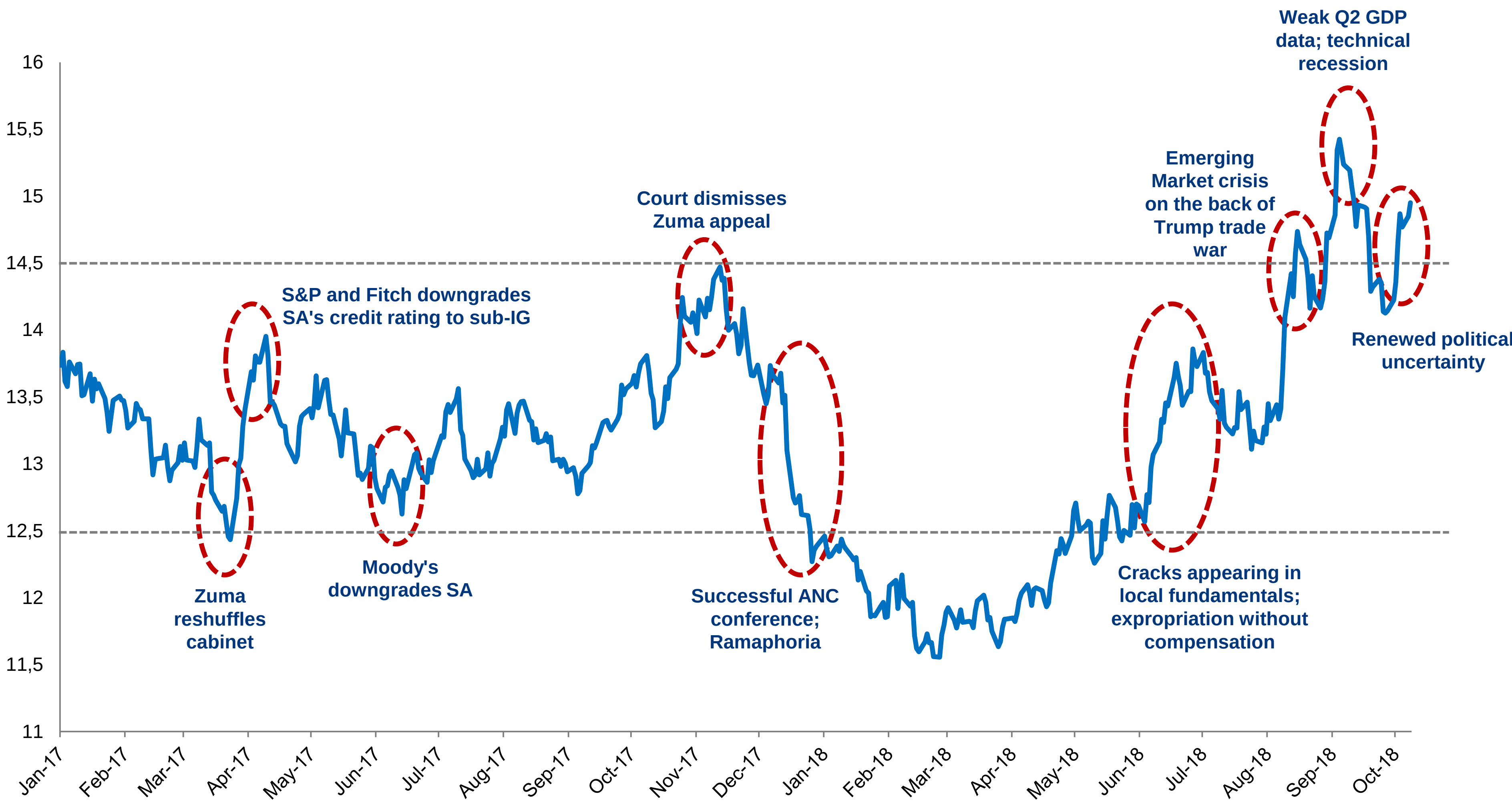
Sources for all charts: Bloomberg, Standard Bank Research estimates

Ratings outlook

	Fitch	S&P	Moody's
Current Rating			
Long-term foreign currency	BB+	BB	Baa3
Long-term local currency	BB+	BB+	Baa3
FC Rating Grade	Sub-investment grade on FC and LC	Sub-investment grade on FC and LC	Investment grade on FC and LC
Outlook	Stable	Stable	Stable

Sources for all charts: Bloomberg, Standard Bank Research

USDZAR 2 year historical view of key events



Sources for all charts: Bloomberg, Standard Bank Research

Currency expectations, target levels, and core view

	Current price/yield	Core 12-month view		
USDZAR	14,62	Local (policy uncertainty) and global (EM caution/contagion) remain headwinds to our forecasts.	1-month	14,35
			Year-end	14,30
			12-month	13,55
Repo rate	6,5%	The SARB has set the scene for a possible interest rate hike, but in our view the inflation prognosis does not justify one yet. Given continued downside surprises in economic growth and inflation, and inflation expectations that are still reasonably contained despite severe inflationary shocks, the SARB should in our view delay any interest rate hikes for now. We are still not pencilling in a rate hike in the coming months.	12-month	6,5%

- **The rand will likely remain on the back foot in the near term given the fragile global setting and investor caution about the rand due to uneasy SA politics and policy alongside SA's twin deficits as well as the country's external debt vulnerabilities. The rand strengthened through our year-end forecast in October, supported by a combination of general gains in EM currencies and local developments. We still view the rand as cheap, but in our view, it is likely to remain undervalued into the early part of next year on the back of the lingering policy uncertainty. The rand is weaker than our purchasing power parity (PPP) estimates against both the USD and EUR; it is weak on a real trade-weighted basis; and it is weak according to our econometric model.**
- **We expect GDP growth at 0,9% in 2018 and 1,8% for 2019. Growth in 2018 is being depressed by headwinds from weak business confidence, stagnant employment, an uncertain global economic setting, and weaker terms of trade. Growth over the coming months will be impacted by the ongoing trade war concerns, together with the slower-than-expected progress with reducing policy uncertainty as well as the recent spike in fuel costs.**
- **We continue to keep a close eye on developments that could derail both our growth and currency outlook.**

Sources for all charts: Standard Bank Research estimates

Contents

FX forecasts

Currency forecast table: SBR vs. consensus and forwards (period-end)						
	(31-October-2018)	Q4:18	Q1:19	Q2:19	Q3:19	2019
USDZAR						
Consensus	14,62	14,50	14,60	14,40	14,40	14,00
Current Fwd	14,62	14,73	14,90	15,07	15,25	15,40
SBR	**14,62**	**14,30**	**14,08**	**13,85**	**13,63**	**13,40**
EURZAR						
Consensus	16,62	16,82	17,23	17,28	17,57	17,36
Current Fwd	16,62	16,84	17,16	17,51	17,86	18,20
SBR	**16,62**	**17,02**	**17,45**	**18,01**	**17,71**	**18,22**
GBPZAR						
Consensus	18,62	19,00	19,42	19,37	19,51	19,60
Current Fwd	18,62	18,82	19,12	19,43	19,75	20,06
SBR	**18,62**	**19,59**	**20,97**	**20,91**	**20,98**	**21,04**
ZARJPY						
Consensus	7,71	7,72	7,67	7,67	7,57	7,65
Current Fwd	7,71	7,61	7,47	7,33	7,18	7,72
SBR	**7,71**	**7,76**	**7,53**	**7,29**	**7,41**	**7,54**

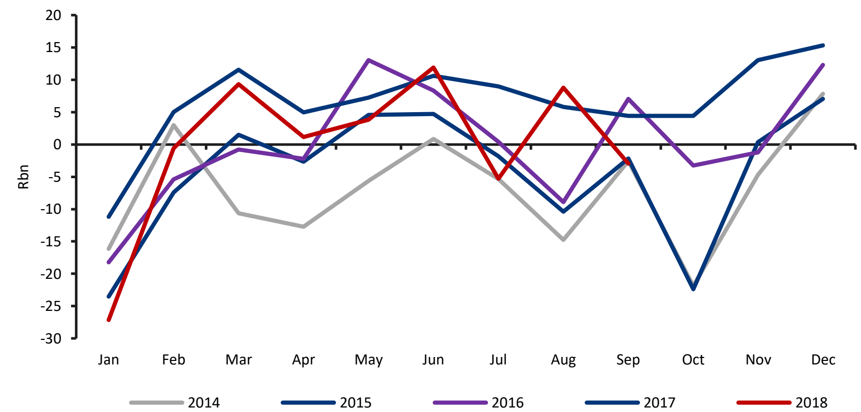
Sources for all charts: Bloomberg; Standard Bank Research estimates

Rand view and risks

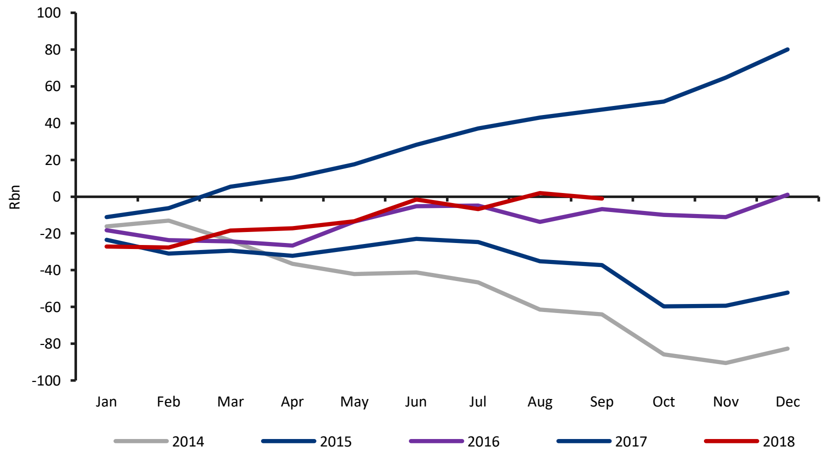
Sizing the risks: trade balance back in the red

- The trade balance swung into a surplus of R9.3bn in March 2018, less than the surplus of March 2017 (at R11.5bn). This follows a deficit in February 2018 of R0.6bn. The surplus compressed to R1.2bn in April, but widened to R3.5bn in May. An even wider trade surplus of R11,9bn was recorded in June, but July saw the second trade deficit for the year at R4,7bn. Encouragingly, the trade balance swung into surplus in August.
- We expect the current account deficit to widen slightly to 3.5% of GDP on the back of a recovery in imports and possibly a rise in the import-intensity of demand. The risks are biased towards a wider current account deficit than we forecast.

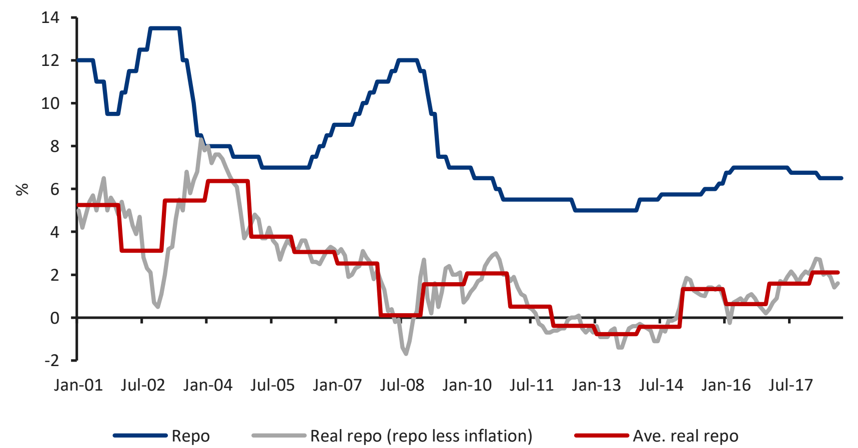
2018 trade balance starting at a low, and back in deficit



Cumulative trade balance in deficit thus far in 2018



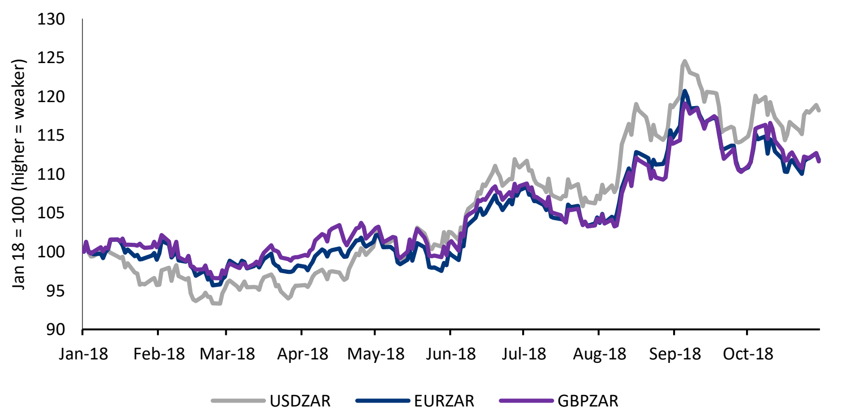
Average real interest rates are up from 2017



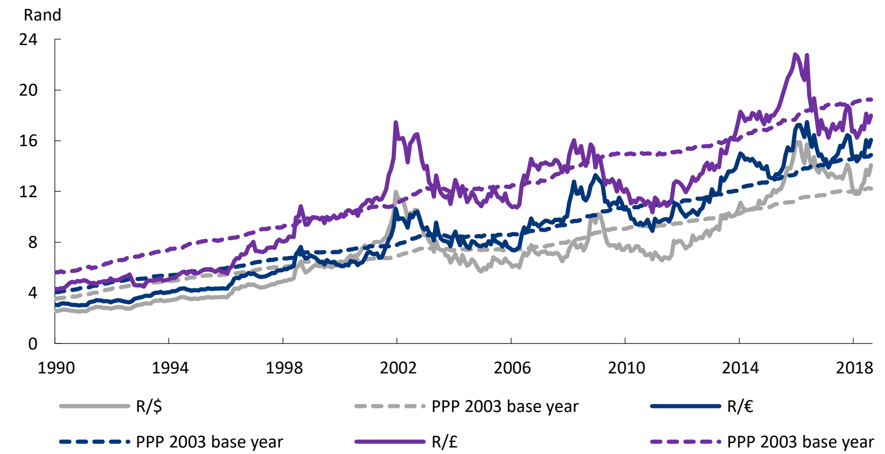
Sources for all charts: SARB, SARS, Standard Bank Research

Rand dynamics

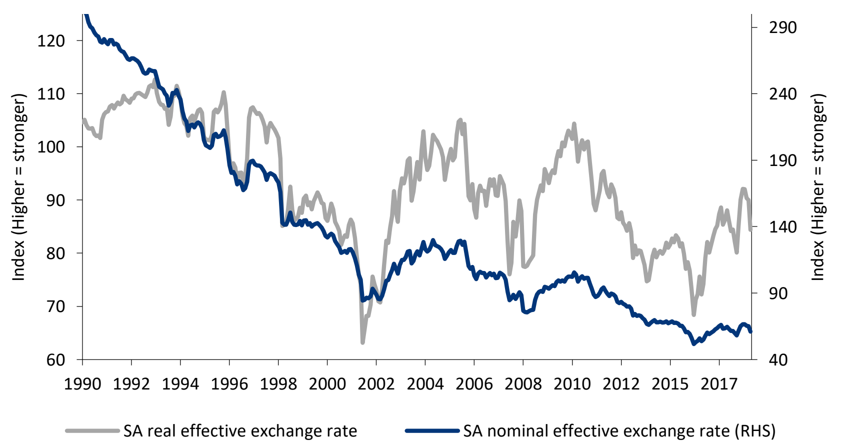
Rand against the majors



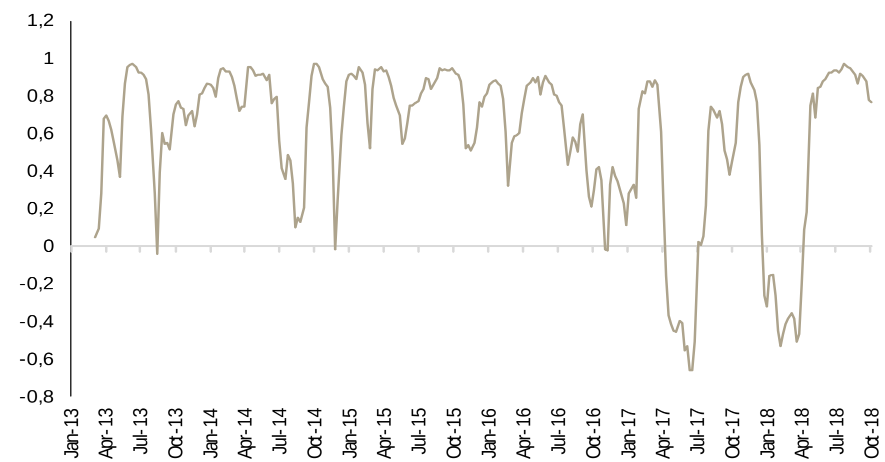
Rand weaker than our purchasing power parity estimates



Real trade-weighted rand - undervalued



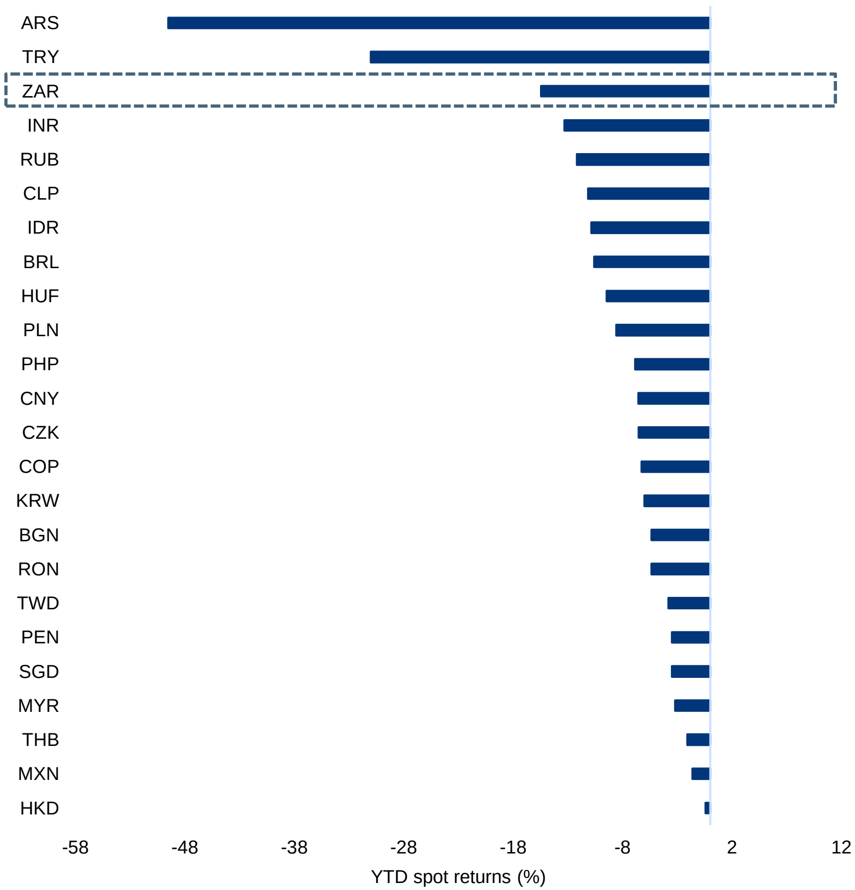
Rand correlation with EM currencies remain high



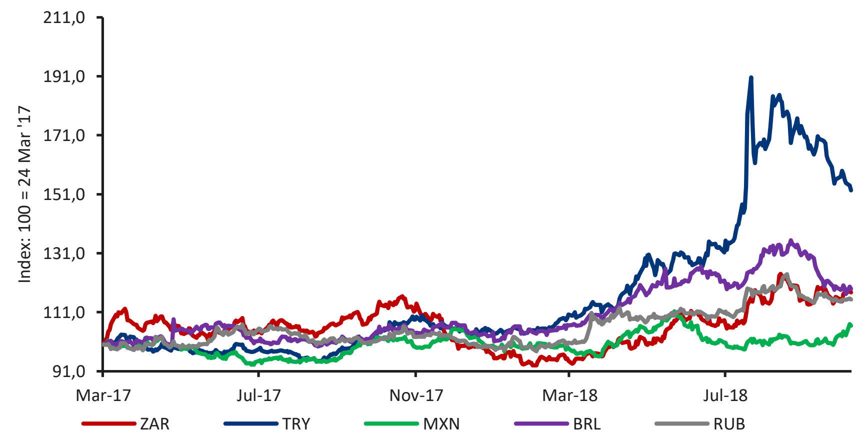
Sources for all charts: Bloomberg, Standard Bank Research

Rand against EM peers

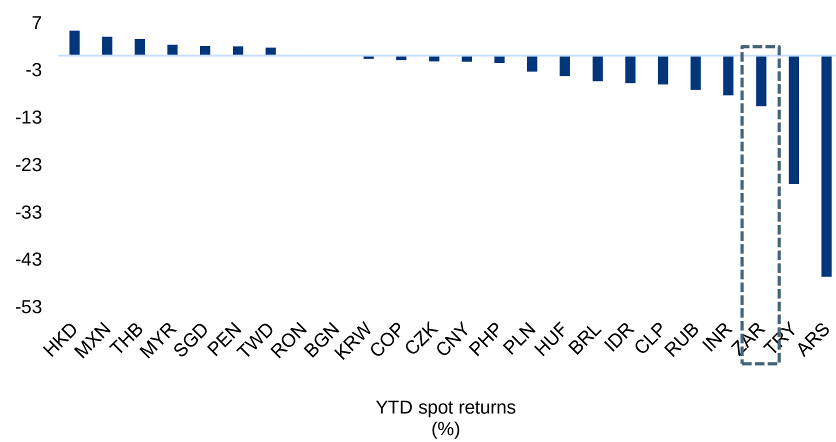
Rand vs. EM currencies against the USD (spot returns, %)



USD vs. other EM peers (since 24 March 2017)



Rand vs. EM currencies against the EUR (spot returns, %)



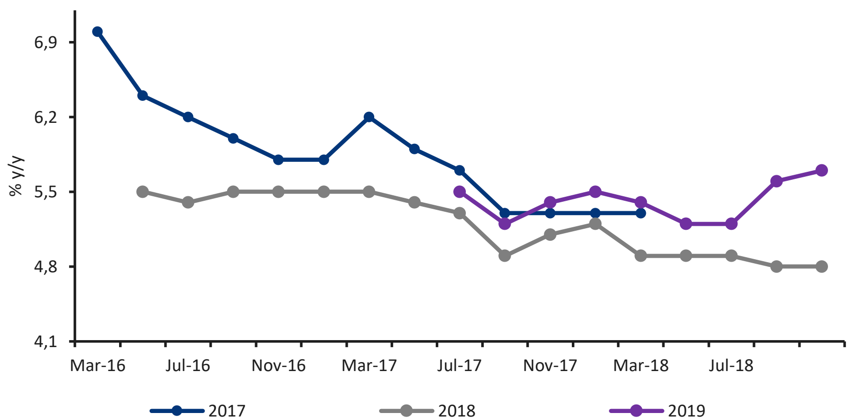
Sources for all charts: Bloomberg, Standard Bank Research

South African monetary policy

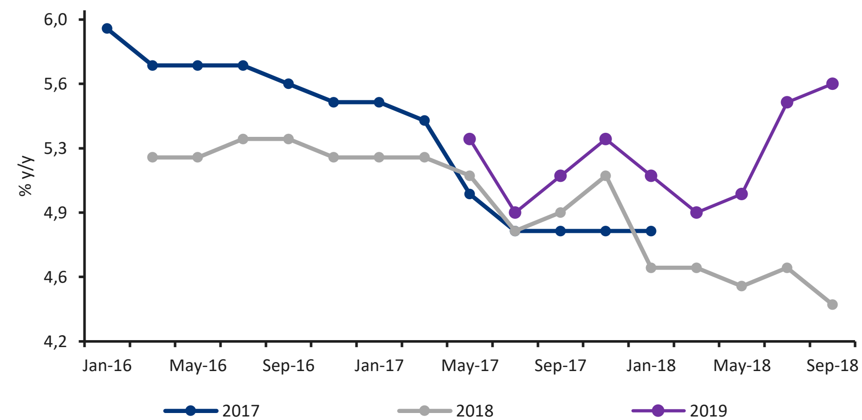
Repo rate: steady

SARB adjusted CPI higher in September, GDP outlook revised significantly lower in 2018

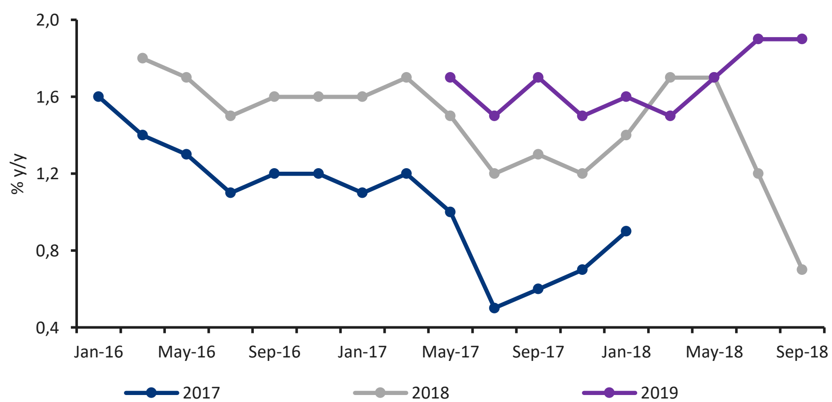
SARB's CPI forecast below upper limit of band: 2017 – 2019



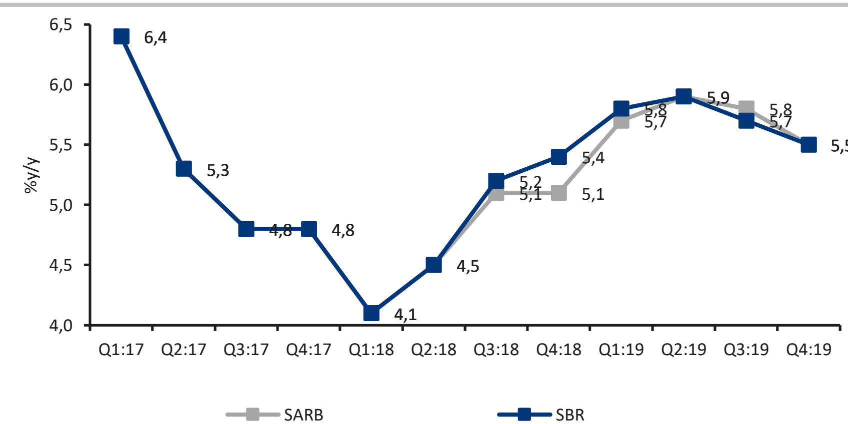
Core inflation expected to increase in 2019



GDP revised down in 2018



Modest adjustment higher to previous CPI forecast



Sources for all charts: SARB, Standard Bank Research

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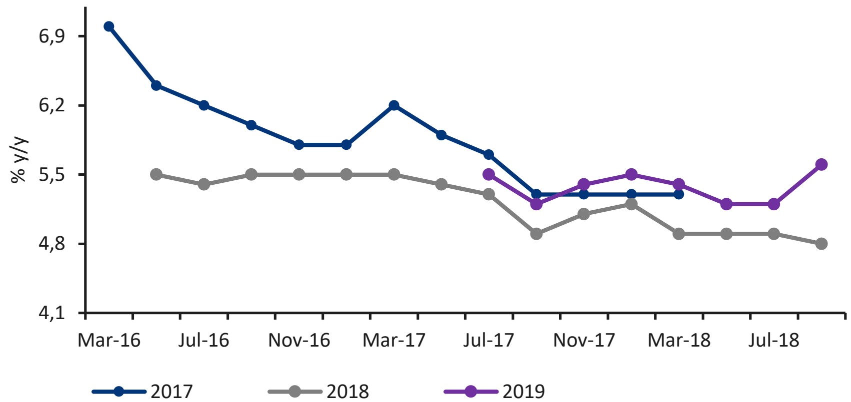
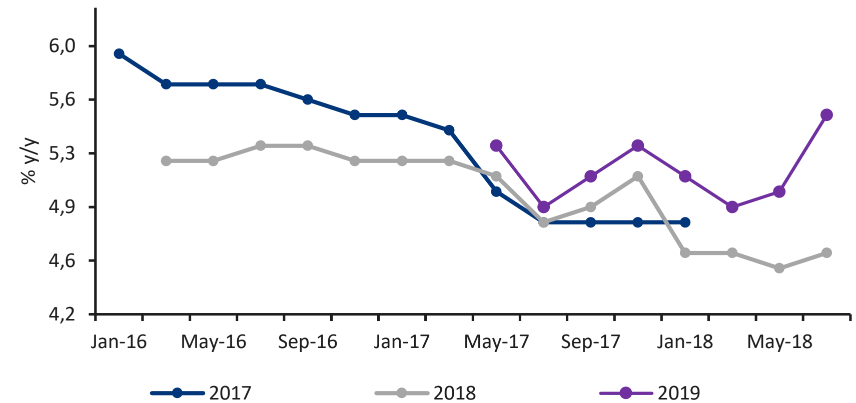
SARB adjusted CPI higher in July, GDP outlook revised lower in 2018

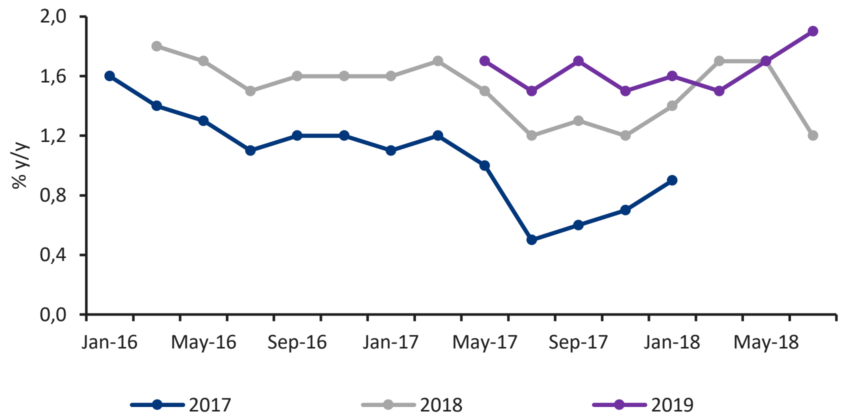
SARB's CPI forecast below upper limit of band: 2017 – 2019



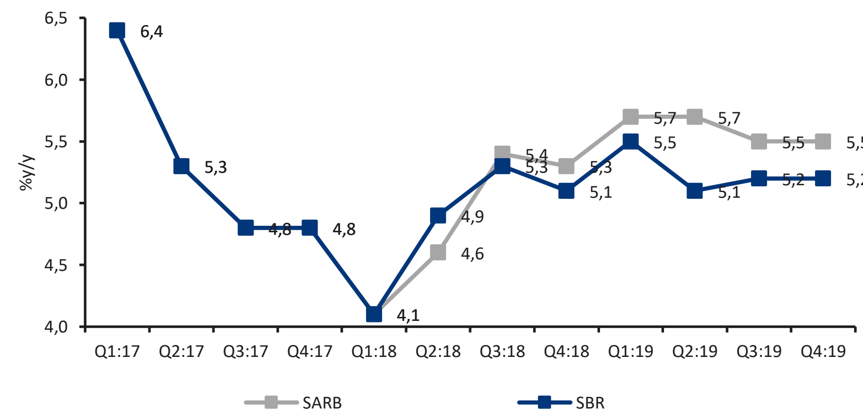
Core inflation expected to increase in 2018 and 2019



GDP revised down in 2018



Modest adjustment higher to previous CPI forecast



Sources for all charts: SARB, Standard Bank Research

Standard Bank

EM mostly still in an easing cycle; few starting to tighten monetary policy

In our sample of 13 EM countries, six have started to hike rates

Country	Central Bank rate	Magnitude of previous change	Date of previous change	Direction of last move	Magnitude of change	Current rate	Date of last change	Inflation target
Brazil	Selic rate	-25 bps	07-Feb-18	Down	-25 bps	6.50%	21-Mar-18	4.5% +/-2.0%
China	Benchmark lending rate	-25 bps	26-Aug-15	Down	-25 bps	4.35%	26-Oct-15	
Chile	Monetary policy rate	-25 bps	18-May-17	Up	+25 bps	2.75%	18-Oct-18	3.0% +/-1.0%
Czech Republic	Repo rate	+25 bps	02-Aug-18	Up	+25 bps	1.50%	26-Se-18	2.0% +/-1.0%
Hungary	Base rate	-15 bps	26-Apr-16	Down	-15 bps	0.90%	24-May-16	3.00%
India	Policy repo rate	+25 bps	06-Jun-18	Up	+25 bps	6.50%	01-Aug-18	8.00%
Indonesia	Reverse repo rate	+25 bps	15-Aug-18	Up	+25 bps	5.75%	27-Sep-18	4.0% +/-1.0%
Mexico	Benchmark rate	+25 bps	31-May-18	Up	+25 bps	7.75%	31-Jul-18	3.0% +/-1.0%
Poland	Reference rate	-50 bps	09-Oct-14	Down	-50 bps	1.50%	04-Mar-15	2.5% +/-1.0%
Russia	Key rate	-25 bps	26-Mar-18	Up	+25 bps	7.50%	17-Sep-18	4.50%
South Africa	Repurchase rate	-25 bps	20-Jul-17	Down	-25 bps	6.50%	28-Mar-18	3.0%-6.0%
Thailand	Repo rate	-25 bps	11-Mar-15	Down	-25 bps	1.50%	29-Apr-15	2.5% +/-1.5%
Turkey	Repo rate	+125 bps	07-Jun-18	Up	+625 bps	24.00%	13-Sep-18	5.00%

5-year USD CDS and 10-year bond table

Country	Moody's	S&P	Fitch	5y USD CDS (bps)	10-yr bond yield (%)
Brazil	Ba2 (Stable)	BB- (Stable)	BB- (Stable)	205,22	10,21
Bulgaria	Baa2 (Stable)	BBB- (Positive)	BBB (Stable)	80,33	0,79
China	A1 (Stable)	A+ (Stable)	A+ (Stable)	71,85	3,53
Chile	A1 (Negative)	A+ (Stable)	A (Stable)	51,69	4,78
Colombia	Baa2 (Negative)	BBB- (Stable)	BBB (Stable)	127,56	7,17
Croatia	Ba2 (Stable)	BB+ (Positive)	BB+ (Positive)	92,41	2,09
Czech Republic	A1 (Positive)	AA- (Stable)	AA- (Stable)	40,24	2,12
Hungary	Baa3 (Stable)	BBB- (Positive)	BBB- (Positive)	85,34	3,60
India	Baa2 (Stable)	BBB-u (Stable)	BBB- (Stable)	108,24	7,81
Indonesia	Baa2 (Positive)	BBB- (Stable)	BBB (Stable)	159,38	8,68
Mexico	A3 (Stable)	BBB+ (Stable)	BBB+ (Stable)	142,52	8,34
Panama	Baa2 (Positive)	BBB (Stable)	BBB (Stable)	65,03	4,45
Peru	A3 (Stable)	BBB+ (Stable)	BBB+ (Stable)	82,09	6,05
Philippines	Baa2 (Stable)	BBB (Positive)	BBB (Stable)	98,40	6,48
Poland	A2 (Stable)	A- (Stable)	A- (Stable)	66,27	3,14
Romania	Baa3 (Stable)	BBB- (Stable)	BBB- (Stable)	100,69	5,10
Russia	Ba1 (Positive)	BBB- (Stable)	BBB- (Positive)	146,29	8,62
South Africa	Baa3 (Stable)	BB (Stable)	BB+ (Stable)	233,47	9,47
Thailand	Baa1 (Stable)	BBB+ (Stable)	BBB+ (Stable)	42,59	2,83
Turkey	Ba3 (Negative)	B+u (Stable)	BB+ (Negative)	383,75	n/a

**For the CDS and 10-year bond yield, values as at 30 October 2018.*

Sources for all charts: Bloomberg; Standard Bank Research estimates

Macroeconomic forecasts

Macroeconomic forecasts

%, average	2017	2018f	2019f	Risks
GDP	1.3	0.9	1.8	Growth in 2018 is being depressed by headwinds from weak business confidence, stagnant employment, an uncertain global economic setting, and weaker terms of trade.
Household consumption expenditure (HCE)	2.2	1.7	1.9	Higher fuel costs and taxes are considerable headwinds to consumer spending momentum. 3Q18 momentum should be boosted by the delayed public-sector wage settlement (including retrospective payment for 2Q18); should this not reflect in the 3Q18 HCE data, it would pose a significant downside risk to our HCE forecast. Employment is likely to remain stagnant, while there should be modest support from a further acceleration in household credit growth.
Gross fixed capital formation (GFCF)	0.4	-0.2	1.5	It was encouraging that private sector investment continued expanding through the policy uncertainty in 1H18, but the trajectory is likely to remain subdued until policy reform progress gains more traction. While incremental improvements are possible in the interim, the key reforms such as clarity around expropriation without compensation might only take place after the elections. Government’s renewed focus on infrastructure spending will likely take time to have a tangible impact.
Current account balance (% of GDP)	-2.5	-3.5	-3.0	The weaker growth and rand trajectories should bring some current account relief, with the typical delay. Elevated oil prices are a key risk to our current account forecast.
CPI	5.3	4.7	5.5	Inflation should remain reasonably benign unless the rand is generally weaker over the short to medium term than we currently forecast.
R/$ (year-end)	12.38	14.30	13.40	Incremental further policy improvements and modest fiscal slippage should be rand-supportive but we expect a lack of clarity on expropriation without compensation to underpin a risk premium into next year.
Repo rate (year-end)	6.75	6.50	6.50	There is a high risk that the SARB may hike interest rates in response to rand depreciation to ensure that it does not lose credibility amid the inflation risk from a weaker rand. However, our forecast remains that the bank will look through the first-round impact of a weaker rand given the technical recession, weak consumer demand, lack of demand-driven inflation pressure and the benign underlying inflation dynamics. It is a very close call whether the bank will hike interest rates at one of the upcoming MPC meetings.

Sources for all charts: Bloomberg, Standard Bank Research

Economic outlook

- **Economic growth:** Q2:18 GDP contracted 0.7% QoQ seasonally adjusted and annualised (SAAR) which, following a downwardly revised -2.6% in 1Q18 (previously -2.2%), implies a technical recession. The weakness was unsurprisingly broad based. In H1:18, the economy expanded only 0.6% YoY, which implies that very brisk growth (which would be inconsistent with recent activity data) is required in H2:18 to underpin even moderate full-year growth. Select factors should provide stronger support to the momentum in H2:18, such as the delayed government wage settlement, a recovery in agricultural production and no further decline in the terms of trade. However, the weaker-than-expected data compels us to trim our full-year forecast to 0.9% (from 1.2% previously).

- **Labour market:** Given the weak short-term investment outlook, the employment prognosis remains weak in the short run, with some improvement foreseen in 2019. Year-to-date, the SA economy has created only 56k formal (net) jobs, according to QES, and unemployment stands at a heated 27.2%. Real wage growth appears to have begun moderating, and we expect this to continue.

- **Headline inflation:** The inflation outlook remains benign, averaging 4.7% in 2017, and rising to 5.4% in 2019. The key risk to this outlook is that slaughtering numbers have not yet recovered. Rand weakness, if sustained, also poses an upside risk to grain prices and feed costs. The same holds for oil prices which we expect to retreat by year-end. Should our expected oil price trajectory not materialise, our inflation forecasts would lift materially, but the trajectory should still remain inside the target range.

- **Food inflation:** Food inflation has been benign in 2018. We expect food inflation to start to rise gradually but it should still remain reasonably benign in the medium term. There is upside risk from rand weakness and the possibility of a renewed El Niño weather patterns later this year – but large carry-over stocks and relatively benign global dynamics should contain prices.

- **Exchange rate:** We are cautious about the near-term outlook for the rand, given the prospect of further general EM pressure. But in the medium term, the rand should recover somewhat from current levels. Lower global risk aversion is required to achieve our forecasts. We see the rand closer to R14,30/$ by end-2018. However, the risk is that the recovery to fair value takes longer.

- **Petrol prices:** 2018 petrol prices have overheated due to the weaker than expected rand and higher oil prices. Year-to-date (August), average fuel prices (petrol pump prices) are about 9.6% higher than the 2017 average (and 23% higher y/y). We however expect the rand and oil to retreat by year-end, which should ease the pressure on consumer discretionary income.

- **Interest rates:** We still see the SARB keeping interest rates on hold this year, in contrast to the money market's expectation of rate hikes. We see inflation as anchored within the target band and growth staying weak, and we expect the inflationary impulse to be growth-negative.

- However, there are two key risks to our interest rate forecasts. First, the rand could take longer to recover partly owing to global growth uncertainty and the delayed improvement in domestic policy certainty, in which case it may ultimately lift inflation outside the target range, even if only temporarily. Second, the SARB might increase its inflation forecasts in response to rand weakness, which might see the SARB bringing forward the anticipated monetary tightening.

- **Consumer sentiment:** Consumer sentiment overshot expectations; it averaged 24 index points in H1:18, versus -8.2 average for 2017. Consumers are now much more optimistic about the SA economy. However, this has not translated into consumer spending, with sub-indices showing restraint in big-ticket spending.

- **Household spending:** A combination of higher taxes and record high petrol prices as well as a relatively weak labour market could curtail household spending. These should be partly countered by the expectedly above-inflation public sector wage settlement in Q3:18 as well as gradually rising credit extension. Household level data from BMR suggests that households where the primary source of income is wages and salaries account for approximately 74% of all household expenditure in SA. This easily makes wage growth, which we expect to moderate, a key factor in any near-term improvement in consumer spending.

Sources for all charts: Bloomberg, Standard Bank Research

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