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MONTHLY INSIGHTS CHART PACK

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TABLE OF CONTENTS

Summary of views	3
Global developments	4
Monetary policy dynamics: Global	6
SA's real economy	8
SA inflation trends	9
Monetary policy dynamics: SA	10
Credit risk comparison	11
SA's 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

The Fed is the tide that lifts all boats?

- The World Bank reduced its growth forecasts in June due to the trade conflict between the US and China – between them, the two countries account for more than a third of global economic activity. Global growth is now forecast at just 2.6% for 2019 from 2.9% previously forecast. The Fed has turned sharply dovish as a result of sluggishly low inflation, threats to the growth outlook due to weaker global trade and geopolitical tensions from the trade war. Wage pressures remain muted and unable to boost inflation, while the threat of a recession mounts. The Fed's dot plot is now pricing in a reduction in interest rates by year-end, and a further reduction in 2020, with the long-term Fed funds target rate falling to 2.5% from 2.75% previously.
- SA's GDP posted its biggest quarterly contraction since 1Q09 in 1Q – 3.2% q/q versus 1.4% growth in the previous quarter. High-frequency economic data for 2Q shows somewhat of a recovery, with manufacturing output sharply higher, while retail sales were boosted by Easter spending in April. While Nedbank expects 2Q real growth of 1.6% q/q, this would evolve based on high-frequency monthly data. With no real uptick in confidence expected in 2H19, we could see very subdued levels of growth, with any load-shedding exacerbating this decline. Conversely, fast-tracking structural reforms could lend some upside, but there would be a lagged effect, taking these benefits into 2020, in our opinion.
- While risks to the growth outlook remain to the downside, risks to the inflation outlook remain balanced. Although 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 could see a marginal reduction in the SARB's CPI and growth forecasts at its upcoming MPC meeting that could prompt a more dovish monetary policy stance. We, therefore, believe there is a high likelihood of a SARB rate cut this month.
- The USDZAR appreciated by 3.4% in June as risk sentiment improved amid expectations of looser monetary policy in the US and the Eurozone. A temporary trade truce between the US and China at the G20 meeting also aided the rand and other EM FX as the JP Morgan EM FX Index appreciated by 2.4% in June.
- Moody's released a credit opinion on SA's sovereign credit rating after the presidential inauguration and the announcement of the new Cabinet. Importantly, Moody's hinges its rating trajectory for the sovereign on potential structural reform that could raise potential growth. However, all rating agencies have been warning of the hazards of not implementing structural reform for the better part of the past five years. We believe there is a high likelihood of a Moody's outlook change to 'negative' from the current 'stable', after the MTBPS. Further growth disappointments would also weigh on the rating and the outlook over the medium term. In the absence of a solid improvement in growth projections, we believe Moody's Baa3 (stable) credit rating of SA's LT FC and LC debt will be reduced to non-investment grade within the next 12 months.

	Current price/yield	Core views	Target levels	
USDZAR	14.17	We maintain the view that the rand trading between 14.00 and 14.50 reflects better local and external risks. We would sell into rand strength below 14.00 and buy into rand weakness beyond 14.50	3-month	14.30
			6-month	14.50
			12-month	14.10
Repo rate	6.75	We believe that there is a high likelihood of a SARB rate cut this month		
SAGBs	6.34 (R208)	Our fair value estimate of SA's 10y R2030 bond yield is now 9.25% vs 9.20% previously. The marginally higher yield takes into account a higher credit risk component. We see our fair value estimate as a 6- to 12-month view. We expect further curve steepening in the absence of an increase in risk appetite, as higher credit risk raises yields in the long end portion of the curve, while the front end continues to price in a SARB cut.	3-month	6.7
			Year-end	6.7
	8.15 (R186)		3-month	8.9
			Year-end	8.6
	9.74 (R2048)		3-month	10.0
	Year-end	10.2		

Source: Nedbank CIB Markets Research

Disclaimer – Note that the above and ensuing analyses represent the analyst's 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 weaken after temporary rise in April

- The temporary uptick in global inflation in April due to seasonal Easter spending proved to be short-lived, with PPI, CPI and core inflation falling sharply in May.
- In the Eurozone, CPI declined to 1.2% y/y in May, from 1.7% in April, worse than consensus estimates of 1.3%. Core inflation also tumbled to 0.8% y/y from 1.3% in April as discretionary spending normalised after the Easter shopping season. Prices of energy and services were among those that declined the most, resulting in a sharp fall in headline inflation.
- In the US, CPI eased to 1.8% y/y in May from 2% in April, worse than consensus of 1.9%. Energy prices declined sharply, weighing on CPI. Prices of housing, services, transportation, recreation and commodities either eased or contracted in May. Underlying inflationary pressure, as measured by core CPI, fell to 2% y/y in May, from 2.1% in April, worse than consensus for no change. This implies that inflation has structurally weakened in the economy.
- UK CPI fell to 2% y/y in May, from 2.1% in April, in line with consensus. Core inflation also declined by 10bps in May. There was a broad-based decline in inflation rates within various product categories. The recent fall in inflation also reflects the high base effect from April, which saw more seasonal spending raise prices that month.
- Japan's CPI eased to 0.7% y/y in May, from 0.9% previously, in line with consensus. Although food inflation rose, along with prices of household goods, utilities, medical care, clothing and footwear, prices of transport, communication, entertainment and miscellaneous goods declined. Core inflation fell by 10bps to 0.8% y/y as a result.
- China bucked the trend in global inflation as CPI there rose to 2.7% y/y in May, from 2.5% in April, in line with consensus. However, this rise in inflation was due to sharply higher food prices, with China limiting imports of pork from Africa due to the outbreak of swine fever. Other inflation metrics remained weak – the PPI fell to 0.6% y/y from 0.9% previously.
- EM inflation rates have been contained, with CPI falling in recent months as a result of lower energy costs. Most regions, apart from Turkey, have 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 02-Jul-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	2.9	3.7	122	131	3.1	2.2	51.7	52.1	0.37	-0.39	-4.54	-4.3	2.5	2.5
UK	2.3	5.1	-13	-10	0.5	0.2	48	49.4	-1	1.3	-1.12	-1.42	0.75	0.75
Eurozone	1.5	2	-7.2	-6.5	0.4	0.2	47.6	47.7	-0.4	-0.7	-0.52	-0.44	0	0
Japan	1.2	0.4	38.7	39.4	2.2	1.8	49.3	49.8	-1.8	-1.1	-2.54	-2.96	-0.1	-0.1
Turkey	1	0.84	57.7	55.5	0.3	0.66	47.9	45.3	-4	-2	-2.31	-1.96	24	24
China	8.6	7.2	125	124	6.4	6.4	49.4	49.4	5	5.4	-8.3	-5.3	4.35	4.35
Brazil	1.7	-4.4	88.5	86.6	-0.2	0.1	51	50.2	-3.9	-6.2	-6.99	-7.03	6.5	6.5
Russia	1.4	1.6	68.3	71.3	0.5	2.7	48.6	49.8	0.9	4.6	2.69	2.55	7.5	7.75
India	4772	4778	47.8	46.1	5.8	6.6	52.1	52.7	3.4	0.4	-3.39	-3.61	5.75	6
Mexico	1.6	1.6	108	111	-0.17	0.03	49	49.2	-2.86	-0.06	-1.79	-2.1	8.25	8.25
South Africa	2.4	0.1	5	2	-3.2	1.4	46.2	45.4	4.6	1.3	-4.73	-3.91	6.75	6.75

Chart 1: Global inflation trend turns higher

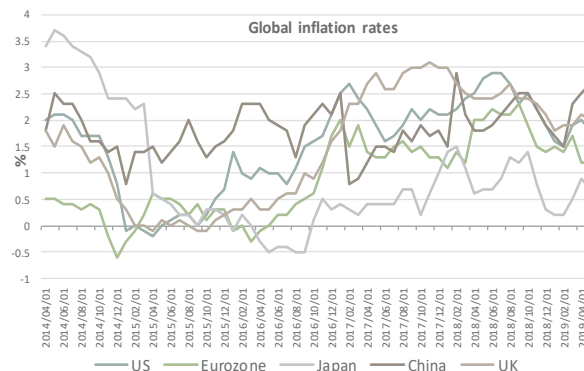
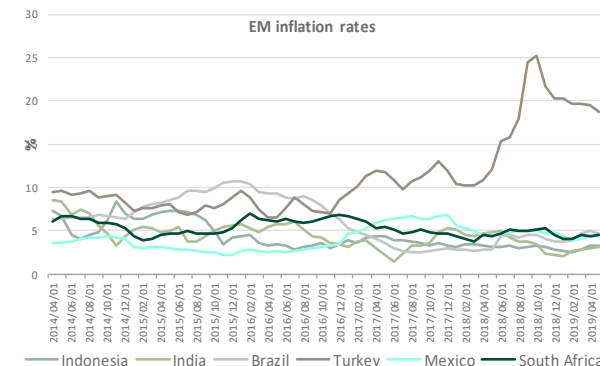


Chart 2: EM inflation rates contained



Source: Bloomberg, Nedbank CIB Markets Research

GLOBAL DEVELOPMENTS

World Bank slashes global growth forecast as a result of trade conflict

- The World Bank reduced its growth forecasts in June due to the trade conflict between the US and China – between them, the two countries account for more than a third of global economic activity. Global growth is now forecast at just 2.6% for 2019 from 2.9% previously forecast. Both investment and business confidence levels have fallen to a three-year low, while growth in trade activity has fallen to a 10-year low. The World Bank warns that any escalation in trade tensions, financial turmoil within EMs and a sharp deceleration in growth of major economies will most likely weaken global growth further.
- Eurozone first-quarter GDP growth was finalised at 0.4% q/q versus 0.2% in 4Q18. Household spending was a key upward driver of growth in 1Q as government spending and gross fixed capital formation growth slowed sharply. Weakness in Germany's economy, following a slump in its exports, was a key driver of the decline in investment. Despite household spending rising over the quarter, growth in imports eased. A deteriorating German manufacturing base and weak global demand led to export growth also easing over the quarter.
- Japan's GDP grew 0.6% q/q in 1Q, versus 0.5% in the previous quarter, in line with consensus. While private consumption and household spending contracted over the quarter, residential and non-residential investment surged, along with public investment. It was only due to this capex boost that the economy was able to expand on a quarterly basis. We could see a temporary boost to household spending in the coming months, as households tend to stockpile ahead of a sales tax hike, set to be implemented in October.
- US 1Q GDP growth remained unchanged at 3.1% q/q in its third estimate, compared to forecasts for an upward revision to 3.2%. Growth has risen from 2.2% q/q in 1Q. While personal consumption weakened relative to the previous estimate, as spending on services was revised sharply lower, private investment was revised higher, prompted by fixed investment and non-residential investment. Net exports were also revised higher as export growth improved.
- Preliminary manufacturing PMIs show a mixed picture, with PMIs in the Eurozone improving marginally, while those in the US and Japan deteriorated. While the Baltic Dry Index has recovered to YTD highs (implying higher shipping volumes), this has not been reflected in manufacturing output and confidence to date.

Source: Bloomberg, IIF, Nedbank CIB Markets Research

Chart 3: Major PMIs are now contractionary

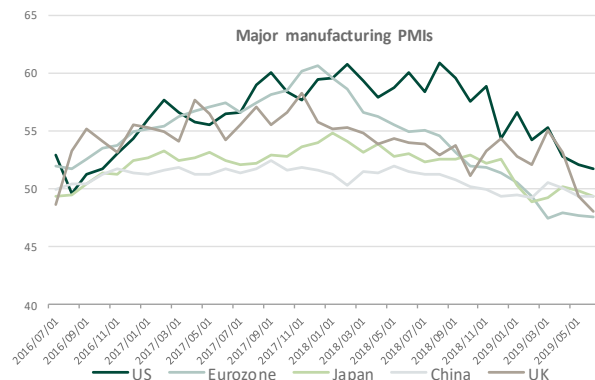


Chart 5: EM PMIs are mixed, SA negative

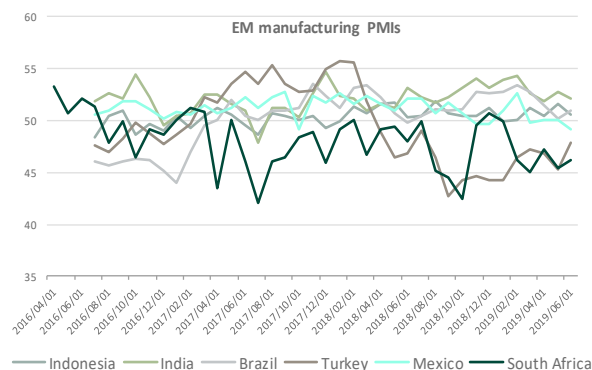


Chart 4: Global manufacturing activity falls sharply as a result of lower growth

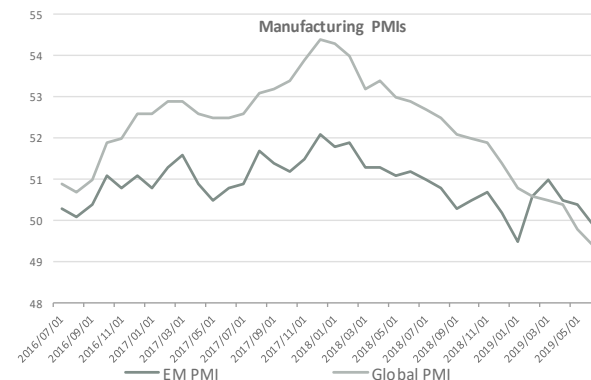
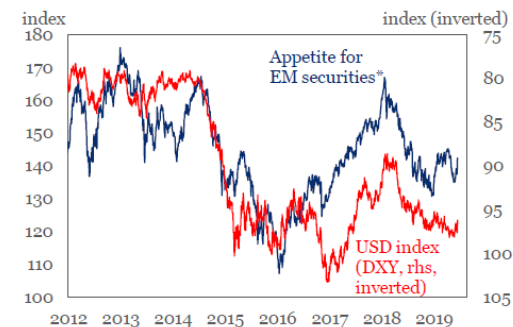


Chart 6: IIF: Appetite for EM assets



Source: Bloomberg, IIF; *composite index of EM carry trade, EMBI bond spreads, EM equity indices and commodity prices; rising values indicate inflows, falling values suggest outflows.

MONETARY POLICY DYNAMICS: GLOBAL

Fed leads the way as market positions for a cut

- The Fed has turned sharply dovish as a result of sluggish low inflation, threats to the growth outlook due to weaker global trade and geopolitical tensions from the trade war. Wage pressures remain muted and unable to boost inflation, while the threat of a recession mounts. The Fed's dot plot is now pricing in a reduction in interest rates by year-end, and a further reduction in 2020, with the long-term Fed funds target rate falling to 2.5% from 2.75% previously.
- The ECB has indicated that it will begin a further round of TLTROs in September. The OIS market has, therefore, raised its rate-cut odds – a month ago, the market was pricing in a 53% probability of a 25bps cut by January 2020, relative to an 86% probability currently.
- While the BoE has adopted a more hawkish policy stance due to the risk of a disorderly Brexit, the market is not convinced that the BoE will diverge from the global rhetoric of looser monetary policy. The UK OIS is pricing in a 36% probability of a 25bps cut in the BoE bank rate, compared to a 0.5% probability of a hike. There is a significant disconnect between the BoE's communication of gradual rate hikes and market expectations of a cut.

	Next MPC meeting	Probability of a hike/cut/hold
US	2019/07/31 20:00:00	100.00%
UK	2019/08/01 13:00:00	100.00%
Eurozone	2019/07/25 13:45:00	63.80%
Japan	2019/07/30	79.60%
China		
India	2019/08/07 08:15:00	68.70%
Mexico	2019/08/15 20:00:00	86.30%
South Africa	2019/07/18	52.00%
Updated 02-Jul-19		

Chart 7: US inflation expectations are sticky above 2%

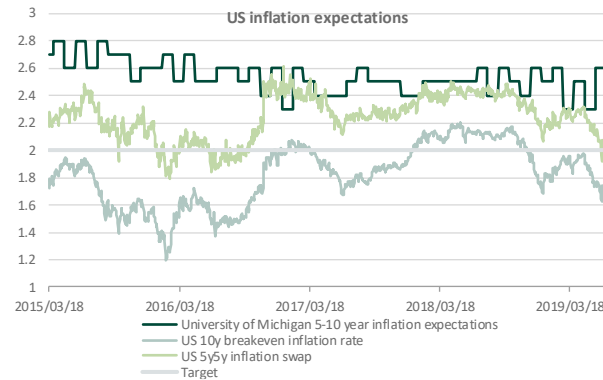


Chart 8: UK inflation remains elevated; expectations rise

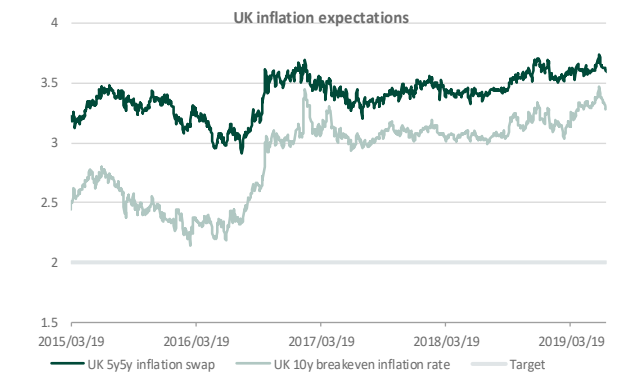


Chart 9: Eurozone swap markets more in tune with actual inflation

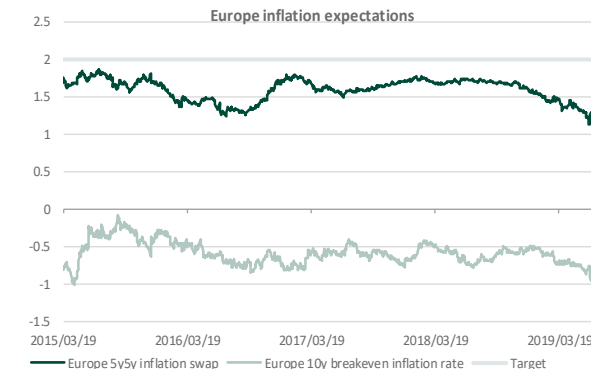
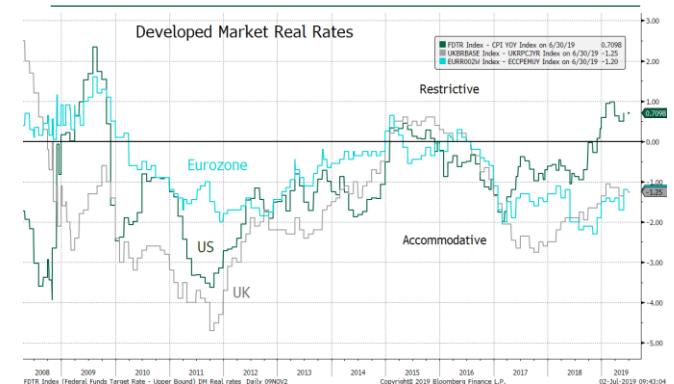


Chart 10: Real rates are now restrictive in the US



Source: Bloomberg, Nedbank CIB Markets Research

MONETARY POLICY DYNAMICS: GLOBAL

A diverse spread – Fed readies for a cut, ECB announces stimulus, BoE more hawkish

- The Fed left the Fed funds target rate unchanged at the upper bound of 2.50%, but the decision was not a unanimous one, with one dissenting vote calling for a cut. While the labour market remains strong, salaries are not growing strongly enough to raise inflation, and the Fed has acknowledged that the pace of economic activity has slowed somewhat since its last meeting. Most policymakers agreed that interest rates may need to be lowered by year-end, while Chairman Powell acknowledged that the possibility of a rate cut has risen. The Fed said that it would still need to wait to assess incoming economic data – any turn in global trade, an uptick in global demand, or a defusing of trade tensions could make the case for not reducing interest rates.
- The ECB also sounded the dovish alarm as it pledged to keep rates low until mid-2020. It previously forecast that rates would be left steady until the end of this year. The ECB also agreed that it will begin a new TLTRO programme, through which it would be able to lend to banks at negative interest rates. This programme will begin in September and could loosen credit conditions. While the ECB raised its 2019 real GDP growth forecast by 10bps to 1.2%, it revised its 2020 and 2021 real GDP growth estimates lower by a cumulative 30bps. The ECB is concerned about external risks emanating from trade and Brexit uncertainty and weak global growth, which have been hampering Eurozone growth in recent months. Inflation is expected to remain well below the 2% target over the medium term, while underlying inflationary pressures remain weak.
- The BoE left interest rates and its asset purchase programme unchanged, but cited increasing concerns of a 'no-deal' Brexit that it previously said could cause an 8% contraction in the UK economy if it materialised. Downside risks to the growth outlook have increased, while the GBP remains weak, keeping inflation elevated. In its forecasts, though, the BoE maintains its expectations for an orderly Brexit. Policymakers, therefore, believe that interest rates would need to rise by more than the market expects, in order to keep inflation close to its 2% target. Markets, however, believe the BoE will not adjust interest rates this year, although the BoE reiterated its stance of gradual rate hikes over the medium term.
- The BoJ has cited significant downside risks to Japan's growth from overseas economies, despite the economy maintaining a moderate expansion. As inflation remains well below its 2% target, Japan continues to adopt a loose monetary policy stance. Of the 53 most watched central banks, seven have hiked interest rates in the past six months, while 12 have reduced rates. Notably, Australia, India, New Zealand and Russia are among the major economies to have eased monetary policy recently. The global monetary policy bias has clearly shifted towards further easing.

Chart 11: Fed remains at the forefront of tightening

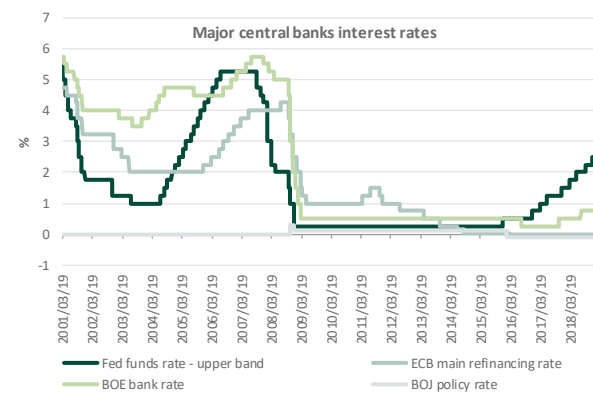


Chart 12: Global bond yields supported by weak global growth and trade uncertainty

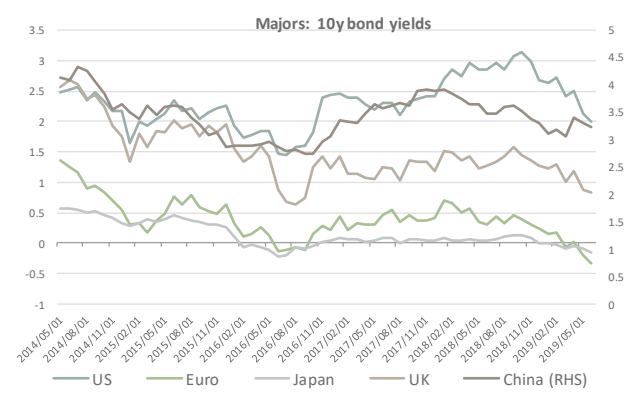


Chart 13: EM monetary policy stance broadly loose, apart from Turkey

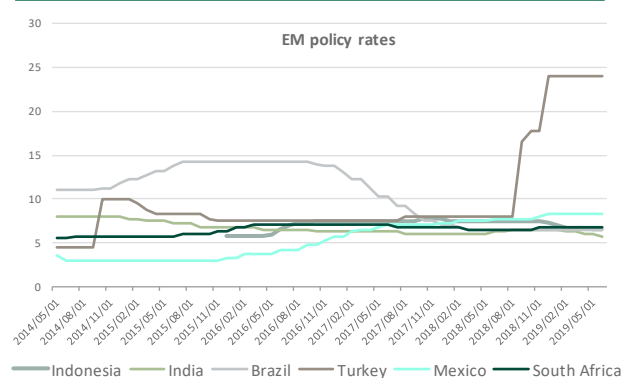
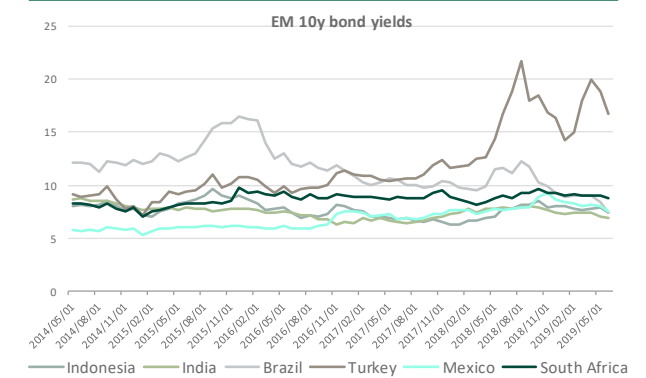


Chart 14: EM bond yields follow those of DMs



Source: Bloomberg, Nedbank CIB Markets Research

SA'S REAL ECONOMY

SA posts largest quarterly contraction since 2009

- The World Bank reduced its growth forecasts for SA by 10-20bps to 1.1%, 1.5% and 1.7% for 2019, 2020 and 2021, respectively. We still believe current-year estimates remain elevated and expect further downward revisions to 2019 growth estimates over the medium term.
- The World Bank cited weak mining production and domestic policy uncertainties as reasons for the weaker growth outlook, but has indicated that it expects elevated policy uncertainty to moderate over the medium term. Greater fiscal risks mount, as fiscal deficits and debt levels have risen due to the bloated public wage bill and SOE bailouts. Any further decline in commodity prices would put further pressures on growth and public-sector revenue. The World Bank is optimistic that the new administration will fast-track reforms that will be supportive of business confidence and investment growth. For now, we see no evidence of pro-business reforms, while business confidence deteriorated in May.
- SA's GDP posted its biggest quarterly contraction since 1Q09 in 1Q – 3.2% q/q versus 1.4% growth in the previous quarter. The biggest negative drivers of growth in 1Q were manufacturing, mining and trade. Notably, transport, agriculture and taxes also weighed heavily on growth in 1Q. On the expenditure side, we saw a deep contraction in exports, with net exports contributing -7.5% towards the GDE contraction of 3.4% q/q. There was a large inventory drawdown in 1Q, while gross fixed capital formation contracted by 4.5% q/q. It was the first time since 1Q16 that household final consumption expenditure declined, highlighting the struggle of the SA consumer lately.
- High-frequency economic data for 2Q shows somewhat of a recovery, with manufacturing output sharply higher, while retail sales were boosted by Easter spending in April. Despite the improvement in manufacturing production and sales, mining output continues to contract, while vehicle sales remain weak. Hence, it is still quite a mixed picture in terms of how strong a rebound we can expect in 2Q.
- While Nedbank expects 2Q real growth of 1.6% q/q, this would evolve based on high-frequency monthly data. With no real uptick in confidence expected in 2H19, we could see very subdued levels of growth, with any load-shedding exacerbating this decline. Conversely, fast-tracking structural reforms could lend some upside, but there would be a lagged effect, taking these benefits into 2020, in our opinion.

Chart 15: SA confidence leads investment growth

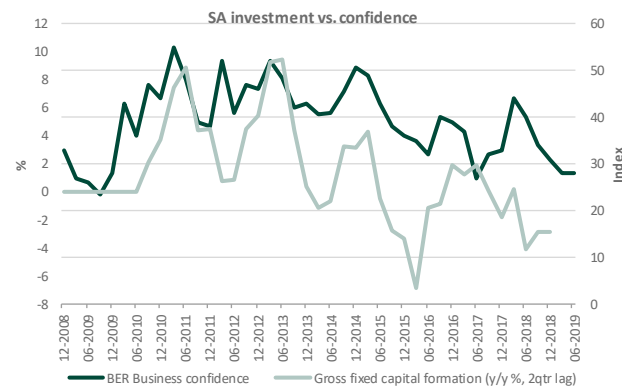


Chart 17: SA's economy needs to reduce dependence on government

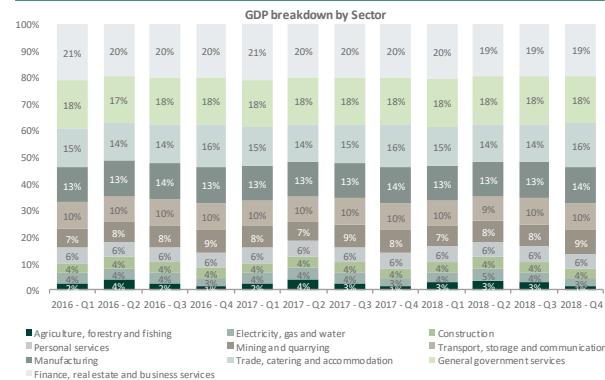


Chart 16: SARB's leading index now declines

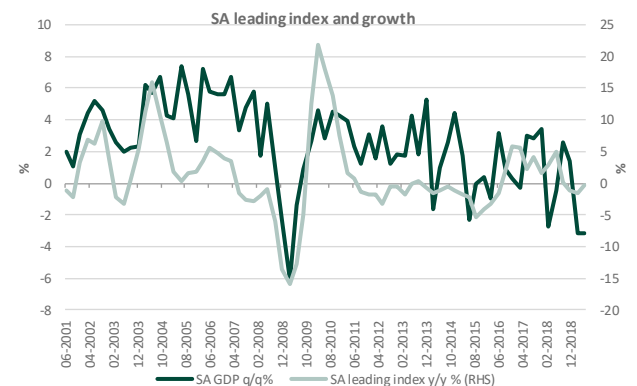
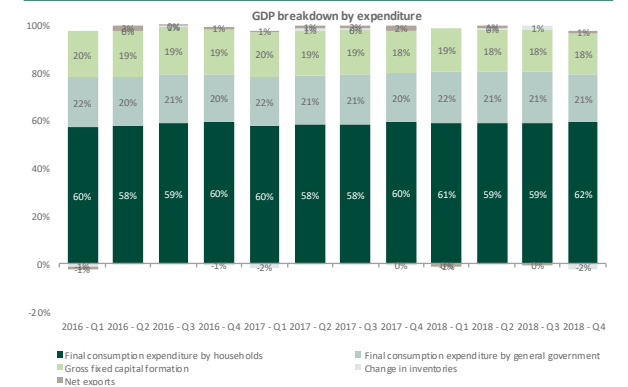


Chart 18: Spending is a key driver of economic activity



Source: Bloomberg, Stats SA, Nedbank CIB Markets Research

SA INFLATION TRENDS

CPI rises marginally on broad-based uptick in the prices of subcomponents

- SA's CPI rose to 4.5% y/y in May, from 4.4% in April, marginally worse than consensus of 4.4%. Core inflation also remained unchanged at 4.1% y/y in May, reflecting weak domestic demand and subdued goods inflation. Both goods and services inflation remained unchanged at 4.2% and 4.6% y/y, respectively.
- Food and non-alcoholic beverage inflation rose marginally in May (3.2% y/y vs 2.9% previously), along with housing and utilities (driven by maintenance and repair costs), household contents and services, healthcare costs (due to medical products), recreation and culture, and prices at restaurants and hotels. While the increases were marginal, they did contribute towards the uptick in CPI through the 20bps rise in the residual component in the CPI basket.
- While transport inflation remained elevated at 7.1% y/y in May, it had declined since April as the annualised growth rate in the fuel price had eased. The other subcomponent that saw price pressures easing was alcoholic beverage prices, although the effect on headline CPI was inconsequential.
- We expect a gradual uptick in CPI through the course of the year as a result of rising food, transport, electricity and services costs. However, some of the upside will likely be capped by weak domestic demand and any decline in the international oil price. Our forecast for CPI remains unchanged at 4.7% and 5.3% for 2019 and 2020, respectively, with risks to the outlook more or less balanced. We believe CPI will remain well below the 6% upper target band over the long run in the absence of a severe drought.

Table 2: Nedbank CIB inflation estimates

Nedbank CIB Markets Research estimates						
Average	CPI	Core	Food	Oil	USDZ	Electricity
2018A	4.6	4.3	3.3	71.6	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

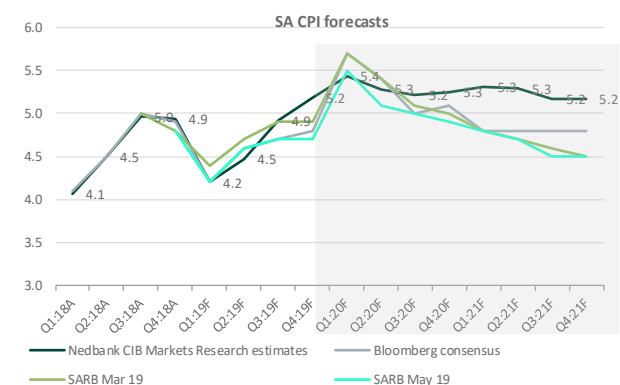
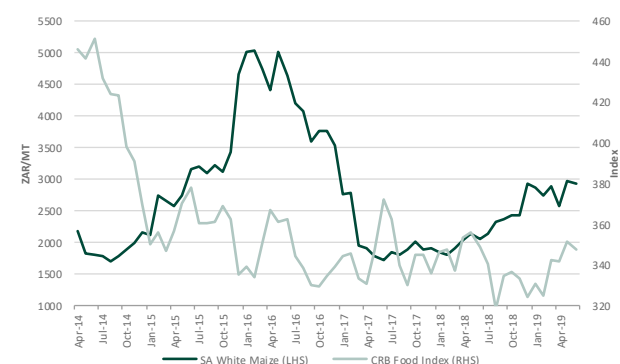


Chart 21: Food prices remain disinflationary, but could rise in the coming months



Source: Bloomberg, Nedbank CIB Markets Research

MONETARY POLICY DYNAMICS: SA

Dovish Fed may prompt SARB rate cut

- A dovish tilt to the Fed has opened up the possibility of a Fed rate cut this month as the Fed tries to prompt inflation and prevent the economy from falling into a recession. This significant shift away from our forecast for a flat Fed funds target rate this year does imply further room for the SARB to loosen monetary policy in the near term, in our opinion.
- A dovish Fed enabled a rally in the rand in June to below the implied starting point for the USDZAR in the SARB's QPM. This would aid the SARB's CPI forecasts, along with a 6% decline in the Brent crude price since the May MPC meeting. A weaker growth trajectory would imply a wider output gap, further loosening the implied policy path in the QPM.
- The SARB's Quarterly Bulletin highlighted what seems to be a structural shift in wage growth in the SA economy: "On an annual average basis, growth in nominal remuneration per worker moderated from 6.4% in 2017 to a record low (since the inception of the data in 1971) of 4.7% in 2018. For 2018 as a whole, growth in nominal unit labour costs slowed to 4.4% – its slowest pace since 2007 – indicative of the lack of wage pressure in the domestic economy."
- Although this is due to very weak real growth and the fifth consecutive quarterly contraction in real gross fixed capital formation, as even trade union inflation expectations have come down sharply recently. By far, private-sector employees have been hard hit, with almost all industries recording negative real wage growth. While public-sector wage growth moderated to 6.9% in 4Q18, and halved from 10.7% in 2017 to 5.3% in 2018, it remains above the CPI midpoint.
- While risks to the growth outlook remain to the downside, risks to the inflation outlook remain balanced. Although 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 could see a marginal reduction in the SARB's CPI and growth forecasts at its upcoming MPC meeting that could prompt a more dovish monetary policy stance. We, therefore, believe there is a high likelihood of a SARB rate cut this month.

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

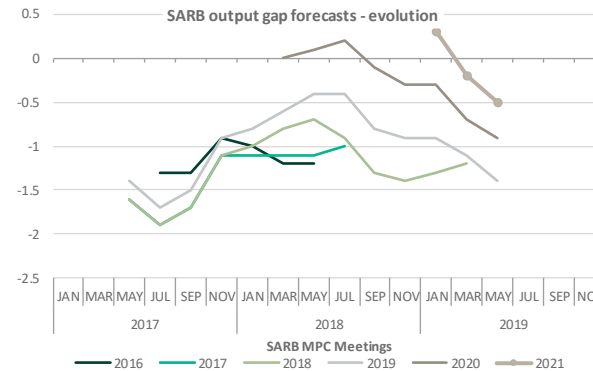


Chart 24: SARB's inflation forecasts are well below its 2016 and 2017 estimates

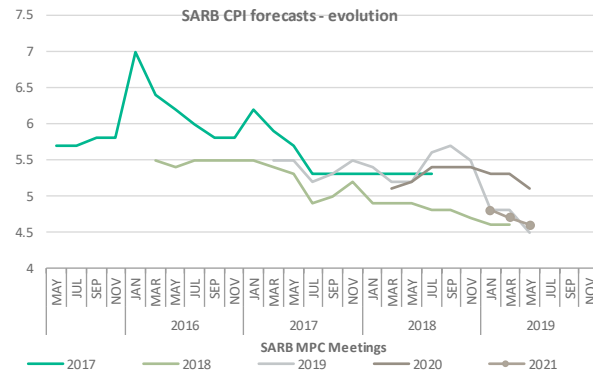


Chart 23: SARB revises 2018 growth estimate sharply lower

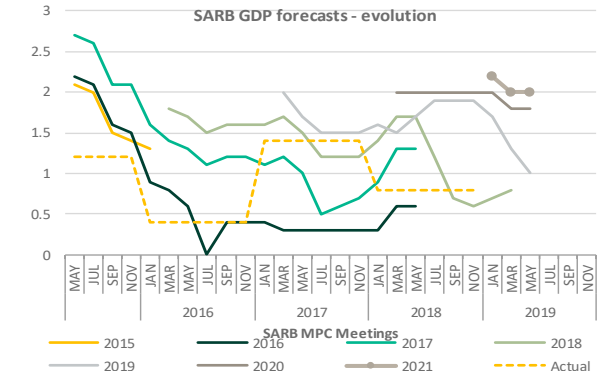
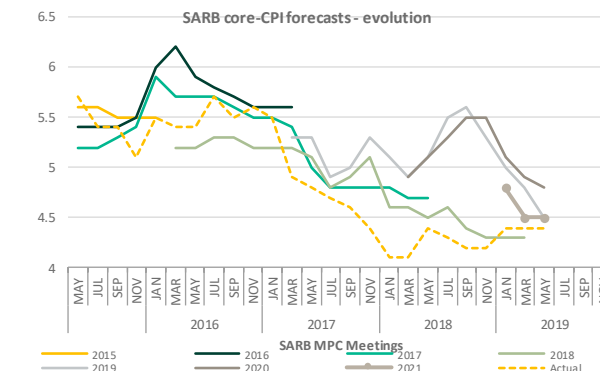


Chart 25: Core inflation estimates revised lower, signaling lack of demand-pull inflation



Source: Bloomberg, SARB, Nedbank CIB Markets Research

CREDIT RISK COMPARISON

Moody's views election result as positive, in contrast to Fitch

- Moody's released a credit opinion on SA's sovereign credit rating after the presidential inauguration and the announcement of the new Cabinet. The following are some key highlights from the communication:
 - Moody's believes that the comfortable majority held by the ruling party will allow the president to advance implementation of his reform agenda. This includes raising potential growth and productivity, attracting investment, reducing government debt and strengthening state institutions.
 - The new Cabinet is likely to remain committed to the reform efforts. Moody's highlighted the reappointment of Finance Minister Tito Mboweni and Public Enterprises Minister Pravin Gordhan as they try to lead the president's efforts to improve the fiscal trajectory and address the financial and operational problems within Eskom and other SOEs.
 - Despite this, we believe the 1Q growth disappointment will weigh on revenue collection – this has compelled Moody's to reduce its growth forecast to 1% for 2019 from 1.3% previously and to raise its main budget deficit forecast to 5.2% of GDP from 4.9% previously.
 - Moody's includes Eskom's government-guaranteed contingent liabilities in its calculation of total government debt, which it sees rising above 70% of GDP by 2022.
- Importantly, Moody's hinges its rating trajectory for the sovereign on potential structural reform that could raise potential growth. However, all rating agencies have been warning of the hazards of not implementing structural reform for the better part of the past five years. We believe there is a high likelihood of a Moody's outlook change to 'negative' from the current 'stable', after the MTBPS. Further growth disappointments would also weigh on the rating and the outlook over the medium term. In the absence of a solid improvement in growth projections, we believe Moody's Baa3 (stable) credit rating of SA's LT FC and LC debt will be reduced to non-investment grade within the next 12 months.
- In contrast, Fitch Ratings has indicated that the government is even more constrained after the elections, following the drop in support for the ruling party, which could fuel populist policies. Hence, it believes that the reform momentum will be weak and that this will continue to weigh on potential growth and the sovereign's BB+ (Stable) credit rating.

Table 3: A summary of SA's credit ratings

Moody's		S&P		Fitch		<SA Credit ratings>
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-1		A+
A2	A	A				
A3	A-	A-				
Baa1	P-2	BBB+	A-2	BBB+	F2	Lower medium grade
Baa2		BBB		BBB		
Baa3 (stable) FC+LC	P-3	BBB-	A-3	BBB-	F3	
Ba1		BB+ (stable) LC		B		
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						

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

Chart 26: SA is among the high-risk EMs

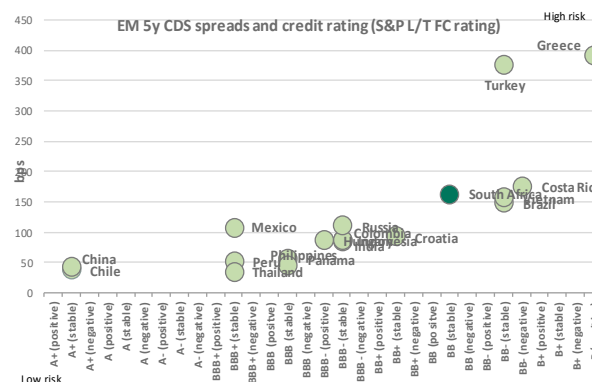
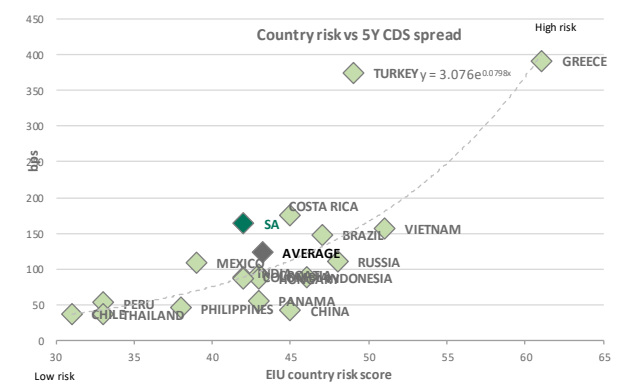


Chart 27: SA's above-trend credit risk score



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

SA'S BOND MARKET

Mid-year rebalancing and a dovish Fed caused SAGB yield curve to flatten

- While the SAGB curve remained steep for most of the month, rebalancing and half-year-end flows triggered a flattening bias in the last week of June. Expectations of a 'trade truce' between the US and China at the G20 meeting also fuelled risk-on sentiment, enabling EM assets to post a rally at month-end. As a result, SA stocks were supported, the 5y CDS spread narrowed sharply and bond yields were supported.
- The Fed's pivot was also a key factor supporting risk assets globally, as the market is now pricing in two interest rate cuts by the Fed this year as the Fed tries to be proactive and prevent the economy from falling into a recession. We believe that local country risk remains elevated, despite the decline in local yields as an extension of the move in UST yields. Weak growth and a deteriorating fiscal backdrop necessitating greater debt issuance will likely maintain a steeper curve, in our view. However, near-term risk sentiment has been driven by the trade war and other global developments and not local fundamentals.
- Due to a dovish Fed and dovish SARB, the FRA market is now projecting a 54% probability of a 25bps rate cut by the SARB at its meeting this month, and a 110% probability of a 25bps cut in November. We believe that in the absence of a blowout in the rand exchange rate, the SARB may reduce interest rates this month as inflation remains close to its 4.5% inflation target.
- Our fair value estimate of SA's 10y R2030 bond yield is now 9.25% vs 9.20% previously. The marginally higher yield takes into account a higher credit risk component. We see our fair value estimate as a 6- to 12-month view. We expect further curve steepening in the absence of an increase in risk appetite, as higher credit risk raises yields in the long end portion of the curve, while the front end continues to price in a SARB cut.

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

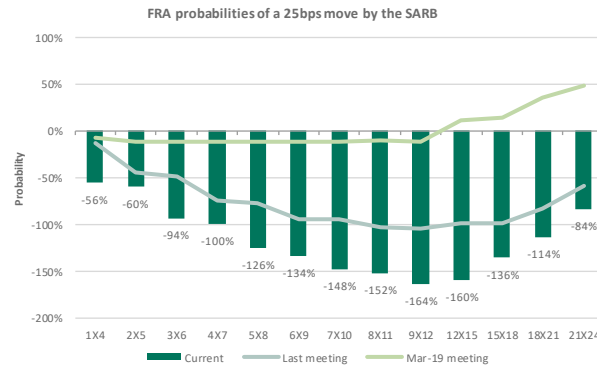
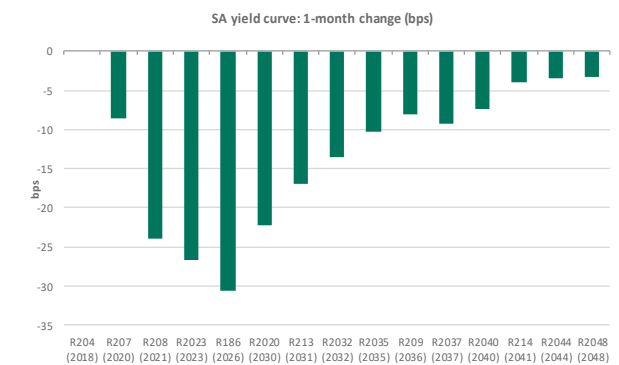


Chart 29: Yields decline across the curve due to Fed cut expectations



THE RAND AND KEY RISKS

USDZAR sharply stronger, prompted by looser global monetary policy expectations

- The USDZAR appreciated by 3.4% in June as risk sentiment improved amid expectations of looser monetary policy in the US and Eurozone. A temporary trade truce between the US and China at the G20 meeting also aided the rand and other EM FX as the JP Morgan EM FX Index appreciated by 2.4% in June.
- Against the crosses, the rand appreciated by 2.9% against the GBP and 1.7% against the EUR. The trade-weighted rand gained 2.8% over the same period. However, the main reason for the rand's fortunes in June was a more dovish Fed, which caused the USD index to weaken by 1.8% as the search for yield resumed amid expectations of a Fed rate cut.
- Looking 12 months ahead, the question for the rand against the USD is whether the SARB could turn more dovish than the Fed, i.e., whether the SARB could cut more than 50bps within the next 12 months. We doubt this, but believe it is possible for the Fed to cut by more than 50bps. On balance, a more dovish Fed than SARB beyond the next 12 months would offset some rand weakness that may be induced by SA's precarious fiscal position.
- Technically, we expect a consolidation phase after testing 14.12, followed by another wave to the downside. Extended target levels for the USDZAR correction are 13.86 and then the previous low of January 2019 at 13.20 (see [Technical Strategy Note](#) dated 25 June 2019).
- However, from a fundamental perspective, we still do not believe strength beyond 14.00 is sustainable. Just as we sold USD into strength above the 14.50 level, we will buy USD into weakness below the 14.00 level (see [SA FX Insight: No new local risks introduced](#) dated 31 May 2019).
- In fact, as pointed out in our previous report, we firmly believe the bias for the currency has shifted more towards weakness than less on a multi-month view (see [SA FX Insight: Value is built on trust](#) dated 14 June 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

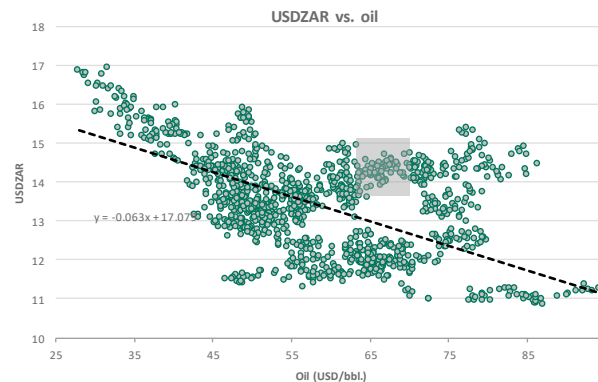


Chart 33: ZAR pulls back in the near term

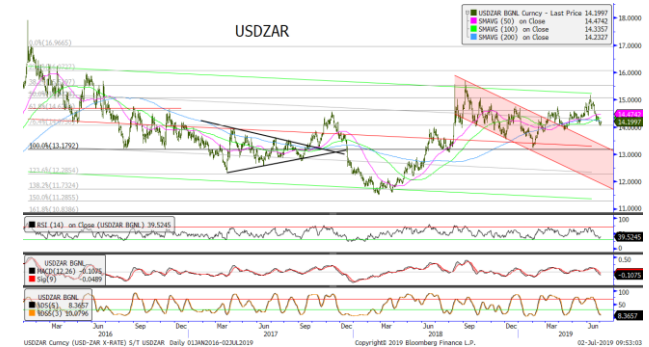
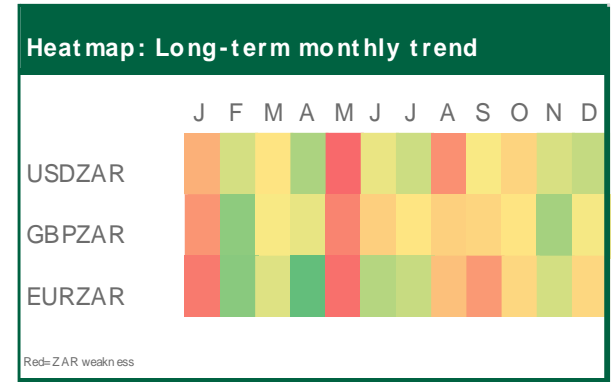


Chart 35: Heat map suggests that the rand is likely to remain volatile



Source: Bloomberg, Nedbank CIB Markets Research

THE RAND AND KEY RISKS

All EM currencies gain in June as a result of a weaker USD, dovish Fed

- All EM currencies posted gains against the USD in June as the USD depreciated due to a dovish Fed and yield-seeking market sentiment. The best-performing currency was the Argentine peso, which appreciated by 5.44% against the USD, while the worst-performing currency was the Hong Kong dollar, which appreciated by 0.35%.
- Global event risks remain the key driver of risk sentiment, with the US-China trade negotiations being key. For now, this risk seems to have been alleviated, with the two nations placing new tariffs on hold. Further uncertainty over Brexit negotiations, geopolitical tensions between the US and Iran, and global central bank monetary policy responses are all likely to remain key risks to the strengthening EM FX trend we have seen thus far. 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.
- For SA specifically, we await Eskom's financial results in the coming days, with a special appropriation to be passed in Parliament to allow the National Treasury to expedite the release of bailout funds for Eskom. The MTBPS in October will remain on our and the credit rating agencies' radars, while a Moody's sovereign credit rating review is scheduled to take place on 1 November.
- Our core view on the USDZAR, 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

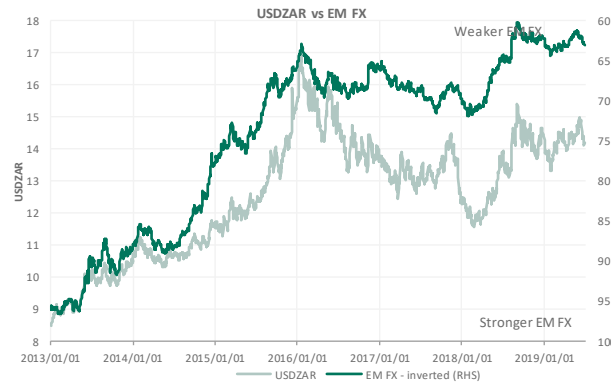


Chart 38: EM FX recovers somewhat in 2019, although unlikely to sustain rally

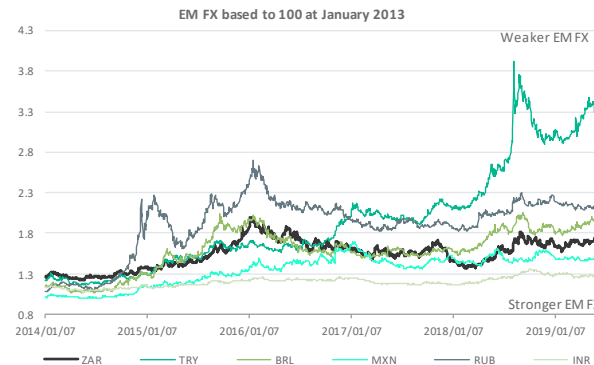


Chart 37: IIF: Only Indonesia and Mexico stand out; SA continues to see very weak flows

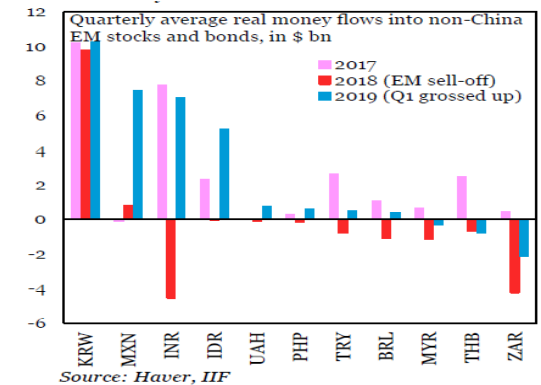
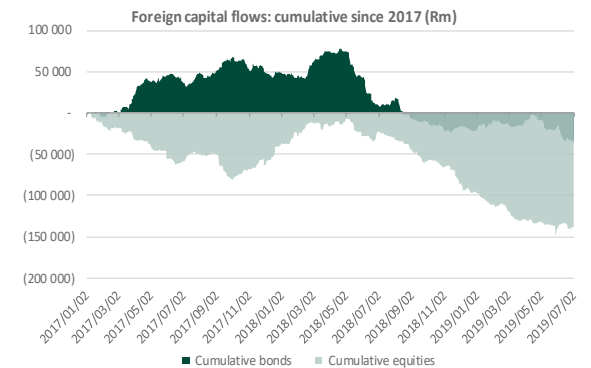


Chart 39: Foreign capital flows are an extension of ZAR weakness in 2018



Source: Bloomberg, IIF, Nedbank CIB Markets Research

Equity markets experience an about-turn in June

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

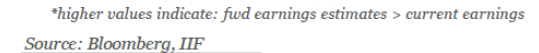


Chart 42: Global risk-on since December sees some recovery in equity indices



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 – Nigeria 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 – Turkey 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 – Indonesia general elections 12-24 Apr – Spring meetings of the World Bank and IMF Apr/May – India general elections	01 May – US FOMC meeting 02 May – UK local elections 08 May – SA national elections 13 May – Philippines 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 – Russia 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 – Canada 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's 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
07/03/2019	09:15	Standard Bank South Africa PMI	Jun	49.3
07/03/2019	11:30	SACCI Business Confidence	Jun	93
07/04/2019	13:00	Electricity Production YoY	May	1.80%
07/04/2019	13:00	Electricity Consumption YoY	May	1.60%
07/05/2019	08:00	Gross Reserves	Jun	\$48.33b
07/05/2019	08:00	Net Reserves	Jun	\$43.18b
07/11/2019	11:30	Mining Production YoY	May	-1.50%
07/11/2019	11:30	Mining Production MoM	May	-2.30%
07/11/2019	11:30	Gold Production YoY	May	-19.50%
07/11/2019	11:30	Platinum Production YoY	May	1.70%
07/11/2019	13:00	Manufacturing Prod NSA YoY	May	4.60%
07/11/2019	13:00	Manufacturing Prod SA MoM	May	2.80%
07/17/2019	13:00	Retail Sales Constant YoY	May	2.40%
07/17/2019	13:00	Retail Sales MoM	May	0.80%
07/18/2019	09:00	Bloomberg July South Africa Economic Survey		
07/18/2019		SARB Announce Interest Rate	18-Jul	6.75%
07/23/2019	09:00	Leading Indicator	May	105.5
07/24/2019	10:00	CPI YoY	Jun	4.50%
07/24/2019	10:00	CPI MoM	Jun	0.30%
07/24/2019	10:00	CPI Core YoY	Jun	4.10%
07/24/2019	10:00	CPI Core MoM	Jun	0.00%
07/25/2019	11:30	PPI YoY	Jun	6.40%
07/25/2019	11:30	PPI MoM	Jun	0.50%
07/29/2019	08:00	Money Supply M3 YoY	Jun	9.07%
07/29/2019	08:00	Private Sector Credit YoY	Jun	7.66%
07/30/2019	11:30	South Africa Unemployment	2Q	27.60%
07/30/2019	14:00	South Africa Budget	Jun	-17.5b
07/31/2019	14:00	Trade Balance Rand	Jun	1.7b

Source: Nedbank, Bloomberg

Source: Bloomberg, Nedbank CIB Markets Research

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	-3.17	2.00	1.70	2.10	0.50	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	14.731	14.584	14.875	14.875	14.726	14.947	15.097	15.323	15.323	15.331	15.484	15.639	15.874	15.874
EURZAR	16.447	16.396	16.396	16.200	16.442	16.442	16.116	16.277	16.439	16.603	16.603	16.447	16.529	16.694	16.860	16.860
GBPZAR	18.256	19.077	19.077	18.792	19.168	19.168	18.789	19.071	19.165	19.356	19.356	19.463	19.658	19.815	20.012	20.012
AUDZAR	10.347	10.357	10.156	10.044	10.286	10.286	10.133	10.326	10.408	10.543	10.543	10.496	10.644	10.736	10.868	10.868
ZARJPY	7.674	7.583	7.433	7.546	7.398	7.398	7.435	7.325	7.289	7.217	7.217	7.177	7.106	7.071	7.001	7.001
GBPUSD	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
EURUSD	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	6.791	6.805	6.811	6.811	6.818	6.852	6.866	6.873	6.873	6.880	6.914	6.923	6.935	6.935
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	7.15	6.90	6.93	6.93	6.93	6.92	6.91	6.93	6.93	6.94	6.93	6.91	6.90	6.90
Prime	10.25	10.25	10.25	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00
Long bond (10-yr)	9.22	8.99	8.85	8.65	8.70	8.70	8.75	8.60	8.55	8.50	8.50	8.40	8.60	8.65	8.40	8.40
CPI % (EOP)	4.49	4.52	4.43	4.61	4.91	4.91	5.42	5.00	4.96	5.01	5.01	5.08	5.05	5.05	5.05	5.05
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)

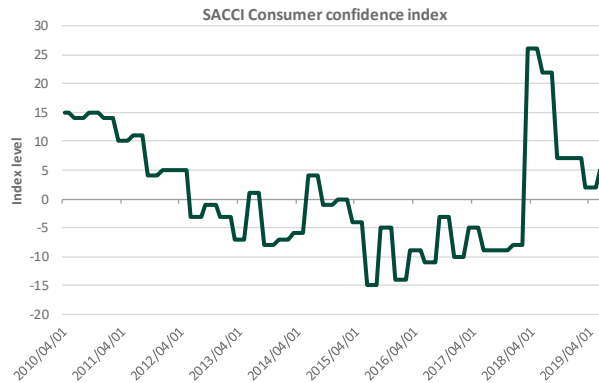


Chart 45: BER Manufacturing PMI (monthly)

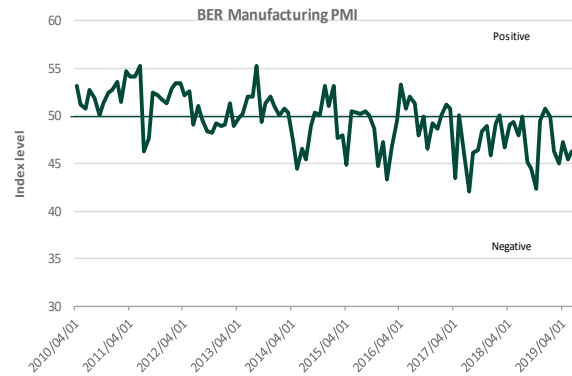


Chart 46: SA CPI y/y percentage (monthly)

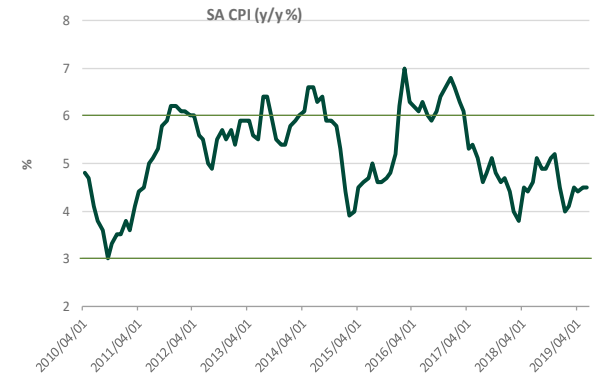


Chart 47: SA repo rate (monthly)

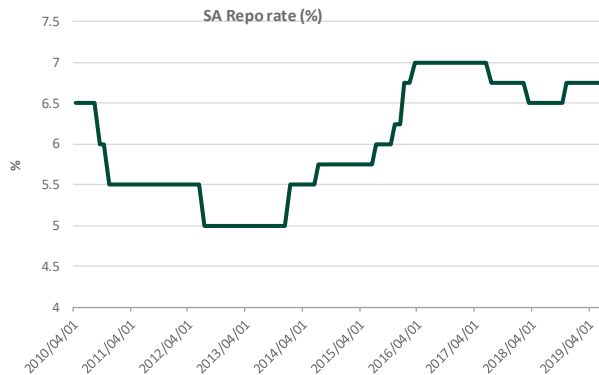


Chart 48: SA 10y generic bond yield (monthly)

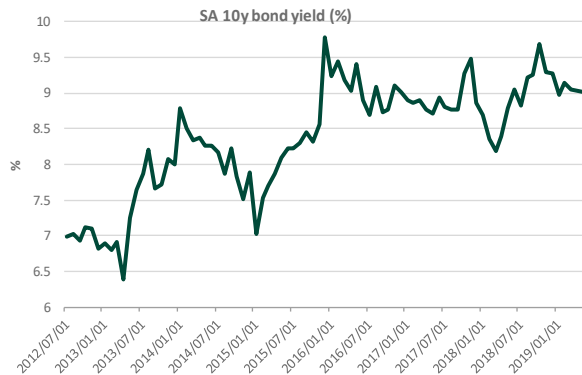
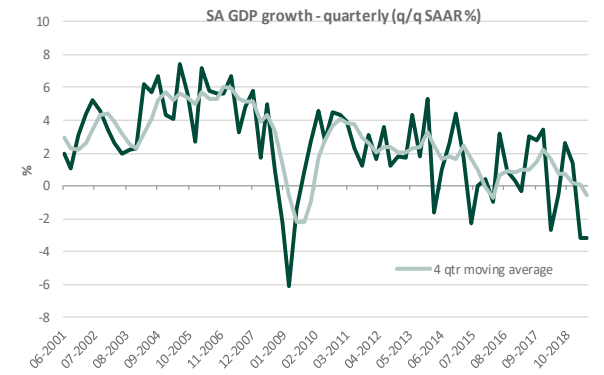


Chart 49: SA GDP growth q/q % SAAR (quarterly)



Source: Bloomberg, Nedbank CIB Markets Research