

MONTHLY INSIGHTS CHART PACK

June 2019

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TABLE OF CONTENTS

▪ Summary of views	3
▪ Global developments	4
▪ Monetary policy dynamics: Global	6
▪ South Africa's real economy	8
▪ SA inflation trends	9
▪ Monetary policy dynamics: SA	10
▪ Credit risk comparison	11
▪ The SA bond market	12
▪ The rand and key risks	13
▪ Other markets	15
▪ Appendices:	
– Calendar of event risks	16
– Upcoming economic data releases	17
– Nedbank Group forecasts	18
– Other SA charts	19

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SUMMARY OF VIEWS

Trade uncertainty hampers EMs, SA economy remains weak

- Last month, we noted an uptick in headline global inflationary pressures that was not mirrored by a rise in core or underlying inflation. However, core inflation edged higher in April in both the US and the Eurozone, while core CPI in the UK remained elevated. The Easter holiday shopping season played a key role in boosting prices of services and other discretionary products, increasing core inflation. This may prove to be a temporary feature if global growth remains weak.
- Trade tensions between the US and China escalated in May, with both countries imposing retaliatory tariffs on imports. The IMF has warned that the additional tariffs would reduce global growth by 30bps in the short term (currently forecast at 3.3% for 2019). From the IMF and the World Bank to the OECD and the SARB, SA's growth estimates have been slashed. Come the MTBPS in October 2019, we expect the same from the NT, which currently projects real GDP growth of 1.5% and 1.7% for 2019 and 2020, respectively. The Nedbank Group Economic Unit currently forecasts growth of 0.8% for 2019 and 1.6% for 2020, with risks to the outlook still firmly on the downside. The OECD reduced SA's growth forecasts to 1.2% for 2019 (prev. 1.7%) and 1.7% for 2020 (prev. 2.0%).
- SA CPI declined to 4.4% y/y in April from 4.5% in March, below consensus of 4.5%. Core inflation slumped to 4.1% y/y from 4.4% previously. The downside surprise in CPI reflects the weak pricing power of business in the face of a very weak consumer base. We also see the (still limited) effect of the VAT hike that was initiated a year ago working itself into the CPI base, keeping price increases limited, despite a weaker rand exchange rate and higher import costs. This has resulted in a downward revision of our CPI estimate to 4.7% (average for 2019) from 4.9% previously. The estimate for 2020 remains unchanged at 5.3%. We expect CPI to rise gradually in the coming months as a result of a volatile rand exchange rate and an unpredictable international oil price. The full adjustment to the electricity tariff will kick in on 1 July 2019 (9.4% + 4.4%), affecting utility costs in the whole economy to a greater extent.
- While risks to the growth outlook remain to the downside, risks to the inflation outlook remain balanced. While the SARB seems to be on track to achieve its 4.5% CPI target in 2019, it has warned that the MPC would like to see inflation remain close to the midpoint of the target range on a more sustained basis. We read this as the 2020 CPI print needs to drop more for the MPC to consider easing monetary policy further. We, therefore, maintain our view for flat interest rates in the interim, with the possibility of a 25bps reduction towards year-end or early 2020.
- The USDZAR weakened by 2.1% in May. While risk sentiment remained downbeat as a result of geopolitical tensions, a key reason for the weakness stemmed from a technical rebalancing of the MSCI EM equity index, which increased the weight of Chinese A shares in the index, reducing SA's weight and necessitating outflows from index-tracking funds.

	Current price/yield	Core views	Target levels	
USDZAR	14.59	We maintain the view that the rand trading between 14.00 and 14.50 reflects better local and external risks.	3-month	14.30
			6-month	14.10
			12-month	14.50
Repo rate	6.75	We expect the SARB to remain on hold for now, probability of a cut has risen sharply		
	6.56 (R208)		3-month	6.7
SAGBs	8.45 (R186)	We pin our "fair value" estimate for the R186 around 8.65% (and the 10-year at 8.90%; this is down marginally from 9.10%). On approach of 8.30% for the R186, upside is becoming compressed, while on approach of 9.30%, downside is becoming compressed.	Year-end	6.8
			3-month	8.9
			Year-end	8.7
	9.76 (R2048)		3-month	10.0
			Year-end	9.9

Source: Nedbank CIB Markets Research

Disclaimer – Note that the above and ensuing analyses represent the analysts' own view within Nedbank Corporate and Investment Banking (Nedbank CIB Markets Research) and not necessarily the Nedbank Group House view.

GLOBAL DEVELOPMENTS

Underlying inflationary pressures start to build despite still-weak growth conditions

- Last month, we noted an uptick in headline inflationary pressures that was not mirrored by a rise in core or underlying inflation. However, core inflation edged higher in April in both the US and the Eurozone, while core CPI in the UK remained elevated. The Easter holiday shopping season played a key role in boosting prices of services and other discretionary products, increasing core inflation. This may prove to be a temporary feature if global growth remains weak. In Asia, producer input costs were driven higher by increased prices of food, manufacturing items, and mineral resources. Food inflation in some Asian countries remain elevated on higher hog prices. Higher import tariffs and the ongoing trade uncertainty will likely remain key upside risks to global inflation (and downside risks to growth) over the medium term.
- In the Eurozone, core CPI surged by 50bps in April to 1.3% y/y, beating consensus of 1%. Core inflation is currently at its highest level since 2017, but inflation expectations have fallen below 1.5% (5y5y swap on Chart 9) this year. This likely implies that underlying inflationary pressures in the economy are still weak despite the recent rise in core inflation.
- UK CPI rose to 2.1% y/y in April from 1.9% in March, while core CPI remained unchanged at 1.8% y/y. While the prices of a broad range of goods and services rose in April, energy costs eased marginally. The GBP has weakened by 2% in the past month due to political uncertainty, which will likely raise import costs and inflationary pressures further.
- US CPI rose to 2% y/y in April from 1.9% in March, while core inflation also rose by 10bps to 2.1% y/y. Energy, food, transportation and commodity prices eased in April. Apparel prices remained in deflation. The main driver of the higher inflation print in April was housing costs (or owners' equivalent rent), which rose for a second consecutive month.
- EM inflation rates have been contained, with CPI falling in recent months as a result of lower energy costs. Most regions, apart from Turkey, maintained inflation rates within the targeted levels. The concern for 2019 is that any period of sustained currency weakness may hamper inflation over the medium term. An escalation in geopolitical tensions could fuel this currency volatility.

Table 1: Summary of economic and financial indicators

Economic, fiscal and monetary indicators Available data as at: 03-Jun-19	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.
US	3.1	3.8	134	129	3.1	2.2	52.8	55.3	-0.51	0.15	-4.1	-4.2	2.5	2.5
UK	5.2	6.7	-10	-13	0.5	0.2	53.1	55.1	1.3	0.4	-1.15	-1.53	0.75	0.75
Eurozone	1.9	3	-6.5	-7.3	0.4	0.2	47.7	47.9	-0.6	0	-0.52	-0.44	0	0
Japan	0.5	1	39.4	40.4	2.1	1.6	49.8	50.2	-1.1	-4.3	-2.54	-2.96	-0.1	-0.1
Turkey	1	0.84	55.5	64.5	0.3	0.66	46.8	47.2	-2.2	-5	-2.31	-1.96	24	24
China	7.2	8.7	125	124	6.4	6.4	49.4	50.1	5.4	8.5	-8.3	-5.3	4.35	4.35
Brazil	-4.5	4	86.6	89.5	-0.2	0.1	51.5	52.8	-6.1	2.1	-6.99	-7.03	6.5	6.5
Russia	1.2	1.6	68.3	71.3	0.5	2.7	49.8	51.8	4.6	1.2	1.41	-0.09	7.75	7.75
India	4879	4809	47.8	46.1	5.8	6.6	52.7	51.8	-0.1	0.1	-3.39	-3.61	6	6
Mexico	1.6	1.8	111	113	-0.17	0.03	52	51.2	-0.15	-0.96	-1.79	-2.1	8.25	8.25
South Africa	0.2	1.4	5	2	1.4	2.6	47.2	45	1.2	0.5	-3.91	-4	6.75	6.75

Chart 1: Global inflation trend turns higher

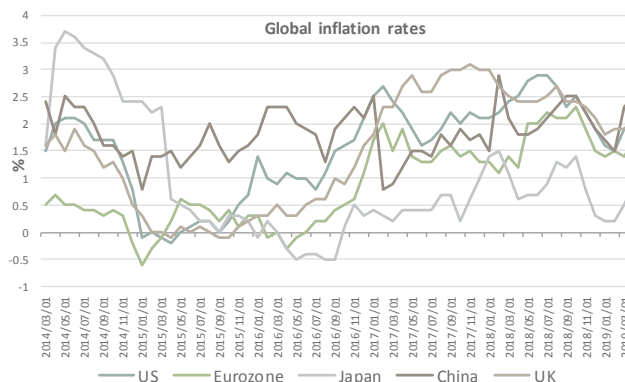
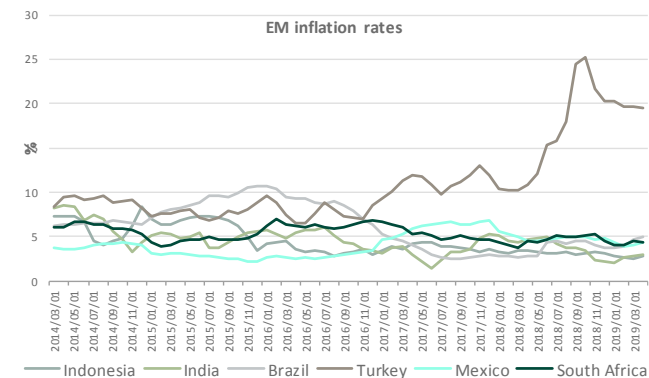


Chart 2: EM inflation rates contained



GLOBAL DEVELOPMENTS

IMF warns of a deceleration in global growth as a result of trade war

- Trade tensions between the US and China escalated in May, with both countries imposing retaliatory tariffs on imports. The IMF has warned that the additional tariffs would reduce global growth by 30bps in the short term (currently forecast at 3.3% for 2019). It has found that it is US and Chinese consumers and importers that bear the brunt of higher tariffs. In most cases in the US, importers of Chinese products have absorbed the increased import costs through reduced profit margins, or in some cases, passed on part of the cost escalation to consumers. The IMF has warned that the trade war could jeopardise the growth recovery it expects in 2019, posing the threat of disrupting global supply chains and denting business confidence.
- UK real GDP growth accelerated to 0.5% q/q in 1Q from 0.2% in 4Q18, in line with consensus. While net exports fell sharply as a result of no growth in exports, general government expenditure and gross fixed capital formation (GFCF) surged, aiding headline growth in 1Q.
- In the US, preliminary GDP grew 3.1% q/q in 1Q, versus 2.2% in the previous quarter, lifted by private investment and net exports. However, consumer spending slowed sharply for a third consecutive quarter, despite an upbeat labour market and rising real wage growth. In the Eurozone, GDP growth advanced to 0.4% q/q in 1Q from 0.2% in the previous quarter, better than consensus of 0.3%, with weakness in Germany offset by an uptick in growth in Spain, France and Italy.
- Preliminary manufacturing PMIs have shown that manufacturing conditions may have deteriorated in May as trade uncertainty rose. PMIs for the US, China, Eurozone and Japan declined in May as global trade activity deteriorated after the temporary surge in April. While the leading indicator in the US has continued to grind higher, signalling continued growth in the next six to nine months, confidence indicators in other countries have deteriorated or remained stagnant. The risk of a sharp slowdown in global trade activity and global growth still hangs in the balance as the trade war remains unresolved.

Chart 3: Major PMIs are now contractionary

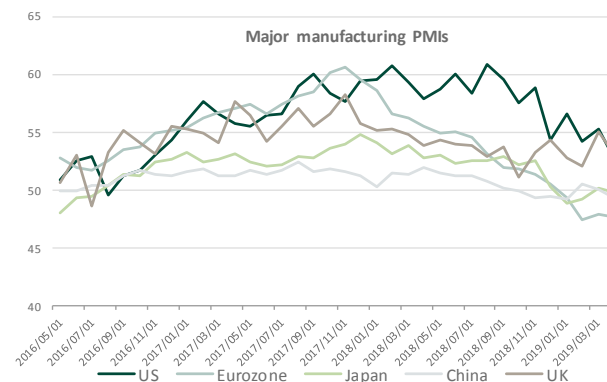


Chart 5: EM PMIs are mixed, SA negative

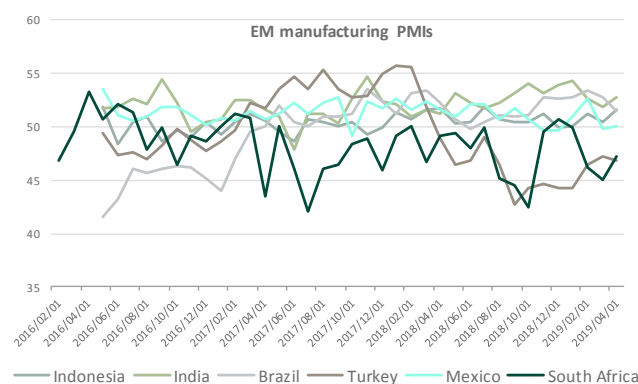


Chart 4: Global manufacturing activity falls sharply as a result of lower growth

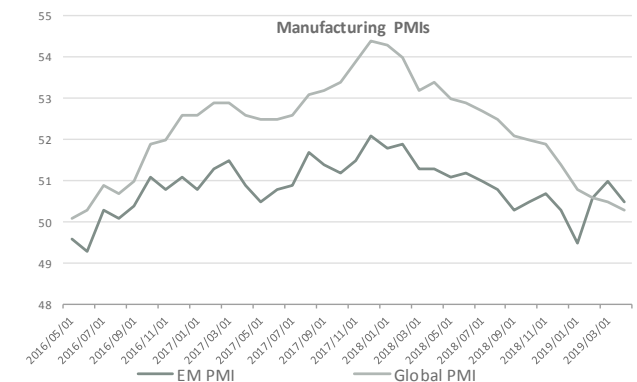
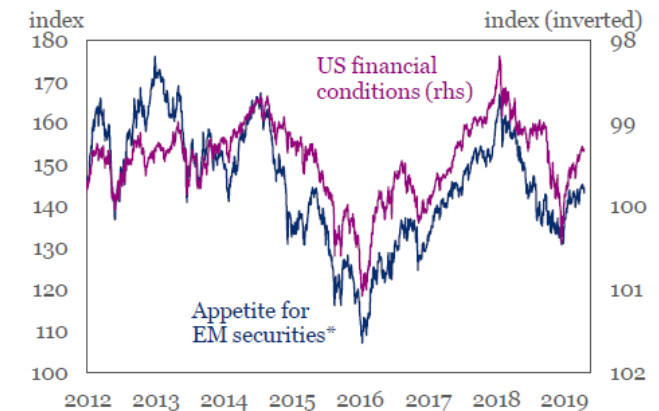


Chart 6: IIF: Appetite for EM assets



MONETARY POLICY DYNAMICS: GLOBAL

More changes from key central bank messaging

- The Fed softened its dovish monetary policy message on the back of an improvement in recent economic data. The Fed funds market is currently pricing in an 80% probability of a 25bps reduction in the interest rate by year-end and a 94% probability of a cut by mid-2020.
- The ECB has decided to resume its TLTRO programme in the latter part of the year. This will likely coincide with the Fed ending its balance sheet normalisation (September 2019). The ECB has also admitted to considering negative loan rates as it tries to reverse the weak growth trajectory. This despite recent growth data surprising to the upside. The OIS market, however, is not pricing in a reduction in interest rates over the medium term.
- At the BoE's last meeting, policymakers adopted a more hawkish stance, with Governor Carney indicating that the current projections would need to be revised to show a faster pace of interest rate hikes in order to clamp down on inflation. Ironically, the market has barely reacted to such a revelation, with the OIS market currently pricing in a 7% probability of a hike by year-end, compared to 37% before the meeting.

	Next MPC meeting	Probability of a hike/cut/hold
US	2019/06/19 20:00:00	83.40%
UK	2019/06/20 13:00:00	99.50%
Eurozone	2019/06/06 13:45:00	94.50%
Japan	2019/06/20	86.70%
China		
India	2019/06/06 08:15:00	100.00%
Mexico	2019/06/27 20:00:00	51.60%
South Africa	2019/07/18	58.80%
Updated 03-Jun-19		

Chart 7: US inflation expectations are sticky above 2%



Chart 8: UK inflation remains elevated; expectations rise

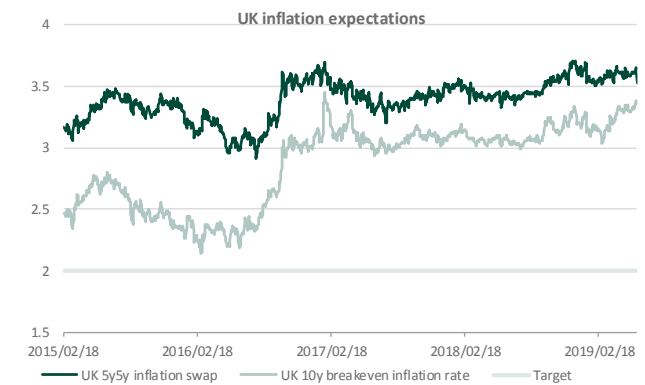


Chart 9: Eurozone swap markets more in tune with actual inflation

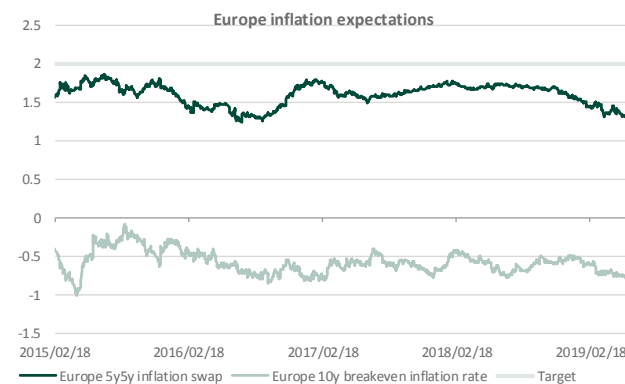
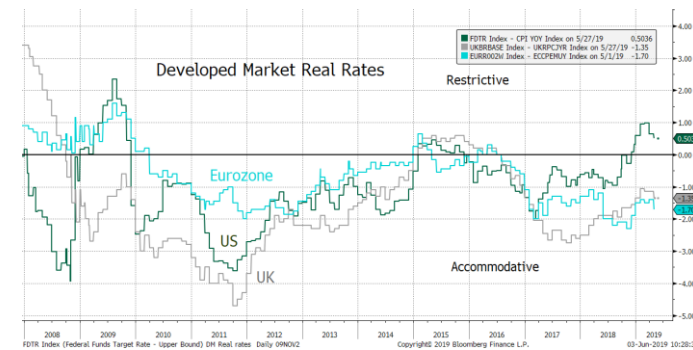


Chart 10: Real rates are now restrictive in the US



GLOBAL DEVELOPMENTS

Fed sounds less dovish, ECB still committed to TLTROs, BoE more hawkish

- FOMC minutes reflected further patience in changing interest rates, with policymakers agreeing that the current policy rate was appropriate for now and that there is no strong case to move interest rates in either direction. The Fed reinforced its view that the recent decline in inflation is transitory, and that any policy adjustments would be consistent with the sustained expansion of economic activity, an upbeat labour market and inflation near the 2% symmetric level. The recent improvement in economic activity will likely offset the rise in unemployment levels in the economy, but the key issue the Fed is grappling with is the sub-2% inflation rate, which it states will be temporary. Given the confluence of factors affecting Fed monetary policy, we do not expect a change to the Fed funds rate this year. Should the low inflation not prove transitory, the Fed may be forced to take a more dovish stance in the long run.
- The BoE left interest rates unchanged at 0.75%. In contrast to its previous meetings, where it adopted a neutral tone as a result of Brexit and geopolitical uncertainties, Governor Carney stressed the need to raise interest rates faster than previously forecast in order to combat elevated inflation levels. Ironically, the market has barely reacted to such a revelation, with the OIS market pricing in a 1.4% probability of a rate hike by March 2020, compared to 37% before the meeting. The OIS market is pricing in a 2% chance of a hike by year-end, compared to 29% before the meeting. Policymakers agreed that Brexit was the single biggest risk to regional growth, and the uncertainty over the related terms and timing has made it even more difficult to estimate growth. Carney indicated that a smooth Brexit would require more frequent rate increases than what the market is currently pricing. The BoE has shifted from its neutral monetary policy outlook to one that is seemingly more hawkish, as it expects to raise interest rates more frequently should there be a smooth Brexit outcome.
- The BoJ targets a 10y bond yield of around 0%, with a 20bps threshold above and below this level. The yield declined to its lowest level since 2016 (-0.1%), pressured by downside risks to growth and speculation of a reduction in bond purchases this month. As inflation remains well below its 2% target, Japan continues to adopt a loose monetary policy stance. Of the 53 most watched central banks, 18 have hiked interest rates in the past six months, while seven (Venezuela, India, Egypt, New Zealand, Malaysia, Iceland and Ukraine) have reduced rates.

Chart 11: Fed remains at the forefront of tightening

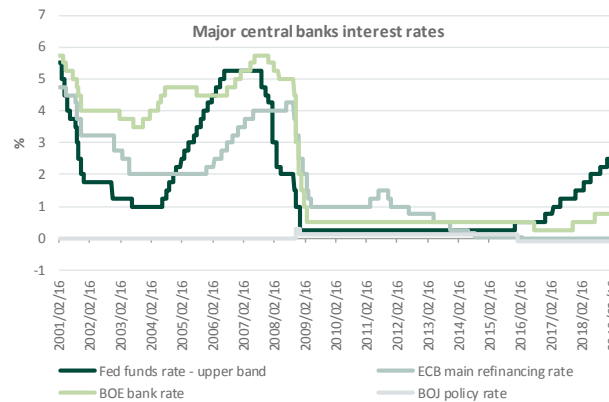


Chart 13: EM monetary policy stance broadly loose, apart from Turkey

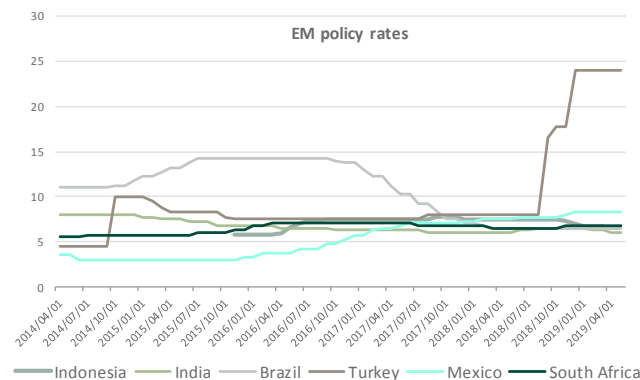


Chart 12: Global bond yields supported by weak global growth and trade uncertainty

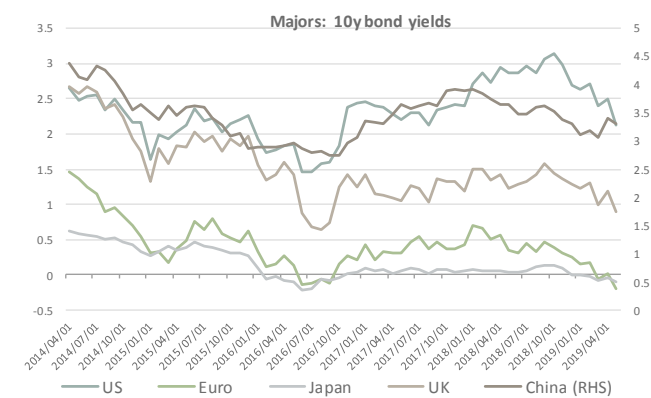
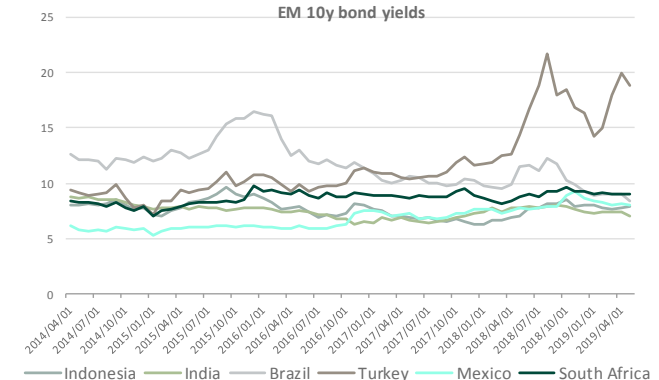


Chart 14: EM bond yields follow those of DMs



SA'S REAL ECONOMY

SA economy held hostage by lack of reform

- From the IMF and the World Bank to the OECD and the SARB, SA's growth estimates have been slashed. Come the MTBPS in October 2019, we expect the same from the NT, which currently projects real GDP growth of 1.5% and 1.7% for 2019 and 2020, respectively. The Nedbank Group Economic Unit currently forecasts growth of 0.8% for 2019 and 1.6% for 2020, with risks to the outlook still firmly on the downside. The OECD reduced SA's growth forecasts to 1.2% for 2019 (prev. 1.7%) and 1.7% for 2020 (prev. 2.0%). Key issues it sought to highlight were the job deficiency and the lack of structural reforms. However, the OECD notes that investment levels will likely rise as the government's reform agenda becomes clearer.
- High-frequency economic indicators, discussed in earlier reports, have shown deep contractions in the mining, manufacturing, utilities, trade and agricultural industries in the first quarter. We project a contraction of -1.8% q/q, with the risk still that the contraction is deeper than projected. The outlook for the second quarter looks more promising, albeit off a low base. As we entered the second quarter, vehicle sales increased slightly and the manufacturing PMI improved to 47.2 points from 45 in March. The BER Consumer Confidence Index rose above the long-run average to 5 index points in 2Q19. While the BER cautions that this may reflect election-related hype (as confidence levels improved similarly during the previous four general elections), it is a welcome development that could boost spending in the quarter.
- On the other hand, we remain cautious on near-term growth because the leading index declined in March, against consensus expectations of a slight increase – we believe this reflects further weakness in economic activity in the next six to nine months. Consumers are grappling with higher transport costs and an elevated unemployment rate, which may limit the recovery in household consumption in 2Q. Lastly, any further disruption to electricity supply would weigh heavily on the productivity of secondary-sector industries.
- The outlook for 2019 remains subdued. We believe that the SARB, NT and IMF estimates for real GDP growth (see Appendix) are still too optimistic and will probably be revised lower in the coming months. Some downside risks are the weaker global environment and decline in global trade, weak domestic demand and productive capacity, and continued disinvestment by the private sector, as evidenced by falling GFCF in recent years.

Chart 15: SA confidence leads investment growth

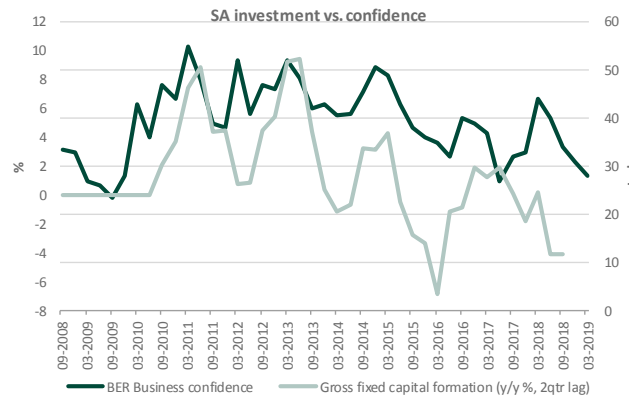


Chart 16: SARB's leading index now declines

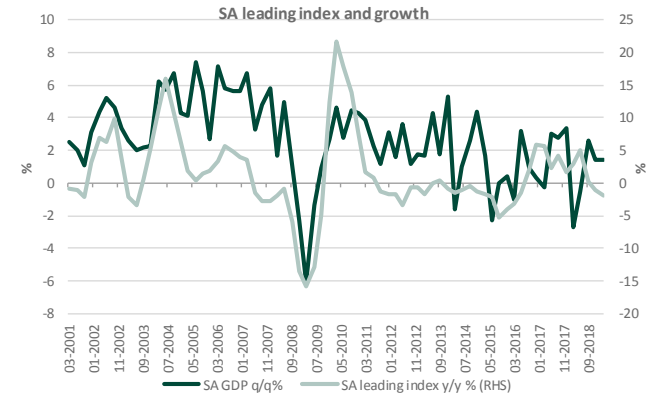


Chart 17: SA's economy needs to reduce dependence on government

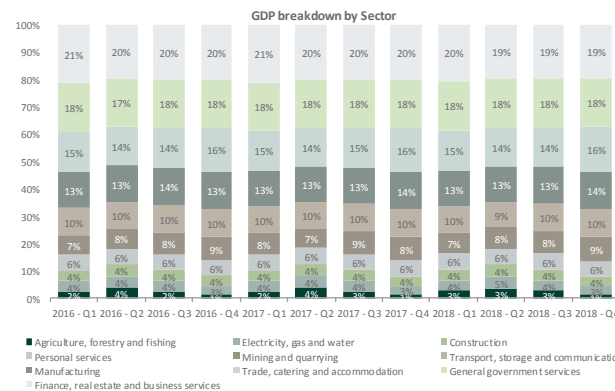
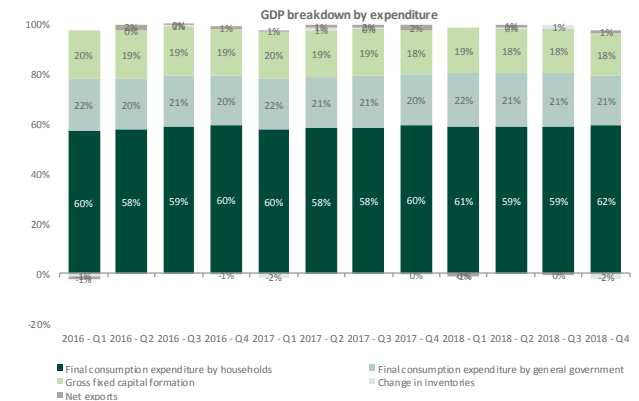


Chart 18: Spending is a key driver of economic activity



Source: Bloomberg, Stats SA, Nedbank CIB Markets Research

SA INFLATION TRENDS

CPI surprises to the downside on weak core inflation

- SA CPI declined to 4.4% y/y in April from 4.5% in March, below consensus of 4.5%. Core inflation slumped to 4.1% y/y from 4.4% previously. Goods inflation rose 10bps to 4.2% y/y, while services inflation continued to fall to 4.6% y/y in April from 4.9% previously.
- The uptick in alcoholic beverage inflation in March proved to be temporary, with price inflation easing sharply in April – this component was a key downward driver of inflation in April (contributing 10bps less than a month ago). Given very weak local demand, inflation in the recreation and culture category and among restaurants also eased sharply (contributing 10bps less than a month ago), while the residual component subtracted a further 10bps. We also saw marginal declines in inflation in the following product categories: housing and utilities, household contents and services, health and communication. These declines were partly offset by a surge in transport inflation.
- Transport costs were the only positive contributor to headline CPI, with transport inflation rising to 7.4% y/y from 6.4% previously. This was due to the rise in fuel costs (on the R1.31/litre hike in the petrol price in April). Hence, we expect administered costs to continue to rise. The current over-recovery in the petrol price is 13 cents/litre, implying that a tiny fuel price cut is imminent in June. This may be partly offset by the carbon tax of 9-cents which takes effect in June.
- The downside surprise in CPI reflects the weak pricing power of business in the face of a very weak consumer base. We also see the (still limited) effect of the VAT hike that was initiated a year ago working itself into the CPI base, keeping price increases limited, despite a weaker rand exchange rate and higher import costs. This has resulted in a downward revision of our CPI estimate to 4.7% (average for 2019) from 4.9% previously. The estimate for 2020 remains unchanged at 5.3%. We expect CPI to rise gradually in the coming months as a result of a volatile rand exchange rate and an unpredictable international oil price. The full adjustment to the electricity tariff will kick in on 1 July 2019 (9.4% + 4.4%), affecting utility costs in the whole economy to a greater extent.

Table 2: Nedbank CIB inflation estimates

Nedbank CIB Markets Research estimates						
Average	CPI	Core	Food	Oil	USDZAR	Electricity
2018A	4.6	4.3	3.3	716	13.3	5.2
2019F	4.7	4.3	4.4	69.2	14.1	11.4
2020F	5.3	4.5	6.6	71.0	14.1	12.7
2021F	5.2	4.5	6.9	68.6	14.6	10.4
Q1:18A	4.1	4.1	4.1	68.4	11.8	2.2
Q2:18A	4.5	4.4	3.3	77.4	13.0	3.1
Q3:18A	5.0	4.2	3.1	78.1	14.0	7.8
Q4:18A	4.9	4.3	2.7	62.7	14.3	7.7
Q1:19F	4.2	4.4	2.3	65.4	14.0	7.6
Q2:19F	4.5	4.1	3.1	68.6	14.3	10.3
Q3:19F	4.9	4.3	5.5	70.2	14.0	13.8
Q4:19F	5.2	4.4	6.8	72.4	14.0	13.8
Q1:20F	5.4	4.5	7.0	71.9	13.9	13.8
Q2:20F	5.3	4.5	6.7	71.3	14.0	13.2
Q3:20F	5.2	4.5	6.4	70.7	14.2	11.9
Q4:20F	5.3	4.6	6.4	70.1	14.4	11.9

Chart 20: Breakeven inflation getting closer to 4.5%



Chart 19: We expect CPI inflation to remain contained below 6% at least until 2021

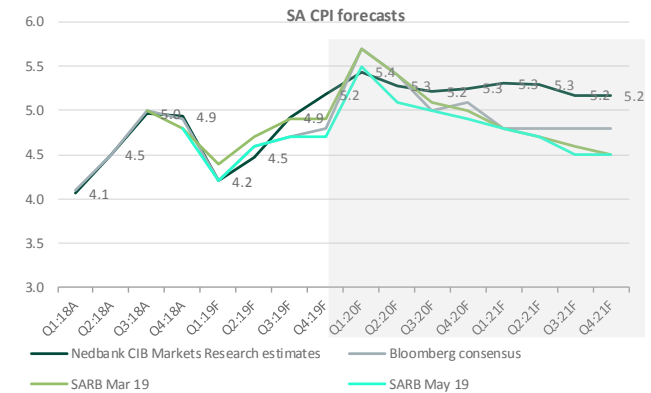
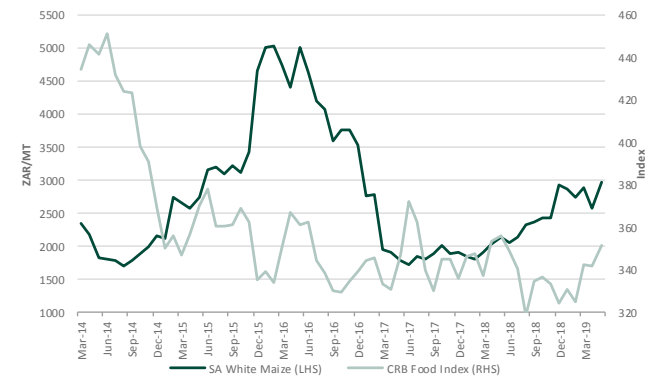


Chart 21: Food prices remain disinflationary, but could rise in the coming months



MONETARY POLICY DYNAMICS: SA

Dovish SARB prompted by QPM's rate cut projection

- In line with our expectations, the SARB kept the repo rate at 6.75%, with three members voting for a hold. We have previously argued that the bias for the next move in interest rates being a cut is greater than that for a hike. We now see the QPM move reflecting this. The notable adjustment at this meeting was a QPM moving to reflect a 25bps cut in early 2020, compared to one hike for 2019 at the previous MPC meeting. We view this MPC statement as significantly more dovish than our and the market's expectations.
- The SARB revised its CPI forecasts to 4.5%, 5.1% and 4.6% for 2019 to 2021, a cumulative 60bps lower than the forecasts at its previous meeting. The SARB attributes the downward adjustment to lower food inflation, services inflation, rentals, unit labour costs and inflation expectations. It also reduced its growth estimates, which likely means that the negative output gap, which has proved elusive in recent years, has widened. The SARB now sees 2019 growth at 1%, down from 1.3% at its previous meeting.
- While the MPC statement was clearly dovish, it was littered with caution, evident in the first sentence highlighting downside risks from a global trade war and a weak secondary-sector performance, which was worsened by the electricity outages in 1Q. The MPC acknowledged the neutral global monetary policy stance but cautioned that a renewed tightening of financial conditions should not be underestimated. Furthermore, the SARB sees a weaker rand exchange rate relative to its last meeting as it revises its forecast for the performance of the real effective exchange rate (weaker).
- While risks to the growth outlook remain to the downside, risks to the inflation outlook remain balanced. While the SARB seems to be on track to achieve its 4.5% CPI target in 2019, it has warned that the MPC would like to see inflation remain close to the midpoint of the target range on a more sustained basis. We read this as the 2020 CPI print needs to drop more for the MPC to consider easing monetary policy further. We, therefore, maintain our view for flat interest rates in the interim, with the possibility of a 25bps reduction towards year-end or early 2020.

Chart 22: SARB's negative output gap does not close by 2021

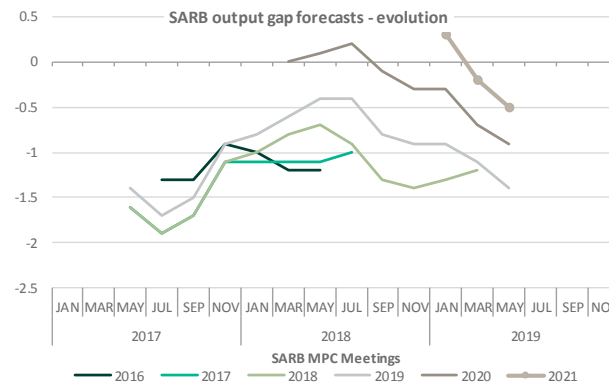


Chart 24: SARB's inflation forecasts are well below its 2016 and 2017 estimates

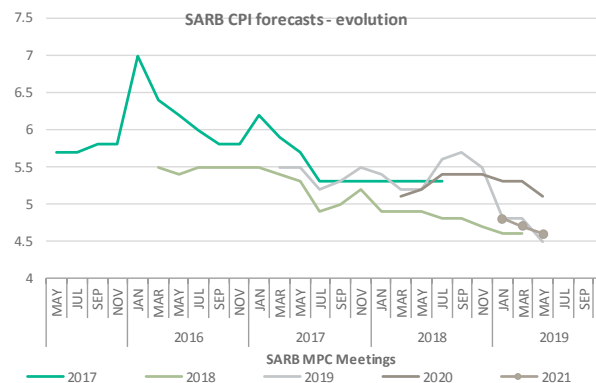


Chart 23: SARB revises 2018 growth estimate sharply lower

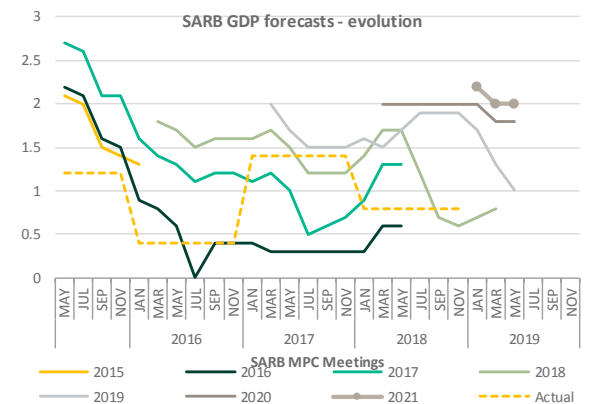
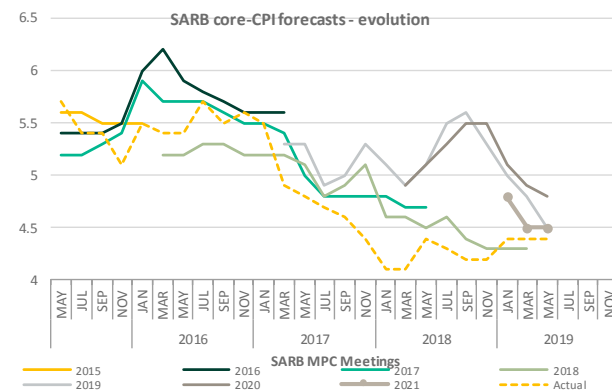


Chart 25: Core inflation estimates revised lower, signalling lack of demand-pull inflation



CREDIT RISK COMPARISON

Moody's publishes a scathing report contrasting SA with similarly rated peers

- Moody's released an Issuer In-Depth report on SA after the general elections in May. The following are some key highlights:
 - The most significant development was the inclusion of Eskom's government-guaranteed contingent liability debt in the government's balance sheet, with Moody's now indicating that the government's debt burden will rise above 70% of GDP by 2023, a trend that contrasts with Baa3-rated peers'. Essentially, Moody's has 'fiscalised' Eskom's debt due to the fact that the NT has stepped in to bail out the utility to prevent it from defaulting on its debt repayments. In its credit review in March 2018 (which is the last time the credit rating was affirmed by the credit committee), this was one of the key factors that the committee stated could lead to a downgrade of the sovereign rating. Importantly, if the government-guaranteed debt of other SOEs was to be added to the government's balance sheet, this would add a further 10% (of GDP) to the debt-to-GDP ratio, which, in our opinion, would necessitate a downgrade.
- SA's long-term growth outlook remains weak as a result of a deterioration in investment and productivity growth. While Moody's still believes SA's potential growth will rise gradually as a result of credit-positive policies it expects the new administration to pursue, it still sees SA's growth remaining one of the lowest among Baa3-rated peers.
- We believe that the risk of a Moody's downgrade has increased substantially as a result of the sharply higher debt-to-GDP projections.
- S&P also released a country update on SA's credit rating. The following were the key issues highlighted:
 - S&P's growth outlook for SA is markedly weaker. GDP growth was revised down to 1.0% (2019e) from 1.6% forecast at the start of the year. It believes the government will try to limit any fiscal slippage, despite having breached its self-imposed expenditure ceiling in 2019/20. It expects the slight uplift in GDP growth to help revenue only marginally.
 - It expects the deficit to peak this year at 4.5% and to trim down to 4.0% by 2021/22. These compare to the following previous estimates: 2019e: 3.9%; 2020f: 3.9% and 2021f: 3.8%. The government's debt-to-GDP ratio was revised higher (2019e: 57.4%; 2020f: 58.0%; 2021f: 58.5% and 2022f: 58.9%) compared to November 2018 forecasts of 2019e: 56.1%; 2020f: 56.6%; and 2021f: 57.0%. The overall public-sector net debt/GDP in 2019 (including SOCs and municipalities) is expected at 75%.
- Overall, the rating is comfortably in the "bb" indicative rating level zone, barring further fiscal slippage, unbudgeted bailouts of SOCs and shocks to GDP growth (and therefore revenue) outlooks.

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		A+		A+		Upper medium grade
A2	P-2	A	A-1	A	F1	
A3		A-		A-		
Baa1		BBB+		BBB+		Lower medium grade
Baa2	P-3	BBB	A-3	BBB	F3	
Baa3 (stable)		BBB-		BBB-		
FC+LC	Not prime		B	BB+ (stable)	B	Non-investment grade
Ba1		BB+ (stable) LC		FC+LC		
Ba2		BB (stable) FC		BB		speculative
Ba3		BB-		BB-		
B1		B+		B+		Highly speculative
B2		B		B		
B3		B-		B-		

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

Chart 26: SA is among the high-risk EMs

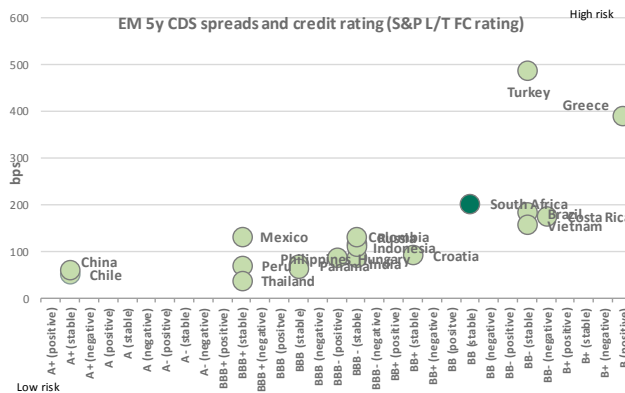
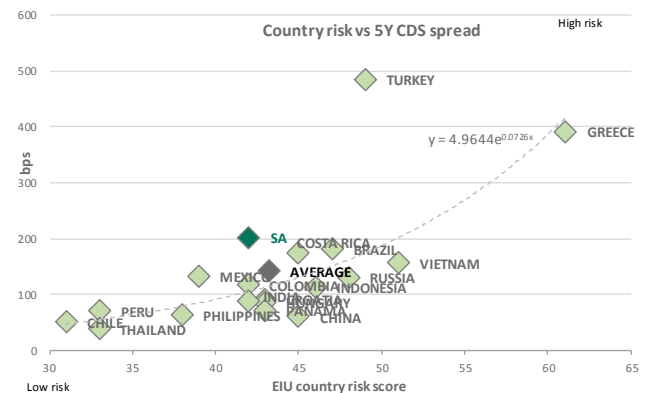


Chart 27: SA's above-trend credit risk score



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

SA'S BOND MARKET

SAGB curve steepens further, prompted by lower front-end yields

- A dovish SARB maintained the bear steepening bias of the SAGB yield curve in May as front-end yields repriced lower on expectations of an interest rate cut by the SARB later this year. Risk-off sentiment persisted in May as a result of rising trade tensions between the US and China, and weakness in some Asian economies, which kept EM assets out of favour with foreign investors. However, domestic events in the form of a peaceful election and the appointment of a new Cabinet offset the risk aversion prompted by global forces.
- Due to a highly dovish SARB statement, the FRA markets have now repriced sharply lower, to signal an 89% probability of a 25bps rate cut by year-end. The FRA market is pricing in a 49% probability of a cut at its next meeting in July. Despite the SARB's insistence on achieving a 4.5% long-term inflation expectation rate, Deputy Governor Mminele commented that the recent decline in inflation expectations was encouraging. We believe this further reinforces the FRA market view of a rate cut materialising this year. We also still believe that credit rating risks hang in the balance, while we expect inflation to climb marginally higher. Nonetheless, the bias for a rate cut has risen given the about-turn by the SARB, lower inflation estimates, and the fact that global central bank rhetoric is still for a loose monetary policy bias.
- Less-dovish global central bank rhetoric may limit further rallies in the SAGB yield curve in the near term, while global risk aversion and the trade war could also curtail flows into EMs. On the other hand, a continuation of loose monetary policy may kick-start the search for yield.
- From a fair value perspective, we maintain our trimmed-down estimate for the R186 yield, based on the downward revision to year-end base rates, although this was partly mitigated by higher credit risk as a result of a weaker growth outlook and a deteriorating fiscal balance. We see the R186's fair value yield closer to 8.65% currently (from 8.9% previously) and the 10-year's fair value yield closer to 8.9% (from 9.1% previously).

Chart 28: FRA curve now prices in a cut this year, after highly dovish MPC

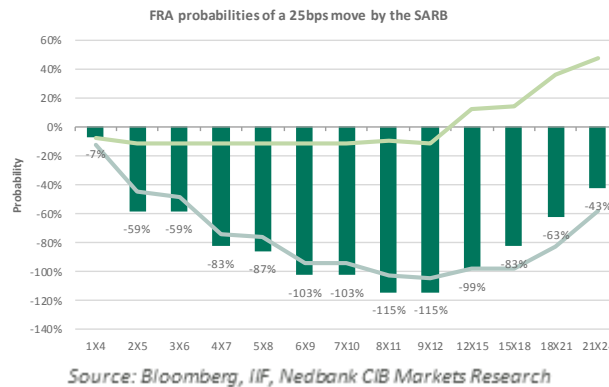


Chart 30: Short-end portion of the curve has eased recently on dovish rhetoric



Chart 29: Yield curve steepens marginally in March

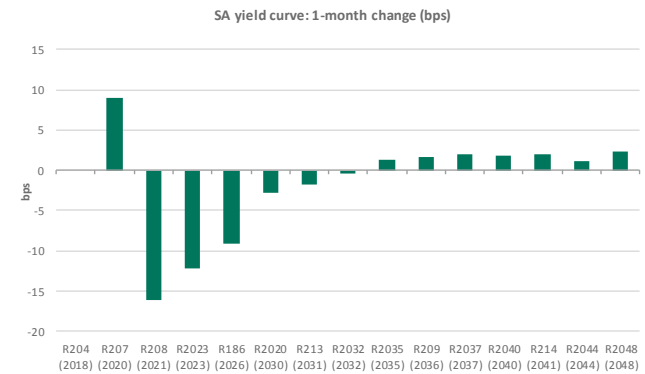
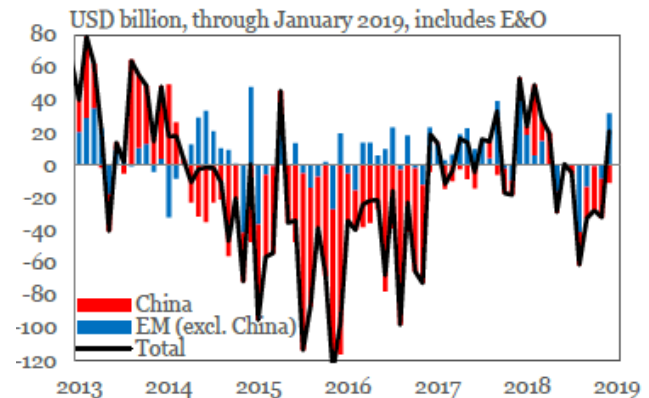


Chart 31: IIF: Net capital flows to emerging markets



Source: Bloomberg, IIF, Nedbank CIB Markets Research

THE RAND AND KEY RISKS

USDZAR loses 2,1% in May as a result of risk aversion, rebalancing

- The USDZAR weakened by 2.1% in May. While risk sentiment remained downbeat as a result of geopolitical tensions, a key reason for the weakness stemmed from a technical rebalancing of the MSCI EM equity index, which increased the weight of Chinese A shares in the index, reducing SA's weight and necessitating outflows from index-tracking funds.
- Against the crosses, the rand fared better, weakening by 1,4% against the EUR and strengthened by 1,3% against the GBP. The trade-weighted rand weakened by 2,1% in May. The Fed maintained its noncommittal stance towards the direction of the Fed funds rate and attributed subdued inflationary pressures to transitory factors – this likely implies that the Fed expects inflation to pick up in the future. The Fed's less-dovish nature in recent months has also weighed on the rand, and by extension, supported the USD.
- Due to the subtle shift in the Fed's language, we are doubtful that the search for yield that characterised the earlier months of the year will persist as fervently as before. However, the market currently disagrees – the futures market is pricing in a 92% probability of a 25bps reduction in the Fed funds target rate by year-end. The rand's fate is very much tied to the signalling of the Fed, along with local event risk in the near term.
- Our core view on the rand has not changed since the start of the year – we maintain a fair value range for the USDZAR of R14.00-R14.50/USD as our strategic view. Any breakout above or below this range is unlikely to be sustained, in our view. We still believe that the rand trading between 14.00 and 14.50 reflects local and external risks better.
- From a technical analysis perspective, we keep a close eye on the 14.39 level. Only a break below 14.39 would negate the negative rand outlook and confirm our core fundamental view (see [Technical Strategy Note](#) dated 30 May 2019).

Chart 32: ZAR REER falls below fair value



Chart 34: Lower oil price suggests a weaker rand exchange rate, vice versa for higher oil price

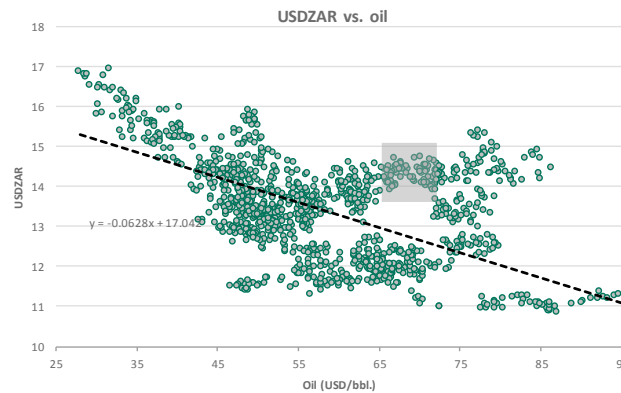
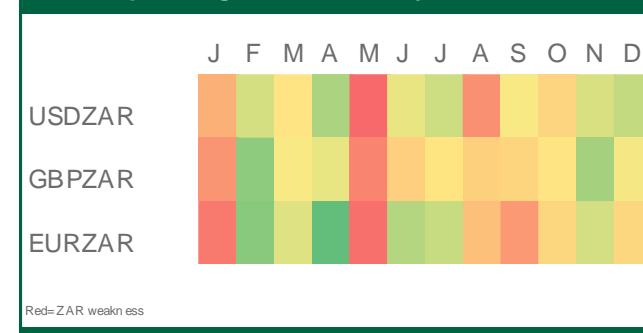


Chart 33: ZAR maintains weakness ahead of elections



Chart 35: Heat map suggests that the rand is likely to remain volatile

Heatmap: Long-term monthly trend



THE RAND AND KEY RISKS

EM FX faces the same fate as the rand in the current risk-off environment

- Despite the rand losing significant ground in May, it was the Chilean, Mexican and Columbian pesos that were the biggest losers. In stark contrast, the Japanese yen and Turkish lira were the best-performing currencies, gaining 2.7% and 1.8%, respectively. The gain in the yen was more a reflection of safe-haven buying than of optimism on Japan's growth or monetary policy, while the lira posted a recovery after being the worst performer in the previous month, when it lost 8.2% of its value as a result of central bank uncertainty and a USD shortage.
- Country-specific event risks may have passed for the moment, but global event risks are more profound, with trade uncertainty weighing on demand for risk assets and threatening to derail global growth. EM FX will likely come under pressure if the Fed becomes more hawkish or if the trade threats persist. However, from September onwards, a spate of general elections are set to take place, which may present added risk aversion as a result of country-specific factors. Furthermore, uncertainty over Brexit conditions is also likely keep risk sentiment muted. The resolution of the Brexit deal has been postponed to August.
- Overall, the JP Morgan EM FX index weakened by 1.5%, while the rand lagged behind, weakening by 2.1% in May.
- The Cabinet announcements have not changed our fundamental view on the rand. While the risks remain, the important aspect is that no new risks have been introduced – in fact, some have been mitigated. Our core view, therefore, remains unchanged – we are neutral in the 14.00-14.50 range, selling into rand strength below 14.00 and buying into rand weakness beyond 14.50.

Chart 36: The rand remains volatile, underperforming EM index recently

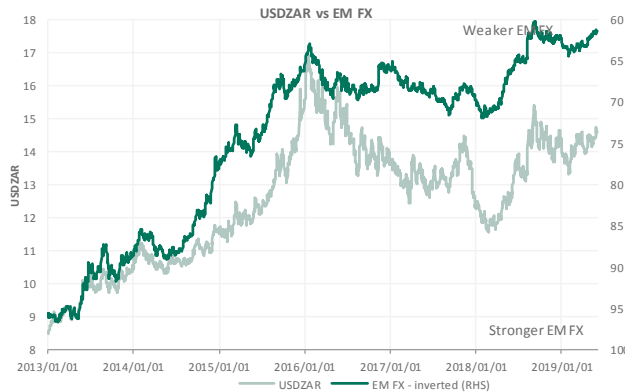


Chart 38: EM FX recovers somewhat in 2019, although unlikely to sustain rally

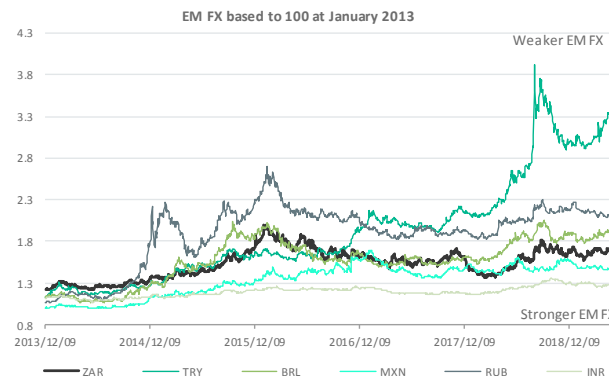


Chart 37: IIF: Only Indonesia and Mexico stand out; SA continues to see very weak flows

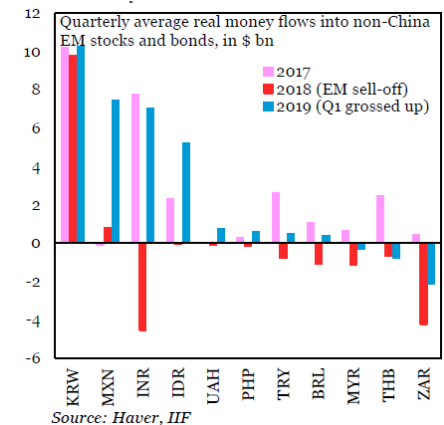
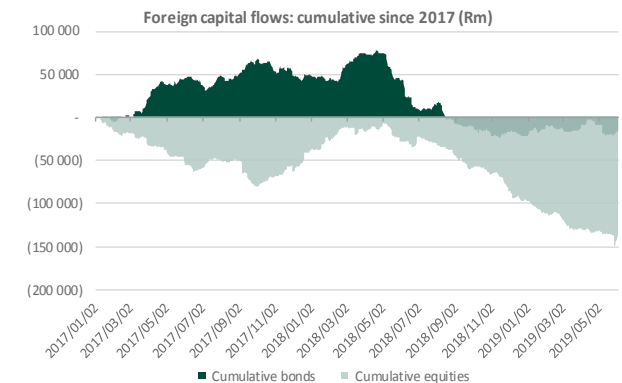


Chart 39: Foreign capital flows are an extension of ZAR weakness in 2018



OTHER MARKETS

Global equity market rout fuelled by trade war

- In May, US President Trump raised tariffs on USD200bn worth of Chinese goods, while China retaliated by raising tariffs on USD60bn worth of American goods.
- The trade spat escalated quickly, with China threatening to halt exports of its rare-earth minerals to the US, while it also considers establishing a 'blacklist' of foreign firms that damage the interests of Chinese companies. The US has targeted other countries, too, placing a 5% tariff on Mexican imports to the US, which could potentially escalate to 25% by October if Mexico does nothing to prevent illegal immigrants from crossing the border and into the US.
- As the trade war intensified, global equities came under significant pressure, while safe-haven assets like USTs, the USD, the JPY and gold thrived. The S&P 500 is still the best equity index across the major markets, gaining 12% for the YTD, while the MSCI EM index is the worst performer, up only 3.3% (in USD terms) this year.
- China poses a key risk if growth there slows sharply on the back of higher US tariffs, declining global demand and falling global trade activity. This would be particularly painful for EMs that depend on export flows to China, commodity-based countries that rely on robust Chinese consumption and high commodity prices, and other Asian countries relying on China for re-export purposes. Another risk we note is the ongoing Brexit uncertainty and the ability of an unresolved agreement to derail the UK's economic prospects over the medium term. This would be particularly painful for regional European growth, which is already slowing.

Chart 40: Local fuel costs likely to increase sharply as a result of the higher oil price

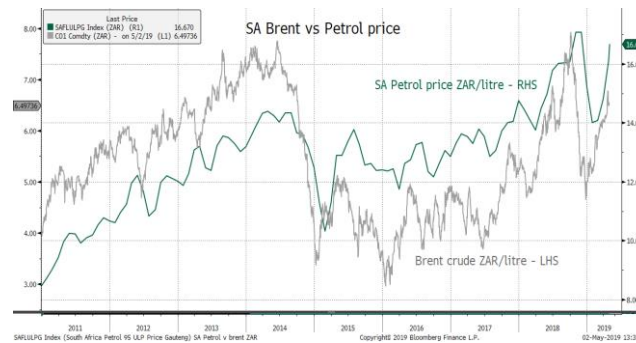


Chart 42: Global risk-on since December sees some recovery in equity indices

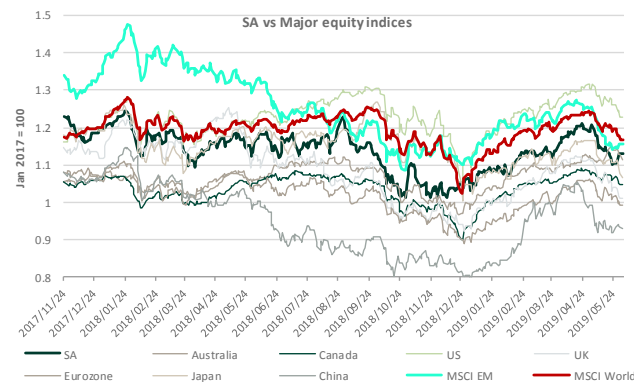
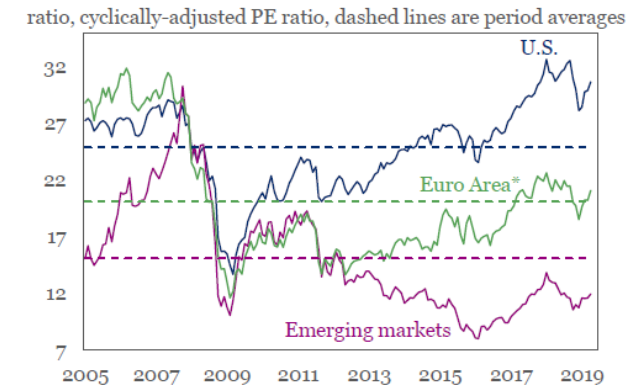
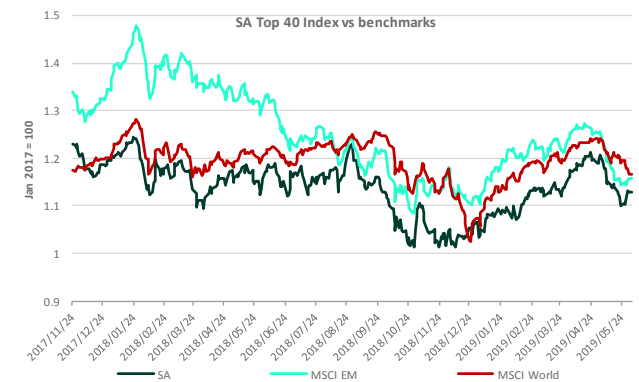


Chart 41: IIF: Stock valuations reflect confidence in US markets



Source: Bloomberg, IIF; *average of Germany and France

Chart 43: Equity indices marginally higher recently; SA equities under pressure



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 and unplanned meetings such as Cabinet changes, court cases, leadership changes, other political developments and any sort of Constitutional changes/reform.

January	February	March
Week of 08 Jan – ANC 8 Jan statement, election manifesto launch 14 Jan – US earnings season* 17 Jan – SARB MPC 24 Jan – ECB meeting 22-25 Jan – WEF meeting in Davos-Klosters 30 Jan – US FOMC meeting Jan – President Trump mulls tariffs on Chinese goods	14 Feb – SA State of the Nation address (SONA2019)* 16 Feb – Nigerian general election 20 Feb – SA Budget Speech*	07 Mar – NERSA MYPD RCA decision 07 Mar – ECB meeting 17 Mar – BER 1Q Business confidence 05 Mar – SA 4Q18 GDP 20 Mar – US FOMC meeting 28 Mar – SARB MPC 29 Mar – Brexit commencement date (transition period until 31 Dec 2020)* 29 Mar – Moody's review of SA credit rating 31 Mar – Turkish local elections
April	May	June
04 Apr – NATO meeting 06 Apr – BER 1Q Consumer confidence 10 Apr – ECB meeting 14 Apr – US earnings season* 17 Apr – Indonesian general elections 12-24 Apr – Spring Meetings of the World Bank & IMF Apr/May – Indian general elections	01 May – US FOMC meeting 02 May – UK local elections 08 May – SA National Elections 13 May – Philippine general elections 17 May – S&P review of SA credit rating* 17 May – Fitch review of SA credit rating* 23 May – SARB MPC Late May – EU Parliament elections	06 Jun – ECB meeting 15 Jun – SA 1Q19 GDP 16 Jun – BER 2Q Business confidence 19 Jun – US FOMC meeting Mid-2019 – UN Security Council election (SARB) Deputy Governor Daniel Mminele's second term ends
July	August	September
05 Jul – BER 2Q Consumer confidence 14 Jul – US earnings season* 18 Jul – SARB MPC 25 Jul – ECB meeting 31 Jul – US FOMC meeting Jul – Japan Legislative (Upper House) elections	Aug – Fed's Jackson Hole symposium*	08 Sep – Russian elections* 12 Sep – ECB meeting 16 Sep – BER 3Q Business confidence 16 Sep – SA 2Q19 GDP 18 Sep – US FOMC meeting 19 Sep – SARB MPC
October	November	December
03 Oct – BER 3Q Consumer confidence 14 Oct – US earnings season* 15 Oct – Mozambique general elections 18-20 Oct – IMF Annual Meetings 21 Oct – Canadian federal election 23 Oct – SA MTBPS Speech* 24 Oct – ECB meeting 27 Oct – Argentina National elections 30 Oct – US FOMC meeting 31 Oct – ECB Chair Draghi's term ends Oct – Botswana, Greece, Portugal elections	01 Nov – European Commission Presidential Succession 01 Nov – Moody's review of SA credit rating 05 Nov – US mayoral/legislative elections 21 Nov – SARB MPC 22 Nov – S&P review of SA credit rating* 22 Nov – Fitch review of SA credit rating* Nov – Namibia, Australia, Israel, Poland elections (SARB) Governor Lesetja Kganyago first term ends	11 Dec – US FOMC meeting 12 Dec – ECB meeting 16 Dec – BER 4Q Consumer confidence 16 Dec – SA 3Q19 GDP 17 Dec – BER 4Q Business confidence Dec – Tunisia, Mauritius, Croatia elections

*Indicative

Source: Media reports, Bloomberg

APPENDICES

Upcoming economic data releases

Economic data releases

Date	Time	Indicator	Period	Previous
06/03/2019	11:00	Absa Manufacturing PMI	May	47.2
06/03/2019		Naamsa Vehicle Sales YoY	May	0.70%
06/04/2019	11:30	GDP Annualized QoQ	1Q	1.40%
06/04/2019	11:30	GDP YoY	1Q	1.10%
06/05/2019	09:15	Standard Bank South Africa PMI	May	50.3
06/05/2019	11:30	SACCI Business Confidence	May	93.7
06/06/2019	11:00	Current Account as a % GDP	1Q	-2.20%
06/06/2019	11:00	Current Account Balance	1Q	-110b
06/07/2019	08:00	Gross Reserves	May	\$49.54b
06/07/2019	08:00	Net Reserves	May	\$43.25b
06/11/2019	13:00	Manufacturing Prod NSA YoY	Apr	1.20%
06/11/2019	13:00	Manufacturing Prod SA MoM	Apr	0.80%
06/12/2019	12:00	BER Business Confidence	2Q	28
06/12/2019	13:00	Retail Sales Constant YoY	Apr	0.20%
06/12/2019	13:00	Retail Sales MoM	Apr	-0.70%
06/13/2019	11:30	Mining Production YoY	Apr	-1.10%
06/13/2019	11:30	Mining Production MoM	Apr	3.80%
06/13/2019	11:30	Gold Production YoY	Apr	-17.70%
06/13/2019	11:30	Platinum Production YoY	Apr	-0.50%
06/19/2019	10:00	CPI YoY	May	4.40%
06/19/2019	10:00	CPI MoM	May	0.60%
06/19/2019	10:00	CPI Core YoY	May	4.10%
06/19/2019	10:00	CPI Core MoM	May	0.30%
06/25/2019	09:00	Leading Indicator	Apr	104.5
06/27/2019	11:30	PPI YoY	May	6.50%
06/27/2019	11:30	PPI MoM	May	1.30%
06/28/2019	14:00	South Africa Budget	May	-63.5b
06/28/2019	14:00	Trade Balance Rand	May	-3.4b
06/30/2019	08:00	Money Supply M3 YoY	May	8.77%
06/30/2019	08:00	Private Sector Credit YoY	May	7.95%

Source: Nedbank, Bloomberg

SARB MPC meeting dates – 2019

15 - 17 January 2019

26 - 28 March 2019

21 - 23 May 2019

16 - 18 July 2019

17 - 19 September 2019

19 - 21 November 2019

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 raised to 6.75% (previously 6.50%) following the November 2018 MPC meeting.

Source: SARB

APPENDICES

Nedbank Group forecasts

	2018	2019				2019	2020				2020	2021				2021
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
GDP q/q SAAR	0.80	-1.80	1.60	1.90	2.20	0.80	1.00	1.40	2.10	1.90	1.60	1.60	2.10	1.90	1.90	1.90
Current account as a % of GDP	-3.70					-3.30					-3.40					-3.40
Gold \$/oz. (EOP)	1280.30	1305.91	1318.97	1345.34	1331.89	1331.89	1305.25	1318.31	1344.67	1331.23	1331.23	1304.60	1317.65	1344.00	1330.56	1330.56
Exchange rates (EOP)																
USDZAR	14.390	14.585	14.512	14.367	14.654	14.654	14.508	14.725	14.873	15.096	15.096	15.103	15.254	15.407	15.638	15.638
EURZAR	16.447	16.396	16.153	15.959	16.198	16.198	15.877	16.035	16.195	16.356	16.356	16.203	16.283	16.446	16.610	16.610
GBPZAR	18.256	19.077	18.794	18.513	18.884	18.884	18.510	18.787	18.881	19.069	19.069	19.174	19.366	19.520	19.715	19.715
AUDZAR	10.347	10.357	10.005	9.895	10.133	10.133	9.982	10.173	10.254	10.387	10.387	10.340	10.486	10.576	10.706	10.706
ZARJPY	7.674	7.583	7.545	7.659	7.509	7.509	7.547	7.436	7.399	7.326	7.326	7.286	7.213	7.178	7.107	7.107
GBPU\$	1.269	1.308	1.295	1.289	1.289	1.289	1.276	1.276	1.270	1.263	1.263	1.270	1.270	1.267	1.261	1.261
EUR\$	1.143	1.124	1.113	1.111	1.105	1.105	1.094	1.089	1.089	1.084	1.084	1.073	1.067	1.067	1.062	1.062
USDJPY	110.42	110.60	109.49	110.04	110.04	110.04	109.49	109.49	110.04	110.59	110.59	110.04	110.04	110.59	111.14	111.14
USDCNY	6.893	6.724	6.757	6.771	6.778	6.778	6.784	6.818	6.832	6.839	6.839	6.846	6.880	6.889	6.901	6.901
USDCHF	0.990	0.996	1.004	1.004	1.007	1.007	1.015	1.018	1.020	1.023	1.023	1.031	1.034	1.036	1.040	1.040
USDAUD	1.391	1.408	1.450	1.452	1.446	1.446	1.453	1.448	1.450	1.453	1.453	1.461	1.455	1.457	1.461	1.461
SA Interest rates (EOP)																
3-month JIBAR	7.15	7.15	7.16	7.16	7.19	7.19	7.19	7.18	7.17	7.19	7.19	7.20	7.19	7.17	7.16	7.16
Prime	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25	10.25
Long bond (10-yr)	9.22	8.99	8.85	8.90	8.95	8.95	9.00	8.85	8.80	8.75	8.75	8.65	8.85	8.90	8.65	8.65
CPI % (EOP)	4.49	4.52	4.42	4.62	4.93	4.93	5.56	5.08	4.99	5.16	5.16	5.14	5.13	5.18	5.17	5.17
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 represent the Nedbank Group House view estimates

APPENDICES

Other SA charts

Chart 44: SACCI Consumer Confidence Index (monthly)

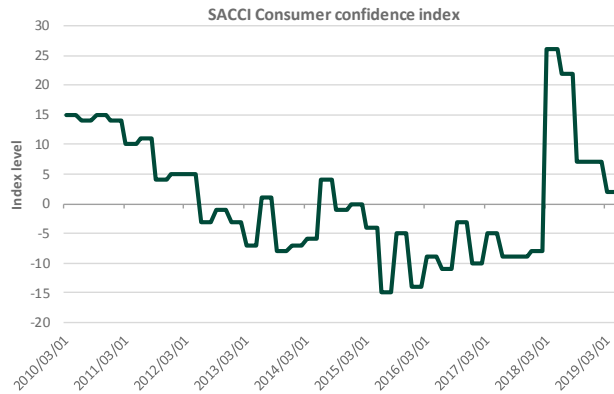


Chart 45: BER Manufacturing PMI (monthly)

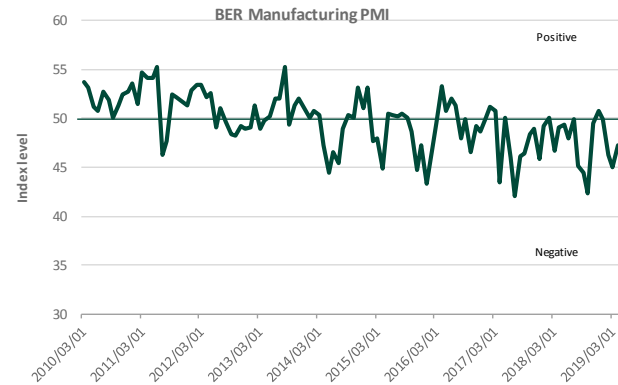


Chart 46: SA CPI y/y percentage (monthly)

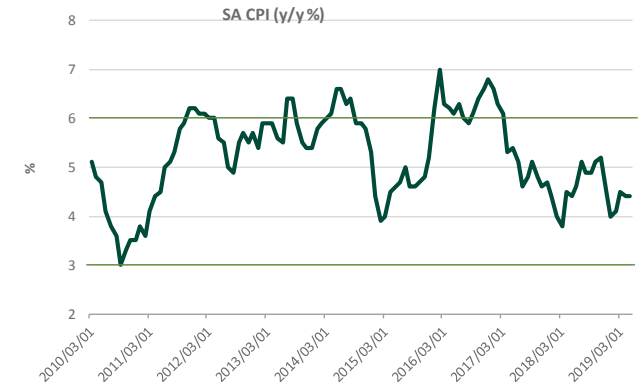


Chart 47: SA repo rate (monthly)

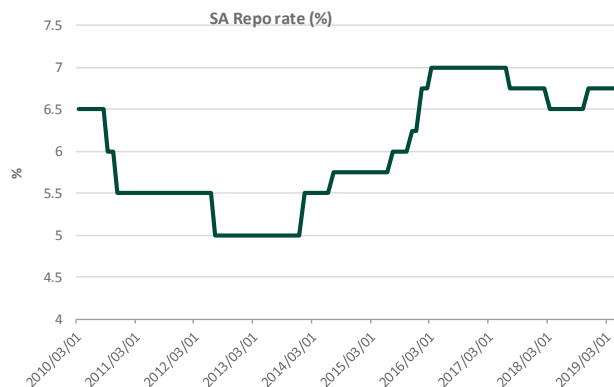


Chart 48: SA 10y generic bond yield (monthly)

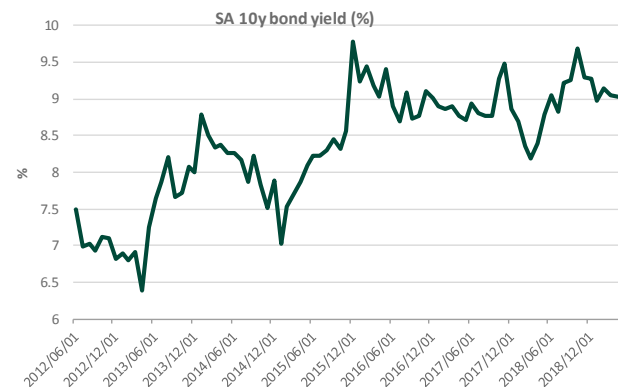


Chart 49: SA GDP growth q/q % SAAR (quarterly)

