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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

Fed disappointment and Trump trade war fuels risk-off

- Policymakers from the Fed to the ECB believe that a key risk to the global economy is the uncertain trade conditions being stoked by the US and China. The Fed has come under increasing criticism from President Trump to ease policy as fast as his DM peers, while the ECB is grappling with a weak inflation outlook, fuelling calls for further QE. The BoE remains stuck in limbo as it forecasts higher policy rates over the medium term but has conceded that it may need to reduce interest rates if a 'no-deal' Brexit becomes a reality.
- SA GDP posted a recovery in Q2, with real GDP growth rising to 3.1% q/q in Q2, from -3.1% in Q2 (revised from -3.2%), ahead of consensus of +2.5%. On an annualised basis, GDP rose 0.9% y/y, from no growth in Q1, better than consensus of +0.7%. The main reason for the surge in growth is due to the low base effect in Q1, and not necessarily any significant improvement in the economy. While the Q2 recovery is welcome, confidence levels remain weak, and if it wasn't for dangerously low inventory levels, the secondary industry would have remained in the doldrums as well. We have seen sales of minerals and manufactured items start to slow down recently, and so the inventory rebuild comes at a time when both domestic and international demand is under pressure. This implies that growth in the last two quarters of the year will need to be driven by services, utilities and agriculture because output from the secondary industry may falter – we have already seen this in the PMI slump in August. Hence the potential for a disappointment is high, given recent downsizing taking place in the tertiary sector.
- SA's CPI fell sharply to 4.0% y/y in July, from 4.5% in June, well below estimates of 4.3%. The Fed reiterated its willingness to support the US economy in the event of deterioration in economic data, warranting further reductions to the US Fed funds rate. The fact that central banks are currently dovish globally has resulted in the SA FRA curve pricing in a 39% probability of a 25bps reduction in the repo rate at the SARB's MPC meeting later this month. The FRA market is also pricing in an 83% probability of a 25bps cut at the SARB's November MPC meeting. We still believe there will be room for a further repo rate cut if inflation and inflation expectations remain anchored, if growth surprises to the downside and the Fed eases the Fed funds rate further this year.
- The USDZAR weakened 7.2% in August, with the bulk of this move coming after the Fed's interest rate decision, which was viewed as neutral and strengthened the dollar. Local headwinds also added pressure on the currency, as political infighting persisted, policy uncertainty remained high, after a NT white paper on growth did not garner much support from politicians, and the fiscal outlook continued to worsen. Against the crosses, the rand depreciated 6.7% against the GBP and 5.8% against the EUR in August – here again, the bulk of the weakness came shortly after the Fed's policy meeting, with the crosses effectively remaining unchanged since early August. The trade-weighted rand weakened 5.5% in August.

	Current price/yield	Core views	Target levels		
USDZAR	15.17	We maintain the view that the rand trading between 14.00 and 14.50 reflects better local and external risks. However, current period of rand weakness could be sustained until MTBPS and Moody's review	3-month	15.10	
			6-month	14.50	
			12-month	14.10	
Repo rate	6.50	We believe that the repo rate will remain unchanged at the next meeting, but that the door is still open for a further 25bps cut, possibly in November 2019			
SAGBs	6.57 (R208)	Our fair value estimate of SA's 10y R2030 bond yield remains at 9.25% with a US 10y yield fair value of 2.50%. If we reduce the US 10y fair value to 2.00% instead (due to benign US inflationary pressure and falling real yields), our SA 10y R2030 fair value falls to 9.05%. 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 marginally price in a SARB cut.	3-month	6.7	
			Year-end	6.4	
	8.12 (R186)			3-month	8.9
				Year-end	8.6
	9.79 (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

Global CPI lull prompted by lower factory costs (ex. UK)

- Global inflation rates remain low, despite the uptick in China's and the UK's CPI in July. The US is still exporting deflation to the rest of the world, with US export prices contracting by 0.9% y/y in July. Low CPI is being driven by depressed factory gate prices, with the OECD G7 PPI falling to deflation in June, for the first time since October 2016.
- China's CPI rose by 10bps to 2.8% y/y in July, better than consensus of 2.7%. Food, tobacco, medical care and other costs surged, causing the uptick in July. China's PPI fell to deflation in July, at -0.3% y/y, worse than consensus of -0.1%. This is the first time since September 2016 that producer costs are in deflation. PPI was weighed down by a fall in commodity and raw material prices. Since China is the biggest exporter in the world, it will likely export this deflation to the rest of the world and weigh on global inflationary pressures.
- The UK's CPI also rose by 10bps in July, from 2.0% y/y in June, better than consensus of 1.9%. Core inflation saw a similar rise to 1.9% y/y, while the UK's PPI surged to 1.3% y/y, from 0.3% in June. The UK remains an outlier relative to peers, as the weak GBP has kept import costs elevated, propping up headline CPI since the Brexit referendum.
- The Eurozone's core CPI fell to 0.9% y/y in July, from 1.1% in June, in line with consensus. Its headline CPI fell to 1% y/y, from 1.1% previously. The main reason for the fall in both headline and core is the drop in services inflation to 1.2% y/y in July, from 1.6% in June. A slump in energy costs also weighed on headline CPI.
- In the US, headline CPI jumped to 1.8% y/y in July, from 1.6% previously, better than consensus of 1.7%. Core inflation also surged to 2.2% y/y, from 2.1% in June. The main reason for the uptick was higher services, energy, transportation and commodity prices. On the other hand, the US PCE deflator remained subdued at 1.4% y/y in July, while the core deflator benefited from the uptick in service costs, but remained below target at 1.6% y/y.
- 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.

Source: Bloomberg, Nedbank CIB Markets Research

Table 1: Summary of economic and financial indicators

Economic, fiscal and monetary indicators Available data as at 03-Sep-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	3.4	3.3	135	136	2	3.1	51.2	51.7	-0.22	0.17	-4.51	-4.36	2.25	2.25
UK	3.3	3.8	-14	-11	-0.2	0.5	47.4	48	-0.6	0.5	-1.27	-1.1	0.75	0.75
Eurozone	2.6	1	-7.1	-6.6	0.2	0.4	47	46.5	-2.6	-0.8	-0.65	-0.53	0	0
Japan	-2	0.5	37.1	37.8	1.8	2.8	49.3	49.4	0.7	-3.8	-2.54	-2.96	-0.1	-0.1
Turkey	2.35	0.54	58.5	56.7	0.3	0.66	48	46.7	-3.85	-1.3	-2.63	-2.29	19.8	19.8
China	7.6	9.8	126	123	6.2	6.4	49.5	49.7	4.8	6.3	-8.3	-5.3	4.35	4.35
Brazil	-0.3	1	89.2	88.1	0.4	-0.1	52.5	49.9	-5.9	7.4	-6.84	-6.99	6	6
Russia	1	1.4	68.3	71.3	0.9	0.5	49.1	49.3	2.8	3.3	2.69	2.55	7.25	7.25
India	4575	4673	47.8	46.1	5	5.8	51.4	52.5	2	4.6	-3.35	-3.39	5.4	5.75
Mexico	1	2.8	105	106	0.02	-0.26	47.4	48.9	-2.91	-3.29	-1.7	-1.79	8	8.25
South Africa	2.4	2.3	5	2	3.1	-3.1	45.7	52.1	-3.2	0.4	-5.28	-4.73	6.5	6.75

Chart 1: Global inflation trend subdued

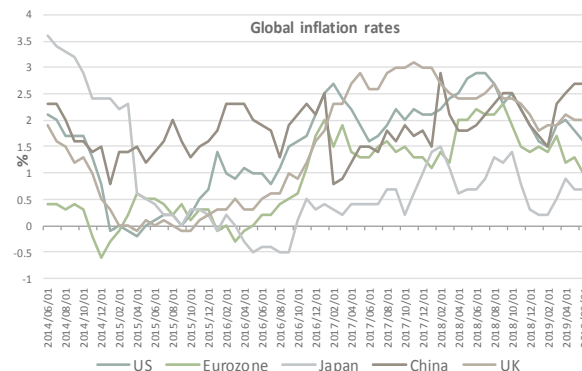
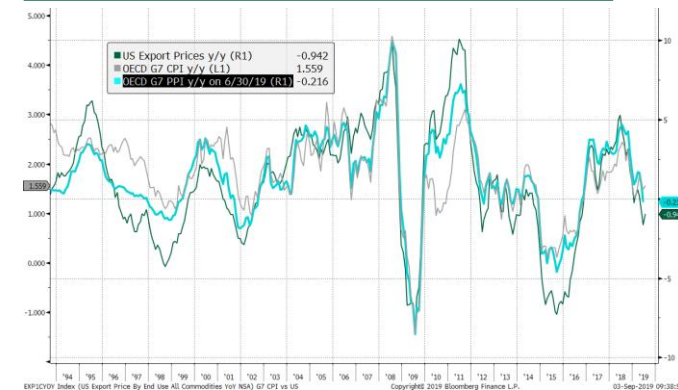


Chart 2: G7 input costs are in deflation



GLOBAL DEVELOPMENTS

Jackson Hole outlines the incapacity of monetary policy to deal with geopolitical shocks

- The major global financial event in August was the Jackson Hole conference. There was general consensus among policymakers and academics that the global economy cannot be cushioned against geopolitical shocks by using monetary policy. Instead, infrastructure investment and structural reform would remain the major catalysts for economic prosperity. The IMF has also voiced concern over the single biggest risk we currently face, which is the trade war between the US and China. The IMF estimates that an escalation in the trade war would subtract 50bps from global growth in 2020. However, a full-blown recession may be far off, according to IMF research. While the inversion of the US yield curve (the spread between 10y and 2y yields) does signal greater demand for safer assets, the IMF argues that asset prices are still elevated and that the market is not switching away from equities and into bonds. The inversion is merely a reflection of low inflation expectations, and ultra-low policy rates. Consumer spending is still very upbeat in the US, while in developed economies labour markets are still strong, supporting consumer spending.
- The UK economy contracted by 0.2% q/q in 2Q, from growth of 0.5% in 1Q, worse than expectations for no growth. Household demand weakened and gross fixed capital formation contracted sharply, while net exports also contributed negatively towards growth. The uncertainty over Brexit is causing businesses to hold back investment in the economy. This has also led to limited long-term planning by businesses.
- Japans' GDP growth eased to 0.4% q/q in 2Q, from 0.7% in 1Q, better than consensus of 0.1%. Domestic demand picked up in 2Q, driven by household consumption. Government consumption was also higher, with both factors offsetting weakness in private and public investment growth, while net exports declined. The economy is being buoyed by local consumption, whereas global demand has weakened – this has hampered exports from Japan, even while import growth has risen on the back of strong domestic demand.
- The Eurozone's GDP growth eased to 0.2% q/q in 2Q, from 0.4% in 1Q, in line with consensus. Growth slowed to a five-year low of 1.1% y/y, weighed down by sluggish growth in Germany. The German economy contracted by 0.2% q/q in 2Q, from 0.5% in 1Q, the weakest pace of growth since 1Q 2009. The slump in German exports, driven by weak global demand, has been the key reason for Germany's contraction and the slowdown in the Eurozone.
- US GDP growth eased to 2% q/q in 2Q, from 2.1% in the first estimate, down from 3.1% growth achieved in 1Q. While personal consumption surged in 2Q, gross private investment contracted sharply, along with net exports. Exports declined as the trade uncertainty intensified and global growth eased. The US consumer drives economic activity, and we believe the fact that consumer spending rebounded sharply in 2Q bodes well for full-year growth. There are still downside risks emanating from global trade, geopolitical tensions and weak global demand that may weigh on US growth over the medium term.

Chart 3: Major PMIs are now contractionary

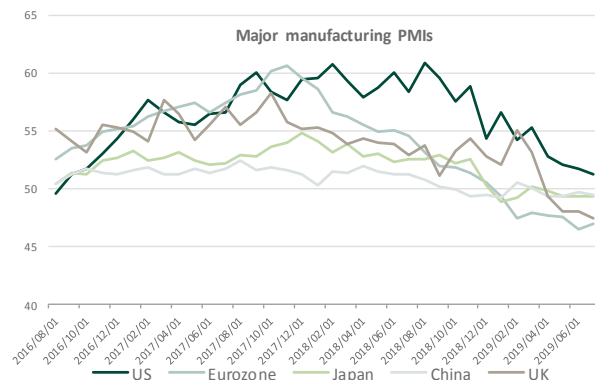


Chart 4: Global manufacturing activity falls sharply as a result of lower growth

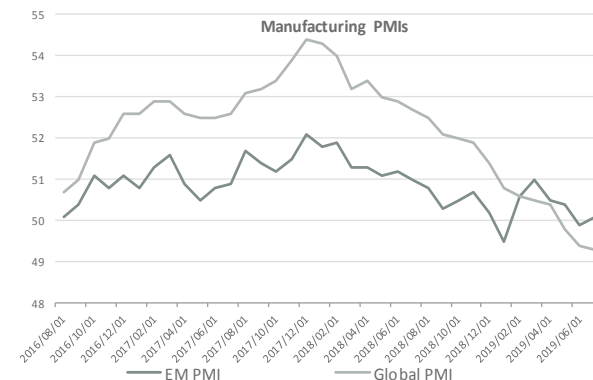


Chart 5: EM PMIs are mixed

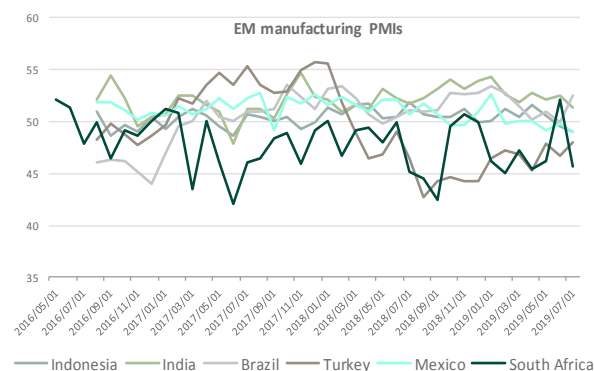
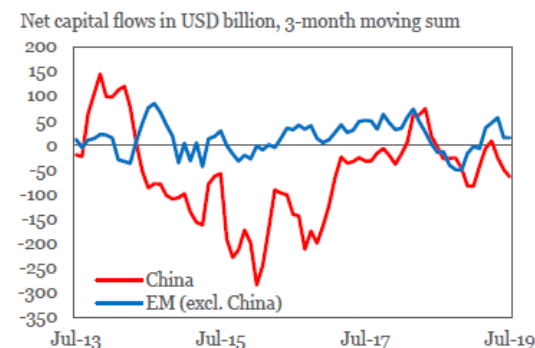


Chart 6: IIF: Appetite for EM assets

Exhibit 3. EM Net Capital Flows Tracker



Source: Bloomberg, IIF, Nedbank CIB Markets Research

Source: IIF

MONETARY POLICY DYNAMICS: GLOBAL

Policymakers in a quagmire over global geopolitical tensions

- Policymakers from the Fed to the ECB believe that a key risk to the global economy is the uncertain trade conditions being stoked by the US and China. The Fed has come under increasing criticism from President Trump to ease policy as fast as his DM peers, while the ECB is grappling with a weak inflation outlook, fuelling calls for further QE. The BoE remains stuck in limbo as it forecasts higher policy rates over the medium term but has conceded that it may need to reduce interest rates if a 'no-deal' Brexit becomes a reality.
- In all three cases, the market is poised for further interest rate cuts. The Fed funds futures market is seeing an 81% probability of a 25bps cut in September. The Eurozone OIS swap curve is reflecting a 67% probability of a 20bps reduction of the ECB's deposit rate to -0.60% in September, while the UK swap market is pricing in a more muted 75% probability of a 25bps cut within the next 12 months.

	Next MPC meeting	Probability of a hike/cut/hold
US	2019/09/18 20:00:00	100.00%
UK	2019/09/19 13:00:00	94.50%
Eurozone	2019/09/12 13:45:00	100.00%
Japan	2019/09/19	94.60%
China		
India	2019/10/04 08:15:00	82.10%
Mexico	2019/09/26 20:00:00	57.50%
South Africa	2019/09/19	39.20%
Updated 03-Sep-19		

Chart 7: US inflation expectations are sticky above 2%

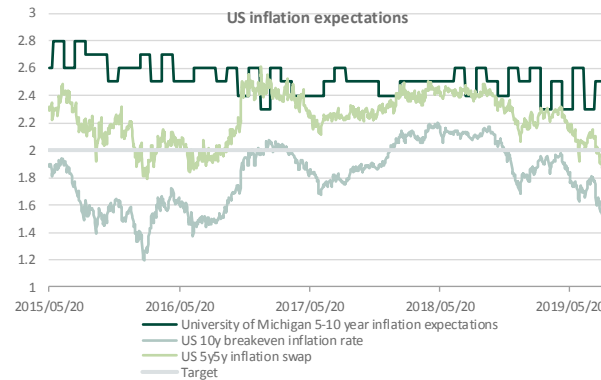


Chart 8: UK inflation remains elevated; expectations rise

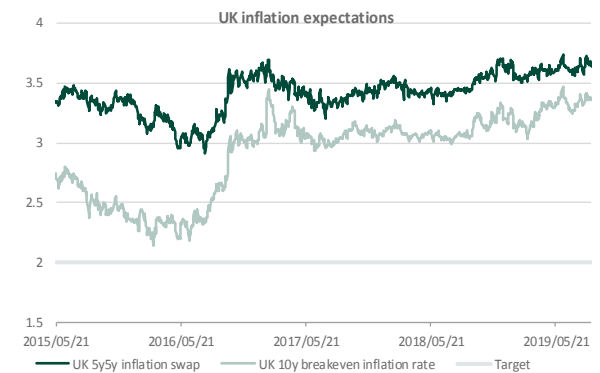


Chart 9: Eurozone swap markets more in tune with actual inflation

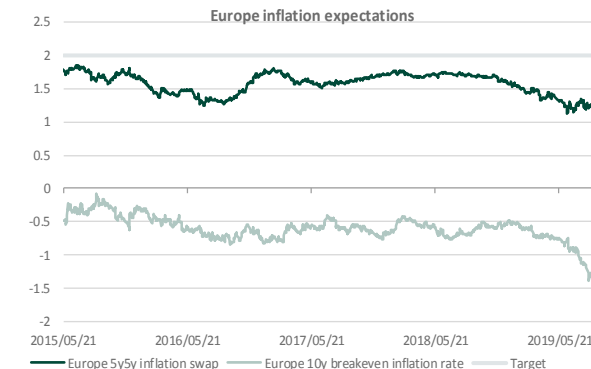
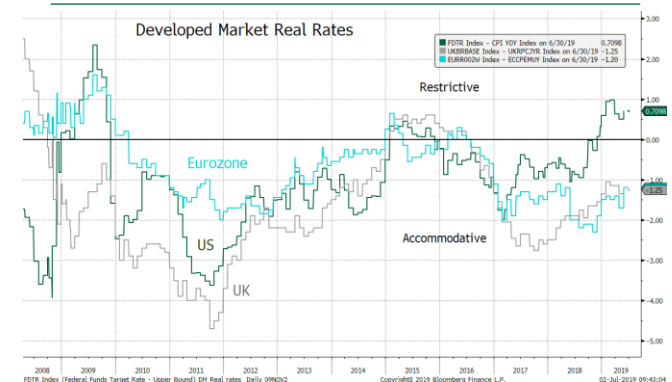


Chart 10: Real rates are now restrictive in the US



Source: Bloomberg, Nedbank CIB Markets Research

MONETARY POLICY DYNAMICS: GLOBAL

Uncertainty is back as policymakers debate the merits of QE

- Policymakers within the ECB and Fed have differing views on QE – the ECB's Lautenschlaeger has indicated that she does not see deflation risk in the Eurozone, and hence does not see the need to restart QE. Dutch policymaker Klaas Knot reiterated this view, explaining that the Eurozone economy is not weak enough to warrant further QE. This sentiment has been echoed by German policymaker Jens Weidmann. However, ECB President Draghi indicated in July that the ECB was exploring all options in order to prevent a deterioration in the economic outlook. Draghi's successor Christine Lagarde shared this sentiment, explaining that the ECB has not reached the lower bound on interest rates, keeping the door open for further cuts. Hence, we could see significant debate and dissent at the ECB's policy meeting this month.
- In the US, San Francisco Fed policymaker Mary Daly sees the US economy as still strong and has voiced concern about overly easy monetary policy in such an environment. In contrast, the Dallas Fed's Kaplan maintains an open mind on a further cut, as he believes the Fed needs to be forward-looking. The Richmond Fed's Tom Barkin has acknowledged that any threats to the US economic outlook could warrant further easing. For now, however, the economy remains strong. At the Jackson Hole conference, Fed Chair Jerome Powell said that the Fed will act as appropriate to sustain the current expansion, leaving the door open for further interest rate cuts should economic data disappoint.
- The BoE has turned more dovish recently, with Governor Carney indicating that it could ease monetary policy if the economy were to experience a 'no-deal' Brexit, but that this would depend on how demand, supply and the exchange rate are impacted by the disruptive Brexit. The BoE kept its interest rate and asset purchase programme unchanged in August, but its communication has been very volatile – it still projects a 25bps hike within the next three years to get inflation to its 2% inflation target. This compares to the market expectation of a 25bps cut, and for inflation to rise to 2.4%.
- Of the 53 most-watched central banks, five have hiked interest rates in the past three months, while 23 have reduced rates. The global monetary policy bias has clearly shifted towards further easing.

Chart 11: Fed begins loosening monetary policy

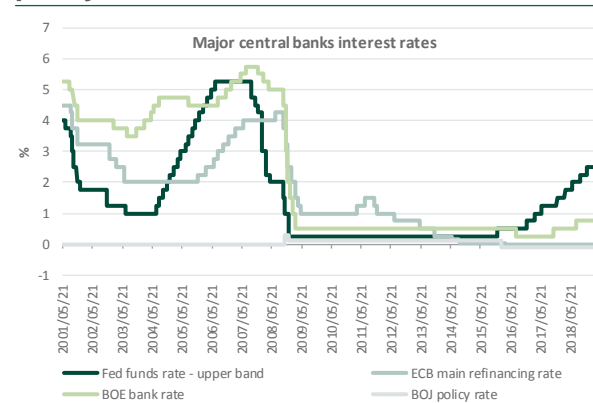


Chart 13: EM monetary policy stance broadly loose, apart from Turkey

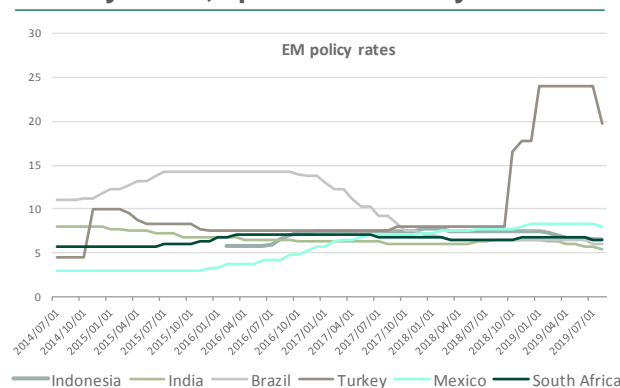


Chart 12: Global bond yields supported by weak global growth and trade uncertainty

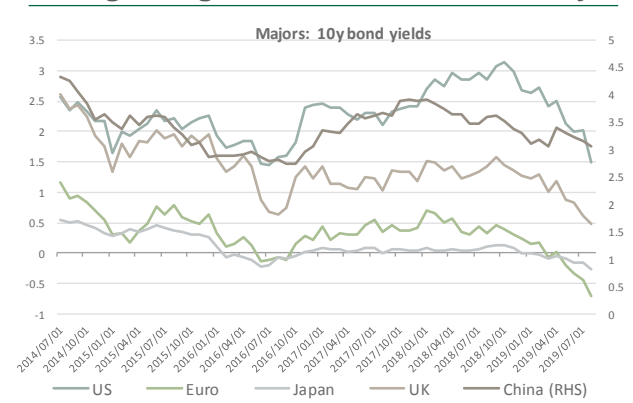
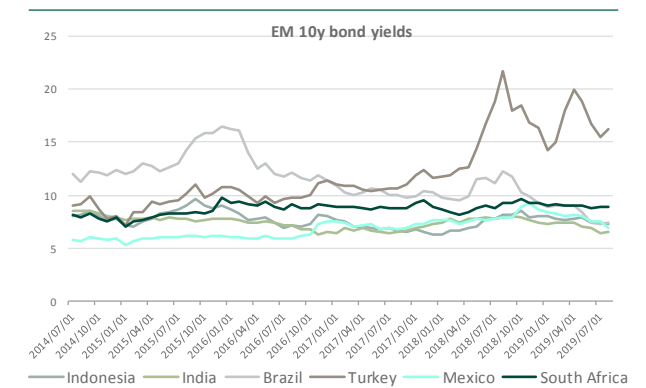


Chart 14: EM bond yields follow those of DMs



Source: Bloomberg, Nedbank CIB Markets Research

SA'S REAL ECONOMY

SA's economy remains weak despite recovery in Q2

- SA GDP posted a recovery in Q2, with real GDP growth rising to 3.1% q/q in Q2, from -3.1% in Q1 (revised from -3.2%), ahead of consensus of +2.5%. On an annualised basis, GDP rose 0.9% y/y, from no growth in Q1, better than consensus of +0.7%. The main reason for the surge in growth is due to the low base effect in Q1, and not necessarily any significant improvement in the economy. An inventory rebuild process has resulted in a sharp increase in secondary sector output in Q2, after inventories declined in previous two quarters. As a result, the mining industry grew 14.4% q/q, contributing 1% to headline growth, while trade, manufacturing, and utilities production also rose and contributed a cumulative 0.9%. Marginal negative contributions were made by agriculture and construction
- On the expenditure side, the surge in inventories meant that this was the main driver of GDE growth of 3% q/q, with inventories rising by R26bn and contributing 5.1% towards GDE growth. Household final consumption expenditure rebounded as well, rising 2.8% q/q, and contributing 1.7% towards GDE growth – spending in all product categories improved, apart from spending at restaurants. Gross fixed capital formation rose after five consecutive quarters of contraction – the 6.1% rise in GFCF was driven by investment in machinery and equipment, transport equipment and residential property.
- While the Q2 recovery is welcome, confidence levels remain weak, and if it wasn't for dangerously low inventory levels, the secondary industry would have remained in the doldrums as well. We have seen sales of minerals and manufactured items start to slow down recently, and so the inventory rebuild comes at a time when both domestic and international demand is under pressure. This implies that growth in the last two quarters of the year will need to be driven by services, utilities and agriculture because output from the secondary industry may falter – we have already seen this in the PMI slump in August. Hence the potential for a disappointment is high, given recent downsizing taking place in the tertiary sector.
- The National Treasury published a white paper on transformation, inclusive growth and competitiveness in August that essentially outlines key structural reform measures needed in SA's economy, which, if implemented, could boost SA's real GDP growth by 2-3%. The paper referenced the NDP and covered aspects such as education, training, and skills development reforms, tackling anti-competitive behaviour and promoting competitive markets, an unconstrained IRP to explore all energy policy options, and modernizing the transport, energy, water and communications industries, along with communicating a stable macroeconomic policy. Rating agencies have been assessing SA's inability to enact structural reform for at least five years now, and this has been a key hindrance to potential growth. Businesses have indicated that the problem stems from the lack of political will, and not the lack of ability, to enact such reforms.

Chart 15: SA confidence leads investment growth

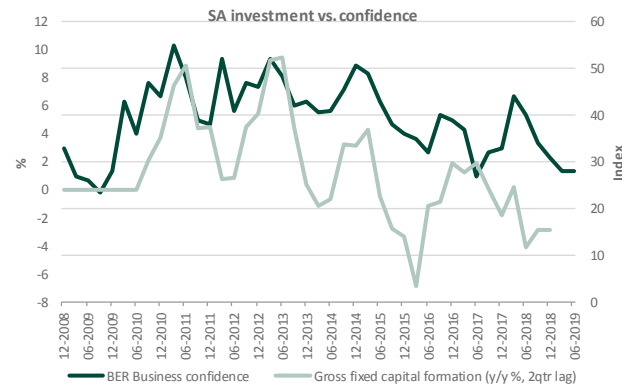


Chart 17: SA's economy needs to reduce dependence on government

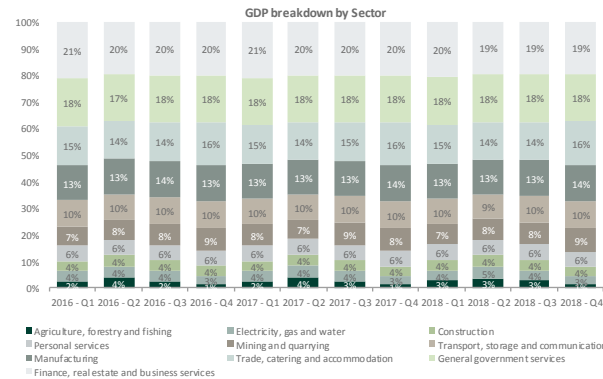


Chart 16: SARB's leading index now declines

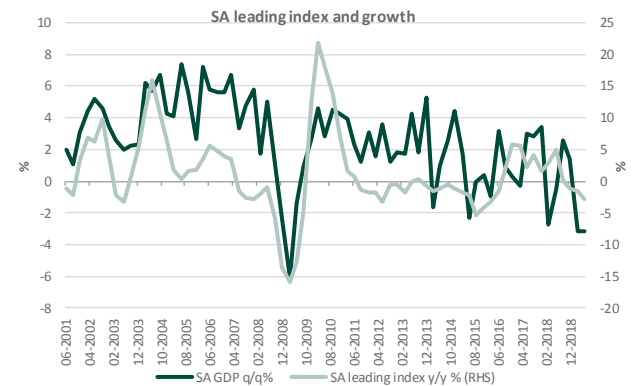
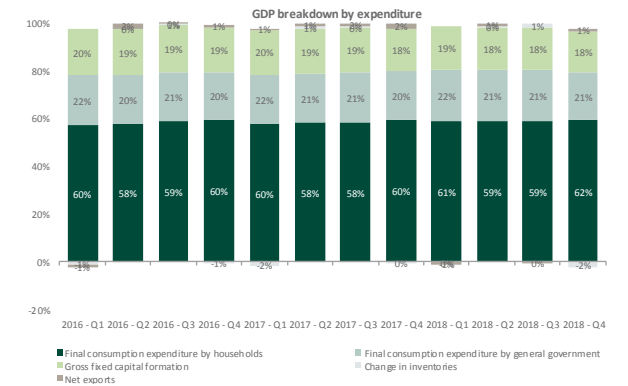


Chart 18: Spending is a key driver of economic activity



Source: Bloomberg, Stats SA, Nedbank CIB Markets Research

SA INFLATION TRENDS

SA's CPI surprises to the downside in July as transport costs slump

- SA's CPI fell sharply to 4.0% y/y in July, from 4.5% in June, well below estimates of 4.3%. Core inflation fell to 4.2% y/y in July, from 4.3% previously, as goods price inflation slumped to 3.4% y/y, from 4% previously. Services inflation was 10bps lower, at 4.7% y/y. Administered price inflation dropped to 4.7% y/y, from 6.9% previously, as a result of a sharp fall in transport costs in July.
- The main reason for the inflation slump was transport inflation falling to 3% y/y, from 5.5% in June, essentially halving its contribution towards headline inflation to just 40bps. The residual was reduced by 10bps, providing the 50bps decline in headline CPI.
- Food inflation eased marginally as higher bread and cereal prices were offset by lower dairy and processed food inflation. Weak demand resulted in price inflation at restaurants and hotels, and of recreation goods falling below 3%, and in some cases, in outright deflation. Housing and utilities inflation rose in July as a result of the higher electricity tariff, while costs of medical products, insurance and personal care items also rose.
- Due to the sharp downside surprise in inflation, we have revised our CPI forecasts to 4.4% for 2019 and 5.1% for 2020 (from 4.6% and 5.2%, respectively) – the revision mainly stems from lower electricity price inflation, as the full extent of the NERSA-approved tariff hike and RCA adjustment has not filtered into utilities CPI (electricity inflation revised to 8.8% and 9.2%, respectively, from 10.5% and 12.7%). Estimates and assumptions are alongside. The risk to this forecast is to the upside, especially if the USDZAR maintains the current shock until year-end.
- SA's PPI fell to 4.9% y/y in July, from 5.8% previously, better than consensus of 5.3%. The main driver of the PPI slump was coke, petroleum and chemical costs declining sharply. While PPI and CPI have trended together since 2017, producers and wholesalers have had to take significant margin compression since mid-2018, when producer input costs surged and producers were loath to pass these on to a very weak consumer base, keeping CPI muted and close to the SARB's 4.5% target. Since 2018, PPI has exceeded CPI by an average of 98bps, compared to the average in the previous five years of 19bps. Overall inflationary pressure remains muted, but upside risks remain should the rand maintain its weak trajectory. Food inflation is also on a gradual rise and represents a key upside risk to inflation over the medium term.
- Given the recent downside surprise in both CPI and PPI, we believe the SARB could reduce the repo rate by a further 25bps in November 2019 should SA avert a Moody's downgrade. Factors that would support this view are a further Fed rate cut, a reduction of the SARB's neutral real rate projection at its September MPC meeting, and should the rand recover to levels closer to R14.50/USD. Further downside inflation surprises would also be supportive of the repo rate projection in the SARB's QPM.

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	71.6	13.3	5.2
2019F	4.4	4.3	3.3	66.9	14.5	8.8
2020F	5.1	4.4	7.2	66.8	15.3	9.2
2021F	5.0	4.3	6.9	66.4	15.8	8.6
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	4.2	2.8	67.9	14.3	6.8
Q3:19F	4.2	4.2	3.3	66.8	14.5	10.4
Q4:19F	4.7	4.3	4.9	67.3	15.1	10.4
Q1:20F	5.2	4.4	6.6	67.1	15.1	10.4
Q2:20F	5.2	4.4	7.4	66.9	15.2	9.8
Q3:20F	5.1	4.3	7.4	66.8	15.3	8.3
Q4:20F	5.1	4.3	7.2	66.6	15.5	8.3

Chart 20: Breakeven inflation getting closer to 4.5%

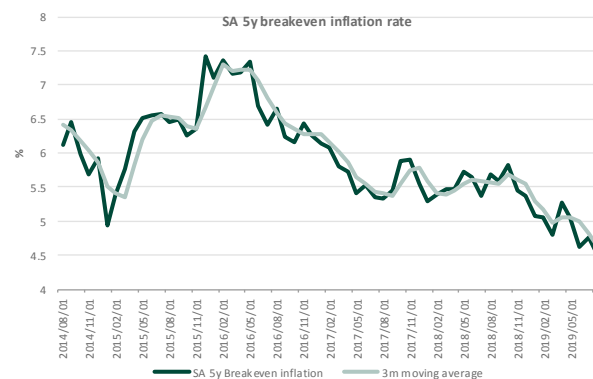


Chart 19: We expect CPI inflation to remain contained below 6% at least until 2021

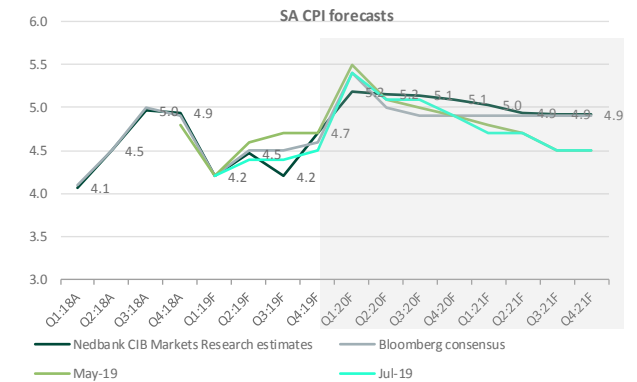
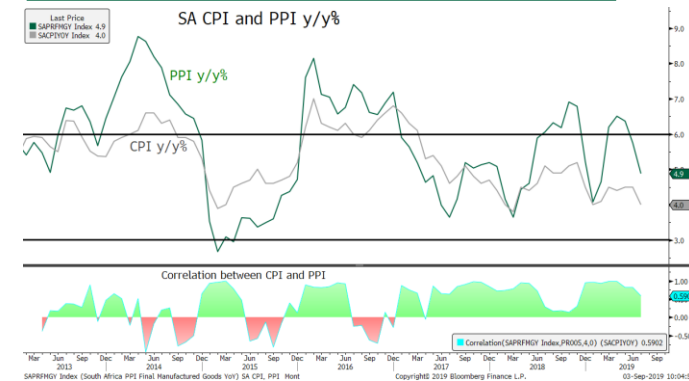


Chart 21: SA PPI remains above CPI as producers absorb higher input costs



Source: Bloomberg, Nedbank CIB Markets Research

MONETARY POLICY DYNAMICS: SA

SARB needs to assess a weak rand with low growth and low core inflation

- In line with our expectations, the SARB unanimously cut the repo rate by 25bps to 6.50% in July, with prime at 10%. The most significant developments in its statement were a sharp reduction in its growth estimate for 2019 and its measure of potential growth, a wider output gap, and a QPM that still reflects a 10bps reduction in the repo rate in 2020.
- We believe the bias remains firmly for the SARB's next move to be another cut of 25bps. This, however, may happen only after a few MPC meetings where the repo rate is kept unchanged. The SARB's September MPC meeting will be important for a few reasons: its QPM projections would need to reflect a lower starting point for inflation; given the recent downside surprise in both headline and core inflation, it would be important to watch for any further changes to the SARB's neutral real rate forecast. A lower neutral real rate target, combined with a weak growth outlook and a dovish QPM, means that the SARB is likely to keep the option open for a further interest rate reduction in the current cycle, especially if the Fed and other global central banks become more dovish. The SARB will likely watch how CPI evolves in the coming months, along with global monetary developments (and by implication, the rand), before considering any further easing.
- We believe that if, by its November MPC meeting, SA averts a Moody's downgrade (which is our base case) and the Fed reduces the Fed funds rate by a further 25bps, the SARB could reduce the repo rate by a further 25bps in the current easing cycle. We remain of the view that the SARB will likely keep the repo rate unchanged in September as a result of the sharp depreciation in the rand exchange rate since its last MPC meeting (9.7% weaker relative to the USD).

Chart 22: SARB's negative output gap does not close, QPM dovish

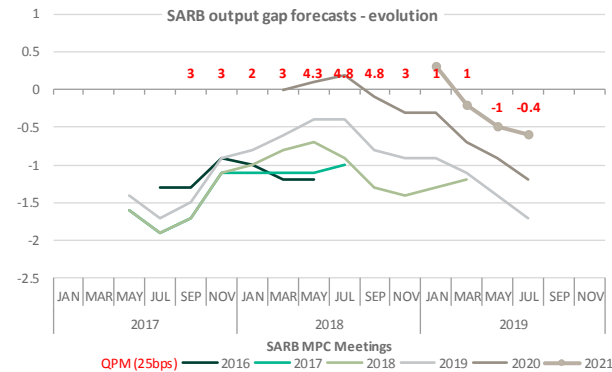


Chart 24: SARB's inflation forecasts are well below its 2016 and 2017 estimates

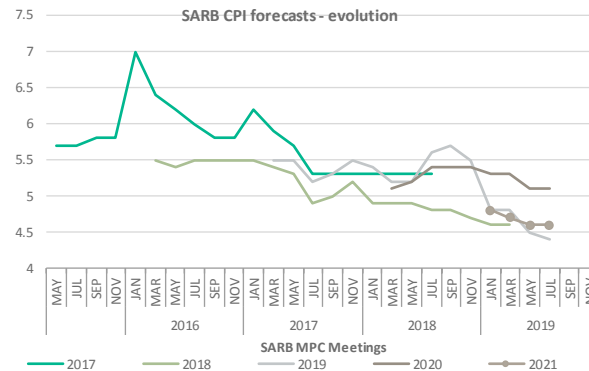


Chart 23: SARB revises 2019 growth estimate sharply lower

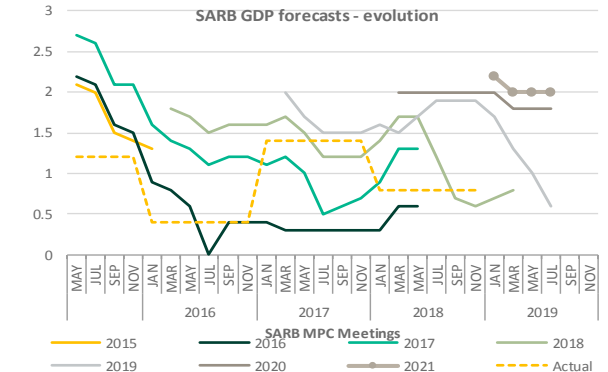
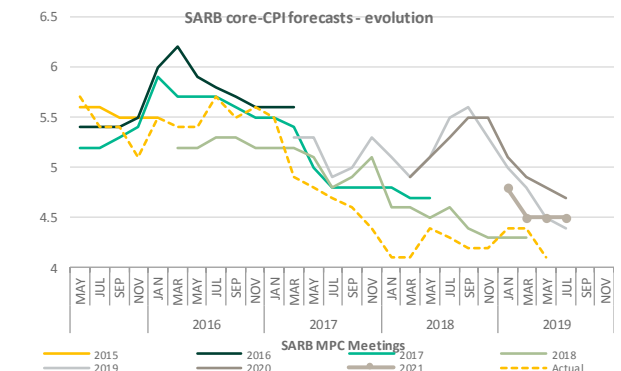


Chart 25: Core inflation estimates revised lower, signaling lack of demand-pull inflation



Source: Bloomberg, SARB, Nedbank CIB Markets Research

CREDIT RISK COMPARISON

Fiscal woes fester, but the NT is working on reducing expenditure – this may appease rating agencies

- SA's overall fiscal trajectory is concerning. The only light at the end of the tunnel seems to be the expenditure-reduction guidelines provided by the NT, in which a compulsory expenditure reduction is applicable to national departments over the MTEF. These cuts to expenditure will be made from the 2020/21 fiscal year, and so, while the main budget deficit is likely to be above 6% of GDP for the current fiscal year in the absence of expenditure cuts, we could see the 2020/21 deficit fall below 6% of GDP if these expenditure cuts are enforced. For now, revenue collection remains weak, and there really is no fiscal space to muscle this area of the budget in the near term.
- Any prospects of reducing expenditure will likely appease credit rating agencies in the near term. The medium-term impact would depend on whether or not these expenditure cuts actually materialise.
- Ultimately, the rating agencies are not convinced that the rising sovereign debt is sustainable in the long run. Moody's penned a "Credit Negative" commentary, and Fitch took its view one step further and lowered SA's outlook to "Negative" from "Stable", while affirming the "BB+" rating level. In our opinion, the MTBPS has become a critical rating downgrade event at both Fitch and Moody's. S&P Ratings is yet to formally comment on the extraordinary bailout to Eskom. Without any sort of meaningful 'plan' to reduce expenditure or reignite growth, we believe there is a high likelihood of an outlook change to "Negative" by Moody's.

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	
Aa a	P-1	AAA	A-1+	AAA	F1+	Prime
Aa 1		AA+		AA+		High grade
Aa 2		AA		AA		
Aa 3		AA-		AA-		
A1		A+		A+		Upper medium grade
A2	P-2	A	A-2	A	F2	
A3		A-		A-		
Baa 1		BBB+		BBB+		Lower medium grade
Baa 2	P-3	BBB	A-3	BBB	F3	
Baa 3 (stable)		BBB-		BBB-		
FC+LC	Not prime	BB+ (stable) LC	B	BB+ (stable) FC+LC	B	Non-investment grade
Ba 1		BB (stable) FC		BB		speculative
Ba 2		BB-		BB-		
Ba 3		B+		B+		
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

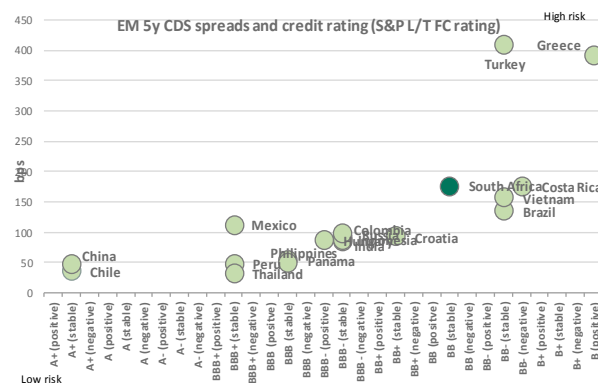
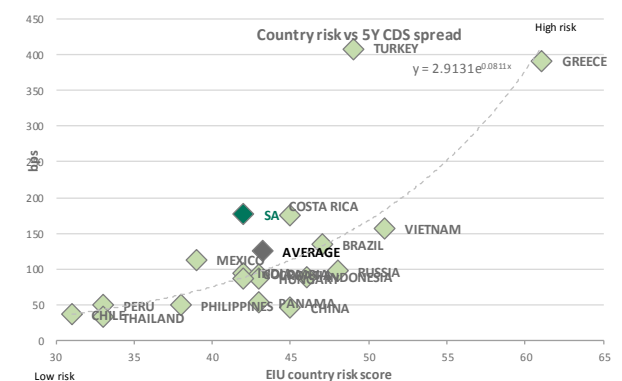


Chart 27: SA's above-trend credit risk score



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

SA'S BOND MARKET

Marginally steeper curve as front-end yields decline

- The SAGB yield curve maintained its steepening bias, albeit marginally so, towards the end of August. The bull steepener was driven by lower yields in the front end of the yield curve after a sharply lower inflation print, at 4.0% in July, well below the SARB's 4.5% inflation target. The market has, therefore, started pricing in a further 25bps cut by the SARB within the next 12 months as a result of this downside surprise to inflation.
- The NT rolled out its super-sized issuance in August, with R4.53bn in nominal bonds on offer, up from a weekly issuance amount of R3.3bn previously. The hike was needed because of the large revenue shortfall in the current year, as well as expenditure-related pressure due to the recent bailout provided to Eskom. Despite the substantially larger offering, bid-to-cover ratios were higher, as market participants took advantage of the green-shoe offering that covered SA CPI print in August.
- The Fed reiterated its willingness to support the US economy in the event of deterioration in economic data, warranting further reductions to the US Fed funds rate. The fact that central banks are currently dovish globally has resulted in the SA FRA curve pricing in a 39% probability of a 25bps reduction in the repo rate at the SARB's MPC meeting later this month. The FRA market is also pricing in an 83% probability of a 25bps cut at the SARB's November MPC meeting. We still believe there will be room for a further repo rate cut if inflation and inflation expectations remain anchored, if growth surprises to the downside and the Fed eases the Fed funds rate further this year.
- Our fair value estimate of SA's 10y R2030 bond yield remains at 9.25%, with the US 10y yield's fair value at 2.50%. If we reduce the US 10y bond yield's fair value to 2.00% instead (due to benign US inflationary pressure and falling real yields), our SA 10y R2030 yield's fair value falls to 9.05%. We see our fair value estimate as a 6- to 12-month view. We expect further steepening in the curve 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 marginally price in a SARB cut.

Chart 28: FRA curve projects a further 25bps cut by the SARB

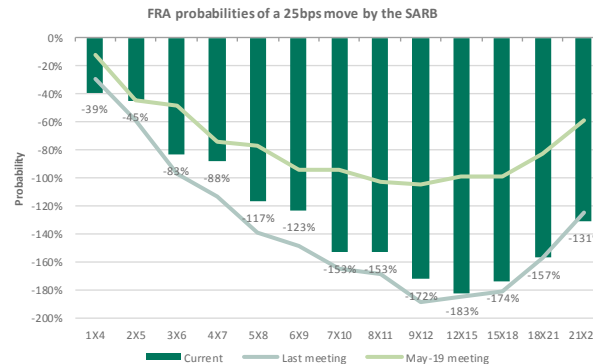


Chart 30: Short-end portion of the curve looking for direction

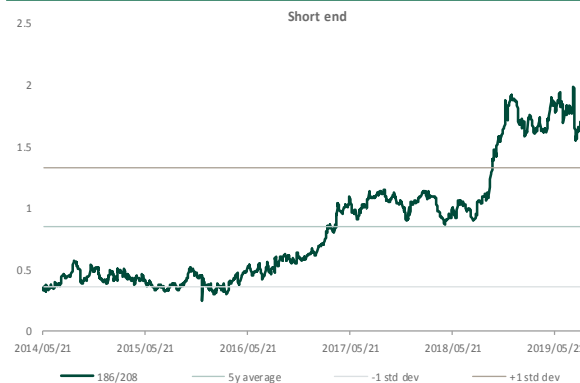


Chart 29: Front-end yields sharply lower as market prices in a repo rate cut

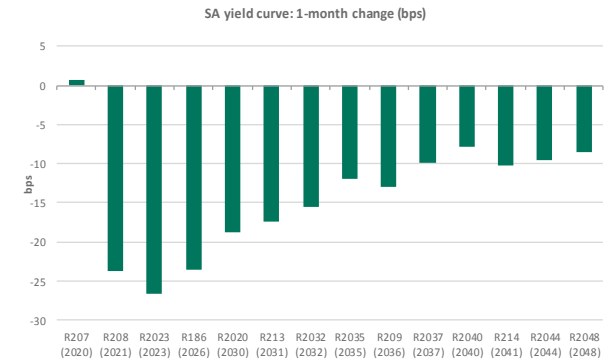
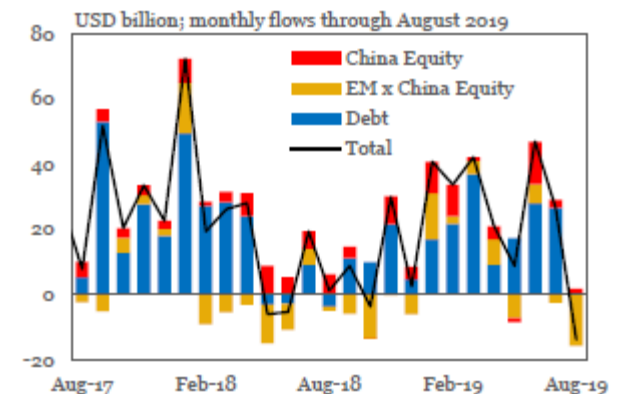


Chart 31: IIF: EM portfolio flows tracker



Source: Bloomberg, IIF, Nedbank CIB Markets Research

Source: Haver, IIF

THE RAND AND KEY RISKS

USDZAR maintains weakness, given the 'neutral' Fed, strong USD

- The USDZAR weakened 7.2% in August, with the bulk of this move coming after the Fed's interest rate decision, which was viewed as neutral and strengthened the dollar. Local headwinds also added pressure on the currency, as political infighting persisted, policy uncertainty remained high, after a NT white paper on growth did not garner much support from politicians, and the fiscal outlook continued to worsen.
- Against the crosses, the rand depreciated 6.7% against the GBP and 5.8% against the EUR in August – here again, the bulk of the weakness came shortly after the Fed's policy meeting, with the crosses effectively remaining unchanged since early August. The trade-weighted rand weakened 5.5% in August.
- Although we expect the SARB to cut rates by 25bps once more in the coming months, its ability to ease is being hampered by fiscal risks (which are unlikely to abate in the foreseeable future). We see the Fed's ability to ease as greater than that of the SARB's. This easing is likely to keep implied volatility more muted in the FX market.
- As a result, while it is easy to assume that SA's fiscal position could lead to substantial rand weakness, we remain cognisant of the fact that, on balance, a Fed that is more dovish than the SARB beyond the next 12 months would offset some rand weakness that may be induced by SA's precarious fiscal position. Furthermore, plenty of SA's fiscal situation is most likely priced into the currency already.
- However, from a fundamental perspective, we still do not believe strength beyond 14.00 – or weakness above R15.00/USD for that matter – is sustainable.

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

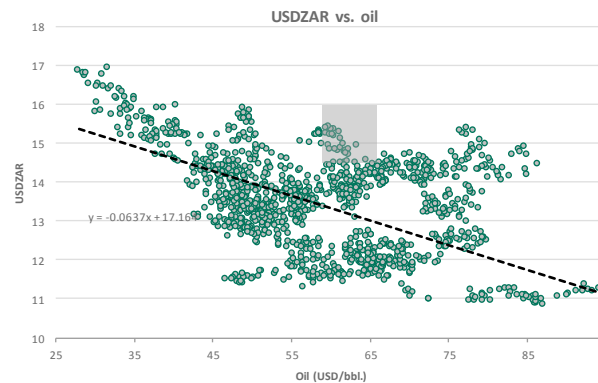


Chart 33: ZAR weakens on local woes, Fed and strong dollar

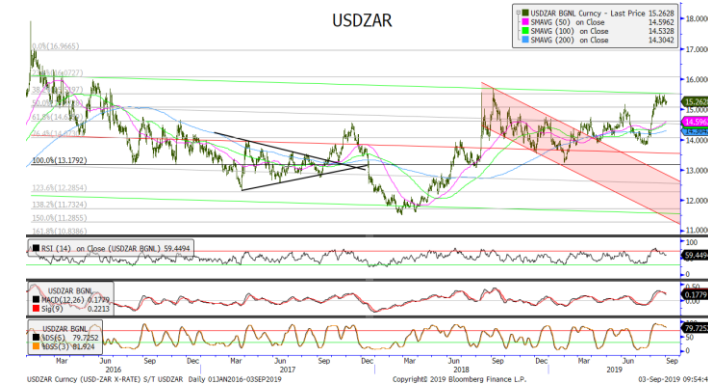
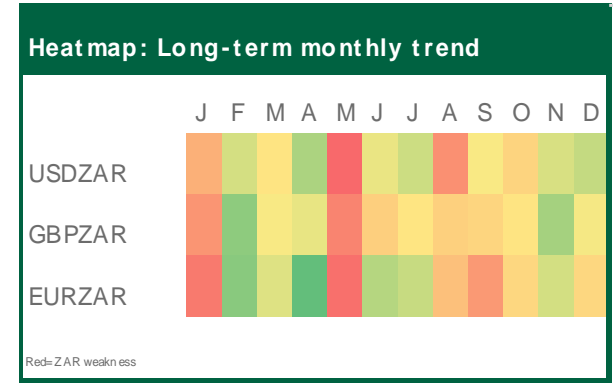


Chart 35: Heat map suggests that the rand is likely to remain volatile



Source: Bloomberg, Nedbank CIB Markets Research

THE RAND AND KEY RISKS

Worst August performance in 22 years – EM FX under pressure

- August was a month of rising trade tensions between the US and China as the market prepared for USD110bn worth of Chinese goods attracting US import tariffs of 25% starting from 1 September. President Trump has announced that an additional \$160bn worth of Chinese goods will attract a tariff of 15% starting from 15 December 2019. China imposed retaliatory tariffs on \$75bn of US imports. The US Congressional Budget Office has estimated that the average household income in the US could decline by USD580 by 2020, while it estimated that the US' real GDP growth will likely be 30bps lower as a direct result of the trade war.
- The escalating tensions have contributed to significant market uncertainty, as well as volatility in EM FX markets in recent months. For the YTD, the Argentine Peso was the worst performer, falling 33% against the USD. The peso was followed by the Swedish Krona and the Turkish Lira, which fell 9.6% and 8.94%, respectively, in the same period. The ZAR was 11th on the list, having depreciated 5.3% for the YTD. Among the best performers were the Israeli shekel and the Russian ruble, gaining 5.7% and 4.5%, respectively, against the USD for the YTD.
- Global event risks remain the key drivers of risk sentiment, with the US-China trade negotiations being the key driver. Further uncertainty over Brexit negotiations, geopolitical tensions between the US and Iran, and global central banks' monetary policy responses are all likely to remain key risks to EM FX. However, from September onwards, a spate of general elections are scheduled globally; these may lead to added risk aversion as a result of country-specific factors.
- For SA, specifically, the MTBPS in October will remain on our radar, as well as on the radars of credit rating agencies; a Moody's sovereign credit rating review is scheduled on 1 November.
- Our fundamental 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 15.00.

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

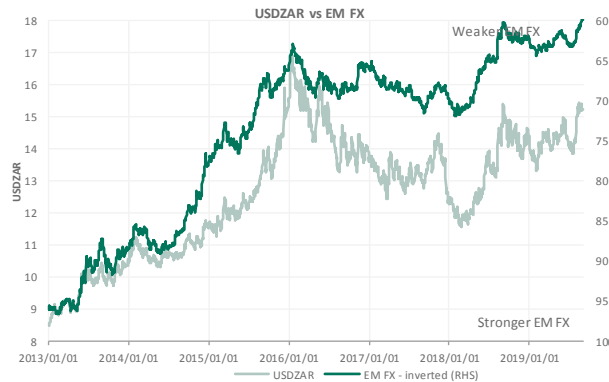


Chart 38: EM FX recovers somewhat in 2019, although unlikely to sustain rally

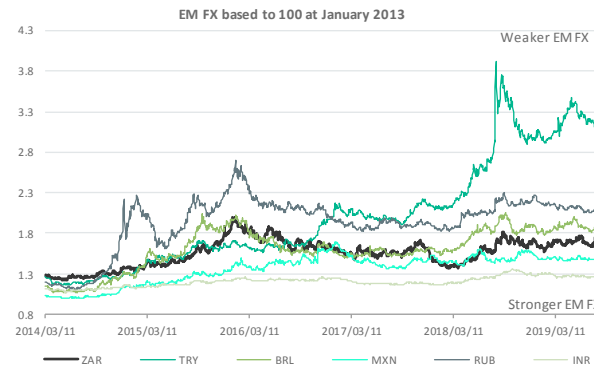
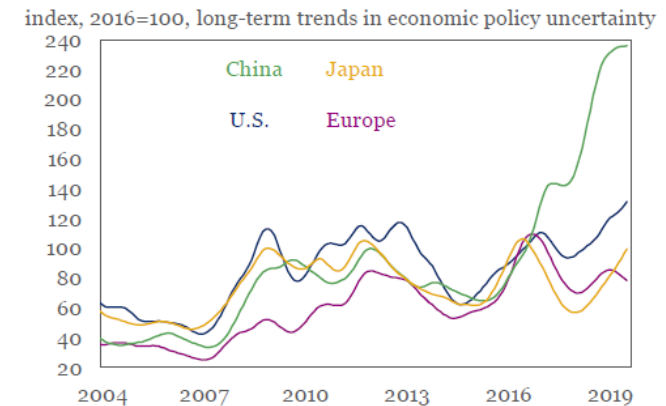
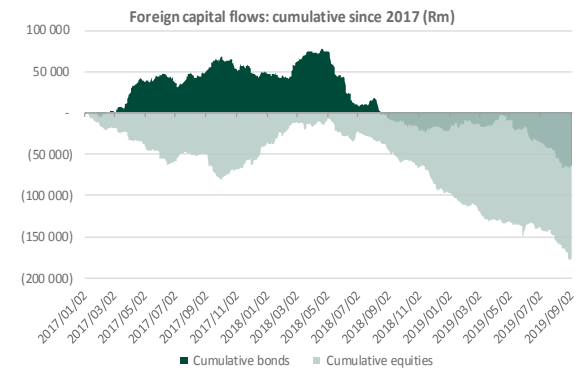


Chart 37: IIF: Economic policy uncertainty at record highs for US and China



Source: Bloomberg, Economic Policy Uncertainty Index, IIF

Chart 39: Foreign capital flows are an extension of ZAR weakness in 2019



Source: Bloomberg, IIF, Nedbank CIB Markets Research

OTHER MARKETS

All major equity markets slumped in August, EM equities led the losses

- Equity indices performed poorly in August on the back of uncertainty over the US-China trade war. However, towards the end of the month, stocks firmed up slightly, paring earlier losses as hopes of a trade truce began to surface. Naturally, EM equity indices led the losses in August as a result of the risk-off sentiment that had gripped markets for most of the month. The JSE All Share index lost almost 10% in USD terms in August, followed by the MSCI EM index, which gave up more than 5%. In contrast, the FTSE lost the least, falling 0.6% in USD terms in August.
- According to the Wall Street Journal, September is the worst month for equities – since its inception, the S&P 500 index has ended lower in September 54% of the time, more than in any other month. Concerns over global growth and the contagion effect of weaker EMs and European economies have been fuelling concerns over the US economy, keeping commodity prices in a downtrend and taking US bond yields to multi-year lows, as USTs are seen as the ultimate safe-haven asset.
- China poses a key risk if growth 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, as well as commodity-based countries that rely on robust Chinese consumption and high commodity prices and other Asian countries that rely on China for re-exports. Another risk we note is the current uncertainty around Brexit 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 growth in Europe, which is already slowing down.

Chart 40: Local fuel costs ease as Brent declines

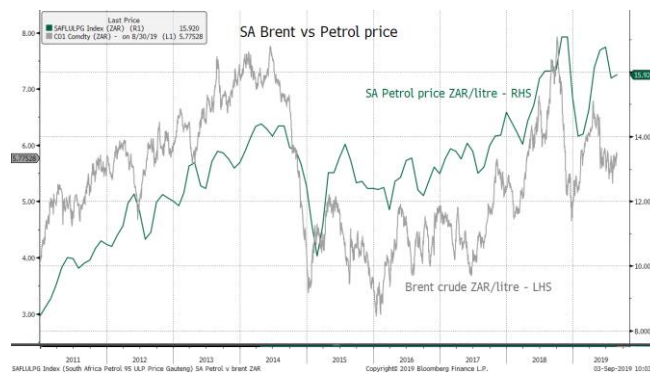


Chart 41: IIF: Safe haven bets favor gold, JPY

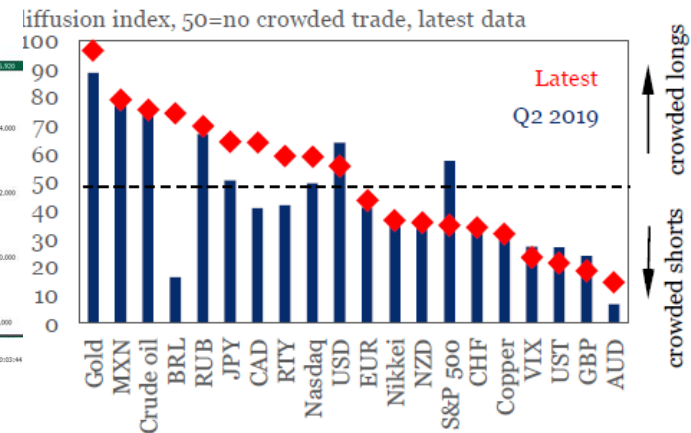


Chart 42: Global risk-off recently, as the Fed disappoints markets

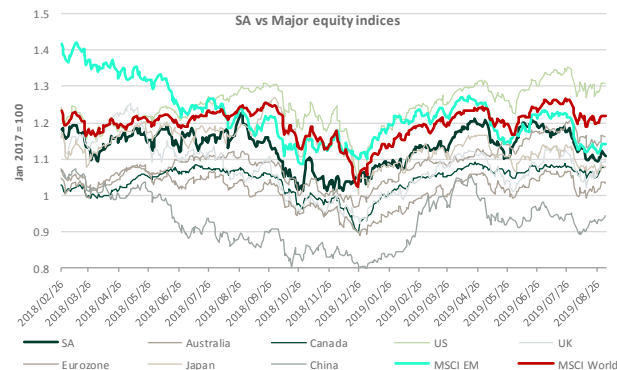
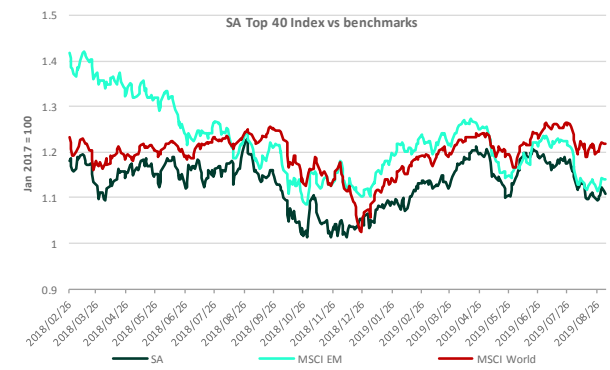


Chart 43: Equity indices marginally higher recently; SA equities under pressure



Source: Bloomberg, IIF, Nedbank CIB Markets Research

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
09/03/2019	11:30	GDP Annualized QoQ	2Q	-3.20%
09/03/2019	11:30	GDP YoY	2Q	0.00%
09/05/2019	11:00	Current Account as a % GDP	2Q	-2.90%
09/05/2019	11:00	Current Account Balance	2Q	-143b
09/05/2019	13:00	Electricity Production YoY	Jul	0.10%
09/05/2019	13:00	Electricity Consumption YoY	Jul	-1.60%
09/06/2019	08:00	Gross Reserves	Aug	\$49.36b
09/06/2019	08:00	Net Reserves	Aug	\$43.90b
09/10/2019	12:00	BER Business Confidence	3Q	28
09/10/2019	13:00	Manufacturing Prod NSA YoY	Jul	-3.20%
09/10/2019	13:00	Manufacturing Prod SA MoM	Jul	-1.50%
09/11/2019	11:30	SACCI Business Confidence	Aug	92
09/12/2019	11:30	Mining Production YoY	Jul	-4.20%
09/12/2019	11:30	Mining Production MoM	Jul	3.30%
09/12/2019	11:30	Gold Production YoY	Jul	-16.00%
09/12/2019	11:30	Platinum Production YoY	Jul	-6.30%
09/18/2019	10:00	CPI YoY	Aug	4.00%
09/18/2019	10:00	CPI MoM	Aug	0.40%
09/18/2019	10:00	CPI Core YoY	Aug	4.20%
09/18/2019	10:00	CPI Core MoM	Aug	0.40%
09/18/2019	13:00	Retail Sales Constant YoY	Jul	2.40%
09/18/2019	13:00	Retail Sales MoM	Jul	0.30%
09/19/2019		SARB Announce Interest Rate	19-Sep	6.50%
09/25/2019	09:00	Leading Indicator	Jul	103.4
09/26/2019	11:30	PPI YoY	Aug	4.90%
09/26/2019	11:30	PPI MoM	Aug	-0.20%
09/30/2019	08:00	Money Supply M3 YoY	Aug	8.28%
09/30/2019	08:00	Private Sector Credit YoY	Aug	7.19%
09/30/2019	14:00	South Africa Budget	Aug	-99.1b
09/30/2019	14:00	Trade Balance Rand	Aug	-2.9b

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 reduced to 6.50% (previously 6.75%) following the July 2019 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	2.80	1.40	1.00	0.50	1.60	1.50	2.00	1.90	1.40	1.60	2.10	1.90	1.90	1.70
Current account as a % of GDP	-3.50					-3.10					-3.60					-3.60
Gold \$/oz. (EOP)	1280.30	1287.55	1411.83	1433.01	1418.68	1418.68	1390.31	1404.21	1432.29	1417.97	1417.97	1389.61	1403.51	1431.58	1417.26	1417.26
Exchange rates (EOP)																
USDZAR	14.390	14.585	14.149	14.998	15.298	15.298	15.145	15.297	15.450	15.635	15.635	15.643	15.799	15.957	16.197	16.197
EURZAR	16.447	16.396	16.105	16.736	16.986	16.986	16.650	16.732	16.900	17.017	17.017	16.857	16.941	17.111	17.281	17.281
GBPZAR	18.256	19.077	17.931	18.102	18.191	18.191	17.831	18.009	18.099	18.225	18.225	18.326	18.509	18.657	18.842	18.842
AUDZAR	10.347	10.357	9.928	9.882	10.140	10.140	9.989	10.129	10.210	10.312	10.312	10.266	10.410	10.500	10.630	10.630
ZARJPY	7.674	7.583	7.615	7.126	6.986	6.986	7.022	6.952	6.918	6.870	6.870	6.832	6.764	6.731	6.665	6.665
GBPUSD	1.269	1.308	1.267	1.207	1.189	1.189	1.177	1.177	1.171	1.166	1.166	1.172	1.172	1.169	1.163	1.163
EURUSD	1.143	1.124	1.138	1.116	1.110	1.110	1.099	1.094	1.094	1.088	1.088	1.078	1.072	1.072	1.067	1.067
USDJPY	110.42	110.60	107.74	106.88	106.88	106.88	106.34	106.34	106.88	107.41	107.41	106.87	106.87	107.41	107.94	107.94
USDCNY	6.893	6.724	6.868	6.971	6.978	6.978	6.985	7.020	7.034	7.041	7.041	7.048	7.083	7.093	7.105	7.105
USDCHF	0.990	0.996	0.975	0.993	0.996	0.996	1.003	1.007	1.009	1.012	1.012	1.020	1.023	1.024	1.028	1.028
USDAUD	1.391	1.408	1.425	1.518	1.509	1.509	1.516	1.510	1.513	1.516	1.516	1.524	1.518	1.520	1.524	1.524
SA Interest rates (EOP)																
3-month JIBAR	7.15	7.15	7.03	6.91	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95
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	8.68	8.86	8.83	8.83	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	4.46	4.30	4.77	4.77	5.25	4.72	4.92	4.79	4.79	4.84	4.89	4.81	4.76	4.76
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)

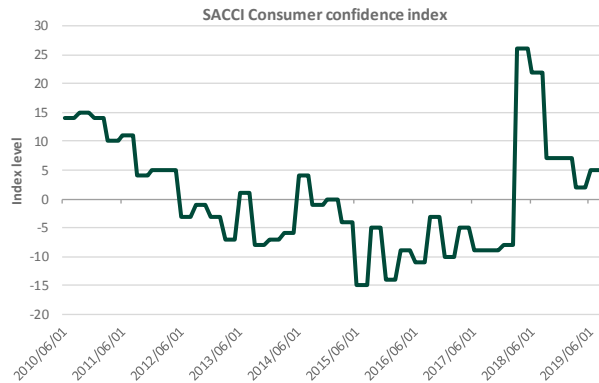


Chart 45: BER Manufacturing PMI (monthly)

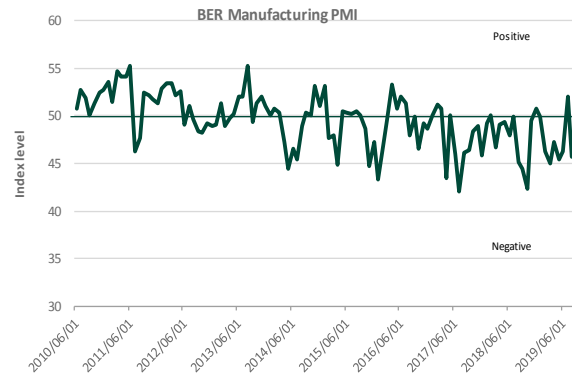


Chart 46: SA CPI y/y percentage (monthly)

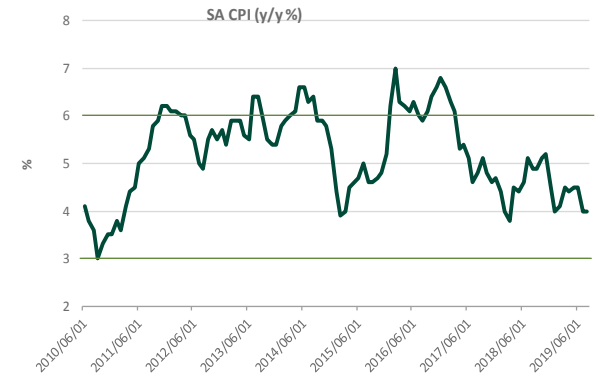


Chart 47: SA repo rate (monthly)

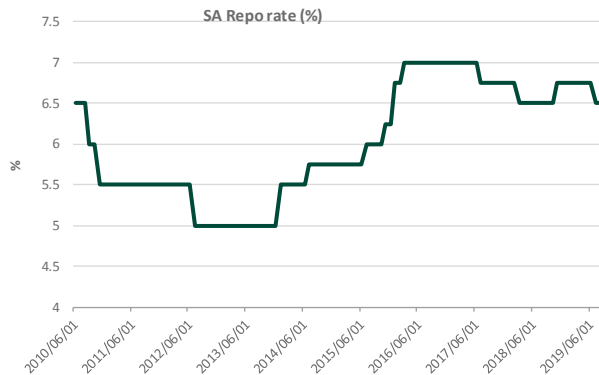


Chart 48: SA 10y generic bond yield (monthly)

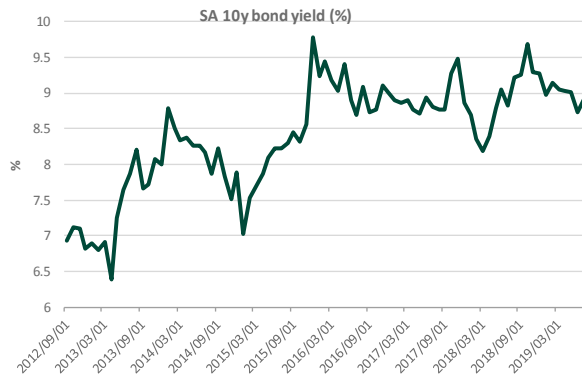
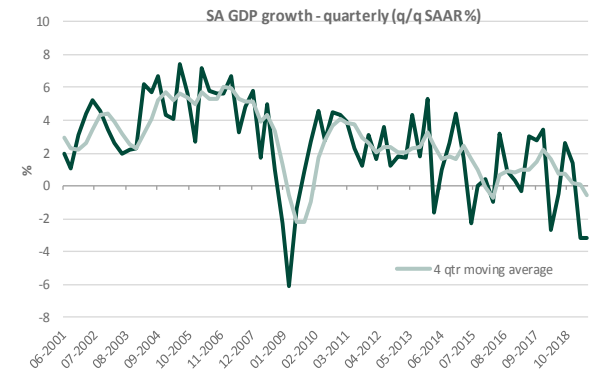


Chart 49: SA GDP growth q/q % SAAR (quarterly)



Source: Bloomberg, Nedbank CIB Markets Research