ABSA

Economic Research
6 April 2017

South Africa Quarterly Perspectives: Q2 17

Political event risk manifests in a big way

Peter Worthington
+27 21 927 6525
peter.worthington@absacapital.com
Absa, South Africa

Miyelani Maluleke
+27 11 895 5655
miyelani.maluleke@absacapital.com
Absa, South Africa

www.absa.co.za

- South Africa looks set for a modest growth upswing, with domestic demand constraints serving to limit some of the supply-side improvement. The agricultural sector appears set for a major rebound, but the manufacturing sector should continue to struggle, in our view. We forecast GDP growth of just 1.0% this year.
- Headline CPI inflation should return within the target range in Q2 17; in the last MPC, the SARB moderated its inflation forecast to express a similar view. Core CPI is currently falling owing to base effects, but will likely drift up again in the second half of the year, while inflation expectations have also risen.
- The Q4 16 current account deficit came in much smaller than we expected, but is unlikely to be sustained at these levels, although it will continue to be supported by higher export commodity prices, flat oil prices and import demand compression. We now forecast a deficit of 3.5% of GDP in 2017, compared to 4.5% of GDP at the time of the last Quarterly Perspectives.
- Despite a surprisingly dovish MPC at end-March, we think that the SARB will leave the repo rate on hold at 7%, given high core inflation and ongoing risks to the exchange rate, combined with a new fiscal slippage and downgrade risks in the wake of President Zuma's cabinet reshuffle.
- The 2017/18 Budget reflected a large fiscal adjustment of 1% of GDP. Although nominal expenditure ceilings should hold this year, we see more downside risks on the revenue side than upside ones, and the resulting fiscal slippage means the debt-to-GDP ratio is unlikely to stabilise without further tough action.
- Structural reform progress has been patchy, with some welcome reforms in the labour market, electricity supply stabilization, but ongoing regulatory uncertainty in the mining sector and widespread instability in State-Owned Companies.
- Despite strong pushback to President Zuma's cabinet reshuffle (which axed Finance Minister Gordhan and a number of other independent ministers), the ANC seems unwilling to rein Zuma back. Political event risk will remain elevated as the factional battle intensifies in the run up to the ANC's electoral conference in December. These developments have pushed the credit rating agencies to act. S&P implemented an out-of-cycle one-notch downgrade on 4 April to BB+ foreign currency (FC) and BBB- local currency (LC), and maintaining the Negative Outlook. Moody's followed shortly thereafter with notice that it was putting its Baa2 LC and FC ratings on review for a downgrade, and we expect it to follow through with a one-notch move soon. We also expect Fitch to downgrade its BBB- LC and FC ratings shortly. Key is whether Moody's and Fitch move to Stable or maintain a Negative Outlook.

Absa Research is produced by Absa Bank Limited acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and also affiliated with the Investment Bank of Barclays Bank PLC and its affiliates (referred to as "Absa").

PLEASE SEE ANALYST CERTIFICATIONS AND IMPORTANT DISCLOSURES STARTING AFTER PAGE 7

Weak demand and structural constraints will limit the growth recovery

Improving agricultural activity to support growth this year

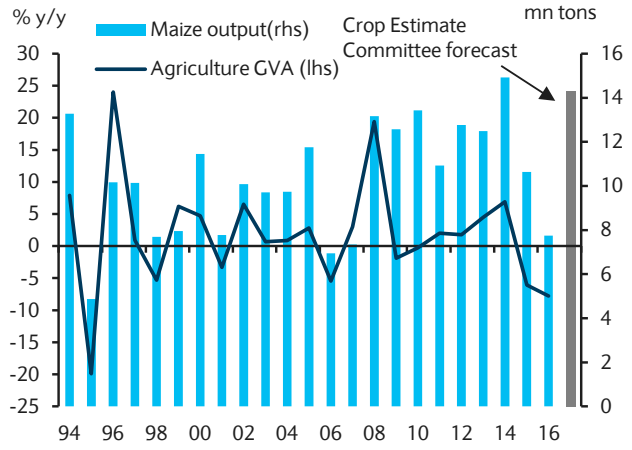
Real GDP growth in Q4 16 came in weaker than we expected at -0.3% q/q saar owing to a surprisingly weak performance from the agricultural sector, despite the country's rebound from drought conditions, as well as low output from the mining and manufacturing sectors. We believe agriculture appears set for a major rebound this year following more favourable weather conditions across most parts of the country. In its latest estimates, the Crop Estimate Committee (CEC) projects that total maize output for this year could be as high as 14.3mn tonnes, which would not only represent an increase of 84% compared to last year's harvest, but also the highest since the 1980/81 bumper crop, which is the largest on record. Expectations of healthy harvests also extend to other key summer crops, such as soybeans and sunflowers, which the CEC forecasts to rise by 55% and 19%, respectively, from last year. While agriculture as a whole should improve this year, risks remain in some parts. The Western Cape, which is the key region for winter crops such as wheat, continues to experience severe drought conditions with very low dam levels presenting risks to water supply, and raising some supply side growth risks for this economically important province.

Mining will benefit from firmer commodity prices but data on manufacturing remain mixed

Mining and manufacturing have had a mixed start to the year. Mining output registered strong 1.7% m/m (sa) growth in January supported by a normalisation in platinum output after a very weak Q4. The recent pick up in some key export commodity prices should remain supportive to mining. For instance, following sustained multi-year declines, iron ore prices have soared by about 52% since the start of H2 16, while coal prices have risen by 42% over the same period. The manufacturing sector had a relatively poor start to the year with output contracting slightly 0.4% m/m (sa) in January despite the Absa manufacturing PMI hinting at a strong rebound. The Absa manufacturing PMI remained strong in February and March, suggesting some improvement in the sector, particularly compared to H2 16. However, it is worth nothing that the Absa PMI prints in Q1 are in sharp contrast to the BER Q1 manufacturing survey, which showed that business confidence was at a weak level of 28, which cautions against being too optimistic on manufacturing's prospects. Encouragingly, other activity indicators suggest that a broader but moderate cyclical rebound is underway. The SARB's leading indicator showed y/y growth of 5.1% in January, its strongest recording since late 2010, while the Markit PMI remained in expansionary territory for the seventh successive month in March.

FIGURE 1

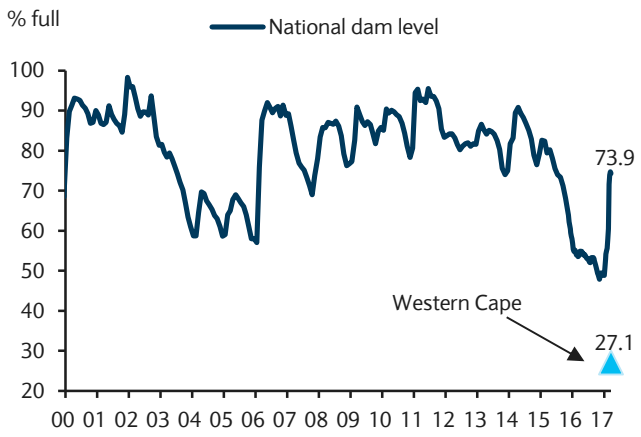
Strong maize harvest should support agriculture



Source: Stats SA, CEC, Department of Agriculture, Barclays Research

FIGURE 2

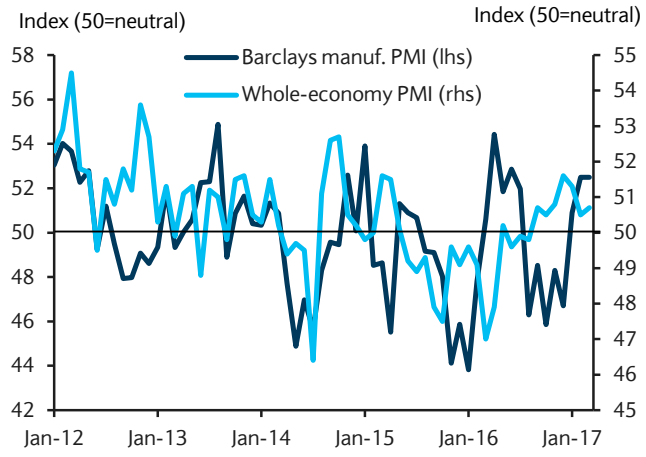
Dam levels have recovered sharply but not in Western Cape



Source: DWS, Barclays Research

FIGURE 3

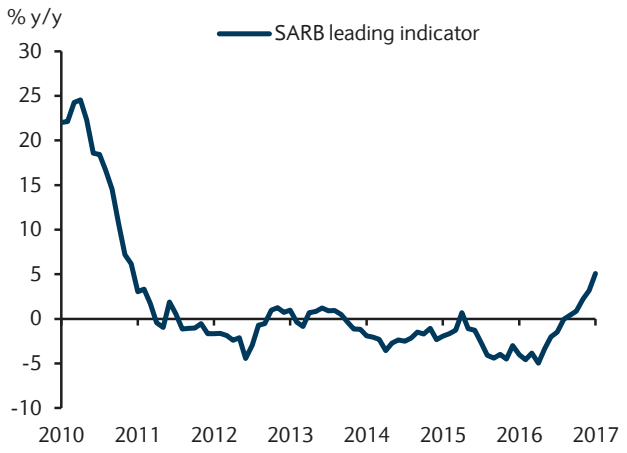
PMIs have maintained strength in Q1….



Source: BER, Markit, Barclays Research

FIGURE 4

…while the SARB's leading indicator continues to improve

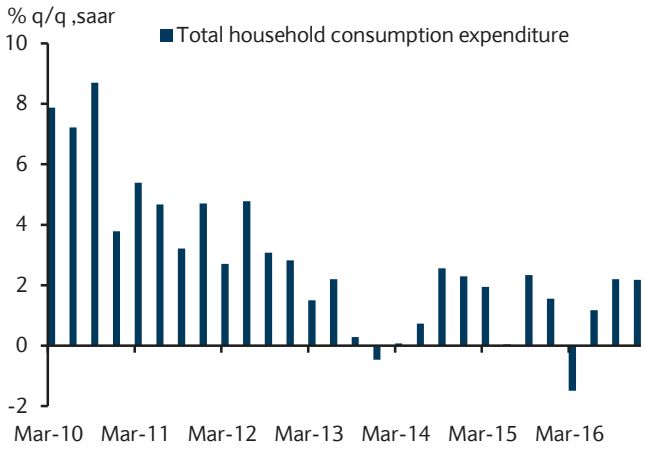


Source: SARB, Barclays Research

The demand side of the economy should remain constrained despite an indication of some improvement in the Q4 national accounts data. Final domestic demand growth improved to 1.7% in Q4 16 from 1.0% q/q saar in Q3, with household consumption, in particular, expanding by 2.2% q/q saar in Q4 (including the first quarterly increase in spending on durables in two years). However, January's retail sales release was extremely poor with the lowest y/y growth rate since 2009 and we think consumers will take a big hit from the 2017/18 Budget: it delivered R28bn worth of tax increases, which will fall predominantly on consumers, and R20bn of expenditure cuts, which will bear down on public sector employment. Positively, low income consumers will get a small lift to their spending power from decelerating food price inflation. However, employment creation and wage settlements this year are likely to be moderate. Despite the strong job gains recorded in the Quarterly Labour Force Survey in H2, the BER's quarterly surveys showed a decline in hiring intentions across all covered sectors. Moreover, there is little sign of increased credit take-up by consumers. The SARB data showed that credit extension to households weakened further to just 0.4% y/y in February. We forecast subdued private consumption growth of 1.0% in 2017.

FIGURE 5

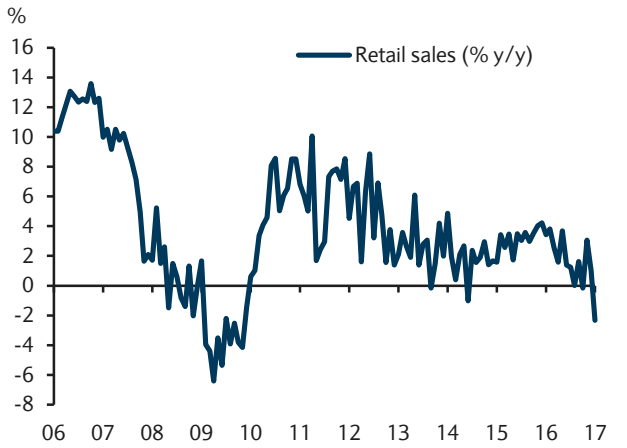
Household consumption spending improved during H2 16…



Source: Stats SA, Barclays Research

FIGURE 6

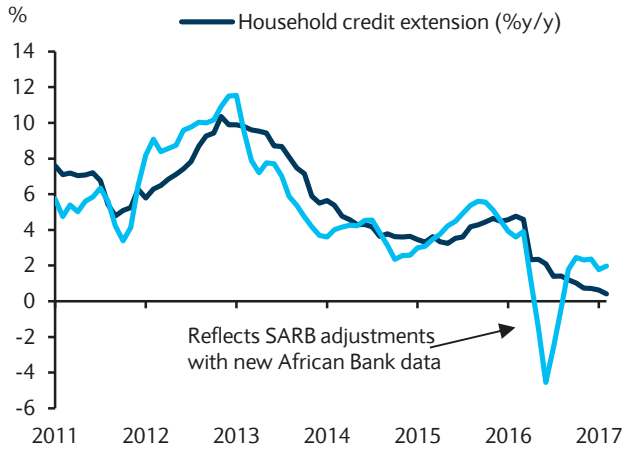
…but January retail sales data came in very weak



Source: Stats SA, Barclays Research

FIGURE 7

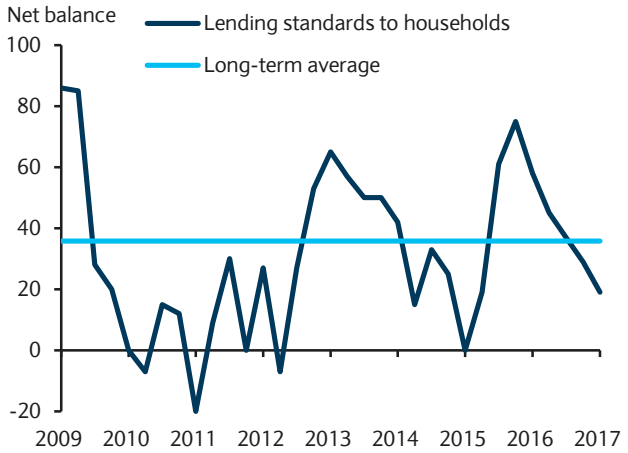
Still not much momentum in household credit extension…



Source: SARB, Barclays Research

FIGURE 8

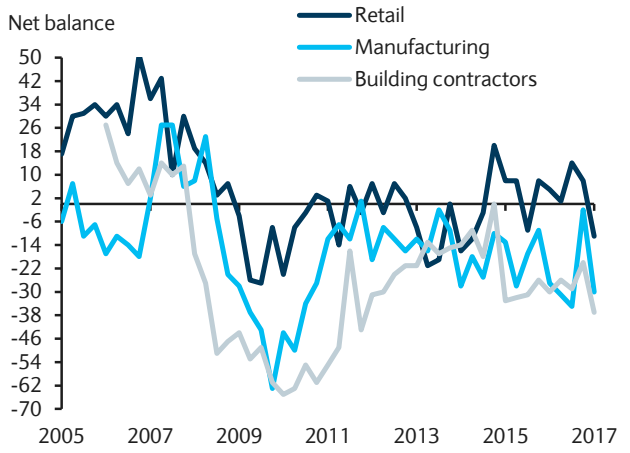
…but easing bank lending standards should be supportive



Source: BER, Barclays Research

FIGURE 9

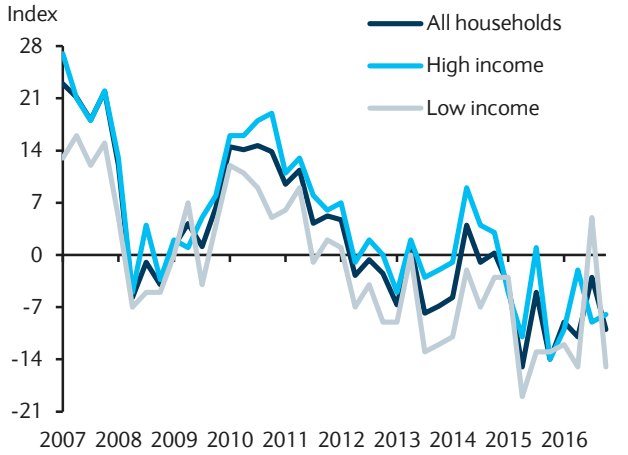
Hiring intentions fell in major sectors during Q1 17



Source: BER, Barclays Research

FIGURE 10

Consumer confidence remains very low



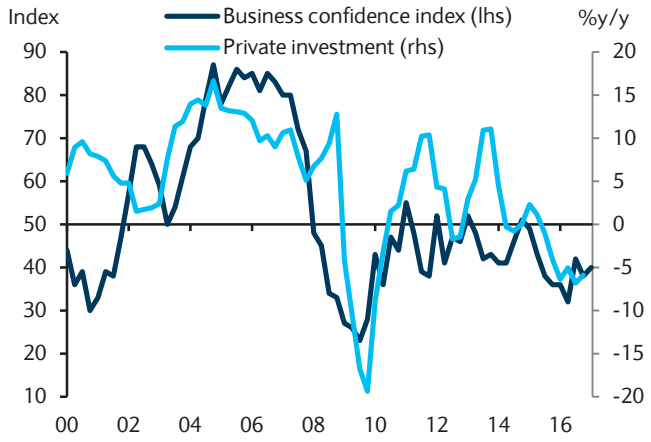
Source: BER, Barclays Research

Weak confidence likely to keep a lid on private fixed investment spending, particularly in manufacturing and mining

Nor do we see much of a lift from investment. Quarterly private sector investment contracted for five consecutive quarters through to Q4 16. The latest business confidence print of 40, which showed that 60% of surveyed businesses view business conditions as unsatisfactory, bodes ill for the near-term outlook. The BER's quarterly manufacturing survey presented an even more grim reading on fixed investment trends, with a net majority of 7% reporting a decline in fixed investment compared with 12 months ago, but a net majority of 37% – the largest ever – now expect a further decline in their fixed investment in the year to come. Survey respondents pointed to the tax regime and the high level of political uncertainty as major deterrents to investment. It is likely also that these two factors are also nagging issues weighing on other sectors. We expect gross fixed capital formation to contract by 1.6% this year.

FIGURE 11

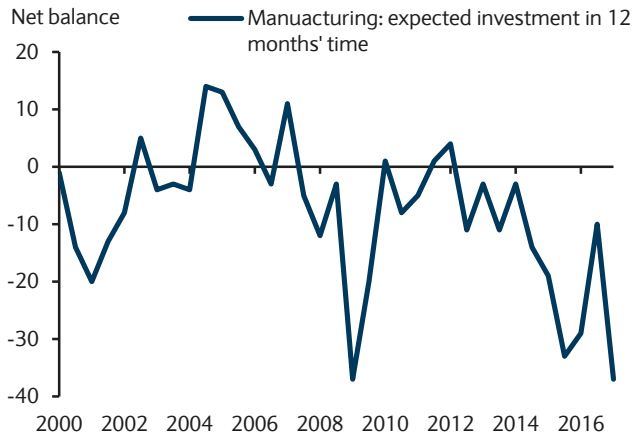
Weak business confidence bodes ill for investment



Source: Stats SA, Barclays Research

FIGURE 12

Manufacturing sector investment expected at an all-time low



Source: BER, Barclays Research

Our growth forecast of 1.0% for 2017 is a bit weaker than what the SARB and National Treasury expect

Overall, we believe that good rainfall, stable electricity supply, higher commodity prices, and stronger global growth should help South Africa achieve a modest growth upswing over the next couple of years, from the low in 2016, but the lack of demand-side support and productivity-boosting structural reforms and investment will constrain gains. Our GDP forecast of 1.0% for 2017 is slightly more pessimistic than official forecasts (with Treasury forecasting 1.3% in the 2017/18 Budget and the SARB 1.3% as of March), although we are exactly in line with the March Thomson Reuters consensus median forecast.

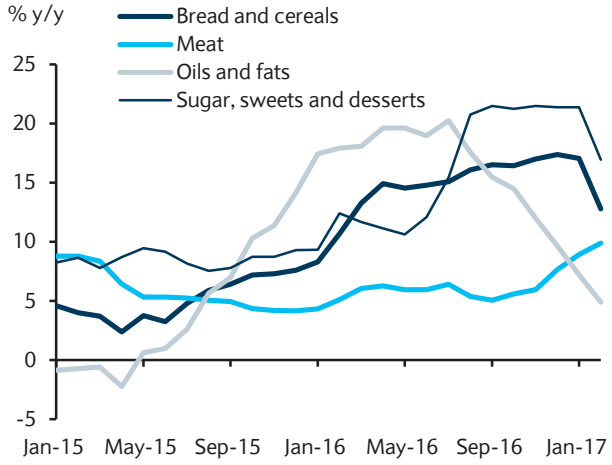
Trajectory for headline CPI depends on uncertain path for food prices

Food prices are a big uncertainty for the overall CPI trajectory

In this post-drought recovery period, the path for overall food prices is highly uncertain with disinflation in most parts of the perishable food basket like vegetables and grain products offset by surging meat prices. Food price inflation eased back to single digits for the first time since March 2016 at 9.9% in February after peaking just below 12% in the Q3 16. Within the food basket, categories such as bread and cereals, oil and fats and vegetables have already started to come down sharply, with vegetables in particular registering outright deflation in February. With crop prices having declined further, downward pressure should remain in these categories of the food basket. However, the feared spike in meat prices has started to manifest. Meat price inflation rose to 9.9% y/y in February, its highest level since 2014 and after averaging just 5.8% in 2016. However, there is some uncertainty how far this increase will go. In the February PPI data, meat price PPI inflation dipped slightly to 11.0% y/y, down from 12.4% y/y in January. We take a 'middle-of-the–road' view that food prices overall will stabilise in 2017, leaving food CPI inflation averaging 6.6%, while the SARB at its latest MPC upped its food price inflation forecast to 7.4% average for 2017.

FIGURE 13

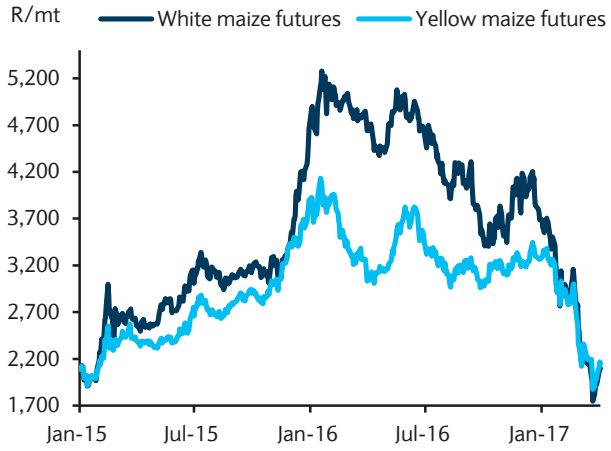
Meat price inflation has started to rise



Source: Stats SA, Barclays Research

FIGURE 14

Maize prices have continued to fall



Source: Reuters, Barclays Research

Crude oil prices are also down and the electricity price assumption for 2017 is now also more favourable

Oil prices have been volatile since the start of the year and also offer some uncertainty on the inflation outlook. After rising to reach about USD55/bbl in January, the Brent crude oil price fell to about USD49/bbl in mid-March before bouncing higher to about USD53/bbl in early April. Our assumption on oil prices is broadly guided by the Brent futures curve. This generates a fairly flat oil price profile that sees the oil price hovering around USD52/bbl over the forecast horizon. We note that this is significantly below the Barclays Commodities Research team's forecast of Brent crude oil prices rising to USD58/bbl by the fourth quarter of this year and to USD70/bbl by the end of next year, which would suggest some upside risk to our inflation forecast. A variance of 10% from our baseline would, holding everything else constant, result in direct deviation of about 0.25pp coming through petrol prices.

Electricity price increase this year will be just 2.2%

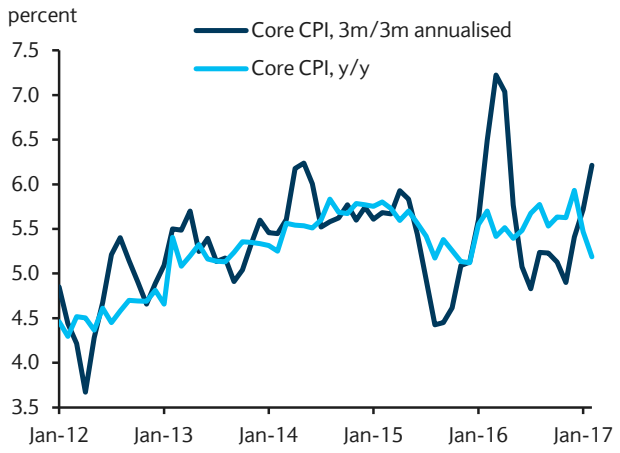
As we noted in, *South Africa Inflation Outlook: Currency and food pressures ease*, dated 10 February 2017, there was a risk that the electricity tariff increase this year could be substantially less than our and SARB's assumption of 8%. On 31 March, the National Energy Regulator of South Africa (NERSA) confirmed its tariff decision made during the MYPD3 process for the FY 18 financial year, which means that hikes this year will be 2.2% (See: *Eskom SOC Holdings Limited – FY 18 2.2% y/y tariff increase stands*, dated 6 April 2017). With respect to FY19 and beyond, there is no clarity as the MYPD4 determination is still to be submitted but we have assumed an electricity tariff increase of 9% for next year in our baseline forecast.

Current dip in core CPI owes to base effects and is unlikely to be sustained into H2 17

Meanwhile, demand-driven pressures on inflation remain limited. However, the fall in core CPI inflation from 5.9% y/y in December to 5.5% in January and 5.2% in February was largely due to base effects which followed some unusually steep increases in early 2016. We expect core to bounce slightly higher, likely tracking around 5.4% through most of 2017 before easing close to 5% at the end of the year and into 2018. New rand weakness will add some upside risk to our core CPI targets though we tend to take a very conservative view on the scale of pass-through. We do not expect South Africa's negative output gap to significantly lower core CPI without some changes to the dynamics of our wage setting process or big productivity improvements to fund large nominal wage increases.

FIGURE 15

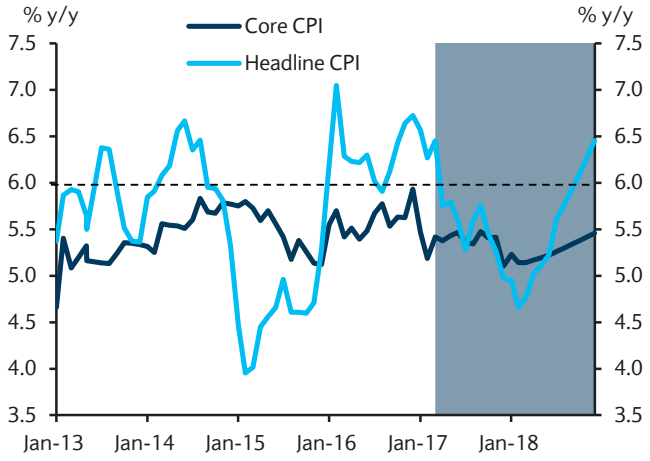
Core momentum rose slightly during January and February



Source: Stats SA, Barclays

FIGURE 16

Headline CPI inflation likely to return into target range in Q2



Source: Stats SA, Barclays Research

We think headline CPI inflation will fall back into the target range in Q2

With all these considerations in mind, we expect headline CPI inflation to return within the 3-6% target range in Q2 17. Our forecast for headline CPI inflation to average 5.7% in 2017 is slightly more optimistic than the SARB's latest forecast (5.9% as of the March MPC compared to 6.2% in January) as of and Treasury's (6.4% in the 2017/18 Budget), chiefly because we are more optimistic on food prices. Although we recognise there is a lot of uncertainty about the food price trajectory, a number of factors leave us comfortable with our new forecast, including: the recent collapse in crude prices;; a sharp 35% fall in maize prices since the over the first estimate of the bountiful harvest size; and the January PPI release, which already showed grain mill product price inflation falling from 12.0% y/y to 5.2% y/y. For 2018 we expect headline CPI inflation to average 5.5% y/y although electricity price base effects could push it above 6% in Q4 18.

Monetary policy likely to remain on hold for the foreseeable future

We think the bar to further rate cuts and also to further rate hikes is fairly high and expect the repo rate to stay at 7% for the foreseeable future

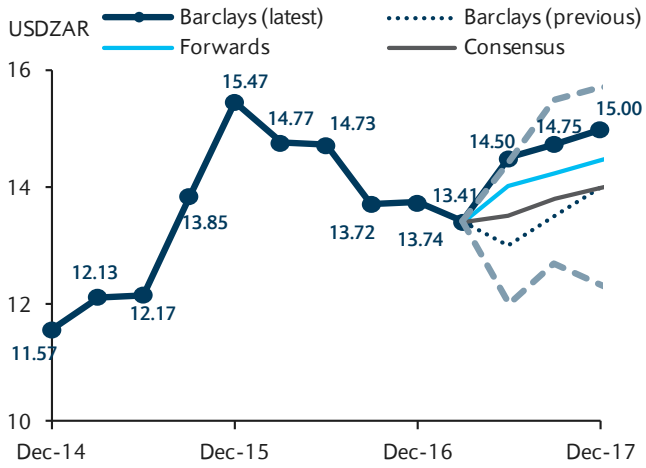
On 30 March, the SARB's monetary policy committee (MPC) kept the repo rate on hold at 7%, which was as we expected, but the fact one committee member voted for a 25bp cut was somewhat unexpected. The SARB lowered its inflation trajectory, and now officially forecasts that headline CPI will return within the target range in Q2 17, in line with our forecast (discussed above). We discern a somewhat less hawkish tone in the SARB's MPC commentary, with the risks to the inflation forecast described as lying only "moderately" on the upside (See: *South African monetary policy: Rates on hold, but one MPC member voted to cut*, 30 March 2017). Even so, we did not then believe that SARB was likely to cut, and the intensified political tensions and rand weakness in the wake of President Zuma's cabinet purge and capture of National Treasury since the MPC provide further support for our view. In many ways, monetary policy is now hostage to political developments, with the exchange rate a key transmission mechanism. However, the bar to a move in either direction remains pretty high, in our view. Our base-case scenario is that the SARB remains on hold for the foreseeable future.

We now expect further weakening in USDZAR, contingent on political developments

Notably, the USDZAR equivalent of the exchange rate assumption used in the SARB's inflation forecast is 13.40 – versus the current spot rate of 13.78, and we expect the ZAR to weaken further before year end. Following the recent cabinet reshuffle and subsequent sovereign rating downgrades, we have revised our ZAR projections back to what we had at the start of the year. More specifically, we expect the ZAR to weaken to 14.50/USD by midyear and to 15.00/USD by the end of the year on the back of further credit rating downgrades, poor sentiment due to ongoing political wrangling and valuations metrics. The

FIGURE 17

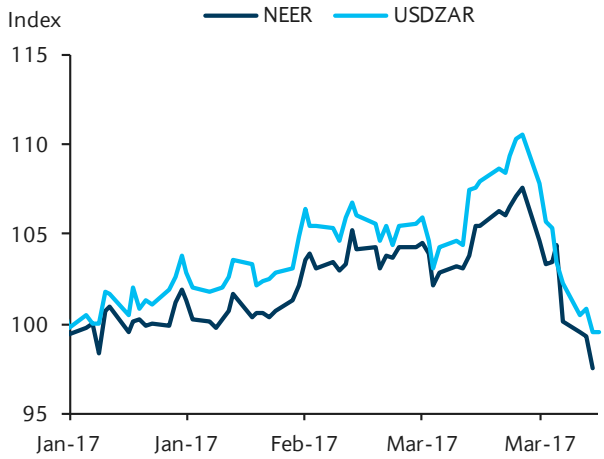
We are again more bearish than consensus about the ZAR



Source: Bloomberg, Barclays Research

FIGURE 18

USD weakness has masked some of the ZAR's deprecation



Source: Bloomberg, Barclays Research

recent spike in ZAR volatility is also hindering the ZAR's carry appeal and we believe that foreigners that continue to buy SAGB will overlay the positions with FX hedges. The biggest risks to our view include heighted global risk appetite and a more constructive commodity price backdrop.

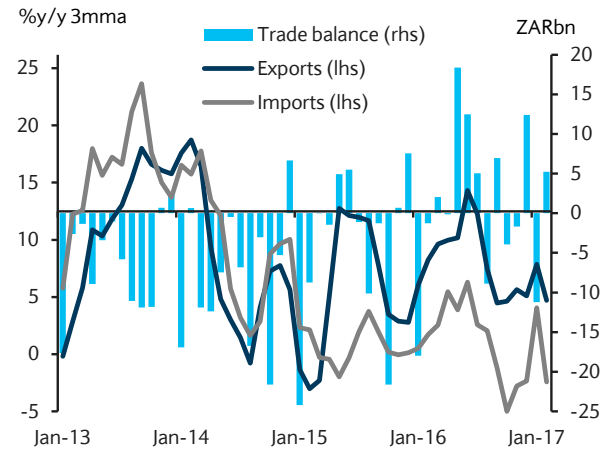
Higher commodity export prices will support the current account

Commodity export prices have risen a little and this will help the current account but the big gains come from import compression

Prices of South Africa's main export commodities have risen a little from their recent lows, while the main import commodity – crude oil – has edged lower, despite some volatility in recent weeks. Still, overall the net gain, as measured by a simple index of the ratio of South Africa's four main commodity export prices to that of crude oil, is marginal. Also, we think there has been little volume response to higher commodity export prices so far, and hardly any response of South Africa's manufacturing exports to the weak exchange rate (which in any event has strengthened markedly over the last year). However, South Africa will move from being a net maize importer last year to a maize exporter this year, while weak consumer demand should lead to some import compression. However, a large structural deficit on invisible flows is likely to remain. Big revisions to portfolio investment data (to more accurately record the movement of shares between the local and foreign share registers of dual-listed companies) were published on 22 March, showing that net portfolio investment in 2015 was nearly R123bn versus R70bn previously estimated, and this amount jumped to R255bn in 2016. Rising net inward investment sets the stage for continued big dividend and income payments to overseas investors.

FIGURE 19

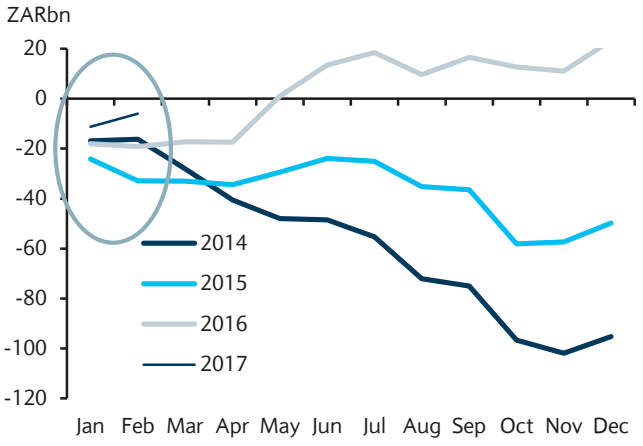
Export growth continues to outpace import growth



Source: SARS, Barclays Research

FIGURE 20

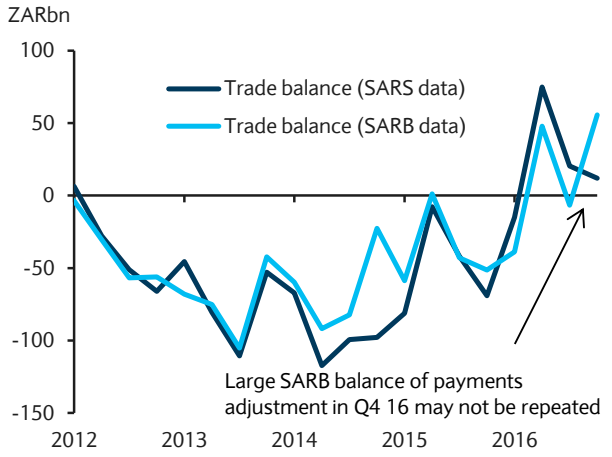
A promising start to the year in the trade accounts



Source: SARS, Barclays Research

FIGURE 21

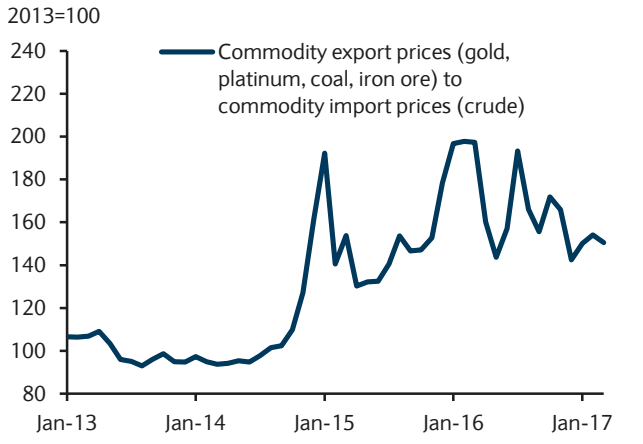
Big BoP adjustment to trade data in Q4 likely was a one-off



Source: SARS, SARB, Barclays Research

FIGURE 22

The ratio of prices of commodity exports versus oil is weak

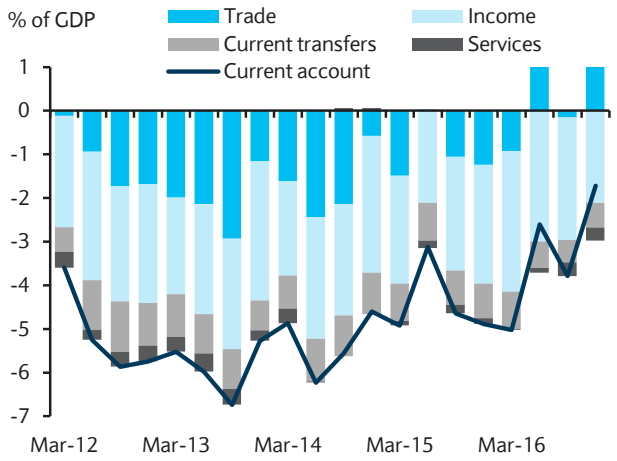


Source: Reuters, Barclays Research

The surprisingly small current account deficit of 1.7% of GDP in Q4 16 pulled the overall figure for last year down to 3.3% of GDP, but we note that the SARB's balance of payment adjustments to the SARS trade data in Q4 was unusually large and may reflect one-off factors that may not be sustained. The monthly trade data delivered a deficit of ZA11.2bn in January and a surplus of ZAR5.2bn in February. Although these data are highly volatile, a March trade balance print that is in line with seasonal trends would mean another quarter of a strong surplus in the merchandise trade accounts (barring any large SARB revisions to the data). We forecast a current account deficit of 3.5% of GDP for 2017. This projected deficit is still smaller than those recorded in years prior to 2016, but the ongoing reliance on portfolio capital inflows to finance leaves the rand looking vulnerable to a sudden change in risk appetite.

FIGURE 23

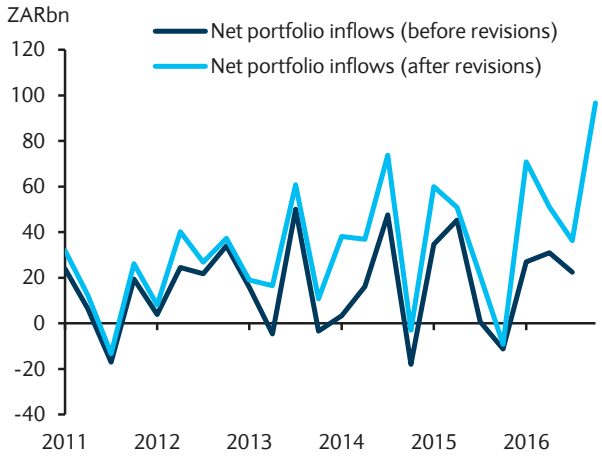
A structural deficit in invisible flows is likely to persist



Source: SARB, Barclays Research

FIGURE 24

The SARB has revised its portfolio equity inflow data higher



Source: SARB, Barclays Research

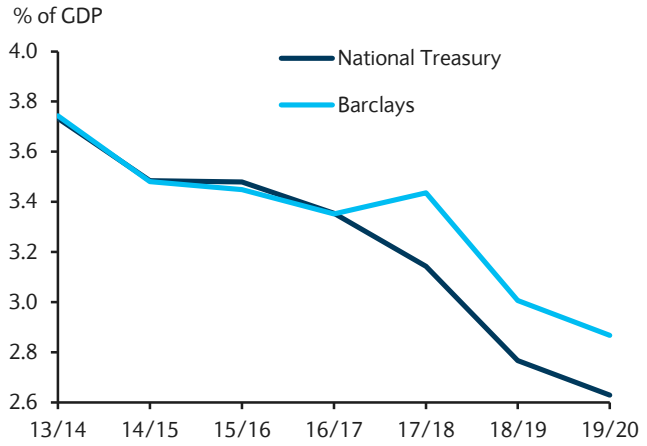
Fiscal consolidation is a tough challenge

Cabinet reshuffle raises concerns about fiscal consolidation no matter what assurances President Zuma and the new finance minister offer

With South Africa skirting the on edge of some fairly slippery debt dynamics currently, the 2017/18 Budget presented in February by then-Finance Minister Gordhan imposed a tough adjustment programme with R28bn of tax hikes falling principally on consumers (worth 0.6% of GDP) and expenditure cuts worth 0.4% of GDP. Our base case scenario is that South Africa's strong budgeting systems will ensure that National Treasury's nominal expenditure ceilings are observed for this year at least, but President Zuma's decision to replace the respected Gordhan with Malusi Gigaba, a staunch loyalist with little public finance experience, has raised certainly raised medium-term risks in this regard. The cabinet reshuffle also moved Faith Muthambi from Communications, where she presided over the financial and institutional collapse of the SABC, to the Department of Public Service and Administration, an important portfolio given the need to renegotiate the key public sector pay deal which expires in March 2018, which only added to concerns. Moreover, we see downside risks to budgeted tax collections in the current fiscal year, given: i) our view that both the GDP growth and GDP deflator assumptions in the budget are a little too high; i) changes to retirement savings schemes effective 1 March 2016 could lead to large personal income tax (PIT) refunds this year; and iii) institutional turmoil at South African Revenue Services (SARS) potentially negatively affecting tax compliance and morality. Partly offsetting this, however, is the possibility of revenues from the sugar tax to be introduced later this year, and unbudgeted revenues from the Special Voluntary Disclosure Program, which runs to 31 August. Furthermore, the R4.4bn that Treasury pencilled into the budget from the new 45% top marginal rate of income tax seems to us to be too low.

FIGURE 25

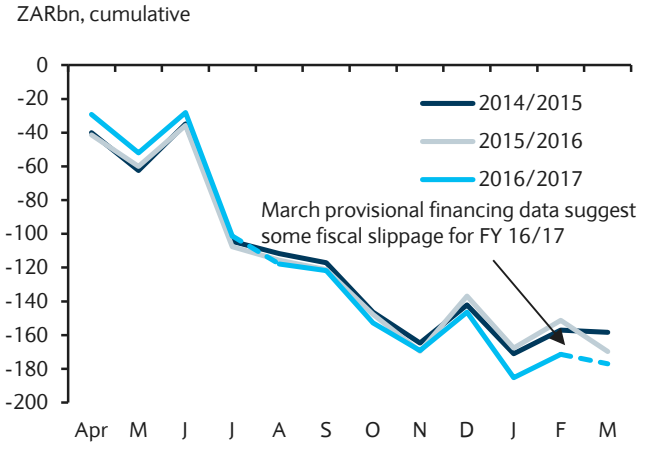
We expect Treasury to miss its fiscal deficit targets



Source: National Treasury, Barclays Research

FIGURE 26

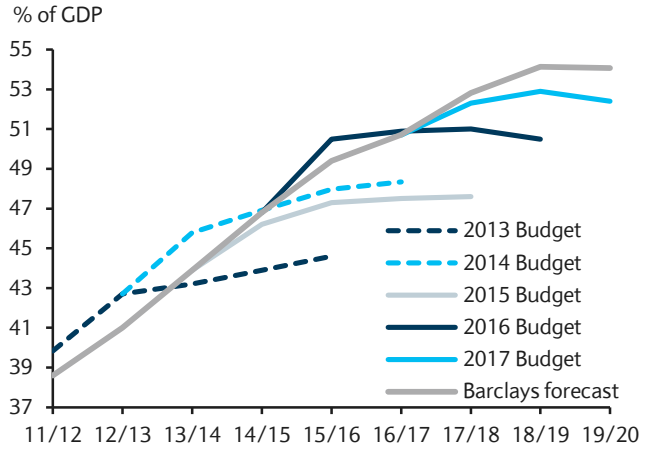
Provisional financing data for March point to a small deficit



Source: National Treasury, Barclays Research

FIGURE 27

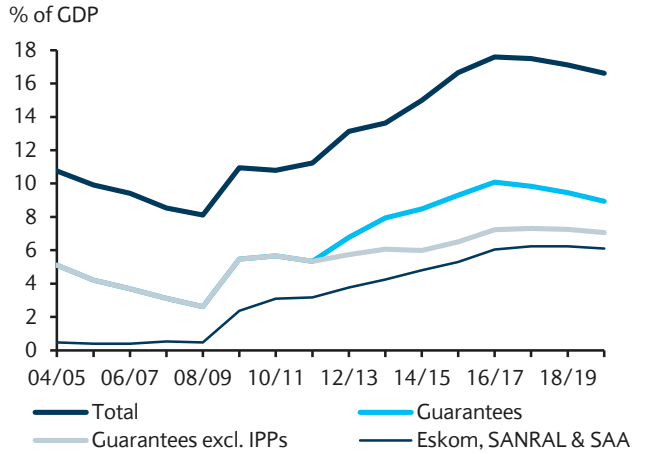
Treasury projects debt to peak in 2018/19 but we disagree



Source: National Treasury, Barclays Research

FIGURE 28

Contingent liabilities are rising



Source: National Treasury, Barclays Research

We see fiscal slippage risks on the revenue front and suspect the debt ratio will not stabilize in 2018/19 as Treasury currently forecasts

Nonetheless, the balance of risks seems to us to be weighted to the downside. In particular, the fact that that the tax buoyancy ratio is estimated to have dropped below 0.9 in FY 16/17, despite some R18bn of new tax measures, highlights that the Budget's assumption that it recovers to 1.5 this year is not by any means guaranteed, despite R28bn of tax hikes. At this early stage, we expect revenue slippage compared to the current budget targets of R13bn. This implies a consolidated deficit of 3.4% of GDP this year, compared to the Treasury's budget target of 3.1% of GDP. Nor are we convinced by SARS's head Tom Moyane's assertion his department exactly hit the budgeted tax collections target of R1144bn in FY 2016/17, since it would imply that tax receipts implausibly rose 15.4% y/y in March; we think it likely that SARS has simply delayed VAT refunds in order to boost net tax receipts in the last fiscal year, at the expense of the current one. Even with fairly modest revenue shortfalls or expenditure overruns, the debt ratios are unlikely to peak at 52.9% of GDP in 2018/19 as forecast by National Treasury, before easing in 2019/20. Instead, we forecast gross debt to GDP flat-lining at 54.1% in 2018/19 and 2019/20. Moreover, we view the longer-term fiscal path as being highly contingent on the outcome of factional battle currently gripping the African National Congress, with victory by the patronage network surrounding President Zuma likely to undermine confidence and growth, and to bind the country into a costly nuclear power procurement programme. Moreover, without a

much stronger approach to the management of state owned companies (SOCs) like Eskom, there is a growing likelihood that some of the Treasury's guarantees on SOC borrowings, already estimated at 10.1% of GDP in 2016/17 (7.2% excluding guarantees to renewable independent power producers), will crystallise onto the government's balance sheet.

Politics motivate agencies to downgrade, despite some structural reforms

Structural reform progress has been mixed, with some positive labour market news, but continued turmoil at state-owned companies, and ongoing regulatory uncertainty in the key mining industry

Broadly, the key concerns of the three main credit rating agencies have been the weakness of growth, the slow pace of fiscal consolidation (including the weak financial position at many SOCs due to poor management), and patchy progress on various necessary but politically and ideologically challenging structural reforms. Even prior to President Zuma's cabinet reshuffle, the credit rating agencies were worried, as evidenced by the Negative Outlooks on their low investment grade ratings. On the structural reform front, we believed that ratings agencies would take encouragement from the official launch of InvestSA, a one-stop-shop investment facilitation service, and reforms like the National Minimum Wage and the associated strike calming measures. However, continuing tensions between the government and the mining industry over regulatory issues like the Mining Charter and President Zuma's proposal for Constitutional change to allow land expropriation without compensation are causing unease, as does the ongoing institutional turmoil at a great many SOCs. Overall, we think that structural reform progress has been patchy and mixed. Nonetheless, we believed that that while Moody's would likely downgrade South Africa to Baa3, S&P and Fitch would probably prefer to wait until December to see how the factional battle for leadership of the ANC and the country plays out before deciding whether to downgrade South Africa.

Downgrades are coming swiftly in the wake of Zuma's reshuffle, and more could follow if the political tensions intensify and undermine an already weak economy

In any event, however, President Zuma's cabinet reshuffle has blown away the rating agencies' caution. In a rather stark move, S&P announced on Monday 3 April that it was implementing an out-of-cycle one-notch rating cut, taking the foreign currency (FC) rating to BB+ (just below investment grade) and the local currency (LC) rating to BBB-. Notably, it retained its Negative Outlook. Shortly afterwards, Moody's announced it was putting South Africa on review for a downgrade, with the review process likely to take anywhere between 30-90 days. This means it is unlikely to announce a decision at its scheduled meeting on Friday 7 April. Nonetheless, we fully expect Moody' to cut its Baa2 LC and FC ratings to Baa3 sooner rather than later, although we highly doubt it will move two notches in one fell swoop as some in the market appear to fear. Meanwhile, Fitch, which does not publish an advance schedule of its releases, could issue its decision any time. We expect it to downgrade South Africa's BBB- LC and FC ratings, by one notch, giving South Africa its first sub-investment grade LC rating. Notably, two sub-investment grade LC ratings are needed to provoke a wave of forced selling of South Africa rand denominated bonds from funds that are passively managed against global government bond indices, but active money managers may of course anticipate this. Thus, the market's reaction may depend very much on whether Moody's and Fitch retain a Negative Outlook on their new ratings, or move to Stable, and what these two rating agencies say about the conditions under which they would implement a further downgrade.

Political tensions likely to drag heavily on confidence and the economy

President Zuma and his allies seem to have the upper hand for now

We have long been flagging that even though politics appeared to be quieter this year than the second half of last year, political event risk would remain elevated in the run-up to the ANC's electoral conference in December. President Zuma's reshuffle which saw not just Gordhan and his deputy axed, but Gordhan came as part of a number of performing ministers replaced, and Zuma's allies (some with patchy performance records as ministers) retained or even promoted. The country has set been set painfully on tenterhooks by Zuma's move, with a rapidly mounting backlash among opposition parties, the ANC's alliance partners (SACP and COSATU) and some segments of the ANC itself, the business community and wider society. Protests are being organised by various groups but it is unclear at the time of this writing how widespread they will be. However, it seems to us that

President Zuma and his allies have secured the upper hand for now, with ANC Secretary General Gwede Mantashe briefing that a meeting of the National Working Committee (NWC) had decided to accept Zuma's reasons for firing Gordhan. Mantashe also said that the NWC had concluded that public criticism of Zuma's move by Mantashe himself, Deputy President Ramaphosa, and ANC Treasurer-General Zweli Mkhize, was "a mistake". The next meeting of the ANC's National Executive Committee (NEC) will be highly important, the timing of which is unclear at this stage. It could once again debate recalling President Zuma, although we doubt that such an initiative from Zuma's critics in the NEC members will be any more successful than last time, especially after Mantashe's backsliding. We think President Zuma is likely to have calculated carefully his level of support in the NEC.

We do not think President Zuma is likely to be dislodged by a parliamentary vote of no confidence

Nor do we expect a parliamentary vote of no-confidence, now scheduled for a special emergency sitting on 18 April, to succeed. The parliamentary arithmetic is simply stacked against Zuma's opponents. The ANC has 249 of National Assembly's 400 MPs. On the surface, this would appear to suggest at least 50 ANC MP's must vote with the opposition (assuming all the opposition MPs are present are in favour of the no confidence motion, which is in fact unlikely.) This is an extremely tall order with Mantashe yesterday warning ANC MPs not to side with the opposition, and Baleka Mbete, the speaker of the National Assembly, having said that there would be no secret vote. Still the SACP has come out publicly to state that Zuma must stand down and many ANC parliamentarians – it is not clear how many – are also members of the SACP, nor where their allegiance would cleave if the SACP advised its members to support the 'no confidence' motion.

Notably, there is some uncertainty on the issue of what happens in the event of abstentions. We have been arguing that an alternative scenario for a successful 'no confidence' vote would be for 100 ANC MPs to abstain (itself a tall order) giving a bare majority of 151 to 149 in favour of the 'no confidence' vote. However, on this matter, South Africa's constitution is not totally clear, since it states simply that "If the National Assembly by a vote supported by a majority of its members passes a motion of no confidence in the President, the President and other members of the cabinet and any Deputy Ministers must resign." This could be read to mean an absolute majority of MPs or a majority of MPs casting a vote. It is not clear what would happen if, for example, 20 ANC MPs voted with the opposition and 60 ANC MPs abstained. This would give a vote outcome of 171 to 169 – a close enough call that it would likely end up in the Constitutional Court. But, in fact, we do not expect the vote to succeed, even in this more ambiguous fashion with lots of ANC abstentions. In previous 'no confidence' vote in November, 216 voted against and 126 in favour with 58 abstentions among both ANC and opposition MPs.

Currently it looks like President Zuma's faction has the upper hand, but political uncertainty looks likely to prevail for some time.

The is no clarity on which faction – if any – will emerge as the dominant force from the contest to replace President Zuma and the rest of the top leadership of the ANC at the electoral conference in December, although it currently appears that President Zuma's faction has the upper hand. In the months to come, investors should pay close attention to any moves that Zuma might make against his opponents within the ANC, as well as the forthcoming ANC policy conference (30 June /5 July), since it may determine measures to avoid factionalism and slate voting in the December contests as well as endorse or reject more populist economic policy approaches to shore up the ANC's support. We expect the remainder of 2017 to be quite bumpy, with plenty of potential domestic political event risk.

FIGURE 29

Main macroeconomic variables in South Africa

	2016		2017				2018									
	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	2015	2016	2017F	2018F	2019F	2020F
Output (% q/q saar)																
Real GDP	0.4	-0.3	1.2	1.3	1.6	1.5	1.3	1.4	1.3	1.4	1.3	0.3	1.0	1.4	1.6	2.0
Real GDP (%y/y)	0.6	0.4	1.1	0.7	0.9	1.4	1.4	1.4	1.4	1.3	1.3	0.3	1.0	1.4	1.6	2.0
Household consumption	2.2	2.2	-0.2	0.1	1.6	1.4	0.9	1.1	1.2	1.2	1.7	0.8	1.0	1.1	1.6	2.0
Durable goods	-3.2	0.2	-5.9	-4.6	6.4	2.0	1.6	2.0	2.0	2.4	-1.9	-7.3	-2.2	2.1	3.1	4.5
Semi-durable goods	-0.9	6.8	0.3	0.3	0.5	0.5	1.2	1.2	1.2	1.2	4.0	3.3	1.5	0.9	1.7	2.4
Non-durable goods	1.1	0.3	0.4	0.8	2.4	2.8	0.4	0.4	0.4	0.4	2.2	0.9	1.0	1.1	1.4	2.0
Services	5.0	3.2	0.4	0.4	0.4	0.4	1.2	1.4	1.6	1.6	1.5	2.1	1.6	1.0	1.3	1.5
Public consumption	1.9	0.3	-0.5	2.2	1.9	2.5	0.9	1.1	1.5	1.7	0.5	2.0	1.2	1.6	1.7	1.8
Investment	-3.5	1.7	-2.7	-2.2	-1.7	0.6	1.6	1.6	1.6	1.9	2.3	-3.9	-1.6	0.8	2.0	2.5
Exports	-21.2	12.5	1.9	2.2	6.6	3.1	0.0	2.3	0.7	2.9	3.9	-0.1	2.1	2.2	1.8	2.0
Imports	-1.0	6.1	1.8	0.2	4.6	0.3	-1.9	3.0	1.5	3.3	5.4	-3.7	1.5	1.1	1.7	2.0
External and government accounts (% of GDP)																
Current account	-3.8	-1.7	-2.5	-3.7	-4.0	-3.6	-3.5	-3.6	-3.5	-3.4	-4.4	-3.3	-3.5	-3.5	-3.6	-4.1
Consolidated fiscal balance*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-3.4	-3.4	-3.4	-3.0	-2.9	-2.5
Consolidated primary balance*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-0.1	0.1	0.2	0.7	0.9	1.3
Government debt*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	49.0	50.7	52.8	54.1	54.1	53.5
Prices (% y/y)																
CPI inflation	6.0	6.6	6.4	5.7	5.5	5.2	4.8	5.1	5.8	6.3	4.6	6.3	5.7	5.5	5.6	5.5
Core CPI inflation	5.7	5.7	5.4	5.4	5.4	5.3	5.2	5.2	5.3	5.4	5.5	5.6	5.4	5.3	5.4	5.4
PPI inflation	7.1	6.9	6.4	5.8	5.5	6.6	5.7	6.1	5.8	5.6	3.6	7.1	6.1	5.8	4.9	4.7
Interest rates (% eop)																
Repurchase rate	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	6.25	7.00	7.00	7.00	7.00	7.00
Prime rate	10.50	10.50	10.50	10.50	10.50	10.50	10.50	10.50	10.50	10.50	9.75	10.50	10.50	10.50	10.50	10.50

Source: SARB, National Treasury, Stats SA, Barclays Research

Analyst Certification
We, Miyelani Maluleke and Peter Worthington, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

Important Disclosures:
Absa Research is produced by Absa Bank Limited acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and also affiliated with the Investment Bank of Barclays Bank PLC and its affiliates (referred to as "Absa").

All authors contributing to this research report are Research Analysts unless otherwise indicated. The publication date at the top of the report reflects the local time where the report was produced and may differ from the release date provided in GMT.

Availability of Disclosures:
For current important disclosures regarding any issuers which are the subject of this research report please refer to https://publicresearch.barclays.com or alternatively send a written request to: Barclays Research Compliance, 745 Seventh Avenue, 13th Floor, New York, NY 10019 or call +1-212-526-1072.

Absa does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Absa may have a conflict of interest that could affect the objectivity of this report. Absa regularly trades, generally deals as principal and generally provides liquidity (as market maker or otherwise) in the debt securities that are the subject of this research report (and related derivatives thereof). Absa trading desks may have either a long and / or short position in such securities, other financial instruments and / or derivatives, which may pose a conflict with the interests of investing customers. Where permitted and subject to appropriate information barrier restrictions, Absa fixed income research analysts regularly interact with its trading desk personnel regarding current market conditions and prices. Absa fixed income research analysts receive compensation based on various factors including, but not limited to, the quality of their work, the overall performance of the firm (including the profitability of the Corporate and Investment Banking division), the profitability and revenues of the Markets business and the potential interest of the firm's investing clients in research with respect to the asset class covered by the analyst. To the extent that any historical pricing information was obtained from Absa trading desks, the firm makes no representation that it is accurate or complete. All levels, prices and spreads are historical and do not represent current market levels, prices or spreads, some or all of which may have changed since the publication of this document. The Absa Research Department within Absa Bank Limited operates independently from the Barclays Research Department within the Investment Bank of Barclays Bank PLC and its affiliates (collectively "Barclays"). Eligible clients may receive research reports from both research departments, which may reach different conclusions and may contain different or conflicting ratings or research recommendations, whether as a result of differing time horizons, methodologies, or otherwise.
In order to access Barclays Statement regarding Research Dissemination Policies and Procedures, please refer to *https://publicresearch.barcap.com/static/S_ResearchDissemination.html*. In order to access Barclays Research Conflict Management Policy Statement, please refer to: *https://publicresearch.barcap.com/static/S_ConflictManagement.html*.

All pricing information is indicative only. Prices are sourced from Thomson Reuters as of the last available closing price at the time of production of the research report, unless another time and source is indicated.

Explanation of other types of investment recommendations produced by Absa FICC Research:
Trade ideas contained herein that have been produced by the Credit teams within Absa Research are valid at current market conditions and may not be otherwise relied upon.
Trade ideas contained herein that have been produced by other research teams within Absa FICC Research shall remain open until they are subsequently amended or closed in a future research report.

Disclosure of previous investment recommendations produced by Absa and Barclays FICC Research:
Absa FICC Research may have published other investment recommendations in respect of the same securities/instruments recommended in this research report during the preceding 12 months. To view previous investment recommendations published by Absa FICC Research and Barclays FICC Research in the preceding 12 months please refer to *https://live.barcap.com/go/research/ResearchInvestmentRecommendations*.

Legal entities involved in producing Absa Research:
Absa Bank Limited (Absa, South Africa)

Disclaimer:
This publication has been produced by Absa Bank Limited acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and affiliated with the Investment Bank of Barclays Bank PLC (referred to as "Absa"). It has been distributed by Absa or one or more Barclays affiliated legal entities listed below. It is provided to our clients for information purposes only, and Absa makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to any data included in this publication. To the extent that this publication states on the front page that it is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors under U.S. FINRA Rule 2242, it is an "institutional debt research report" and distribution to retail investors is strictly prohibited. Absa also distributes such institutional debt research reports to various issuers, regulatory and academic organisations for informational purposes and not for the purpose of making investment decisions regarding any debt securities. Any such recipients that do not want to continue receiving Absa institutional debt research reports should contact debtresearch@barclays.com. Absa will not treat unauthorized recipients of this report as its clients and accepts no liability for use by them of the contents which may not be suitable for their personal use. Prices shown are indicative and Absa is not offering to buy or sell or soliciting offers to buy or sell any financial instrument.
Without limiting any of the foregoing and to the extent permitted by law, in no event shall Absa, nor any affiliate, nor any of their respective officers, directors, partners, or employees have any liability for (a) any special, punitive, indirect, or consequential damages; or (b) any lost profits, lost revenue, loss

of anticipated savings or loss of opportunity or other financial loss, even if notified of the possibility of such damages, arising from any use of this publication or its contents.

Other than disclosures relating to Absa, the information contained in this publication has been obtained from sources that Absa Research believes to be reliable, but Absa does not represent or warrant that it is accurate or complete. Absa is not responsible for, and makes no warranties whatsoever as to, the information or opinions contained in any written, electronic, audio or video presentations of third parties that are accessible via a direct hyperlink in this publication or via a hyperlink to a third-party web site ('Third-Party Content'). Any such Third-Party Content has not been adopted or endorsed by Absa, does not represent the views or opinions of Absa, and is not incorporated by reference into this publication. Third-Party Content is provided for information purposes only and Absa has not independently verified its accuracy or completeness.

The views in this publication are those of the author(s) and are subject to change, and Absa has no obligation to update its opinions or the information in this publication. If this publication contains recommendations, those recommendations reflect solely and exclusively those of the authoring analyst(s), and such opinions were prepared independently of any other interests, including those of Absa and/or its affiliates. This publication does not constitute personal investment advice or take into account the individual financial circumstances or objectives of the clients who receive it. The securities discussed herein may not be suitable for all investors. Absa recommends that investors independently evaluate each issuer, security or instrument discussed herein and consult any independent advisors they believe necessary. The value of and income from any investment may fluctuate from day to day as a result of changes in relevant economic markets (including changes in market liquidity). The information herein is not intended to predict actual results, which may differ substantially from those reflected. Past performance is not necessarily indicative of future results.

This document is being distributed (1) only by or with the approval of an authorised person (Barclays Bank PLC) or (2) to, and is directed at (a) persons in the United Kingdom having professional experience in matters relating to investments and who fall within the definition of "investment professionals" in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order"); or (b) high net worth companies, unincorporated associations and partnerships and trustees of high value trusts as described in Article 49(2) of the Order; or (c) other persons to whom it may otherwise lawfully be communicated (all such persons being "Relevant Persons"). Any investment or investment activity to which this communication relates is only available to and will only be engaged in with Relevant Persons. Any other persons who receive this communication should not rely on or act upon it. Barclays Bank PLC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange.

The Investment Bank of Barclays Bank PLC undertakes U.S. securities business in the name of its wholly owned subsidiary Barclays Capital Inc., a FINRA and SIPC member. Barclays Capital Inc., a U.S. registered broker/dealer, is distributing this material in the United States and, in connection therewith accepts responsibility for its contents. Any U.S. person wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Barclays Capital Inc. in the U.S. at 745 Seventh Avenue, New York, New York 10019.

Non-U.S. persons that are clients of Barclays should contact and execute transactions through a Barclays Bank PLC branch or affiliate in their home jurisdiction unless local regulations permit otherwise.

Barclays Bank PLC, Paris Branch (registered in France under Paris RCS number 381 066 281) is regulated by the Autorité des marchés financiers and the Autorité de contrôle prudentiel. Registered office 34/36 Avenue de Friedland 75008 Paris.

This material is distributed in Canada by Barclays Capital Canada Inc., a registered investment dealer, a Dealer Member of IIROC (www.iiroc.ca), and a Member of the Canadian Investor Protection Fund (CIPF).

Subject to the conditions of this publication as set out above, Absa Bank Limited, acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and affiliated with the Investment Bank of Barclays Bank PLC, an authorised financial services provider (Registration No.: 1986/004794/06. Registered Credit Provider Reg No NCRCP7), is distributing this material in South Africa. Absa Bank Limited is regulated by the South African Reserve Bank. This publication is not, nor is it intended to be, advice as defined and/or contemplated in the (South African) Financial Advisory and Intermediary Services Act, 37 of 2002, or any other financial, investment, trading, tax, legal, accounting, retirement, actuarial or other professional advice or service whatsoever. Any South African person or entity wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Absa Bank Limited acting through its Corporate and Investment Bank division in South Africa, 7th Floor, Barclays Towers West, 15 Troye Street, Johannesburg, 2001. Absa Bank Limited is an affiliate of the Barclays group.

All Absa research reports are distributed to institutional investors in Japan by Barclays Securities Japan Limited. Barclays Securities Japan Limited is a joint-stock company incorporated in Japan with registered office of 6-10-1 Roppongi, Minato-ku, Tokyo 106-6131, Japan. It is a subsidiary of Barclays Bank PLC and a registered financial instruments firm regulated by the Financial Services Agency of Japan. Registered Number: Kanto Zaimukyokucho (kinsho) No. 143.

Barclays Bank PLC, Hong Kong Branch is distributing this material in Hong Kong as an authorised institution regulated by the Hong Kong Monetary Authority. Registered Office: 41/F, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

Absa equity research reports are distributed in India by Barclays Securities (India) Private Limited (BSIPL). BSIPL is a company incorporated under the Companies Act, 1956 having CIN U67120MH2006PTC161063. BSIPL is registered and regulated by the Securities and Exchange Board of India (SEBI) as a Research Analyst: INH000001519; Portfolio Manager INP000002585; Stock Broker/Trading and Clearing Member: National Stock Exchange of India Limited (NSE) Capital Market INB231292732, NSE Futures & Options INF231292732, NSE Currency derivatives INE231450334, Bombay Stock Exchange Limited (BSE) Capital Market INB011292738, BSE Futures & Options INF011292738; Depository Participant (DP) with the National Securities & Depositories Limited (NSDL): DP ID: IN-DP-NSDL-299-2008; Investment Adviser: INA000000391. The registered office of BSIPL is at 208, Ceejay House, Shivsagar Estate, Dr. A. Besant Road, Worli, Mumbai – 400 018, India. Telephone No: +91 2267196000. Fax number: +91 22 67196100. Any other reports produced by Absa are distributed in India by Barclays Bank PLC, India Branch, an associate of BSIPL in India that is registered with Reserve Bank of India (RBI) as a Banking Company under the provisions of The Banking Regulation Act, 1949 (Regn No BOM43) and registered with SEBI as Merchant Banker (Regn No INM000002129) and also as Banker to the Issue (Regn No INBI00000950). Barclays Investments and Loans (India) Limited, registered with RBI as Non Banking Financial Company (Regn No RBI CoR-07-00258), and Barclays Wealth Trustees (India) Private Limited, registered with Registrar of Companies (CIN U93000MH2008PTC188438), are associates of BSIPL in India that are not authorised to distribute any reports produced by Absa.

Barclays Bank PLC Frankfurt Branch distributes this material in Germany under the supervision of Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

This material is distributed in Mexico by Barclays Bank Mexico, S.A.

Nothing herein should be considered investment advice as defined in the Israeli Regulation of Investment Advisory, Investment Marketing and Portfolio Management Law, 1995 ("Advisory Law"). This document is being made to eligible clients (as defined under the Advisory Law) only. Barclays Israeli branch previously held an investment marketing license with the Israel Securities Authority but it cancelled such license on 30/11/2014 as it solely provides its services to eligible clients pursuant to available exemptions under the Advisory Law, therefore a license with the Israel Securities Authority is

not required. Accordingly, Barclays does not maintain an insurance coverage pursuant to the Advisory Law.

Barclays Bank PLC in the Dubai International Financial Centre (Registered No. 0060) is regulated by the Dubai Financial Services Authority (DFSA). Principal place of business in the Dubai International Financial Centre: The Gate Village, Building 4, Level 4, PO Box 506504, Dubai, United Arab Emirates. Barclays Bank PLC-DIFC Branch, may only undertake the financial services activities that fall within the scope of its existing DFSA licence. Related financial products or services are only available to Professional Clients, as defined by the Dubai Financial Services Authority.

Barclays Bank PLC in the UAE is regulated by the Central Bank of the UAE and is licensed to conduct business activities as a branch of a commercial bank incorporated outside the UAE in Dubai (Licence No.: 13/1844/2008, Registered Office: Building No. 6, Burj Dubai Business Hub, Sheikh Zayed Road, Dubai City) and Abu Dhabi (Licence No.: 13/952/2008, Registered Office: Al Jazira Towers, Hamdan Street, PO Box 2734, Abu Dhabi).

Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority (QFCRA). Barclays Bank PLC-QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA licence. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar. Related financial products or services are only available to Business Customers as defined by the Qatar Financial Centre Regulatory Authority.

This material is distributed in the UAE (including the Dubai International Financial Centre) and Qatar by Barclays Bank PLC.

This material is not intended for investors who are not Qualified Investors according to the laws of the Russian Federation as it might contain information about or description of the features of financial instruments not admitted for public offering and/or circulation in the Russian Federation and thus not eligible for non-Qualified Investors. If you are not a Qualified Investor according to the laws of the Russian Federation, please dispose of any copy of this material in your possession.

This material is distributed in Singapore by the Singapore branch of Barclays Bank PLC, a bank licensed in Singapore by the Monetary Authority of Singapore. For matters in connection with this report, recipients in Singapore may contact the Singapore branch of Barclays Bank PLC, whose registered address is 10 Marina Boulevard, #23-01 Marina Bay Financial Centre Tower 2, Singapore 018983.

This material is distributed to persons in Australia by either Barclays Bank PLC, Barclays Capital Inc., Barclays Capital Securities Limited or Barclays Capital Asia Limited. None of Barclays Bank PLC, nor any of the other referenced Barclays group entities, hold an Australian financial services licence and instead they each rely on an exemption from the requirement to hold such a licence. This material is intended to only be distributed to “wholesale clients” as defined by the Australian Corporations Act 2001.

IRS Circular 230 Prepared Materials Disclaimer: Absa does not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.

© Copyright Absa Bank Limited (2017). All rights reserved. No part of this publication may be reproduced or redistributed in any manner without the prior written permission of Absa. Absa Bank Limited is duly registered in South Africa Registration No. 1986/004794/06 Registered office Barclays Towers West, 15 Troye Street, Johannesburg, 2001. Additional information regarding this publication will be furnished upon request.