

MONTHLY INSIGHTS CHART-PACK

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SUMMARY OF VIEWS

Local markets running into external headwinds as domestic conditions ease

- High-frequency data-prints since the start of the year reflect some easing in economic conditions (this is usually the case in the first quarter). The PMI reported a sharp decline in manufacturing activity in March 2018, after having remained above the 50-point level in the previous two months. This as business activity and new sales orders slumped. Over the medium-term, growth is expected to improve in 2018 as a whole. In April, we saw the IMF raise its forecast for SA growth to 1.5% in 2018, and 1.7% in 2019 (previously 0.9%). We have also seen the World Bank raise its estimates to 1.4% in 2018, 1.8% in 2019, and 1.9% in 2020. The SARB's most recent estimates are 1.7%, 1.5%, and 2% respectively for the next three years. Nedbank Group forecasts GDP to grow at 1.8%, 1.9%, and 2.4% respectively until 2020. There are some downside risks to growth in our opinion. The World Bank has indicated that low investment growth, weak integration into global supply chains, high inequality, and low potential growth are some of the key challenges SA needs to tackle in order to break away from the low and uncompetitive growth trajectory.
- SA CPI fell to 3.8% yoy in March, from 4% prior, better than market consensus of 4.1%. Core inflation remained unchanged at 4.1% yoy. The decline in inflation below 4% did not come as much of a surprise to us, particularly as we expected downside risks over the horizon – the lower print would imply a lower base (relative to consensus) particularly when evaluating the impact of the VAT hike in April. As such, where we had previously forecast the April print to be 4.73% yoy, we now drop it to 4.66%, and our average inflation forecast for the year remains unchanged at 4.7% (due to the higher oil price recently). We continue to believe that there are still downside risks to our forecasts should the rand remain below R13.00/\$ until year-end.
- The rand has lost significant ground in April, weakening by 4.8% over the month and essentially wiping out all the gains that we had seen for the YTD. The USDZAR is currently 0.22% weaker for the YTD. On a trade-weighted basis, the rand is still overvalued relative to its long-term average, despite weakening by 2.3% for the YTD.
- Long-term seasonality trends suggest that the rand will likely remain under pressure in May, and then recover in the following months. The SARB MPC decision later in the month, followed by credit ratings reviews, is likely to lend some volatility to the local FX markets. We remain of the opinion that the rand could weaken marginally into year-end, but if the SARB remains hawkish for longer then it would be supportive of real rates and would keep the rand relatively stable.

	Current price/yield	Core views	Target levels
USDZAR	12.64	Gradual rand weakness is envisaged, with a stronger dollar driving most of the moves in the local currency. As such, we expect the rand to perform better against other major crosses than against the USD.	3-month 12.50
			Year-end 13.00
			12-month 13.00
Repo rate	6.50	We expect the SARB will keep rates on hold in May	
SAGBs	6.76 (R204)	We believe local currency bonds still provide value on a multi-month view. This is partly driven by our believe that inflation will remain well anchored within the SARB's target band and that South Africa's real interest rates remain high enough to attract portfolio inflows. YTD our model portfolio held an overweight nominal bond position. We still favour nominal bonds but at the start of 2Q18, we adjusted our model portfolio to reflect the fact that the recent rally in nominal bonds has come a long way and for the time being upside may be less than before.	3-month 6.50
	8.22 (R186)		3-month 8.00
	9.05 (R2048)		3-month 8.90

Source: Nedbank CIB Markets Research

Disclaimer - Note that the above and ensuing analysis represents the analysts own view within Nedbank Corporate and Investment Banking (Nedbank CIB Markets Research) and not necessarily the Nedbank Group House view.

GLOBAL DEVELOPMENTS

Major economies are seeing inflation still well below target; but Fed's measure of inflation hitting 2%

- Global inflation trends remained fairly mixed, although more upbeat than in the past. We have seen inflation in many major economies move closer to central bank targets.
- The Fed's targeted core PCE measure rose a further 10bps in February 2018, to 1.6% yoy. The higher inflation rate has been driven by a modest increase in disposable incomes over the month, and higher services inflation. While underlying inflationary pressures remain benign in the US, they are rising gradually – the higher oil prices seen recently are likely to support inflation in the near-term.
- While Eurozone CPI remains far-off the ECB's 2% target – and unlikely to reach this level over the next three years as per the ECB's estimates – it has risen to 1.3% yoy in March, from 1.1% in February. Core inflation remained low, at 1.1% yoy.
- UK CPI decelerated to 2.5% yoy in March, from 2.7% in February. This comes after CPI remained elevated and close to the 3% level since September 2017. Core inflation fell 10bps to 2.3% yoy in March. The stronger pound over the past year has seen import prices recede and hence resulted in lower cost-push inflation.
- Japanese CPI eased to 1.1% yoy in March, from 1.5% previously (in line with consensus). Chinese inflation dropped sharply in March, but this is typical for this time of year when the week-long Chinese New Year holiday (in February) distorts economic data. Chinese inflation normalised to 2.1% yoy, from 2.9% in February, as fresh food costs eased.
- While EM inflation rates have been broadly contained recently, they are expected to rise in coming months as weaker currencies and higher food and energy prices place some upward pressure on CPI. On the other hand, commodity exporters with spare capacity may see stable inflation rates over the medium-term.

Table 1: Summary of economic and financial indicators

Economic, fiscal and monetary indicators	Retail sales y/y %		Consumer confidence		GDP growth q/q ann.		PMI		Manufact. Prod. y/y %		Budget bal. (% of GDP)		Central bank rate %	
	LAST	PREV.	LAST	PREV.	LAST	PREV.	LAST	PREV.	LAST	PREV.	LAST	PREV.	LAST	PREV.
	Available data as at 26-Apr-18													
US	4.5	4.1	129	127	2.9	3.2	59.3	60.8	0.51	1	-3.4	-3.4	1.75	1.5
UK	1.1	1.5	-7	-10	0.4	0.5	55.1	55	2.2	1.2	-1.92	-2.12	0.5	0.5
Eurozone	1.8	1.5	0.4	0.1	0.7	0.7	56	56.6	2.9	3.7	-0.89	-1.01	0	0
Japan	1.7	1.5	44.3	44.3	1.6	2.4	53.3	53.1	1.6	2.9	-4.98	-5.67	-0.1	-0.1
Turkey	0.76	0.79	71.9	71.3	0.3	0.66	51.8	55.6	9.88	14.4	-1.53	-1.65	8	8
China	10.1	9.4	122	123	6.8	6.8	51.5	50.3	6	6.2	-3.43	-9.2	4.35	4.35
Brazil	1.3	3.1	89.4	92	0.1	0.2	53.4	53.2	2.8	5.8	-8.49	-9.01	6.5	6.75
Russia	2	1.8	68.3	71.3	0.9	2.2	50.6	50.2	1	1.5	-2.14	-2.46	7.25	7.5
India	5031	5021	47.8	46.1	7.2	6.5	51	52.1	7.1	7.4	-3.97	-3.66	6	6
Mexico	1.2	0.5	82.5	82	0.78	-0.17	54	53.1	0.73	0.8	-1.1	-0.88	7.5	7.5
South Africa	4.9	3.3	26	-8	3.1	2.3	46.9	50.8	0.6	2.3	-4.38	-4.21	6.5	6.75

Chart 1: Global inflation trend starts to turn lower

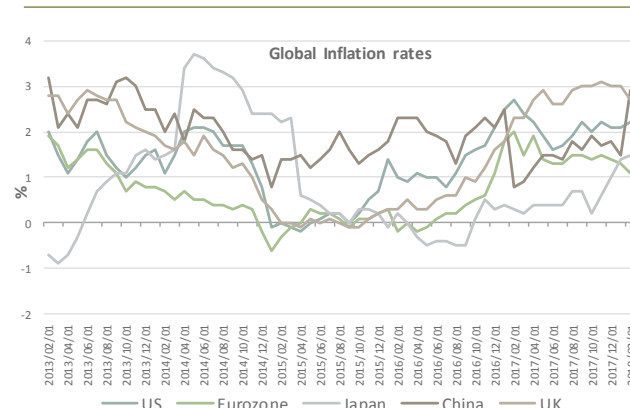
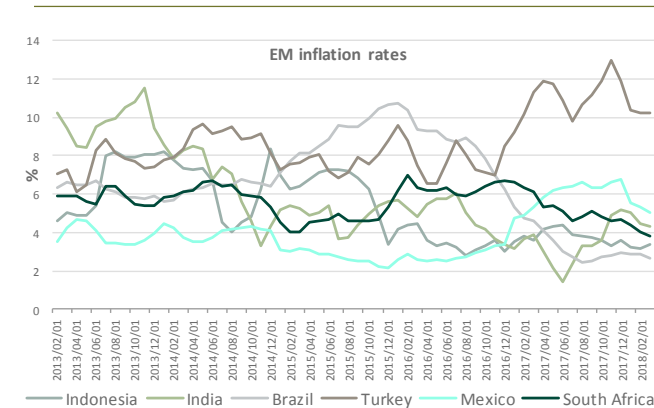


Chart 2: EM inflation rates contained (ex. Turkey)



Source: Bloomberg, Nedbank CIB Markets Research

Economic activity: Growth remains strong; DM and China leads the pack

- The IMF updated its World Economic Outlook report in April 2018, and kept the global growth forecast unchanged at 3.9% (from 3.8% achieved in 2017) over the next two years, but warned that growth will likely weaken to 3.7% thereafter. Advanced economies are expected to grow above potential in 2018 and 2019 while growth in EMs is also expected to rise. Risks to the global growth outlook are trade wars or escalating geopolitical tensions, increased populism or nationalistic policies, labour market polarization, and diminished prospects for household income growth. Importantly, the IMF urged countries to build capital buffers ahead of the economic downturn that is expected beyond 2019. This process would enable weaker countries to improve financial resilience, particularly during the downturn.
- Global PMIs were slightly lower in March, in part due to the slowdown in global demand, as well as a result of fears over trade wars and some curtailment in global trade activity. Recent indications from the Baltic Dry index do suggest a significant slowdown in global trade, despite growth projections remaining upbeat. If we see any slowdown in global demand and growth, it would hamper factory output globally.
- Economic conditions in Japan have deteriorated since February, with a slowdown in industrial activity, a decline in both imports and exports. In China, a higher unemployment rate ensured that economic developments were mixed – Chinese GDP growth eased to 1.4% qoq SAAR in 1Q18, from 1.6% in the previous quarter (worse than consensus of 1.5%). Manufacturing and industrial activity fared well over the quarter, services continued to expand, while the primary industries eased somewhat.
- High-frequency economic data in the Eurozone remained upbeat in February, with retail sales growth improving and industrial activity growing at a modest pace, while confidence metrics continue to reflect better sentiment in the economy.
- The US labour market continued to tighten in March, as the pool of available labour declined at a faster pace, resulting in higher average hourly earnings. Retail sales rebounded sharply. While industrial activity in the US remained resilient, the pace of growth was hampered by trade-war concerns as President Trump announced sharp tariff increases for steel and aluminium imports.
- Economic data in the UK was marginally better in March, as the trade deficit narrowed, industrial production activity picked up, the unemployment rate declined, and inflation fell. Domestic demand remains a key driver of growth in the UK, but concerns over Brexit negotiations is clouding the outlook for UK economic activity over the medium-term.

Chart 3: Major PMI's are expansionary

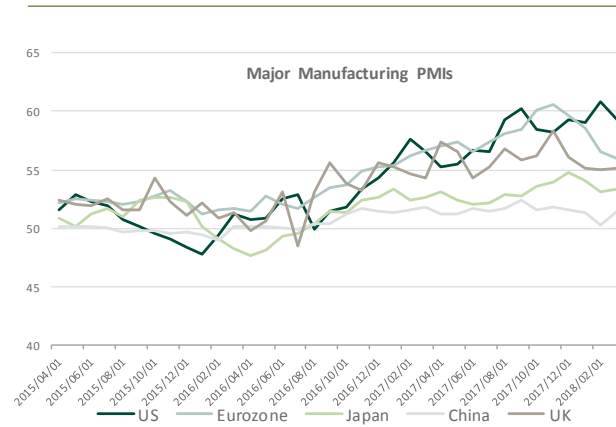


Chart 5: EM PMI's are mixed, SA negative

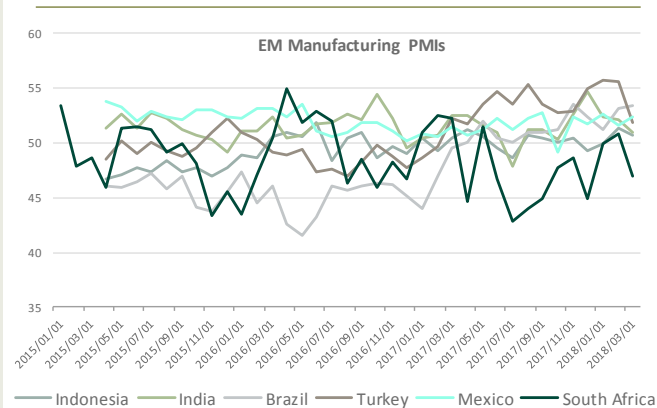


Chart 4: Global manufacturing activity driven by DMs

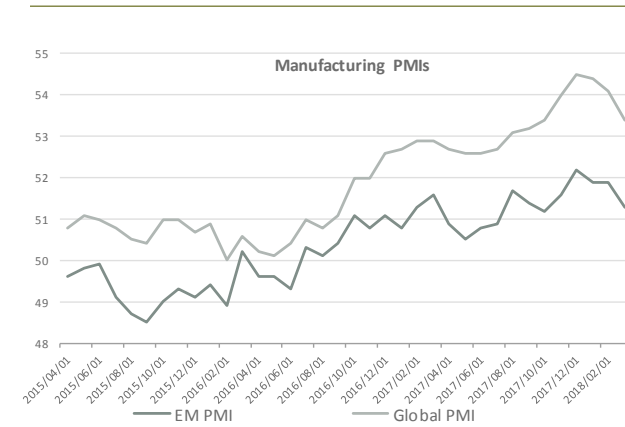
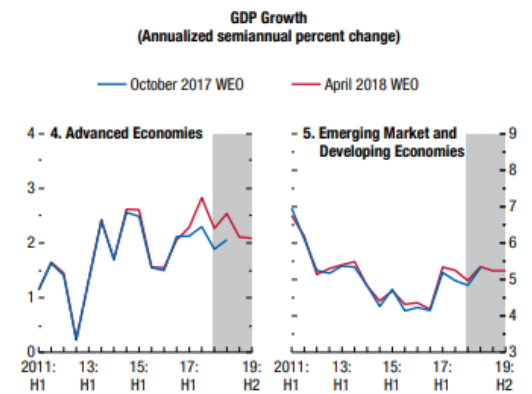


Chart 6: Upward revisions to IMF growth estimates



Source: Bloomberg, IMF, Nedbank CIB Markets Research

MONETARY POLICY DYNAMICS: GLOBAL

Fed set to hike again in June 2018

- The market expects no change to policy rates in the US this month, but there is a 92% probability of a hike in June 2018. The Fed is expected to maintain a hawkish policy stance, with some policymakers debating the need to raise interest rates by more than what is projected in its dot plot. While the Fed minutes of its March meeting remained hawkish (as the Fed had hiked interest rates by 25bps), concerns over the recent trade spat between the US and China were raised, along with uncertainty over the effect of the recent tax cuts.
- The BOE maintains its hawkish tone as inflation is still above its 2% target, but it will exercise caution because of the on-going Brexit negotiations and the uncertainty this causes. The market is expecting one rate hike in May, with rates then likely remaining flat before another hike sometime in 2019.
- The ECB has expressed its willingness to end its asset purchase programme this year. We could see a further reduction in the size of its asset purchases in September. The market is not seeing any changes to the ECB policy rate until at least the middle of 2019.

	Next policy meeting	Probability of a hike/cut/hold
US	2018/05/02 20:00	67.90%
UK	2018/05/10 13:00	57.10%
Eurozone	2018/06/14 13:45	94.70%
Japan	2018/06/15	85.10%
China		
India	2018/06/06 11:00	51.40%
Mexico	2018/05/17 20:00	61.70%
South Africa	2018/05/24	4.00%

Updated 02-May-18

Chart 7: US inflation expectations are sticky above 2%

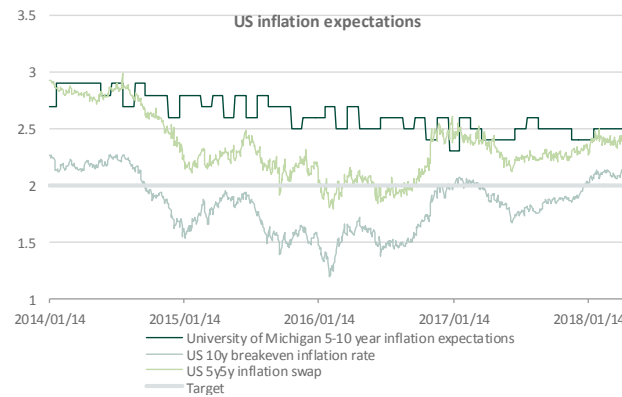


Chart 8: UK inflation remains elevated, expectations ease marginally in the near-term

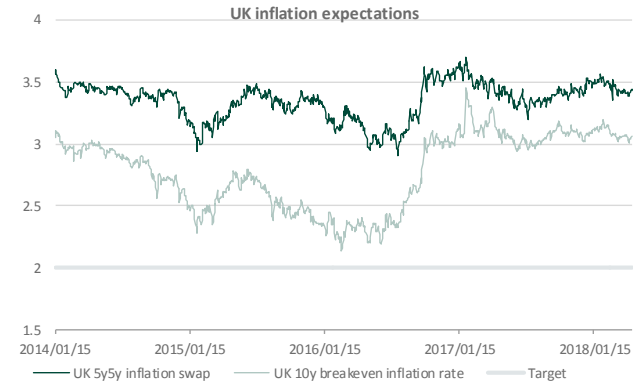


Chart 9: Eurozone swap markets more in tune with actual inflation

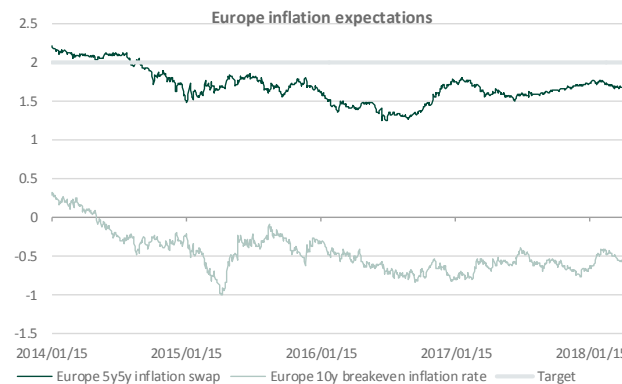
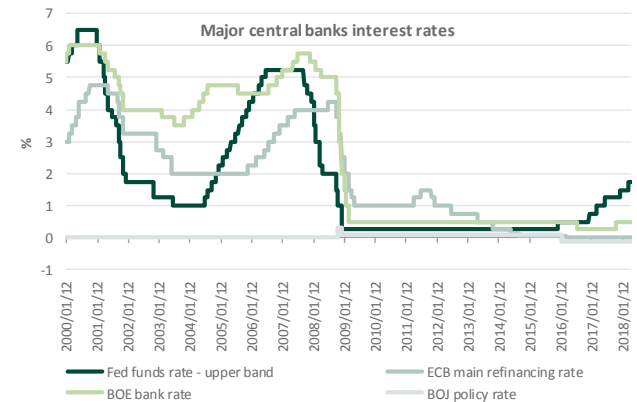


Chart 10: Policy rates across DMs set to rise over the medium- to long-term



Source: Bloomberg, Nedbank CIB Markets Research

Policy rates: Fed set to continue its hiking path, while ECB is edging closer to an end of its asset purchase programme

- While the Fed minutes of its March 2018 meeting remained hawkish, (as the Fed had hiked interest rates by 25bps), concerns over the recent trade spat between the US and China were raised, along with uncertainty over the effect of the recent tax cuts. Policymakers are trying to understand the subsequent impact on the economy, the fiscus, trade, and inflation. While policymakers dismissed any material impact from the recent metals tariff hike, they are more concerned about retaliatory behaviour of trade partners. Another aspect that the Fed seemed to shrug off was the recent stock market volatility. Overall the minutes remained upbeat about the economy, and policymakers expected inflation to rise in coming months.
- At its last meeting in March, the BOE left interest rates unchanged at 0.5%, but remained hawkish, reiterating that gradual rate hikes are needed to reach the inflation target of 2%. The BOE has indicated that Brexit remains a key input for its economic outlook and outlook for rates, while protectionism policies (like steep import tariff hikes by the US) will hurt growth. The BOE expects economic activity to continue to expand at a solid pace, however this would give rise to demand-pull inflation which may offset the previous cost-push inflationary pressures from a weaker pound.
- The ECB left its policy stance unchanged at the April meeting, with its policy statement also unchanged from the previous meeting. The ECB looks set to continue its net asset purchases until the end of September, or beyond if necessary. ECB President Draghi highlighted that the ECB is not yet concerned that recent soft economic data is a weakening trend.
- The BOJ is currently debating an exit strategy for its current asset purchase programme, with some policymakers expecting this to materialise in 2019. However, inflation remains well below target and this would likely keep the BOJ cautious for longer.
- Of the 53 most-watched central banks, 13 have raised interest rates in the last three months, while seven have cut interest rates.

Chart 11: The Fed remains at the forefront of tightening

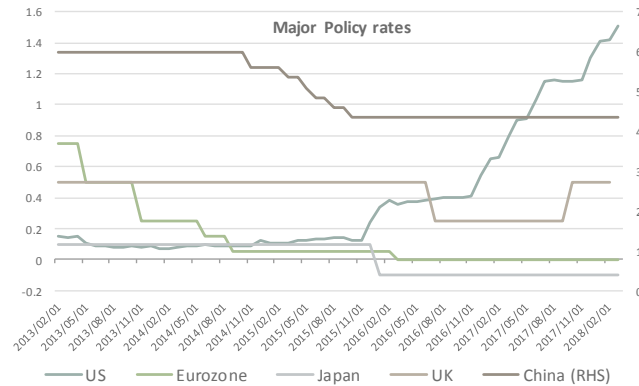


Chart 12: Global bond yields rise as monetary policy tightens

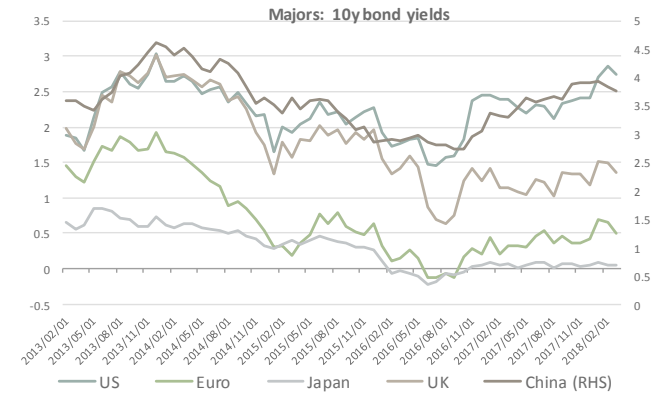


Chart 13: EM monetary policy stance broadly loose

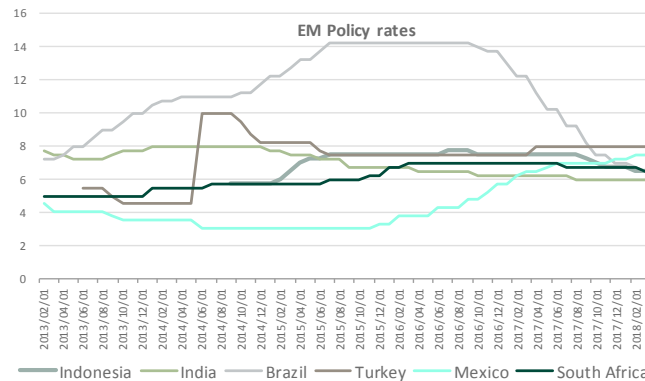
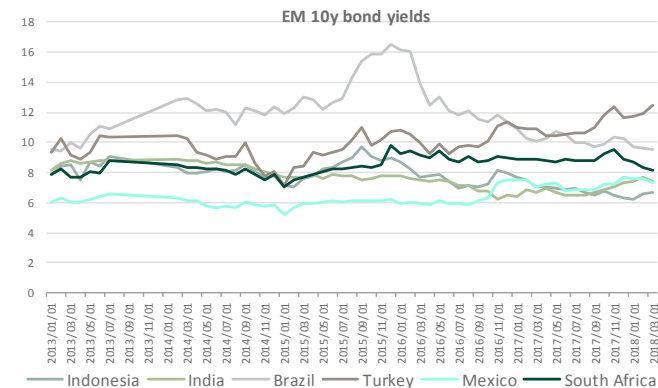


Chart 14: EM bond yield trajectory remains mixed



Source: Bloomberg, Nedbank CIB Markets Research

THE SOUTH AFRICAN REAL ECONOMY

Some softening in economic conditions is expected in 1Q18

- High-frequency data-prints since the start of the year reflect some easing in economic conditions (which is usually the case in the first quarter). The PMI reported a sharp decline in manufacturing activity in March 2018, after remaining above the 50-point level in the previous two months. This as business activity and new sales orders slumped. A further negative development was that sentiment for expected business conditions in six months' time fell (after reporting the best level since 2001 in February) – this was likely due to the recent negative publicity over the land reform policy. However, at 73.1 index points, this sentiment indicator is still well above recent lows, and still reflects very positive business sentiment despite recent easing. SA manufacturing production eased in tandem with the PMI, while mining output in contrast grew by a modest 3.1% yoy pace in February.
- Retail sales surprised to the upside in February and have been driven by better credit extension to households (albeit at still low single-digit growth), low inflation, falling debt servicing costs, and slightly higher disposable incomes. Household consumption remains the key driver of growth – this category has shown significant improvement since September 2017, but we now need to see this being driven by actual labour market gains (as opposed to sentiment) for the positive trend to be sustained. While vehicle sales growth remains very low, it improved marginally in March, from deep contractions in the previous two months. While some improvement is envisaged in 2018, this will be dependent on labour market developments and disposable income growth.
- Over the medium-term, growth is expected to improve in 2018 as a whole. In April, we saw the IMF raise its forecast for SA growth to 1.5% in 2018 and 1.7% in 2019 (previously 0.9%). We have also seen the World Bank raise its estimates to 1.4% in 2018, 1.8% in 2019, and 1.9% in 2020. The SARB's most recent estimates are 1.7%, 1.5%, and 2% respectively over the next three years. Nedbank Group forecasts GDP to grow at 1.8%, 1.9%, and 2.4% respectively until 2020. There are a myriad of downside risks to growth. The World Bank has indicated that low investment growth, weak integration into global supply chains, high inequality, and low potential growth are some of the key challenges SA needs to tackle in order to break away from the low and uncompetitive growth trajectory.

Chart 15: SA confidence leads investment growth

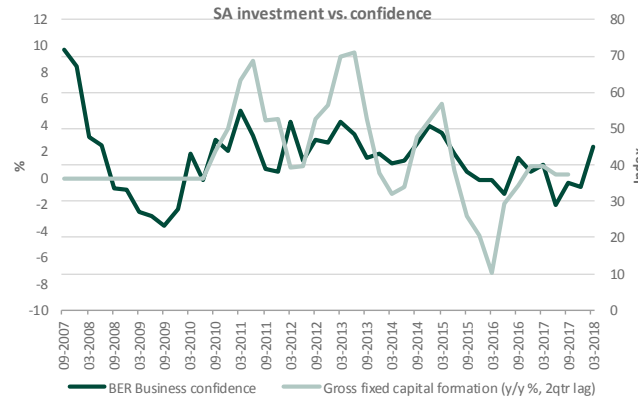


Chart 16: SARB's leading index remains positive

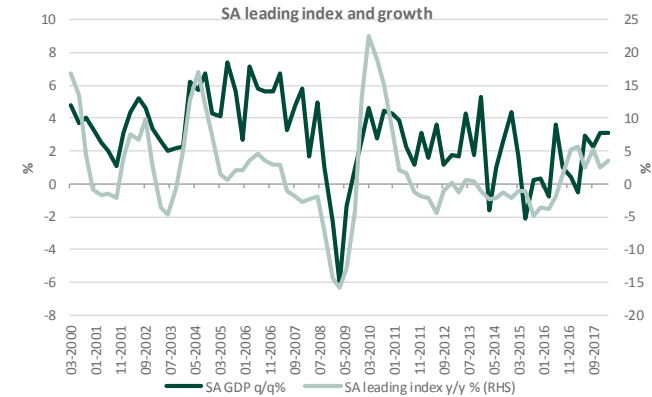


Chart 17: SA economy needs to reduce dependence on government

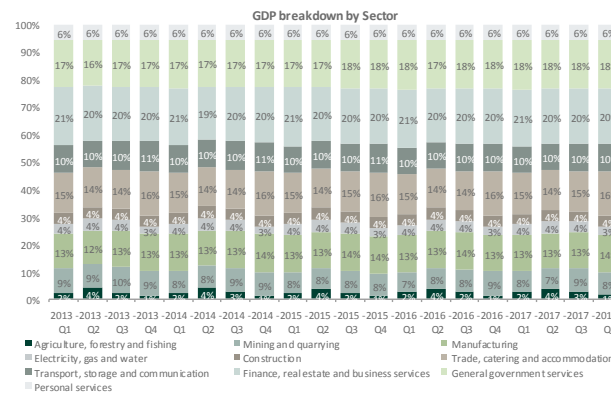
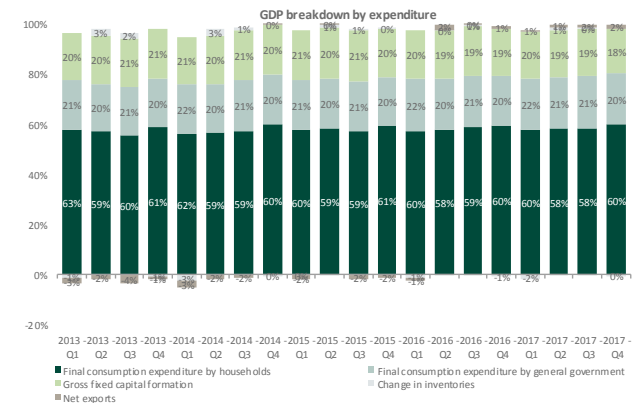


Chart 18: Spending a key driver of economic activity



Source: Bloomberg, Stats SA, Nedbank CIB Markets Research

SA INFLATION TRENDS

Inflation is expected to rise in April 2018 due to the VAT hike

- SA CPI fell to 3.8% yoy in March, from 4% prior, better than market consensus of 4.1%. Core inflation remained unchanged at 4.1% yoy. The decline in inflation to below 4% did not come as much of a surprise, particularly as we expected downside risks over the horizon – the lower print would imply a lower base (relative to consensus) particularly when evaluating the impact of the VAT hike in April. As such, where we had previously forecasted the April print to be 4.73% yoy, we now drop this to 4.66%, and our average inflation forecast for the year remains unchanged at 4.7% (due to the higher oil price recently). We continue to believe that there are still downside risks to our forecasts, should the rand remain below R13.00/\$ until year-end.
- Looking at the inflation subcomponents in March, goods inflation continues to benefit from very low import inflation, with goods price inflation at 2.6% yoy, from 3.2% prior. However, services inflation rose by 20bps to 5.1% yoy (but this was expected given that public transport, education, child care, and other services were surveyed in March). Administered price inflation remained very low, at 3.8% yoy in March (vs 4.3% prior).
- We remain more dovish relative to consensus because of a few reasons: For as long as the SARB remains hawkish and does not lower interest rates, the rand should remain stable or strengthen further as a result of an attractive real interest rate. We have pencilled in gradual rand weakness for our CPI model, and if this does not materialise we could see inflation surprise to the downside relative to our estimates. We believe inflation expectations may come in lower over the medium-term. If inflation expectations decline and remain structurally low, it would reinforce low inflation in the economy. Goods inflation is currently at a two-year low – goods inflation may remain low as a result of a stable currency and this may cap headline price increases. Note that we believe the March 2018 print of 3.8% was the cyclical low, with inflation set to increase in April due to the VAT hike.
- Inflation is expected to remain contained for the foreseeable future. With the new development of the SARB's willingness to target a 4.5% inflation rate, monetary policy becomes more cautious. However, given disinflationary drivers over the medium-term (particularly food, import costs, and the strong rand exchange rate) upside risks from the VAT hike are more or less contained in our view. We believe that if inflation expectations fall below 5% (currently at 5.2%) and if actual inflation continues to surprise to the downside, we could see a further 25bps rate cut by the SARB in 3Q18.

Table 2: Nedbank CIB inflation estimates

Nedbank CIB Markets Research estimates						
	CPI	Core	Food	Oil	USDZAR	Electricity
2017A	5.3	4.8	7.0	55.7	13.3	4.8
2018F	4.7	4.3	4.0	72.0	12.4	3.7
2019F	4.9	4.5	6.0	68.1	13.1	6.6
2020F	4.9	4.5	6.1	67.6	13.1	6.8
Q1:18F	4.1	4.1	4.1	68.4	11.8	2.2
Q2:18F	4.7	4.3	3.4	74.8	12.1	2.2
Q3:18F	5.0	4.4	3.8	73.2	12.7	5.2
Q4:18F	5.0	4.4	4.6	71.6	13.0	5.2
Q1:19F	5.0	4.5	5.2	70.2	13.0	5.2
Q2:19F	4.9	4.5	6.0	68.7	13.0	5.2
Q3:19F	4.9	4.5	6.4	67.4	13.1	8.0
Q4:19F	4.9	4.5	6.3	66.0	13.4	8.0
Q1:20F	4.9	4.5	6.3	65.6	13.1	8.0
Q2:20F	4.9	4.5	6.2	65.2	12.8	8.0
Q3:20F	4.8	4.5	6.1	64.8	12.5	8.0

Chart 20: Breakeven inflation still above 4.5%

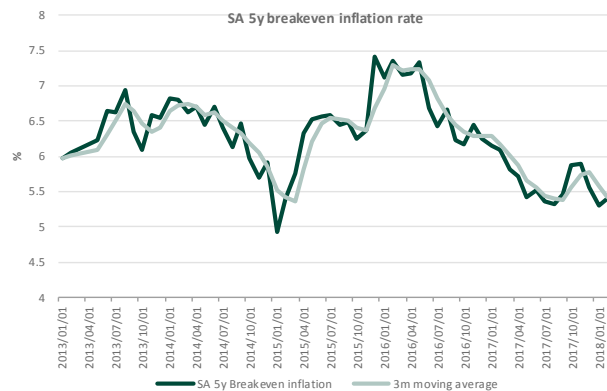


Chart 19: We remain relatively dovish compared to consensus

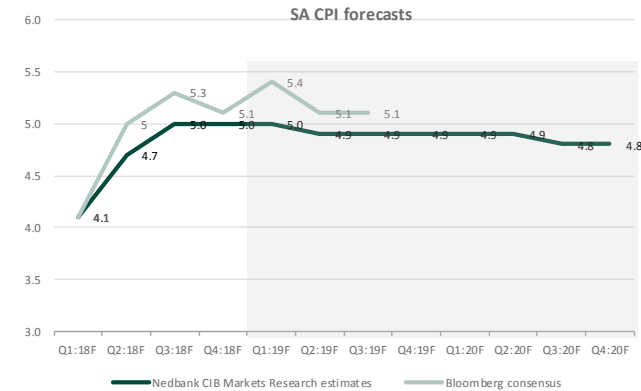
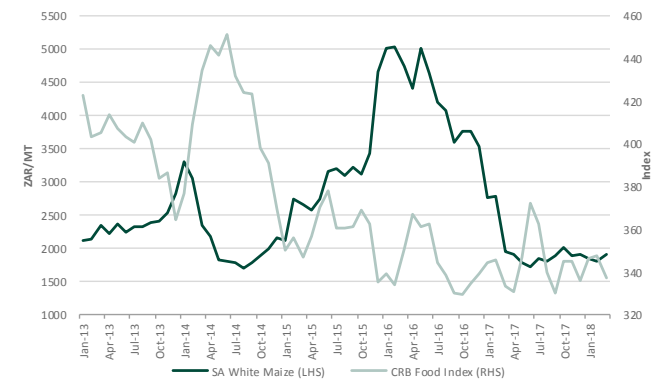


Chart 21: Food prices remain disinflationary



Source: Bloomberg, Nedbank CIB Markets Research

MONETARY POLICY DYNAMICS: SA

SARB expresses its willingness to adopt a point-target on inflation

- At its recent Monetary Policy Forum meeting, the SARB sounded more constructive on SA growth. Furthermore, there seems to be a deliberate attempt by the SARB to get inflation expectations closer to 4.5%, and to anchor expectations at that level over the medium- to longer-term. SA CPI is still higher than the EM average, implying higher borrowing costs – the SARB will now actively try to get SA CPI down to the EM average (to ‘level the playing field’).
- The MPC members sounded very upbeat on growth over the medium-term particularly due to the fact that domestic risks have dissipated (the MPC statement indicated that the risk to growth outlook is to the upside).
- The most important take-away on CPI, in our view, is the explicit communication from the MPC that “we would like a point-target on inflation with some flexibility”. We think it is unlikely to happen soon (ie this year), but the SARB seems to be moving in that direction. There seems to be a sudden shift on this topic of the point target, because last year (and as recently as five months ago) the MPC vehemently stood behind and defended the 3%-6% target range as its mandate (ie opposing a point target), whereas now it is firmly backing a point-target and has indicated that this will in fact materialise eventually (it just depends when/how long). In the meantime the SARB seems set to talk down expectations at levels “closer to” the mid-point of the target band. We think there seems to be some tolerance if inflation expectations come in anywhere between 4.5% to 4.9% (which we think is possible this year).
- One thing to note is that the SARB forecasted 1Q18 inflation exactly right, so it is unlikely to be surprised by the 3.8% inflation print in March. However we do believe that there is at least 20bps of ‘fat’ built into its full-year 2018 projection of 4.9%, and so the inflation estimates may be reduced at upcoming meetings if inflation continues to come in below consensus. Lower inflation prints this year would obviously lower the base, implying that inflation projections further out would need to be lowered as well (ceterus paribus – assuming no surprises from NERSA, wage negotiations, or the rand). So inflation surprises now would definitely have a bearing on upcoming Monetary Policy decisions (which are forward-looking out 12-18 months).

Chart 22: We forecast CPI to remain contained below 5% until at least 2019

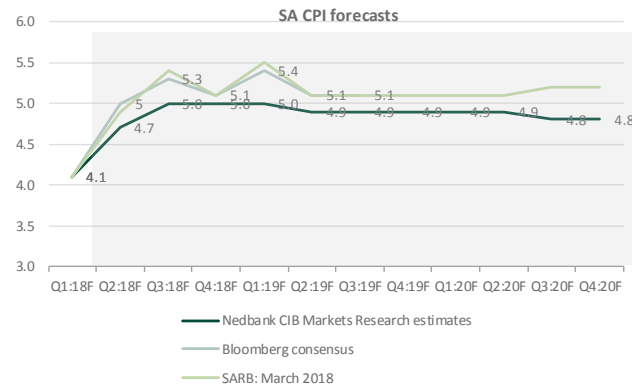


Chart 23: SARB has recently turned more constructive on SA growth

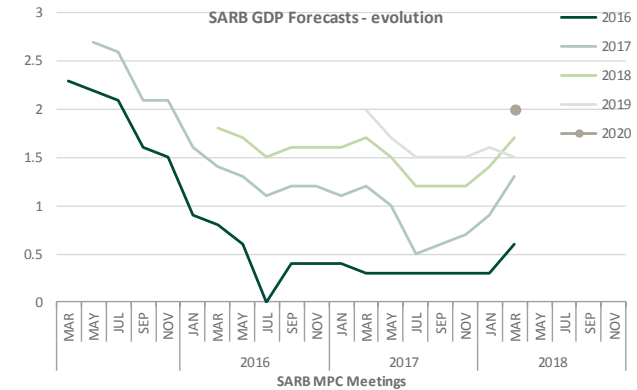


Chart 24: SARB’s inflation forecasts are well below its 2016 and 2017 estimates

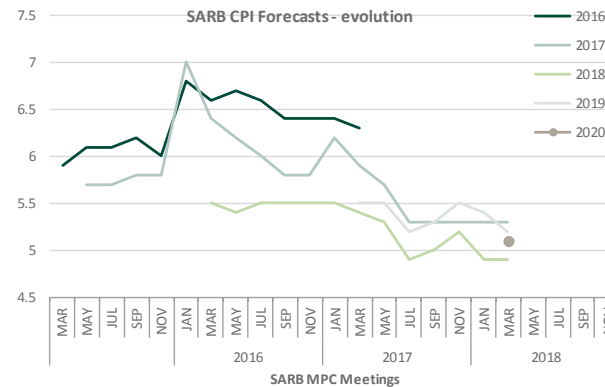
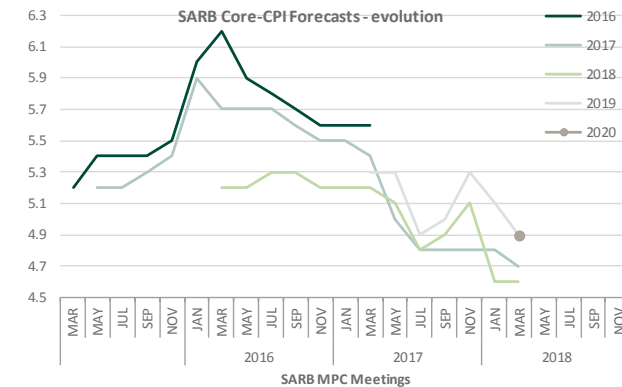


Chart 25: Core inflation will likely remain anchored over the medium-term



Source: Bloomberg, SARB, Nedbank CIB Markets Research

CREDIT RISK COMPARISON

SA credit risk broadly in line with peers, although some upside may prevail

- On our radar this month is the credit rating reviews/updates from S&P and Fitch. Recent commentary from S&P reflected a significant upward revision to real GDP growth estimates (to 2% for 2018, from 1% forecasted in November 2017). Better growth estimates, higher per capita GDP, and some growth in real investment may feature in the commentaries from the rating agencies. However we think it is too soon to expect any changes to the outlooks or the ratings themselves. Further evidence of structural reform implementation, policy certainty, investment growth, tax collection efficiencies, the strengthening of institutions, and an improved fiscal trajectory are needed for an outlook change to 'positive' from the current 'stable'. We believe that by the MTBPS in October, the country is likely to have compiled more evidence to support the above, and we would expect an outlook change only at the November credit rating reviews of both S&P and Fitch.
- We look at a few metrics to determine the relative riskiness of countries. Fiscal metrics remain the key tool to assess a country's external vulnerabilities. We also look at various country risk assessments, one being the Economist Intelligence Unit country risk score. Relative to similarly rated EM peers, SA's CDS spread lies amongst the 'high risk' countries. Should we see structural reform implementation, better growth metrics, and an improvement in the credit rating outlook then SA's CDS spread will likely compress over the medium-term. Hence we remain constructive on SA credit.

Table 3: A Summary of SA's credit ratings

Moody's		S&P		Fitch		<SA Credit rating>			
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term				
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime			
Aa1		AA+		AA+		High grade			
Aa2		AA		AA					
Aa3		AA-		AA-					
A1	P-2	A+	A-1	A+	F1	Upper medium grade			
A2		A		A					
A3		A-		A-					
Baa1		BBB+		BBB+					
Baa2	P-3	BBB	A-3	BBB	F3	Lower medium grade			
Baa3 (stable) FC+LC		BBB-		BBB-					
Ba1	Not prime	BB+ (stable) LC	B	BB+ (stable) FC+LC	B	Non-investment grade			
Ba2		BB (stable) FC		BB		speculative			
Ba3		BB-		BB-					
B1		B+		B+					
B2		B		B					
B3		B-		B-		B-	B-	B-	Highly speculative

Source: Fitch, S&P ratings, Moody's, Nedbank

Chart 26: SA lies amongst the high-risk EMs

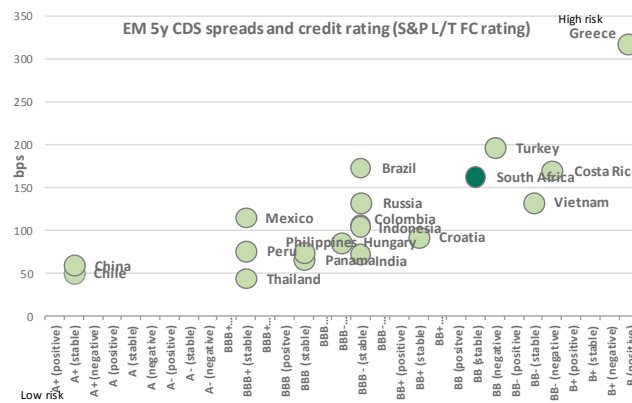
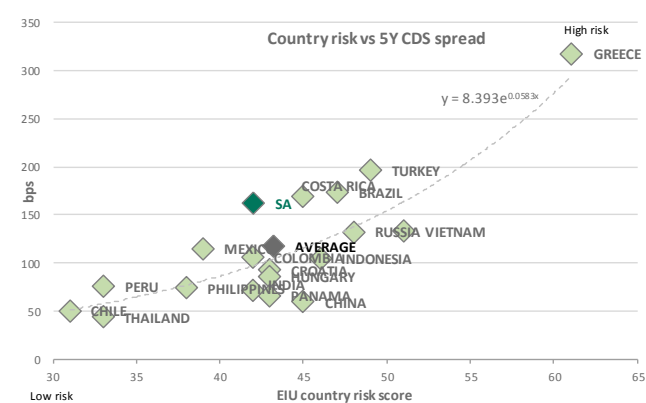


Chart 27: However, SA credit risk should come down



Source: Bloomberg, Credit rating agencies, Nedbank CIB Markets Research

CREDIT RISK COMPARISON

SA's wide twin deficit implies higher external vulnerability; but on a forward looking basis SA may improve

- Countries with large twin deficits are typically more vulnerable to external shocks and require higher real interest rates to attract portfolio flows.
- Countries with fairly healthy twin balances (surpluses as a % of GDP) on a consistent basis have seen lower variances in real yields, with real yields remaining anchored. Countries with large twin deficits are more prone to large swings in risk appetite and therefore have a significantly higher variability in real rates.
- At this point we believe that SA's real yield is fairly valued relative to EM peers. In fact, if NT manages to hit its targets as per the 2018 Budget, credit and currency risk metrics may improve. The IMF forecasts SA's twin deficit to rise to 8% by 2020, from the current 6.1% Nedbank forecasts for 2018.
- Over the near- to medium-term however, fiscal sustainability risks have subsided, while trade activity and portfolio flows remain upbeat and supportive of our constructive view on SA rates.
- We begin the 2018/19 year on a more positive note from a fiscal perspective, with a higher VAT rate likely to drive up VAT revenues for the year; this in conjunction with improving tax buoyancy (albeit probably only temporarily). Changes within SARS may drive up revenue collection efficiencies, while better confidence levels in the economy may see lower levels of tax evasion/avoidance and profit shifting and base erosion. These are more long-term developments which would go a long way in retaining high buoyancy levels.
- With regards to portfolio flows in April, we saw US bond yields rise sharply as the Fed remained hawkish and the US Treasury increased its issuance of treasury bonds (the increased supply has dampened bond prices). As a result of the increase in real interest rates in the US, we have seen portfolio flows into EMs deteriorate.

Source: Bloomberg, IIF, Nedbank CIB Markets Research

Chart 28: SA twin deficit is too wide relative to peers

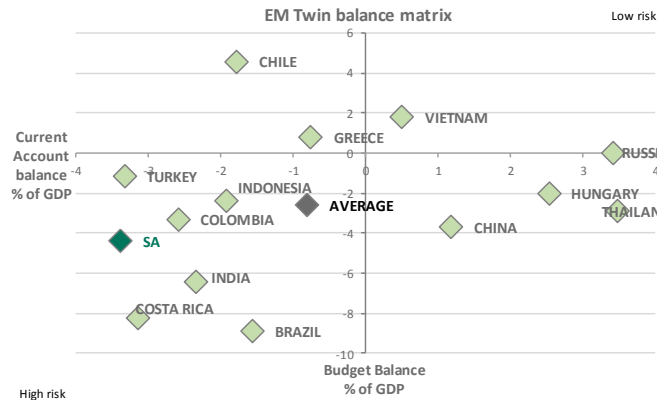


Chart 29: SA remains below EM average

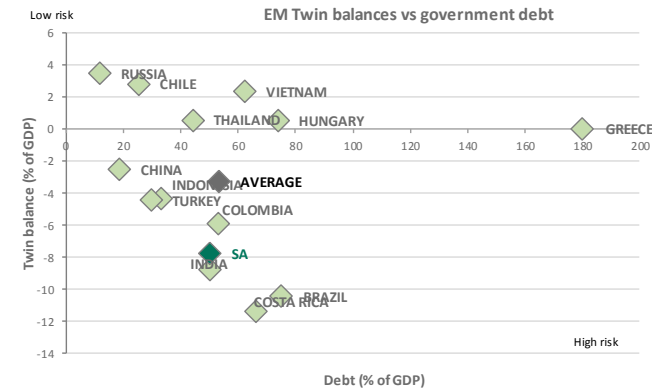


Chart 30: Country risk is fairly stable

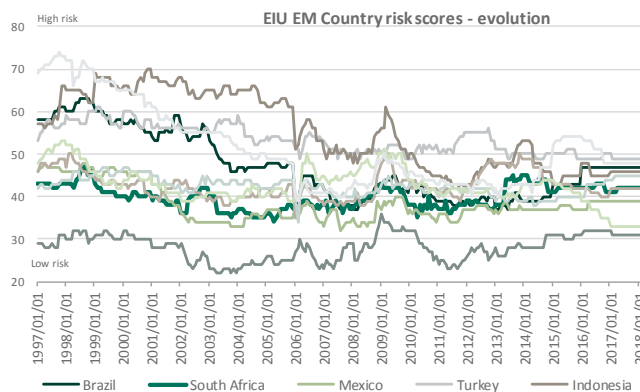
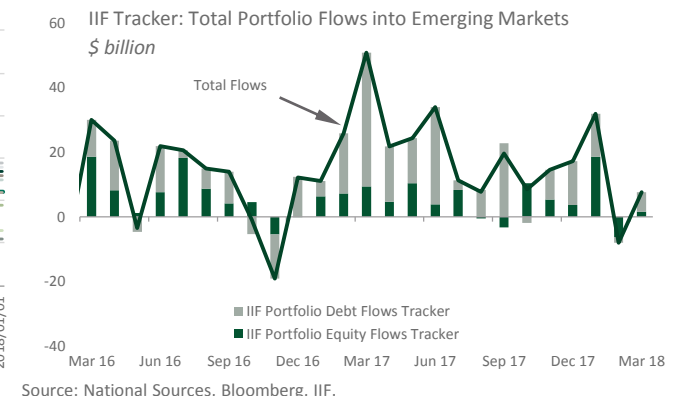


Chart 31: EM portfolio flows eases recently



Source: National Sources, Bloomberg, IIF.

THE SA BOND MARKET

Higher US bond yields sees upward pressure on SA yields; but foreigners still buying local SA bonds

- Since the 25bps repo rate reduction by the SARB in March 2018, the FRA curve has flattened substantially, with the market now seeing a 36% probability of a 25bps cut in July and a 48% probability of a 25bps cut in September. We have outlined our view for a further 25bps reduction in the repo rate either in July or September, dependent on the trajectory of the rand exchange rate and inflation expectations.
- The recent risk-off phase that hampered flows into EM bond markets resulted in a sharp increase in SA nominal bond yields across the curve. Despite the reduction in the policy rate, short-end yields bore the brunt of the risk aversion, with yields rising by around 50bps. Long-end yields rose sharply as well, by 40bps over the past month. As a result of the disproportionate move in yields, the yield curve (particularly the long-end and belly) continues to flatten.
- Foreign investor positioning along the curve is reflective of the variance along the curve. With foreign investors holding 49% of all fixed-rate local currency bonds in issue, we look at their exposure across the yield curve as a proportion of total outstanding bonds in each category. Foreign investors 'like' the belly and the long-end of the curve. However between January and February (which is the latest data available) these investors lightened up their exposure to long-end bonds (albeit marginally), and rotated into the belly.

Chart 32: After rate cut in March, FRAs sees just over 50% chance of another cut this year

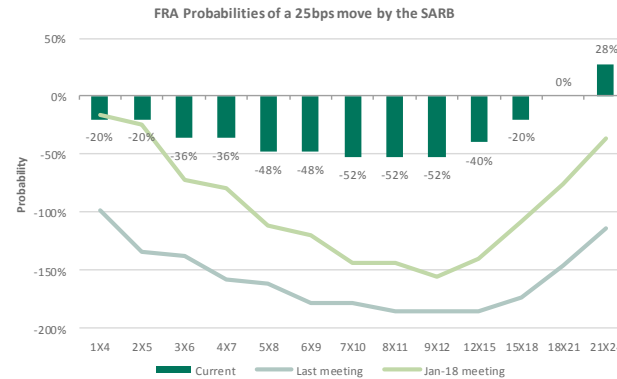


Chart 33: Risk-off dampens SA bond yields

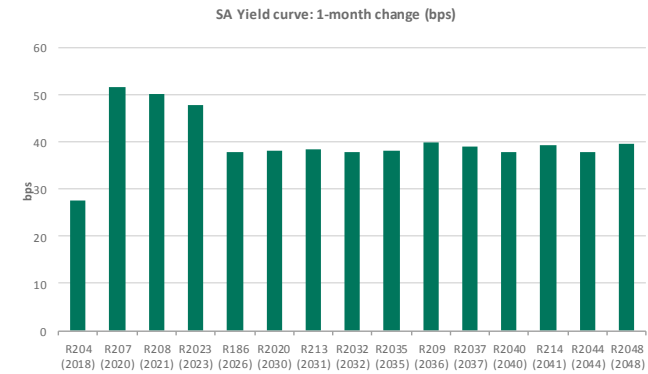


Chart 34: The long-end continues to perform well

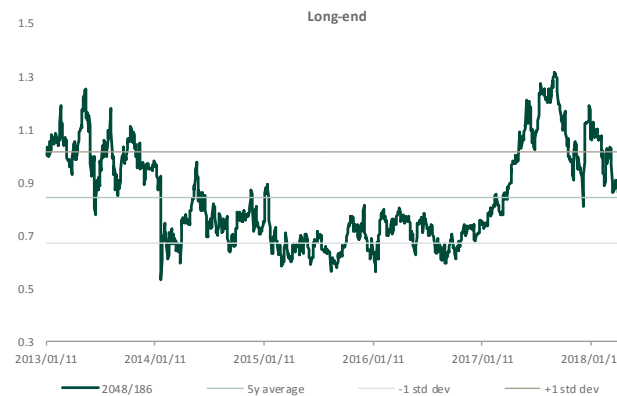
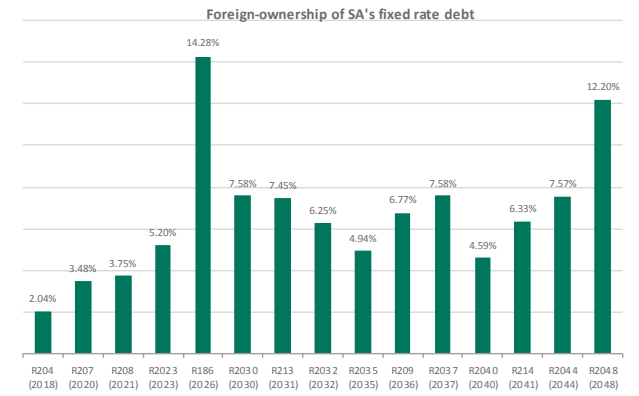


Chart 35: Foreign investors prefer the belly and long-end



Source: Bloomberg, National Treasury, Nedbank CIB Markets Research

THE RAND AND KEY RISKS

The rand is likely to weaken in May 2018, as per seasonal trends

- The rand lost significant ground in April, weakening by 4.8% over the month and essentially wiping out all the gains that we have seen for the YTD. The USDZAR is currently 0.22% weaker for the YTD. On a trade-weighted basis, the rand is still overvalued relative to its long-term average, despite weakening by 2.3% for the YTD.
- Long-term seasonality trends suggest that the rand will likely remain under pressure in May, and then recover in the following months. The SARB MPC decision later in the month, followed by credit ratings reviews, are likely to extend some volatility to the local FX markets. We remain of the opinion that the rand could weaken marginally into year-end, but if the SARB remains hawkish for longer then it would be supportive of real rates and would keep the rand relatively stable.
- Technical support and resistance levels we look out for in the near-term are the +1 standard deviation level of R12.60/\$ as support, and the 138.2% Fibonacci projection of R11.73/\$ as resistance to further rand strength.

Chart 36: ZAR REER close to fair value

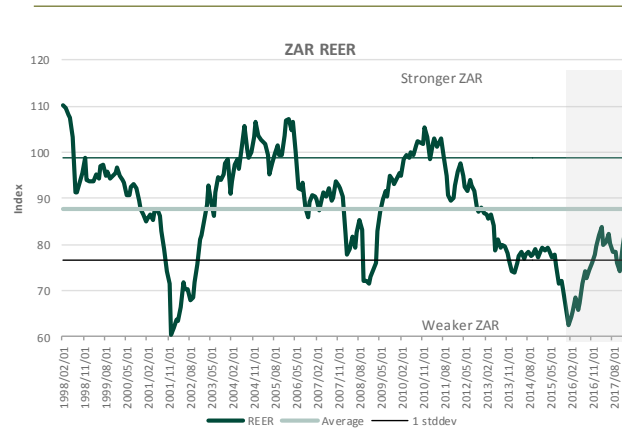


Chart 37: But NEER is overvalued

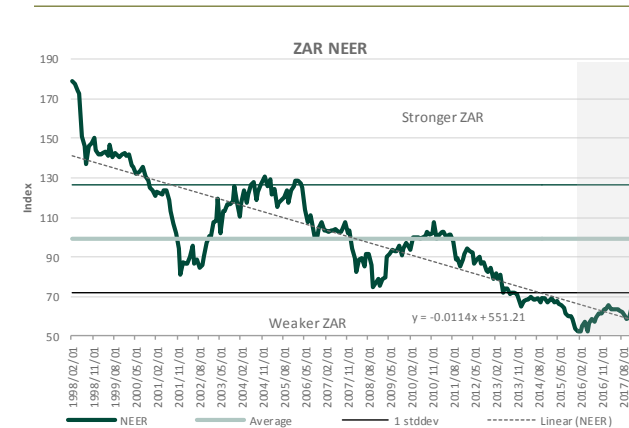


Chart 38: However higher oil price suggests a stronger rand exchange rate

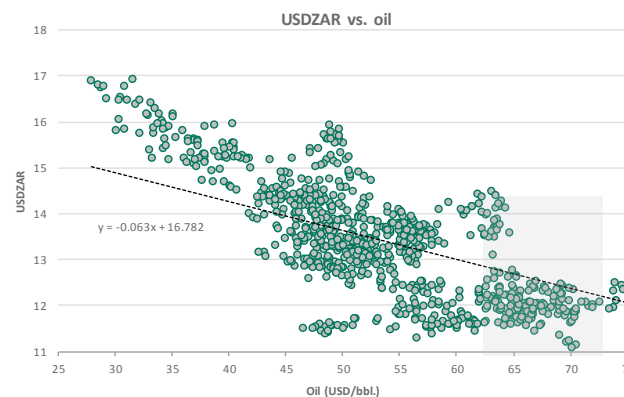
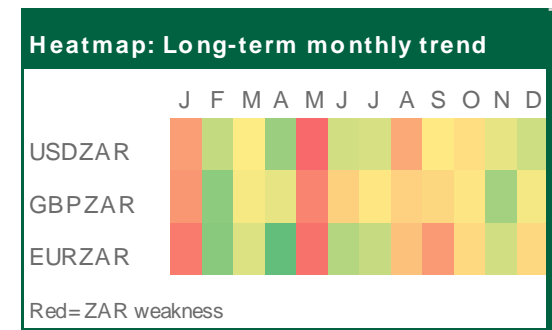


Chart 39: Heat map suggests that the rand may remain vulnerable in May



Source: Bloomberg, Nedbank CIB Markets Research

THE RAND AND KEY RISKS

Rand remains an outperformer relative to the EM benchmark

- Compared to its EM peers, the rand is a relative outperformer, strengthening by 10.6% since 2017 versus 6.1% by the EM FX Index. On a six-month basis the rand is the best performing currency in the EM FX basket, but has recently weakened sharply and is amongst the worst performers on a one-month basis.
- Underpinning the performance of EM FX (and EM assets as a whole) is foreign portfolio flows, which have remained positive since 2016. However, this flow does threaten to derail if risk-aversion persists. Should global yields start to rise, and in the absence of a similar move in EM risk assets, we could see a rotation of foreign investor positioning away from EM assets. We still believe that SA provides a sufficiently high enough real return to warrant portfolio inflows, as opposed to outflows. However, foreign investor sentiment (driven by a variety of factors) remains a key risk to our rand and inflation forecasts.

Chart 40: The rand continues to outperform relative to the EM trend

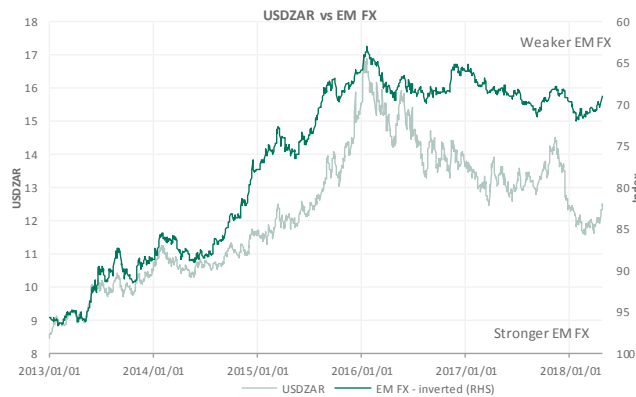


Chart 41: ZAR Fairly stable against commodity currencies

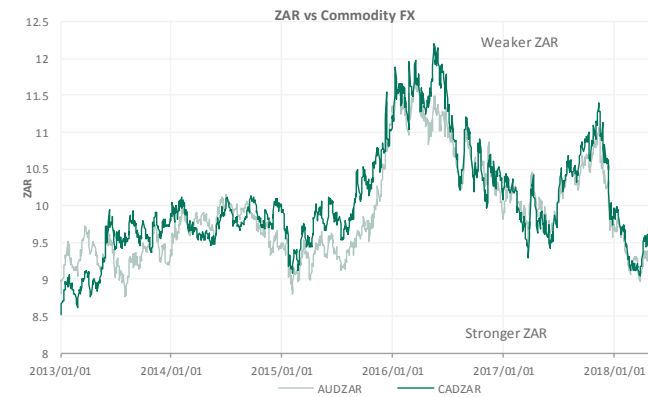


Chart 42: Long-term performance of EM FX

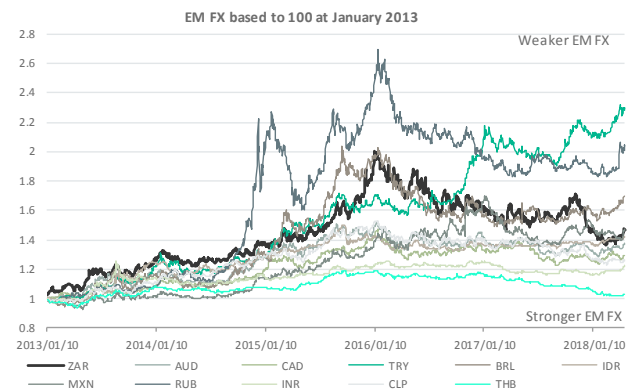
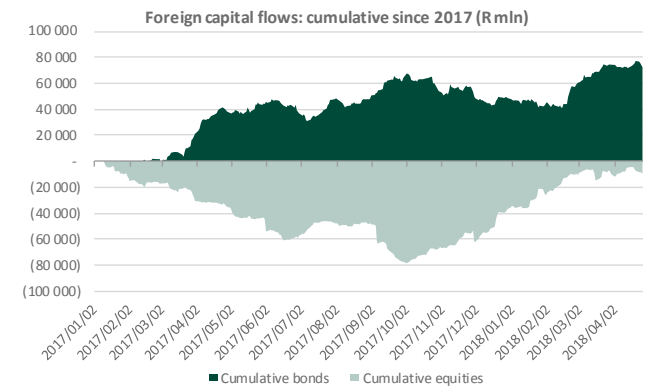


Chart 43: Foreign capital flows remain the key risk for the rand exchange rate



Source: Bloomberg, Nedbank CIB Markets Research

Lower export commodity prices are weighing on SA's terms of trade

- A combination of lower export prices as a result of a stronger rand exchange rate, and a sharply higher oil price (SA's biggest import) has resulted in a deterioration of South Africa's Terms Of Trade index in recent months. Over and above this, the stronger rand has dampened export prices of all major mineral exports since the start of the year. However, South Africa is generally a net importer and maintains a current account deficit, so the net effect may be more or less balanced.
- The oil price surged by almost 14% since February 2018. OPEC is said to be considering a 10-year long production-cut deal with Russia (as opposed to a one-year rolling agreement). Saudi Arabia's oil minister has indicated that the world would be able to withstand the effects of higher oil prices, with the ministry postponing the IPO of Saudi Aramco as it waits for even higher oil prices and a higher IPO valuation. Iran however is against an extension to the production cuts, saying it is comfortable with the current level of the oil price.
- Demand for oil in the US is set to rise in the second half of 2018, which is usually the case as a result of the holiday season. This may result in a draw-down of US inventories, which usually places downside pressure on total supplies and upward pressure on the oil price. Demand and supply data from the Energy Information Administration shows that the market is almost evenly balanced. Any further upside demand pressures are likely to raise energy prices further in coming months.

Chart 44: SA key export prices weighed on by a stronger rand lately

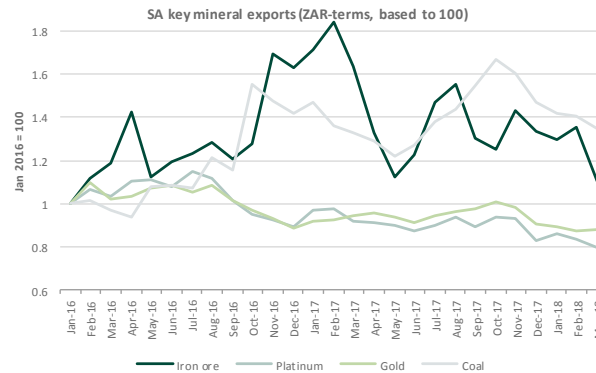


Chart 45: However, \$-based performance remains positive

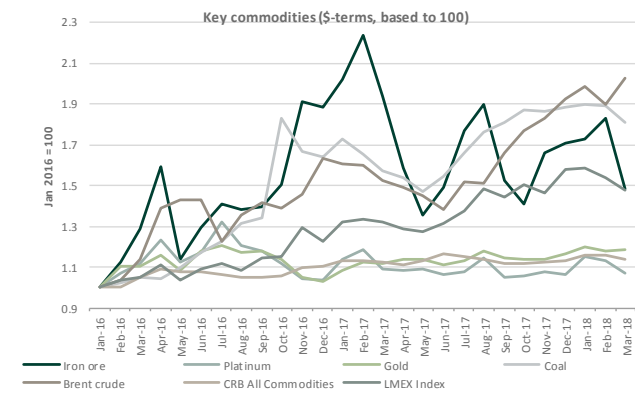


Chart 46: SA Terms Of Trade deteriorates

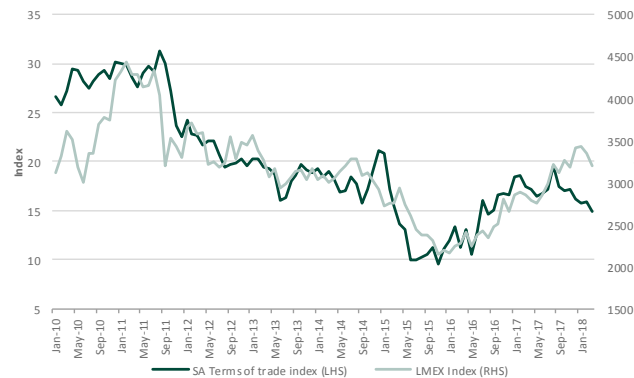
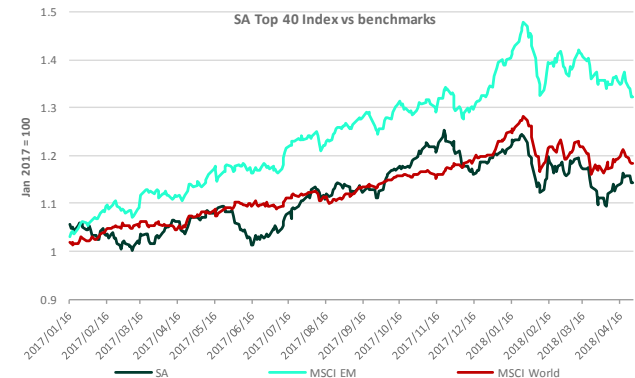


Chart 47: Equity indices remain upbeat, but pace of gains have slowed; EMs outperform



APPENDICES

Calendar of event risks

- The following is a list of planned local and global events, as well as dates of significance. This is a non-exhaustive list, which obviously excludes unscheduled one-off events, or unplanned meetings such as Cabinet changes, court cases, leadership changes, other political developments or any sort of Constitutional changes/reform.

January	February	March
<p>09 Jan – Commission of inquiry into State Capture announced</p> <p>15-26 Jan – US earnings season</p> <p>18 Jan – SARB MPC</p> <p>18-19 Jan – ANC NEC meeting</p> <p>20-21 Jan – ANC NEC Lekgotla</p> <p>23-26 Jan – WEF meeting in Davos</p> <p>25 Jan – ECB meeting</p> <p>31 Jan – US FOMC meeting</p>	<p>Feb – US Fed Chair semi-annual report to Congress</p> <p>08 Feb – BOE meeting</p> <p>08 Feb – SA State of the Nation address (SONA2018)</p> <p>21 Feb – SA Budget Speech</p>	<p>04 Mar – Italian general election</p> <p>08 Mar – ECB meeting</p> <p>18 Mar – Russian presidential election</p> <p>21 Mar – US FOMC meeting (+ press conference)</p> <p>22 Mar – BOE meeting</p> <p>23 Mar – Moody's review of SA credit rating</p> <p>28 Mar – SARB MPC</p>
April	May	June
<p>08 Apr – Hungarian parliamentary election</p> <p>26 Apr – ECB meeting</p> <p>16-27 Apr – US earnings season*</p>	<p>02 May – US FOMC meeting</p> <p>10 May – BOE meeting</p> <p>24 May – SARB MPC</p> <p>25 May – S&P review of SA credit rating</p> <p>Fitch review of SA credit rating*</p>	<p>13 Jun – US FOMC meeting (+ press conference)</p> <p>14 Jun – ECB meeting</p> <p>21 Jun – BOE meeting</p>
July	August	September
<p>16-27 July – US earnings season*</p> <p>19 Jul – SARB MPC</p> <p>Jul – US Fed Chair semi-annual report to Congress</p> <p>Jul – State Capture inquiry to conclude*</p>	<p>01 Aug – US FOMC meeting</p> <p>02 Aug – BOE meeting</p> <p>Aug – Fed's Jackson Hole symposium*</p> <p>30 Aug – Constitutional Review Committee report – land reform and changes to the SA Constitution</p>	<p>13 Sep – BOE meeting</p> <p>13 Sep – ECB meeting</p> <p>20 Sep – SARB MPC</p> <p>26 Sep – US FOMC meeting (+ press conference)</p> <p>Sep – BRICS Summit (hosted in SA)*</p>
October	November	December
<p>07 Oct – Brazilian general election</p> <p>12 Oct – Moody's review of SA credit rating</p> <p>15-26 Oct – US earnings season*</p> <p>24 Oct – SA MTBPS Speech*</p> <p>25 Oct – ECB meeting</p>	<p>01 Nov – BOE meeting</p> <p>08 Nov – US FOMC meeting</p> <p>22 Nov – SARB MPC</p> <p>23 Nov – S&P review of SA credit rating</p> <p>23 Nov – Fitch review of SA credit rating*</p>	<p>13 Dec – ECB meeting</p> <p>19 Dec – US FOMC meeting (+ press conference)</p> <p>20 Dec – BOE meeting</p>

*Indicative

Source: Various media sources, Bloomberg

Upcoming economic data releases

Economic data releases

Date	Time	Indicator	Period	Previous
05/02/2018	11:00	Absa Manufacturing PMI	Apr	46.9
05/02/2018		Naamsa Vehicle Sales YoY	Apr	1.10%
05/03/2018	13:00	Electricity Production YoY	Mar	2.00%
05/03/2018	13:00	Electricity Consumption YoY	Mar	0.40%
05/04/2018	09:15	Standard Bank South Africa PMI	Apr	5110.00%
05/08/2018	08:00	Gross Reserves	Apr	\$49.98b
05/08/2018	08:00	Net Reserves	Apr	\$43.38b
05/09/2018	12:30	SACCI Business Confidence	Apr	9760.00%
05/10/2018	11:30	Mining Production YoY	Mar	3.10%
05/10/2018	11:30	Mining Production MoM	Mar	0.90%
05/10/2018	11:30	Gold Production YoY	Mar	-7.10%
05/10/2018	11:30	Platinum Production YoY	Mar	-8.80%
05/10/2018	13:00	Manufacturing Prod NSA YoY	Mar	0.60%
05/10/2018	13:00	Manufacturing Prod SA MoM	Mar	-2.40%
05/16/2018	13:00	Retail Sales Constant YoY	Mar	4.90%
05/16/2018	13:00	Retail Sales MoM	Mar	1.80%
05/16/2018	23-May	South Africa Unemployment	1Q	26.70%
05/22/2018	09:00	Leading Indicator	Mar	10830.00%
05/23/2018	10:00	CPI YoY	Apr	3.80%
05/23/2018	10:00	CPI MoM	Apr	0.40%
05/23/2018	10:00	CPI Core YoY	Apr	4.10%
05/23/2018	10:00	CPI Core MoM	Apr	0.70%
05/24/2018	11:30	PPI YoY	Apr	--
05/24/2018	11:30	PPI MoM	Apr	--
05/24/2018		SARB Announce Interest Rate	24-May	6.50%
05/30/2018	08:00	Money Supply M3 YoY	Apr	--
05/30/2018	08:00	Private Sector Credit YoY	Apr	--
05/30/2018	14:00	South Africa Budget	Apr	--
05/31/2018	14:00	Trade Balance Rand	Apr	--

Source: Nedbank, Bloomberg

SARB MPC meeting dates – 2018

22 - 24 May 2018
 17 - 19 July 2018
 18 - 20 September 2018
 20 - 22 November 2018

SARB Governor Kganyago typically addresses the market on the third day of the MPC meeting from 15:00 to announce the repo rate decision, which was cut to 6.50% (previously 6.75%) following the March 2018 MPC meeting.

Source: SARB

APPENDICES

Nedbank Group forecasts*

	2017	2018				2018	2019				2019	2020				2020
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
GDP q/q SAAR	1.30	1.00	1.40	1.50	1.50	1.80	1.70	2.30	2.40	2.50	1.90	2.50	2.20	2.40	2.70	2.40
Current account as a % of GDP	-2.50					-2.40					-2.40					-2.50
Gold \$/oz. (EOP)	1295.00	1324.00	1337.00	1364.00	1350.00	1350.00	1323.00	1336.00	1363.00	1349.00	1349.00	1322.00	1336.00	1362.00	1349.00	1349.00
Exchange rates (EOP)																
USDZAR	12.410	11.810	12.290	12.530	12.910	12.910	13.040	13.430	13.290	13.560	13.560	13.420	13.620	13.760	13.970	13.970
EURZAR	14.840	14.540	15.050	15.320	15.700	15.700	15.700	16.090	15.900	16.140	16.140	15.820	15.970	16.130	16.300	16.300
GBPZAR	16.710	16.610	17.170	17.600	18.130	18.130	18.220	18.760	18.480	18.850	18.850	18.390	18.660	18.660	18.760	18.760
AUDZAR	9.682	9.068	9.436	9.640	9.902	9.902	9.952	10.230	10.113	10.360	10.360	10.202	10.395	10.481	10.620	10.620
ZARJPY	9.080	9.030	8.680	8.560	8.310	8.310	8.260	8.020	8.150	7.990	7.990	8.110	7.990	7.950	7.870	7.870
GBPUSD	1.347	1.410	1.400	1.400	1.404	1.404	1.397	1.397	1.390	1.390	1.390	1.370	1.370	1.356	1.343	1.343
EURUSD	1.196	1.231	1.225	1.223	1.217	1.217	1.205	1.199	1.196	1.190	1.190	1.178	1.173	1.173	1.167	1.167
USDJPY	112.68	106.64	106.68	107.26	107.28	107.28	107.71	107.71	108.31	108.34	108.34	108.84	108.82	109.39	109.94	109.94
USDCNY	6.508	6.289	6.320	6.333	6.339	6.339	6.346	6.377	6.390	6.396	6.396	6.403	6.435	6.448	6.454	6.454
USDCHF	0.978	0.957	0.961	0.960	0.963	0.963	0.971	0.973	0.974	0.976	0.976	0.984	0.988	0.989	0.993	0.993
USDAUD	1.282	1.302	1.302	1.300	1.304	1.304	1.310	1.313	1.314	1.309	1.309	1.315	1.310	1.313	1.315	1.315
SA Interest rates (EOP)																
3-month JIBAR	7.16	6.88	6.83	6.83	6.83	6.83	6.83	6.83	7.13	7.13	7.13	7.33	7.38	7.38	7.38	7.38
Prime	10.25	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.25	10.30	10.30	10.50	10.50	10.50	10.50	10.50
Long bond (10-yr)	8.82	8.15	8.20	8.10	8.25	8.25	8.35	8.33	8.45	8.35	8.35	8.40	8.30	8.30	8.30	8.30
CPI % (EOP)	4.70	3.80	4.70	5.10	4.70	4.70	5.50	5.20	5.40	5.60	5.60	5.40	5.30	5.40	5.50	5.50
EOP = End of period rate	Source: Nedbank Group Economic Unit															
	While every care is taken to ensure the accuracy of the information and views contained in this document, no responsibility can be assumed for any action based thereon.															

*Note that the above forecasts represents the Nedbank Group House view estimates

Other SA charts

Chart 48: SACCI Business Confidence Index (Monthly)

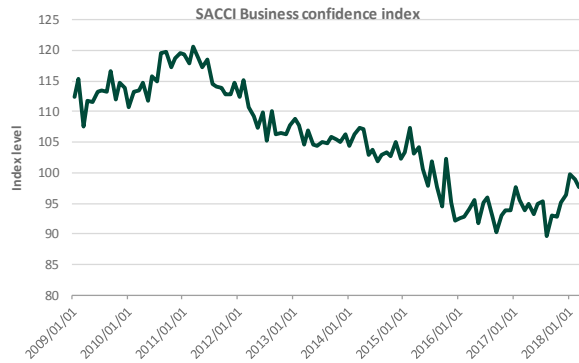


Chart 49: BER Manufacturing PMI (Monthly)

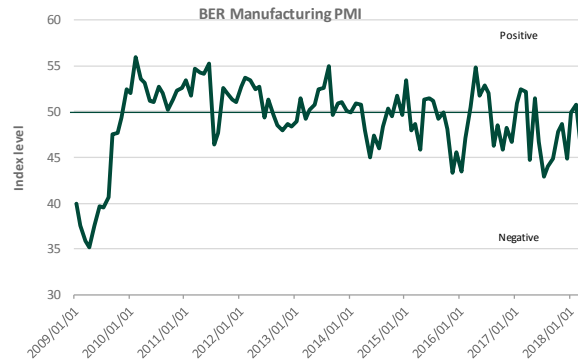


Chart 50: SA CPI yoy % (Monthly)

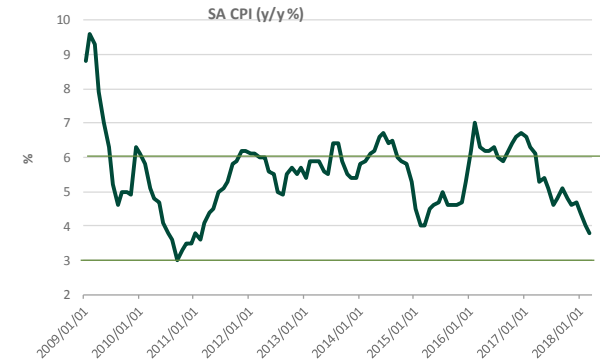


Chart 51: SA Repo rate (Monthly)

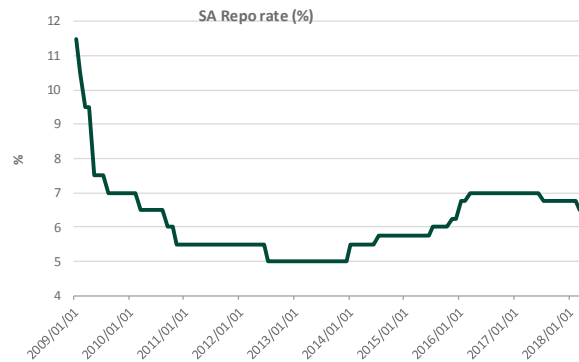


Chart 52: SA 10y generic bond yield (Monthly)

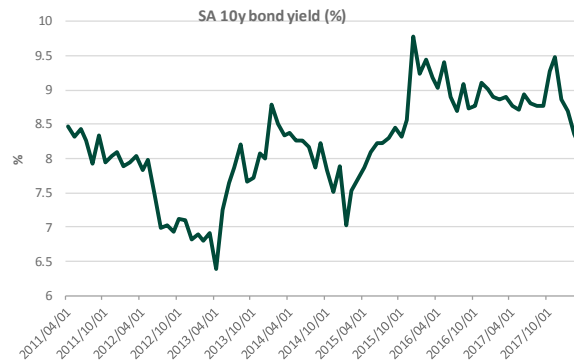
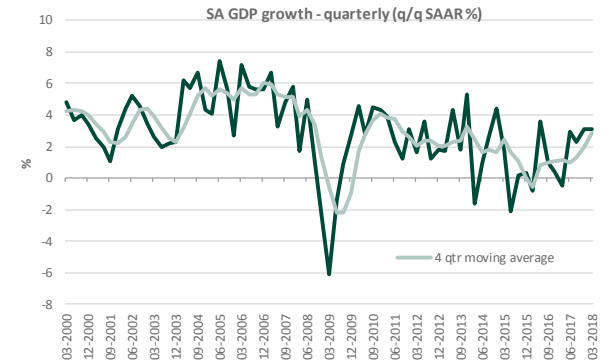


Chart 53: SA GDP growth qoq % SAAR (Quarterly)



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