ABSA

Economic Research
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South Africa Quarterly Perspectives: Q4 17

Countdown to the ANC conference

- South Africa has emerged from recession but the growth outlook is modest. Business confidence remains weak across all key sectors amid lingering political and policy uncertainty. The consumer has showed more resilience than expected but underlying drivers of spending remain downbeat. Our baseline forecasts are for GDP growth of 0.6% in 2017 and some improvement to 1.1% in 2018.
- Headline CPI inflation has continued to ease, due to a sharp slowdown in food price inflation and persistent slack in the economy. We look for headline CPI inflation to reach a low of around 4.2% in Q1 18 before rising gradually to 5.7% in the final quarter of 2018. Electricity tariffs are a key risk for the 2018 outlook.
- Monetary policy is becoming increasingly unpredictable with a divided MPC and a highly uncertain environment. We think the SARB has shown caution recently and will prefer to stay on hold now pending resolution of some of the big risks.
- Tax collections are running short of target and a big deficit slippage of 0.7% of GDP seems likely. In addition, contingent liabilities via Treasury guarantees on troubled SOEs' borrowings are starting to crystallise onto the fiscus. There are no easy answers and we think that Finance Minister Gigaba will struggle to present a reassuring and credible mid-year budget update on 25 October.
- We think the rating agencies will wait for the outcome of the ANC's December electoral conference and the 2018/19 budget in February before taking further action, although Fitch might change its outlook to Negative before end-2017. Without a market-friendly outcome in December and strengthened reform efforts in 2018, we believe further credit rating downgrades are likely.
- We expect the ZAR to weaken to 13.90/USD by year-end and reach 15.10/USD by mid-2018. We think that global low volatility, broad-based dollar weakness and firmer commodity prices which have helped the ZAR in 2017 are mostly already priced in. Thus, we think the ZAR is still vulnerable to negative domestic political and economic news or shifts in sentiment about Fed tightening.
- With the ANC's national elective conference just 10 weeks away, political uncertainties abound. The outcome of the conference remains highly uncertain. However, even if the conference outcome is broadly market-friendly, we believe political uncertainties will persist. General elections are due in 18 months.

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Q2 growth rebound does not herald lasting recovery

Q2 growth rebound unlikely to be sustained; even though agriculture is set to continue to contribute strongly to GDP growth, the outlook for mining is dim

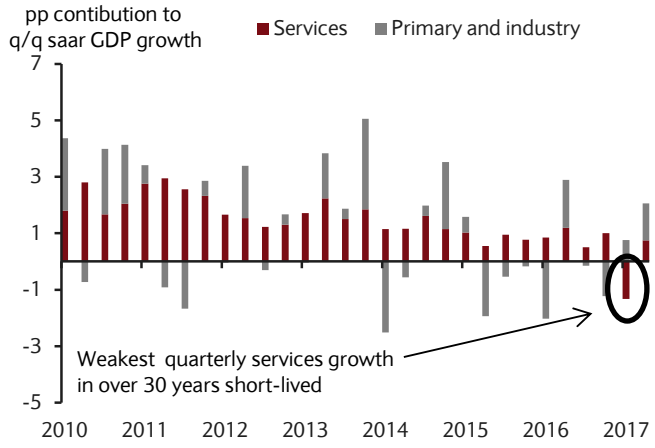
South Africa emerged from its second recession in nearly a decade as GDP growth rebounded to 2.5% q/q saar in Q2 17. While some growth rebound in the second quarter was broadly expected, the broad-based nature of the recovery was especially welcome, suggesting that the unusually weak performance of the services sector in Q1 was an extreme and temporary blip. Eight of the ten production-side GDP sectors expanded in Q2 after as many contracted in Q1. However, despite the encouraging rebound, the outlook for growth in the near- to medium-term remains challenging in our view. Agriculture is set to continue to be a strong contributor to growth in the coming quarters. Expectations for the summer crop harvest have been revised higher with maize output in particular reaching a record high of 16.7mn tons. If the historical relationship between maize output holds (see Figure 2), agricultural GVA growth could be more than 20% this year. Mining, which has already had a strong H1, could continue to benefit from the recent uptick in commodity prices, particularly as mining investment has grown by an average of 5.0% y/y over the past four quarters. We find this surprising given downbeat sentiment in the industry generally, and ongoing regulatory uncertainty over the Mining Charter and the Mineral and Petroleum Resources Development Act amendment legislation. Notably, mining output started the third quarter on low note as seasonally adjusted production fell 0.4% m/m (+0.9% y/y) in July. The resolution of the ongoing regulatory uncertainty is key to the sector's long-term potential growth.

A surprise expansion of the manufacturing sector in Q2 looks unlikely to be sustained given PMI and confidence survey data

The manufacturing sector expanded in Q2 but challenges remain. After three successive quarters of contraction, the sector surprised with a 1.5% q/q saar expansion in Q2 and 1.5 m/m sa in July. However, as with the mining sector, the outlook also remains uncertain with confidence remaining low at 27 in Q3, albeit better than the nadir of 11 in Q2. The pessimism in Q3 was broad based, with 15 of the 16 manufacturing subsectors surveyed by the Bureau of Economic Research reporting confidence levels below the neutral level of 50, with just the clothing sector sitting marginally above it at 52. Tellingly, a near-record 86% of respondents rate the "general political climate" as a constraint on their business while a net balance of 27% expect things to be worse in twelve months time. Moreover, the Absa manufacturing PMI has languished well below 50 throughout Q3. Beyond manufacturing, the Markit PMI, which covers the services sector in addition to the industrial sector, has also continued to hover around 50, indicating that overall growth momentum remains lacklustre.

FIGURE 1

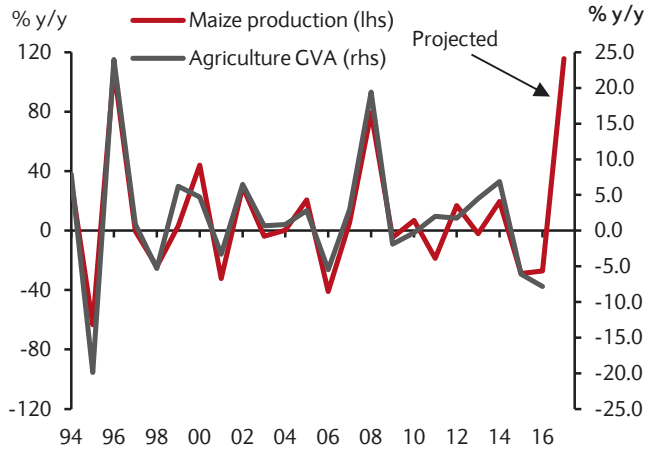
Weak Q1 services growth performance reversed in Q2 17



Source: Thomson Reuters, Absa Research

FIGURE 2

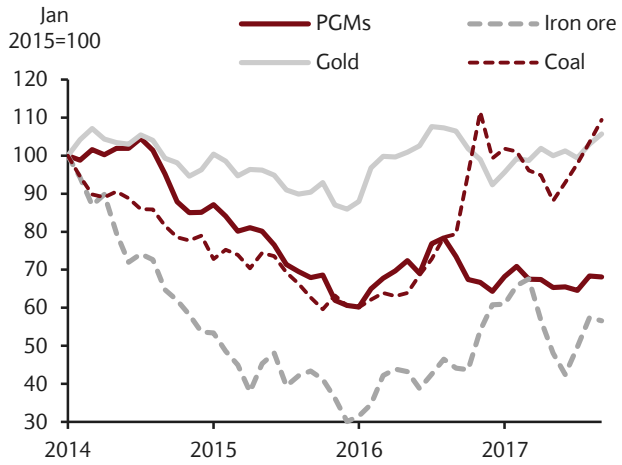
Agricultural activity remains set for a strong year



Source: Department of Agriculture, Stats SA, Absa Research

FIGURE 3

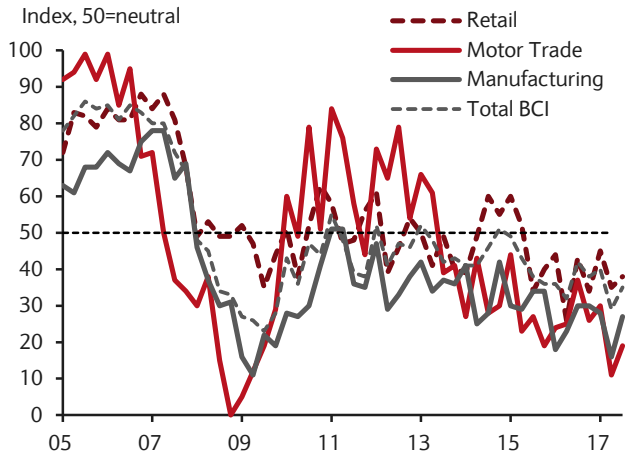
Commodity prices have edged higher in recent months



Source: Thomson Reuters, Absa Research

FIGURE 4

Weak business confidence remained broad-based in Q3

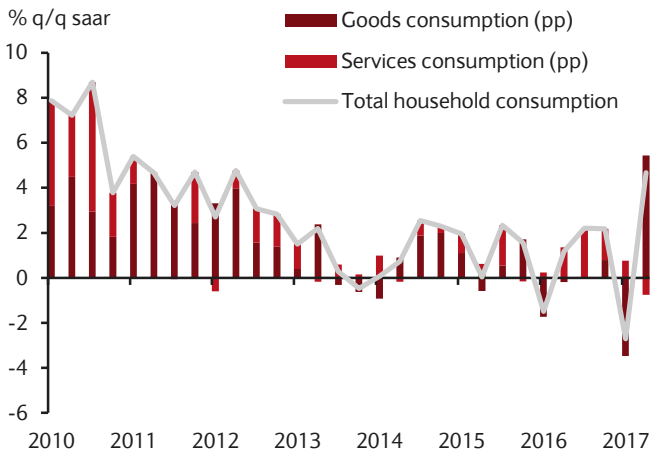


Source: BER, Absa Research

On the demand side of the national accounts some of the data suggests an encouraging stabilisation, particularly in household spending. Household consumption expenditure increased sharply by 4.7% q/q saar in the second quarter, recovering from its weakest contraction since the global financial crisis in Q1. Even after accounting for some of the volatility in the data which reflects a reverberating echo of exceptional and new Black Friday spending in Q4 16, the Q2 17 print was still a lot stronger than expected. However, we still see little to support this momentum in the near term. As we discuss in Box 1 below, support factors for household consumption expenditure remain downbeat. There will of course be pockets of resilience in the consumer story, particularly among the high income households whose personal finances have remained relatively strong according to the recent BER survey of consumer confidence. That said, we think real household consumption expenditure growth will be about 0.9% this year with only a marginal improvement to 1.0% in 2018.

FIGURE 5

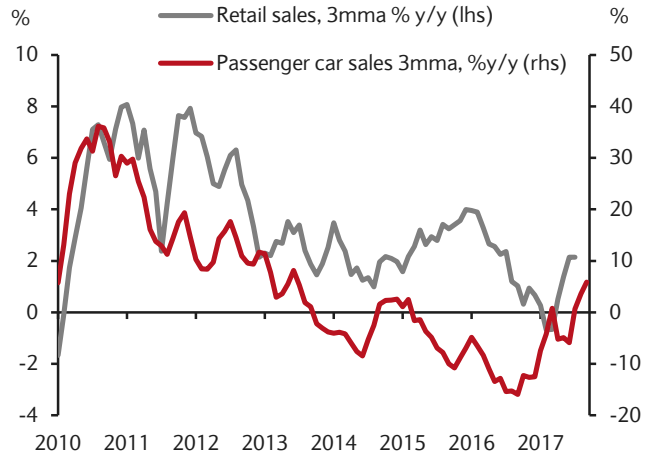
Household consumption rose sharply in Q2 17…



Source: Stats SA, Absa Research

FIGURE 6

…while passenger car sales continued to pick up in Q3



Source: NAAMSA, Stats SA, Absa Research

Box 1: Consumer: volatile spending data but fundamentals remain weak

Recent data on household consumption expenditure have been quite volatile. For instance, household spending growth rose sharply in Q2 after a sharp collapse in Q1. Part of this volatility is likely related to the increasingly significant Black Friday spending, which we think may not yet be fully captured in Stats SA's seasonal adjustment framework. More recent data have been mixed. While passenger car sales growth was stronger than we expected during Q3, retail sales growth eased notably in July by 0.6% m/m (sa). Despite all the mixed spending data, support factors for consumer spending have remained generally downbeat.

On the labour market front, conditions remain unsupportive. Job losses were reported in both the Quarterly Employment Statistics (-113k) and Quarterly Employment Statistics (-38k of formal non-agricultural jobs) with BER surveys suggesting that an improvement is unlikely in Q3. Moreover, it is clear that both mines and government will be looking to shrink their workforces. Generally, income growth also remains under pressure. Gross earnings growth averaged just 6.0% y/y in H1 17, down from an average of 9.6% in 2016. Data such as nominal disposable income are showing similar trends but some of this is being cushioned by slowing consumer inflation.

Consumer credit market data have been mixed. The SARB data have showed continued deleveraging in Q2 while debt service costs remained stable. However, there is still very little in the way of new credit extension with the 25bp rate cut in July yet to make a noticeable difference. The 3m/3m annualised rate of household credit extension has tracked sideways just above 2% between June and August. That said, there is little evidence that the consumer is in a fully fledged credit crisis. The TransUnion Consumer Credit Index increased to 53.8 in Q2 from 50.2 in Q1, indicating some improvement in consumer credit conditions.

The wealth variable as a support factor for consumer spend has also lost some steam. SARB data showed that household net wealth as a % of GDP fell to 373% in Q2, down from 377% in Q1. This could be a reflection of the relatively softer performance of the domestic equity market but also slowing household price growth - and both trends have continued in Q3.

While there is indeed variation between different income groups, the overall picture for the consumer remains challenging. The tax increases announced in February will continue to weigh on the consumer, taking out about ZAR25bn from consumers' pockets this fiscal year through higher personal income taxes and fuel excise levies. Moreover, we estimate that the increase in fuel prices following higher Brent crude prices could take out about ZAR2.5bn from consumers' disposable income in Q4 alone. By way of comparison, the 25bp rate announced in July gives back the same amount to consumers – but only over the course of a whole year. And further tax increases are likely in the 2018/19 Budget due in February. Against this backdrop, the overall consumer spending environment will likely remain weak over the near term.

Contracting private sector capex presents an especially worrying picture

A slightly more concerning part of the weak domestic demand picture is fixed investment. The Q1 GDP data showed that gross fixed capital formation contracted by 2.6% q/q saar in the second quarter following a modest bounce of 1.3% q/q saar in Q1. In y/y terms, gross fixed capital formation has not shown positive growth since Q4 15. Private sector fixed investment is especially weak. After a modest 2.9% q/q saar increase in Q1, private investment contracted sharply by 6.9% q/q saar in the second quarter, the eighth contraction in the past 10 quarters. While business confidence increased marginally in Q3,

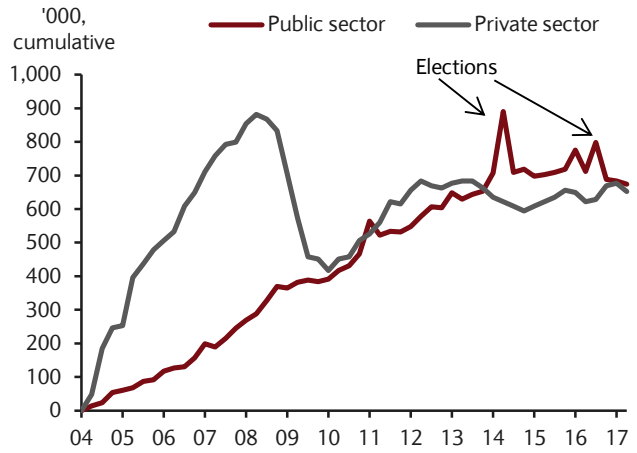
the data continue to show that nearly seven in every 10 businesses surveyed are "unsatisfied" with business conditions, a backdrop that is unlikely to be supportive of a recovery in private sector investment.

We forecast GDP growth of 0.6% this year and only a modest improvement to 1.1% in 2018

The growing need for fiscal restraint also means that the government is not a position to offer much of a lift to growth. Against this, we expect GDP growth to slow to 0.3% q/q saar in Q3 against the strong Q2 base before normalising to about 1.0% q/q saar in Q4. Our full year 2017 GDP growth is just a touch higher at 0.6% mainly to account for much stronger agricultural harvests expected for this year. We have a baseline forecast of 1.1% for GDP growth in 2018 but think that this remains heavily dependent on the outcome of the African National Congress's elective conference in December, in terms of which leadership faction emerges victorious and the broad policy posture that it adopts.

FIGURE 7

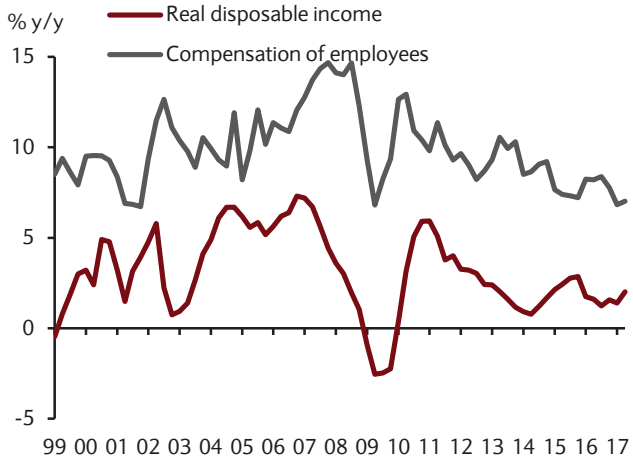
Formal employment creation has flatlined



Source: Stats SA, SARB, Absa Research

FIGURE 8

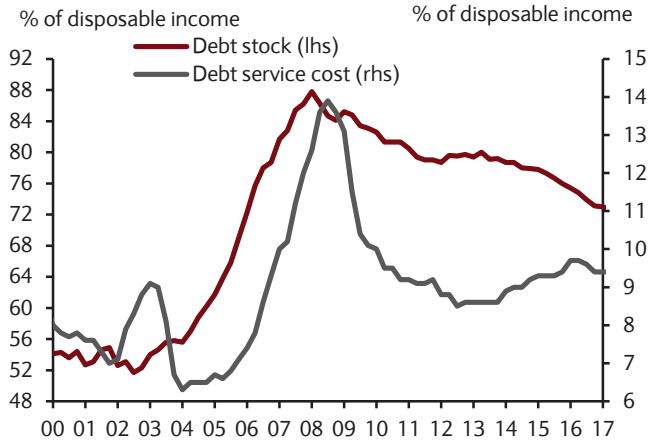
Growth in household incomes remains relatively modest



Source: SARB, Absa Research

FIGURE 9

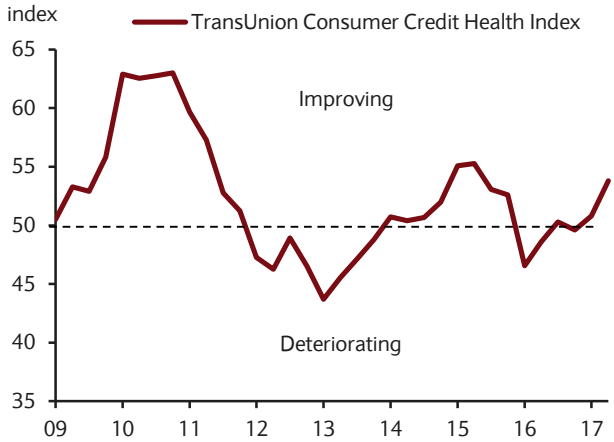
Soft deleveraging in household debt continued in Q2…



Source: SARB, Absa Research

FIGURE 10

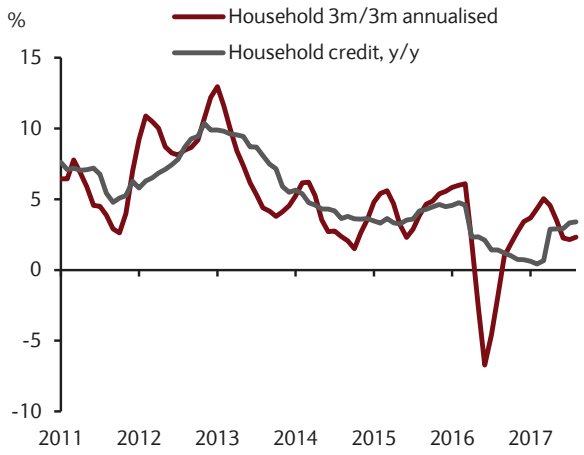
…while the TransUnion Credit Index also improved further



Source: TransUnion, Absa Research

FIGURE 11

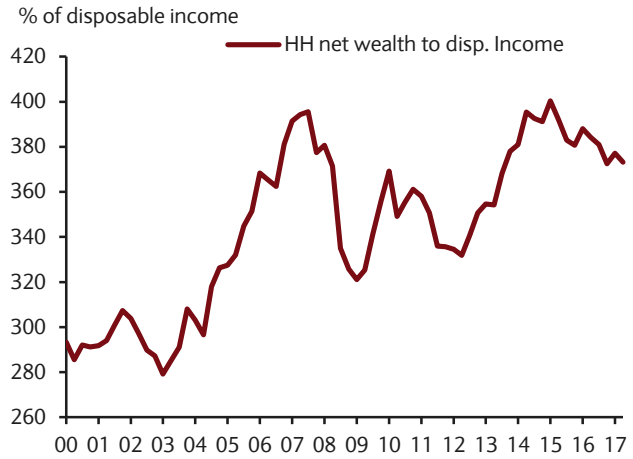
…but credit extension to households remains weak



Source: SARB, Absa Research

FIGURE 12

Household wealth as a % of disposable income still sliding



Source: SARB, Absa Research

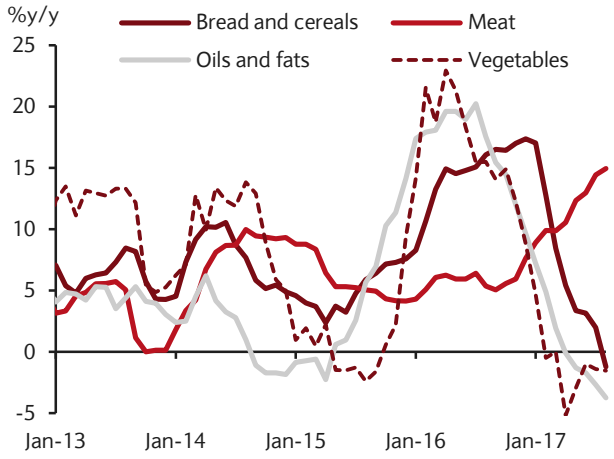
Inflation likely to remain inside the target range with a low point in Q1 17

Food price inflation has fallen broadly as expected, and this has been the main reason for the decline in headline CPI inflation

Headline CPI inflation has fallen, broadly as expected in recent months, mainly thanks to a sharp slowdown in food price inflation as strong summer crop prospects pushed down grain and vegetable prices. Food price inflation reached a near two-year low of 5.7% y/y in August after averaging 8.4% y/y in the first half of the year. However, the details within the food basket, which accounts for 17.2% of the CPI basket, have been mixed. Price inflation on food basket items such as 'bread and cereals', 'oils and fats' as well as 'vegetables' have come down sharply in recent months, with some of these categories falling into outright deflation by August. By contrast, meat price inflation has risen rapidly, reaching 15.0% y/y in August after averaging 12.0% y/y and 9.6% y/y in Q2 and Q1, respectively. This has largely been driven by herd rebuilding by farmers due to more favourable grazing conditions and cheaper grain feedstocks which has resulted in a fall in the supply of red meat. The latest data from the Red Meat Levy Admin show that the number of cattle slaughtered in August remained about 13% fewer compared to the same time last year, suggesting that some upward pressure could remain in the short term. However, a bigger concern with respect to meat prices is on the poultry side amid the risk of a wider spread of the avian

FIGURE 13

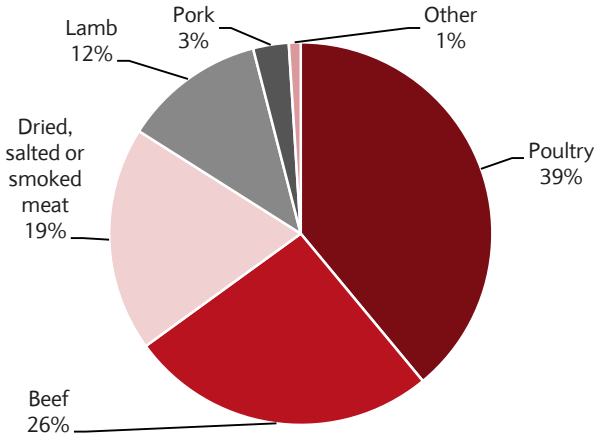
Rising meat prices have been offset by lower crop prices



Source: Stats SA, Absa Research

FIGURE 14

Poultry forms the largest share of the CPI meat category



Source: Stats SA, Absa Research

influenza. Poultry accounts for 39% of the meat component of CPI, compared to just 26% for beef. Our baseline view is for food price inflation to continue easing over coming months, reaching a low point of 3.2% y/y in early 2018 as lower crop prices and favourable base effects dominate rising meat prices but poultry prices are a key upside risk.

Fuel prices are key to the CPI outlook, and investors should remember that the National Treasury has mooted the idea of introducing VAT on fuel sales

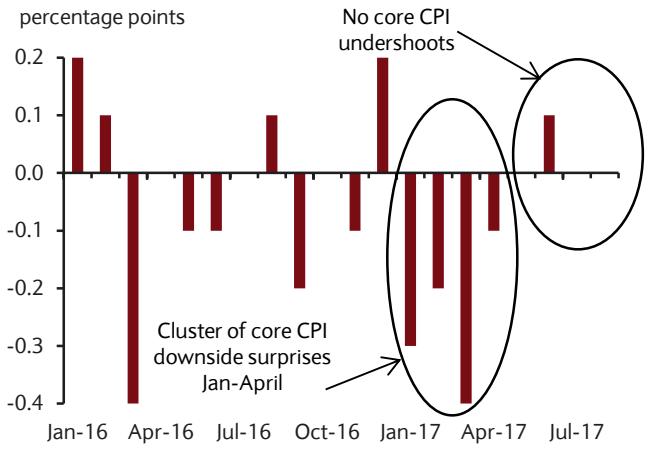
Other than food prices, Brent crude oil prices and electricity tariffs are the two other key assumptions whose volatility can have an important bearing on the CPI inflation. Brent crude oil prices have rallied significantly in recent months, rising by just over 20% since the start of the second quarter. This has already resulted in three consecutive fuel price increases from August to October, pushing the petrol price to its highest level since 2014. Our assumptions for Brent crude oil prices are broadly in line with consensus. We assume an average of USD54/bbl in Q4 17, a moderate increase to about USD55.5/bbl in 2018 and an average of USD59.6/bbl in 2019. However, given our forecast of continued ZAR weakening (see below) and our forecast of further increases in distribution margins of 10c/l every December and fuel excise duty hikes of 25c/l every April we see still further (albeit more moderate) fuel prices increases. However, we note that the last budget mooted the idea of introducing VAT on fuel sales, which suggests some upside risk here. On electricity tariffs, our baseline forecast assumes 12% next year and 6% in 2019. However, we think the risks are tilted to the upside here in 2018. Eskom has announced that it will be seeking an average tariff increase of close to 20% for FY 2018/19, and a good amount of this appears to be pretty nonnegotiable under the current price setting methodology. Moreover, a 20% average tariff hike would translate into a price hike for consumers who receive their electricity via municipal distributors of around 27%, according to Eskom. We are inclined to think that NERSA will try to resist such a steep increase under current domestic economic and political conditions when it announces its decision on 7 December. Notably, a 5 percentage point deviation from our electricity tariff assumption for next year implies a difference of 0.3pp in headline CPI inflation in H2 18, even before second round knock-on effects.

We expect the current account deficit to average 2.4% of GDP in 2017 before widening slightly to 2.9% in 2018

The outlook for underlying price pressures, as broadly measured by core CPI, is also important for the headline CPI inflation outlook. Core CPI inflation has softened rather unexpectedly quickly in early 2017, although undershoots have abated in recent months. Nonetheless, core CPI reached just 4.6% y/y in August, its lowest level since the same month in 2012. We think that this largely reflects a combination of the persistent slack in the economy and moderating growth in compensation of employees against a backdrop of difficult labour market conditions. We expect core CPI inflation to track sideways over the coming months before easing further by year-end to reach a trough of 4.3% y/y. However,

FIGURE 15

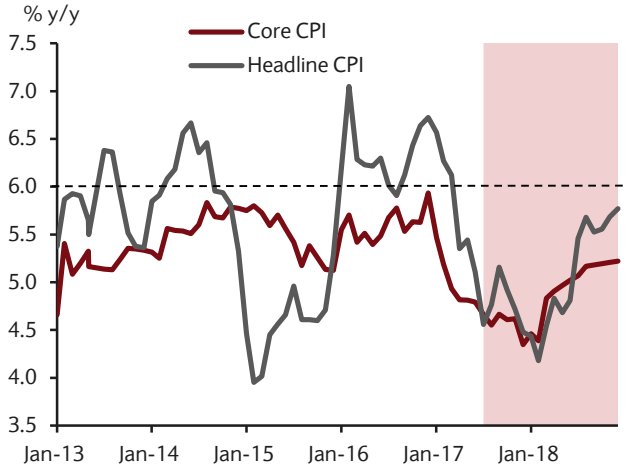
Core CPI inflation no longer surprising to the downside



Source: Thomson Reuters, Absa Research

FIGURE 16

Headline CPI inflation still likely to track within target range



Source: Stats SA, Absa Research

we expect a gradual increase from Q1 18 with the full year average likely to be around 5.0% y/y as economic activity improves marginally and the output gap narrows. Where do all of these factors leave our forecast for headline CPI inflation? The sharp fuel price increases combined with unfavourable base effects will likely see headline CPI inflation bounce just above 5% in September. However, the broad easing trend should resume from October and we expect headline CPI inflation to reach a trough of 4.2% y/y in early 2018 before beginning to rise gradually, reaching an average of 5.7% in the final quarter of 2018.

Current account deficit is likely to retaining widening bias

Decline in the current account reflects material import compression

The SARB's September Quarterly Bulletin showed that South Africa's seasonally adjusted current account deficit widened to 2.4% of GDP in Q2 17 from a revised print of 2.0% (previously: 2.1%) in Q1 17. The wider current account deficit came entirely from deterioration in the "invisibles" deficit, which swelled to 3.8% of GDP in Q1, compared to 3.3% in the first quarter. Within the invisibles, the strongest negative effect came from current transfers, which rose to 1.0% of GDP in the second quarter (Q1: 0.6%). The SARB attributed this to higher payments to South Africa's trading partners in the Southern Africa Customs Union (SACU) at the start of the 2017/18 fiscal year. This offset a marginal improvement in the merchandise trade surplus to to 1.4% of GDP in Q2 compared to 1.3% of GDP in the first quarter. The small improvement in the merchandise trade balance came despite deterioration in South Africa's terms of trade in Q2 which fell 0.3% q/q after increasing by 2.1% in the first quarter. Overall, the recent trend of narrower current account deficits in South Africa reflects more import compression than export growth.

Merchandise trade data have delivered surpluses so far in Q3

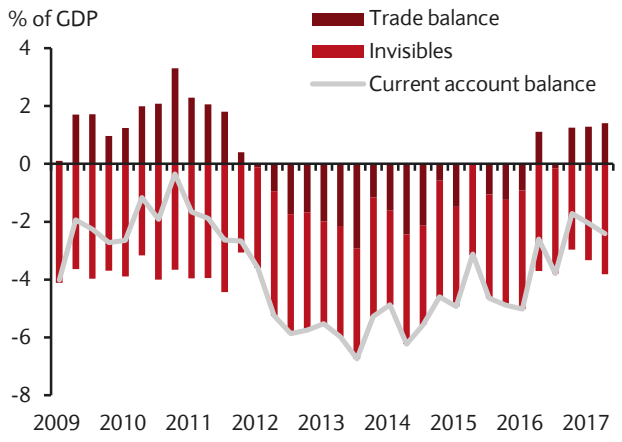
The monthly merchandise trade data from the South African Revenue Service have surprised to the upside, pointing to another surplus in Q3. These data showed surpluses of ZAR9.3bn in July and ZAR5.9bn in August. With our forecast of another surplus of around ZAR7bn in September, the SARS data would point to another strong improvement in the merchandise trade surplus in Q2, after seasonal adjustment. However, moving from the monthly SARS customs data to the balance of payments data as reported by the SARB always involves some degree of uncertainty because the SARB often makes large adjustments to the data to reflect the literal balance of payments as opposed to transfer of goods. Therefore, although the SARS data point to a strong improvement in the current account deficit, we forecast only a marginal narrowing in the CA deficit to 2.0% of GDP in Q3 compared to 2.4% of GDP in the second quarter.

We expect the current account deficit to average 2.4% of GDP in 2017 before widening slightly to 2.9% in 2018

The detailed data from SARS offer some insights on the underlying nature of the improvement in South Africa's merchandise trade accounts and how this could evolve going forward. Strikingly, from the goods trade data, minerals trade continues to drive a large part of the merchandise trade improvement. In the year-to- August, the cumulative surplus in the minerals trade account stood at USD5.6bn, a big improvement compared to just USD2.4bn at the same time in 2016. However, there is little adjustment taking place in the manufacturing trade accounts despite improving global growth and trade volumes. In the year-to-August, the cumulative balance on manufactured goods was at a deficit of USD13.4bn, only marginally smaller than the USD13.6bn deficit at the same time in 2016. This suggests that developments in commodity prices will remain relatively more significant for export earnings. Export commodity prices have been mixed in recent months. For instance, iron ore prices have rallied in Q3 since after falling by nearly 30% in the first half of the year although prices softened again in early October. Meanwhile, coal prices are up 18% since the start of the third quarter. However, increases in precious commodities have been a lot more moderate. However, these will likely be partially offset by the effect of higher crude oil prices. Moreover, export earnings from a bumper maize harvest will also be important this year. We thus forecast the current account deficit to average 2.4% of GDP this year. We expect some moderate widening next year to about 2.9% of GDP.

FIGURE 17

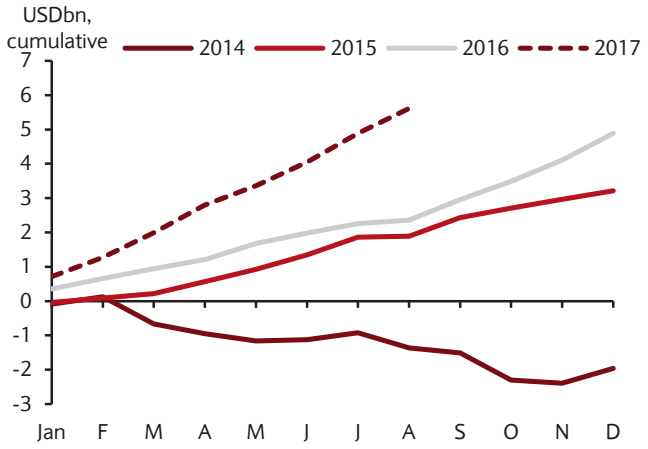
Merchandise trade balance remains in surplus…



Source: SARB, Absa Research

FIGURE 18

…supported largely by improving minerals trade



Source: SARS, Absa Research

Fiscal prospects look precarious

Tax collections so far this year are up 6.1%, a disappointing performance compared to the 17/18 projection of a 10.6% growth rate

South Africa's fiscal performance so far this year looks quite precarious, with a significant risk of a large slippage on the budget deficit target. The main budget deficit for August came in at ZAR12.6bn, versus our forecast of ZAR13.9bn, taking the cumulative deficit to ZAR141.4bn, about 84% of the original budget target. The deficit in the first five months of FY 16/17 was c.70% of the full year outcome. The reason for the deterioration of the fiscal position is weak tax receipts which seems to be partly a function of weaker-than-expected growth and partly a function of institutional disarray at South African Revenue Service (SARS). Gross (main budget) tax collections in the first five months of the fiscal year have grown 6.1% y/y, well below the budgeted growth rate of 10.6% for FY 17/18, while expenditures have grown 6.9%. For the April to July period the "run rate" on tax collections points to a shortfall of about ZAR43bn for the fiscal year as a whole, a little less than 1% of GDP. But we think the pace of tax collections is likely to pick up in the second half of the fiscal year (albeit with some downside risk), given that the timing of the impact of the recession on tax receipts and given that the changes to the dividend withholding tax in the 2016/17 Budget pulled dividend declarations forward from the current fiscal year into the previous one. Meanwhile, the government's above-the-line debt servicing costs have risen 15.9% y/y in the first five months of FY 17/18, making interest cost the fastest growing item of expenditure in the government budget.

The tax amnesty programme provides only a tiny offset to the tax shortfall, many potential participants perhaps having chosen to emigrate, rather than declare their offshore assets to SARS

Regrettably, the Special Voluntary Disclosure Program has not turned out to be a golden goose. In September, Finance Minister Gigaba revealed to parliament that by the 31 August deadline there were over 2000 applications under the Special Voluntary Disclosure Program, covering ZAR35bn of assets. Gigaba said that the total tax collections from the program could amount to over ZAR4bn, a little less than 0.1% of GDP – welcome cash flow given the current constrained fiscal space, but not enough to offset the expected shortfall in regular tax collections. The intense political uncertainty over the past year may have undermined the programme to some degree, and it is possible that some individuals with significant offshore assets could have chosen to emigrate rather than regularise their tax affairs with the South African Revenue Service.

Our projection of a revenue shortfall of ZAR28bn gives some benefit of the doubt to the National Treasury

All in all, we project a revenue shortfall of ZAR28bn this fiscal year but are aware that risks to this number are tilted to the upside. Assuming expenditures are not curtailed to offset the revenue shortfall – and it is hard to see how expenditure could be materially reduced without a proper programme to reduce the size of the public sector payroll – the revenue

shortfall of ZAR28bn would imply a main budget deficit of 4.2% of GDP, compared to the original budget target of 3.5% of GDP and would leave the primary budget balance still deep in the red to the tune of 0.7% of GDP.

Treasury's projections of a stabilisation in the debt-to-GDP ratio look too optimistic; South Africa's debt dynamics are slippery

In February, after the Budget, we opined that the National Treasury's projections of the government's debt-to-GDP trajectory were too optimistic, and subsequent developments have supported our view. The 2017 Budget projected that gross government debt would peak at 52.9% of GDP at the end of FY 18/19. Our conservative estimate is that it will peak at over 55% of GDP – assuming a middle of the road tax shortfall of ZAR28bn this year, a large fiscal adjustment package in the FY 2018/19 budget in February, and no major expenditure ceiling breaches due to SOE guarantees crystallising onto the National Treasury's balance sheet without some non-debt source of financing such as asset sales. With South Africa's primary budget balance in the red to the tune of 0.7% of GDP, and the true real interest rate on government debt (coupons plus amortisations of below-the-line yield for bonds issued at a discount to par less adjustment for inflation) currently around 2.5-3% compared to a real GDP growth rate of about half a percentage point, South Africa's debt fiscal and debt dynamics look slippery.

We think that Finance Minister Gigaba will have to signal another adjustment programme worth about 1% of GDP at the mid-year budget policy statement on 25 October

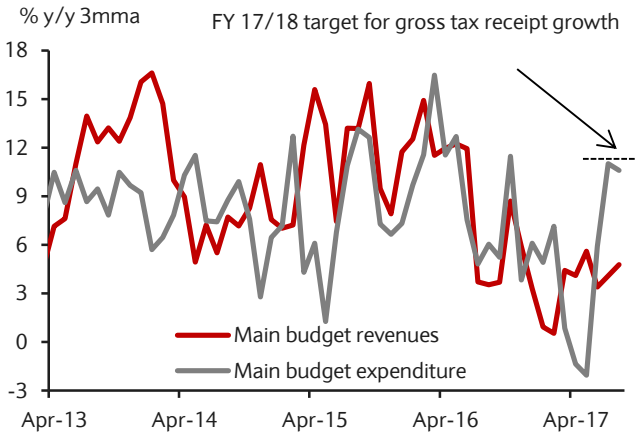
National Treasury will provide its own update of its projected shortfall when it presents the Medium Term Budget Policy Statement (MTBPS) on 25 October. At the MTBPS, Minister Gigaba will also present the broad outlines of a fiscal consolidation programme to get the deficit trajectory back on a narrowing course. In the 2016/17 Budget, then Finance Minister Gordhan introduced 0.6% of GDP in new taxes and 0.4% of GDP in expenditure cuts. In order to credibly signal that the relentless growth in the debt-to-GDP ratio since the global financial crisis will finally be brought under control, we think Gigaba will have to signal an adjustment package of broadly the same order of magnitude as Gordhan did last February. However, Gigaba is unlikely to detail the exact tax levers or spending cuts that will be used until the Budget is presented in February. It remains to be seen if the National Treasury will try to finesse its way around the uncomfortable but urgent fiscal challenges, rather than address them head on in a way that reassures the markets and credit rating agencies that it is not business as usual.

It is not clear what approach the government will take to heavily indebted SOEs who face financing difficulties

Another big issue that will get an airing at the MTBPS will be the National Treasury's approach to bailouts for financially troubled state-owned enterprises, such as South African Airways (SAA) and Eskom. In June, the government provided ZAR2.2bn of emergency funding to SAA to finance the repayment of a Standard Chartered loan in June. ZAR6.9bn more loans fell due at end September and the National Treasury had to tap the National Revenue Fund to provide ZAR3.0bn

FIGURE 19

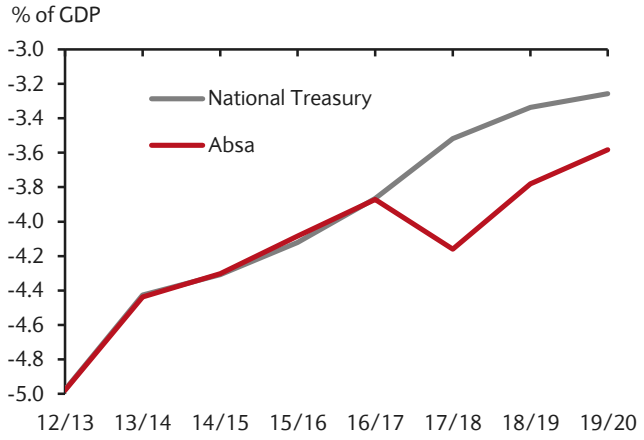
Tax collections are really disappointing



Source: National Treasury, Absa Research

FIGURE 20

Main budget deficit to slip significantly this year



Source: National Treasury, Absa Research

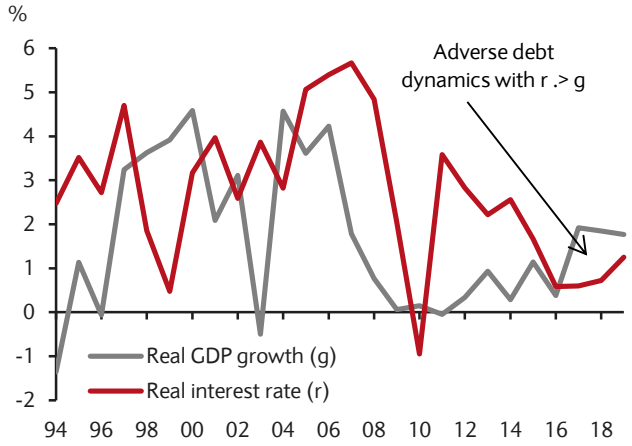
to SAA to ensure it did not default on a ZAR1.8bn maturity, which Citibank had refused to roll over. Meanwhile, the South African Broadcasting Corporation (SABC) has also requested money from Treasury, PetroSA needs substantial funding and Finance Minister Gigaba has said, in the release of Treasury's "action plan for inclusive growth" in mid-July that Eskom needs "soft support" without explaining exactly what this means. It will be interesting to see if the MTBPS gives an update on the Treasury's projections of contingent liabilities that were published in February. At that time, it projected that the Treasury's contingent liabilities would peak at 17.6% of GDP at the end of 2016/17, of which government guarantees to SOEs and independent power producers (IPPs) would account for 10.1% of GDP, of which Eskom's utilised guarantees alone accounted for nearly 5% of GDP.

Eskom's application to lift electricity prices by 20% next year is key to South Africa's macroeconomic outlook; a decision is expected by 7 December

Eskom's application to the National Energy Regulator of South Africa (NERSA) for a tariff increase of nearly 20% next year (even before any upward tariff adjustments through the Regulatory Clearing Account mechanism) is highly contentious, but the degree to which NERSA accommodates Eskom's request is important for Eskom's financial viability and hence Treasury's contingent liabilities (as well as the CPI trajectory in 2018 and 2019). NERSA has said it will issue its ruling on 7 December. The Finance Minister has a hard task

FIGURE 21

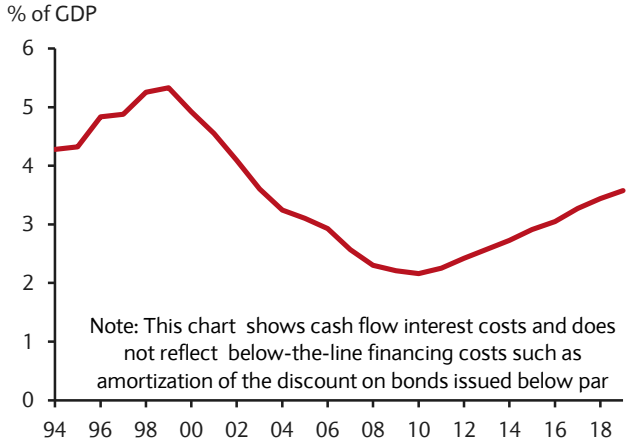
Real interest rate now exceeding real GDP growth rate



Source: National Treasury, SARB, Absa Research

FIGURE 22

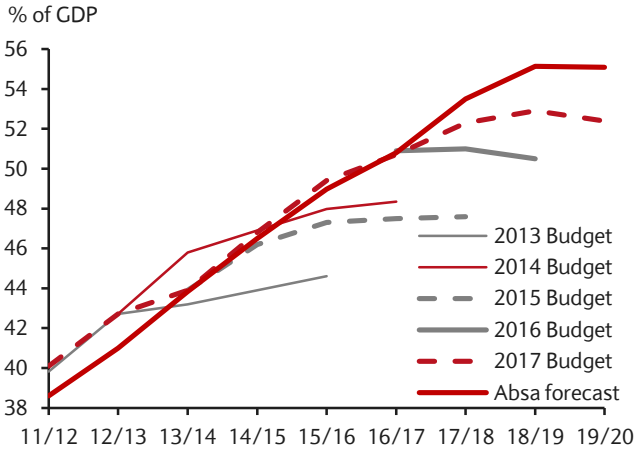
Government's debt service costs are rising steadily



Source: National Treasury, StatsSA, Absa Research

FIGURE 23

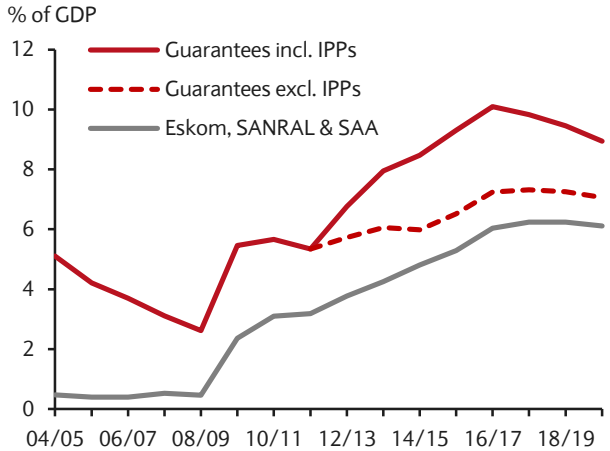
Each fiscal iteration pushes the debt trajectory up and out…



Source: National Treasury, Absa Research

FIGURE 24

…and SOE usage of Treasury guarantees has risen too



Source: National Treasury, Absa Research

ahead of him to persuade markets that SOEs will not sink the fiscus. In the action plan for growth, the National Treasury said that it would finalise the recapitalisation of South African Airways and South African Post Office by August 2017 but these matters do not appear to have been concluded yet. It also promised that it would, by the end of October 2017, "reduce the issuance of government guarantees, especially for operational reasons", but it is not clear what its strategy for doing this is.

Monetary policy: the SARB will likely tread cautiously

A divided SARB MPC and an uncertain environment means monetary policy is becoming quite unpredictable

The SARB MPC surprised the consensus view among economists and the FRA market pricing by cutting the repo rate by 25bp in July and then again by deciding not to cut in a split 3:3 vote in September. Although the SARB prefers not to comment on fiscal policy, we think the growing risks of material deficit slippage may have been one of the main factors that tipped the balance of views on the Monetary Policy Committee marginally in favour of a cautious stance. There has been considerable flux in the MPC voting patterns recently: in May, the MPC voted 4:2 to stay on hold, in July it voted 4:2 to cut, and today it was split evenly, with Governor Kganyago most likely on the hawkish side of vote, since he has the deciding vote in the event of a tie.

There is an outside chance of a rate cut in November if the MTBPS is well-received, but our base case scenario is for the repo rate to stay on hold at 6.75%.

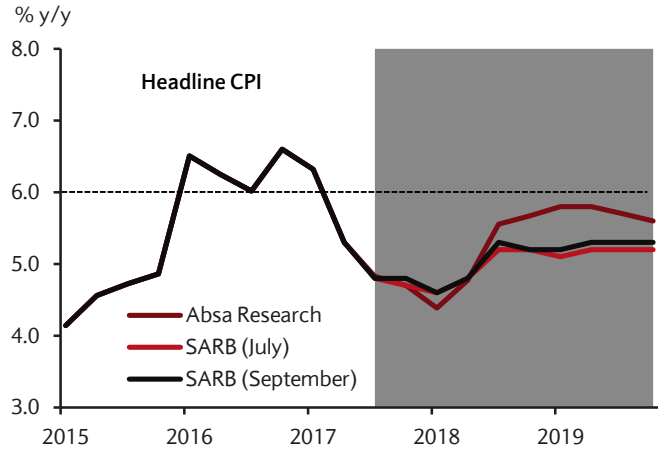
We think the MPC's decision to stay on hold carries a cautionary reminder for doves in the market who have been calling for and/or expecting aggressive cuts from the SARB. In general, the MPC prefers a gradualist and cautious approach, believing that the potential costs of gradualism in an environment of extreme uncertainty are not as high as the potential costs of a precipitous move that proves to have been an error that then needs to be reversed. However, the issue of the nature and timing of the SARB's next move is still uncertain. Interestingly, in the most recent MPC the SARB's inflation forecasts were hardly changed – nothing at all in 2017 and only 0.1 percentage points higher for core and headline CPI in 2018 and 2019. Our forecasts are rather higher, but we have a more pessimistic assumption on electricity tariffs in 2018 (12% versus the SARB's 8%) and a more actively depreciated rand view. We think also that come the next MPC the SARB may have to raise its oil price assumptions. Overall, we think the risk-conscious MPC is unlikely to cut in November just ahead of credit rating reviews, and the ANC's electoral conference, but a robust and well received MTBPS might open a window for a cut; albeit as explained above, we assess the likelihood to be a small.

The monetary policy outlook for 2018 rests on the election outcome

As with so many things in South Africa's future, the outlook for monetary policy also depends on the outcome of the ANC's election, the reforms pursued in early 2018 (or not pursued) and the markets' reaction to both. A well-received outcome that leads to material

FIGURE 25

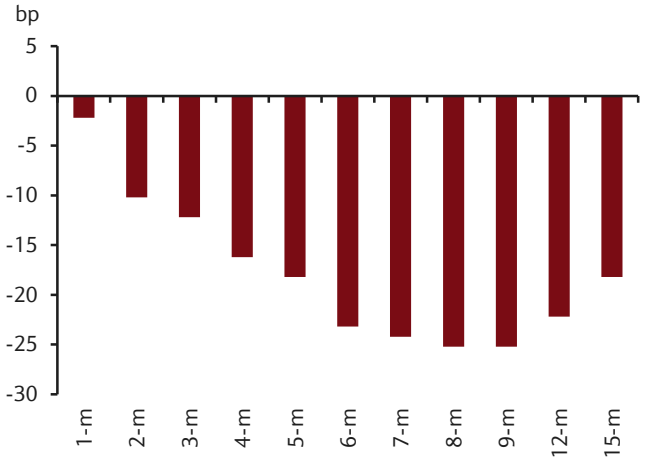
SARB forecasts CPI to return to about 5%



Source: SARB, Absa Research

FIGURE 26

FRAs are pricing in a 50% chance of a rate cut in November



Source: Thompson Reuters, Absa Research

rand strengthening would open the way for a rate cut, provided the SARB felt that it was not a transitory exchange rate shock. Conversely, a negative outcome that leads the rand to weaken could end up provoking a reversal of the recent rate cut. Significantly, at the last MPC Governor Kganyago warned that the MPC had not claimed it was in a cutting "cycle". We understand there are considerable diversity of views among the MPC on such key questions as the level of risk to the rand, the likely impact of another round of potential credit rating downgrades, how quickly inflation should be encouraged towards the midpoint of the 3-6% target against the backdrop of a weak economy, and the real neutral level of interest rates.

Credit ratings depend on the outcome of the ANC's leadership contest

Another round of credit rating reviews are due before year end but on balance we think the rating agencies will wait until next year before taking any further action...

After already having each downgraded South Africa's credit rating by one notch this year, the three main credit rating agencies are due to review the ratings again before year-end. Given South Africa's subdued growth prospects, mounting fiscal challenges, and political constraints on necessary structural reforms, we believe that the direction of South Africa's creditworthiness is tilted to the downside. However, we also believe that South Africa's macroeconomic framework (including the flexible exchange rate), deep financial markets, and lack of material currency mismatches on the balance sheets of banks, households and corporate are important strengths and should slow the pace of any decline. Moreover, the remedies to South Africa's economic ills are easy enough to identify, and could potentially be pursued by a new, reform-minded political leadership. For this reason, we think that all the credit rating agencies will wait until 2018 to see the results of the ANC's December electoral conference and the 2018/19 Budget in February before taking any further action.

…with Moody's essentially saying as much at end September

Indeed, Moody's said as much on 27 September when its lead analyst for South Africa remarked that the agency would wait until after the results of the ANC's leadership conference in 2018 before making any further changes to its credit ratings. Speaking at a conference in London, the lead analyst for South Africa, Zuzana Brixova, reminded that Moody's had downgraded South Africa only in June, and said that the rating agency viewed South Africa's current Baa3 Negative Outlook rating as "well placed". Brixova added, however, that Moody's was concerned about the increasing shortfall of government tax receipts and the growing share of government borrowing financed by foreign investors, trends which she said increased the risk of a "sudden stop". We do think, however, that Fitch might potentially move the outlook on its BB+ ratings from Stable to Negative at its next meeting, which is likely sometime at the end of November (Fitch does not preannounce the dates of its ratings reviews, but likes to keep to a 2 per year schedule.) As for 2018, without a market-friendly outcome for the ANC in December and strengthened reform efforts in 2018, there are risks of more downgrades. Neither Moody's nor S&P have announced the dates for their 2018 reviews yet.

FIGURE 27

Credit rating agencies likely to wait until 2018 before possible further downgrades

	S&P	Moody's	Fitch
Foreign currency	BB+	Baa3	BB+
Local currency	BBB-	Baa3	BB+
Outlook	Negative	Negative	Stable
Date assigned	03-Apr-17	09-Jun-17	07-Apr-17
Next scheduled review	24-Nov-17	24-Nov-17	Flexible – but probably last week November or first week December
Absa forecast	Will hold off but another downgrade is more likely than not in 2018	Another downgrade in 2018 is more likely than not in 2018	May change the outlook from Stable to Negative at the next meeting

Source: S&P, Moody's, Fitch, Absa Research

Rand is less vulnerable, but not invulnerable

Keeping buying USD/ZAR dips

We expect the ZAR to weaken to 13.90/USD by year-end and reach 15.10/USD by mid-2018. Consequently, we recommend buying a 3-month USDZAR call spread (expire 8-Dec) with 13.50/14.00 strikes at a cost of 12c and risk reward payoff profile of 4:1 (see *South Africa Fixed Income Roadmap: Steeper and weaker*, 4 September 2017). Although we acknowledge that the prevailing low volatility, broad-based dollar weakness and firmer commodity price global environment helps explain this year's ZAR appreciation, we believe that a lot of these favourable international developments have already been priced-in. Indeed, foreign investors have already significantly increased their holdings of SAGB in recent quarters and we think it may be difficult for SA to attract a fresh wave of portfolio inflows. We still believe the ZAR remains overvalued based on SA's persistently weak GDP environment and low productivity levels. The ZAR will also have to contend with considerable event risk over the coming months and if the outcome of the MTBPS, the ANC's elective conference or February Budget prompt the credit rating agencies to downgrade the country's local currency rating yet again, then the ZAR would be vulnerable to automatic selling of SAGB by passive bond investors that are mandated to only own investment grade bonds.

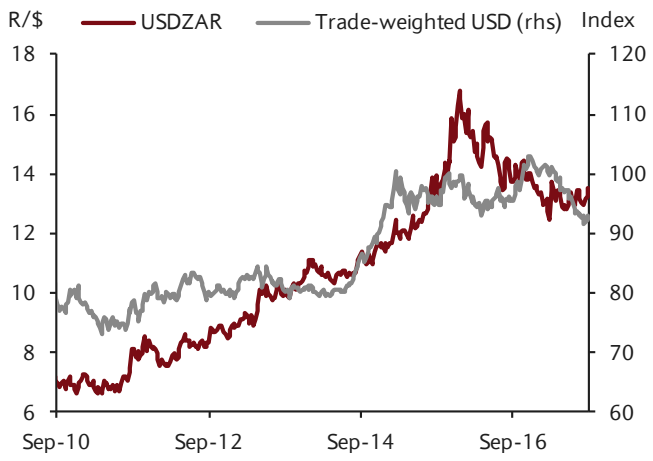
Political uncertainties increase as the ANC's electoral conference approaches

The ANC leadership contest seems to be opening up from a two-horse race as a search within the ANC for a unifying presidential candidate

Despite its critical importance to the future of South Africa, the outcome of the ANC's electoral conference, which is due to take place from 16-20 December, remains highly uncertain. Up until fairly recently, the contest seemed fairly well defined, even if its ebb and flow was largely hidden from public view. Essentially, it was viewed as a fairly binary factional battle for control of the ANC (and consequently the government), as reflected in the contest for the party presidency between the pro-Zuma faction aligned around Nkosazana Dlamini-Zuma (NDZ) and the anti-Zuma technocrats and constitutionalists aligned to Deputy President Cyril Ramaphosa (CR17). However, with the NDZ camp having struggled to gain traction with the wider electorate, not least because of her perceived association with her unpopular ex-husband, and the continued seeming impossibility of a compromise reconciliation between the two sides, the ANC may be increasingly looking for a third candidate who has potential to unify the party and avoid a polarising and divisive slate split (of course, it is important to remember that what really matters for the outcome of the ANC conference is not the views of the electorate at large, but rather those of paid-up ANC members, where NDZ may be making better headway). Nonetheless, attention seems to be coalescing around the current ANC Treasurer General, Zweli Mkhize, which generates a whole new array of permutations for the electoral calculus, because significantly the

FIGURE 28

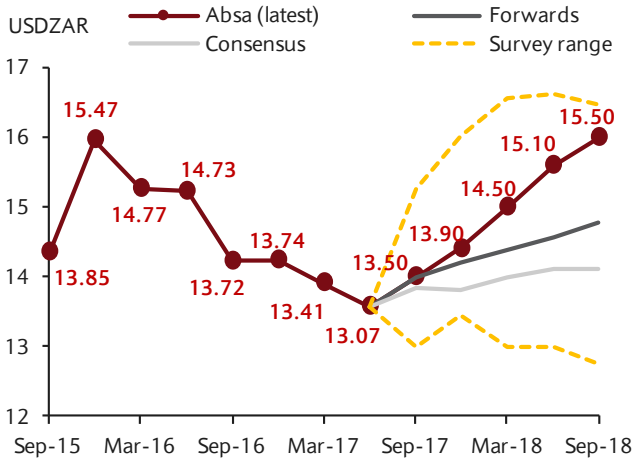
The ZAR has benefitted from a weak USD environment



Source: Bloomberg, Absa Research

FIGURE 29

Comparative USDZAR outlook



Source: Bloomberg, Absa Research

selection of the ANC President, and the rest of the top six officials, is done by a single first-past-the-post vote, with no second-round runoffs or transferable preference voting. With Mkhize one of the few potential alternative candidates who could possibly draw support from both factions this makes the outcome unpredictable, even in the event of only the three candidates standing in the vote; however, there could be more as six officials have come forward. For example, Human Settlements Minister, Lindiwe Sisulu, seems to have garnered some branch support to become president, although she has also been confusingly named as the Ramaphosa faction's slate candidate for the Deputy Presidency.

Turmoil in various provincial ANC leadership contests complicates matters, and membership audits are still outstanding in three provinces; they need to be finalised before provincial delegate allocations can be fixed for end-year

Even before the electoral conference itself, various other complicating uncertainties abound. The ANC's two largest provinces by membership – KwaZulu-Natal and the Eastern Cape – are experiencing turmoil in their provincial leadership contests. A court recently overturned the 2015 leadership contest in KwaZulu-Natal, but it seems that the provincial executive has decided to ignore an instruction from the National Executive Committee not to appeal the ruling. And in the Eastern Cape over the last weekend, Oscar Mabuyane, a close ally of Deputy President Ramaphosa, won the provincial ANC chair, but supporters of his opponent have suggested that they too will approach the courts to have the contest outcome set aside. ANC Secretary General Gwede Mantashe said in September that membership audits in six of South Africa's nine provinces (except KwaZulu-Natal, Eastern Cape and Western Cape) had been completed, without revealing much about their results. Mantashe is due to announce the provinces' allotments of delegates (made in proportion to their audited ANC membership numbers) sometime in October. In addition, if the pro-Zuma faction seems to be losing traction in the regular process to choose new leadership, it could look for a way to postpone the electoral conference itself as has been reported in the media (see "ANC may postpone December conference" Citizen, 3 October 2017), thereby prolonging President Zuma's position as head of the party, despite the ANC constitution, which states that "The National Conference shall be convened at least once every five years".

Political uncertainties will persist, even if the conference selects a reform-minded leadership for the ANC

Even assuming the conference goes ahead as scheduled and the ANC chooses new reform-minded leadership which is broadly accepted by the entire party, political uncertainties will persist. For one thing, President Zuma's term as state president is scheduled to continue until the general elections in Q2 19. It is unclear how the government would function with two rival centres of power: an anti-Zuma faction dominant in the ANC party leadership, but President Zuma remaining in control of the state, especially since he would remain in control of the security and intelligence apparatuses.. The ANC could, perhaps, look to recall him as head of state, in order to attempt a clean break with patronage politics and have a fresh face at the helm for the 2019 general elections. However, because the stakes are so high for President Zuma and his network, it is not clear what his reaction would be to such a move. Nor is it clear how quickly a new ANC leadership, even it were minded to reform, would be able to extract the struggling economy from the widespread influence of Zuma's patronage network. Furthermore, once the ANC's internal election is settled, interparty jockeying for the 2019 general elections, just a little more than a year later, is likely to begin. Ructions in the opposition-led coalition municipalities show the difficulty that opposition parties could experience in working together even if the ANC does lose support.

The downside in the event of a "negative" December outcome is likely to be larger and swifter than the upside to a "positive" outcome although markets should not completely rule out the prospect of a big relief rally if December brings a peaceful exit for President Zuma

All in all, we find South Africa's political future highly uncertain. We think that the downside in the event of a negative outcome in December (such as a victory for the patronage network or a postponement of the conference) will be swift and severe. On the other hand, we see upside in the event of a positive outcome, but think that it would be smaller in magnitude and also less swift, especially if the market anticipates a higher likelihood of a clear Ramaphosa win. However, we do feel that while the outcome of the event is still rather binary, there is some growing middle ground risk of a muddle-through political scenario, perhaps with Mkhize as the compromise candidate. Any outcome which preserved party unity but also served to roll back patronage network and lead to more decisive effective leadership that prioritised the economy would be a big plus for markets, but it could take time for these policies to emerge. Only one thing is clear: there is a lot at stake in December.

FIGURE 30

Main macroeconomic variables in South Africa

	2016		2017				2018									
	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	2015	2016	2017F	2018F	2019F	2020F
Output (% q/q saar)																
Real GDP	0.4	-0.3	-0.6	2.5	0.3	1.0	0.6	1.6	1.4	2.0	1.3	0.3	0.6	1.1	1.7	1.9
Real GDP (%y/y)	0.6	0.4	0.7	0.5	0.5	0.8	1.1	0.9	1.1	1.4	1.3	0.3	0.6	1.1	1.7	1.9
Household consumption	2.2	2.2	-2.7	4.7	-1.3	1.8	0.1	1.2	1.1	2.0	1.7	0.8	0.9	1.0	1.6	1.9
Durable goods	-3.2	0.2	-8.6	7.4	1.6	3.5	-0.7	3.2	2.4	4.3	-1.9	-7.3	-1.2	2.3	2.8	3.4
Semi-durable goods	-0.9	6.8	-13.0	21.2	-8.7	2.4	0.0	1.2	0.9	2.1	4.0	3.3	0.4	1.0	1.5	2.0
Non-durable goods	1.1	0.3	-3.7	7.9	-2.4	1.4	0.1	1.1	1.3	1.8	2.2	0.9	0.5	0.9	1.5	1.7
Services	5.0	3.2	1.8	-1.7	0.8	1.8	0.2	1.0	0.8	1.7	1.5	2.1	1.7	0.8	1.5	1.8
Public consumption	1.9	0.3	-1.7	0.8	0.8	0.7	0.7	0.8	0.8	0.7	0.5	2.0	0.3	0.8	0.8	0.8
Investment	-3.5	1.7	1.3	-2.6	-2.3	-2.0	0.1	1.4	1.5	1.6	2.3	-3.9	-0.9	-0.2	1.9	2.7
Exports	-21.2	12.5	-3.2	14.4	2.0	2.0	1.5	1.3	0.6	1.0	3.9	-0.1	2.3	2.2	1.5	1.7
Imports	-1.0	6.1	3.2	13.3	-0.4	1.5	0.7	0.4	0.0	-0.1	5.4	-3.7	3.7	1.2	0.9	1.6
External and government accounts (% of GDP)																
Current account	-3.8	-1.7	-2.0	-2.4	-2.0	-2.8	-2.8	-2.7	-3.1	-3.2	-4.4	-3.3	-2.3	-3.0	-3.4	-3.6
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	-3.8	-3.1	-2.9	-2.7
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	0.6	0.8	1.0
Government debt*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	49.0	50.8	53.5	55.1	55.1	55.0
Prices (% y/y)																
CPI inflation	6.0	6.6	6.3	5.3	4.8	4.7	4.4	4.8	5.6	5.7	4.6	6.3	5.4	5.4	5.7	5.6
Core CPI inflation	5.7	5.7	5.2	4.8	4.6	4.5	4.6	5.0	5.1	5.2	5.5	5.6	4.8	5.0	5.3	5.4
PPI inflation	7.1	6.9	5.6	4.5	4.0	3.7	3.6	3.8	5.6	6.1	3.6	7.1	4.7	4.8	6.4	6.4
Interest rates (% eop)																
Repurchase rate	7.00	7.00	7.00	7.00	6.75	6.75	6.75	6.75	6.75	6.75	6.25	7.00	6.75	6.75	6.75	6.75
Prime rate	10.50	10.50	10.50	10.50	6.75	6.75	6.75	6.75	6.75	6.75	9.75	10.50	10.25	10.25	10.25	10.25

* Fiscal year starting 1 April Source: SARB, National Treasury, Stats SA, Absa Research

The key role of assumptions in macroeconomic forecasts

Forecasting is invariably a difficult exercise in that it requires assumptions about important economic variables and policies in the future, and the future is inevitably uncertain. There are many possible plausible assumptions, and different combinations of them can have material effects on the output of the econometric forecasting exercise. As discussed in the body of the document, one of the key assumptions for the inflation outlook is the electricity price. Other important variables that one must adopt a specific assumption for include: commodity prices; exchange rates; fiscal settings; and monetary policy. Sometimes the assumptions are more inchoate. For example, as the Quarterly Perspectives write up indicates, the outcome of the December 2018 ANC leadership contest is undoubtedly central and key to South Africa's macroecononomic prospects. Our forecast has assumed a broadly middle-of-the-road scenario from 2018 onwards, although the reality is likely to be more marked – breaking for either good or bad – but we cannot say with any certainty in which direction given the uncertainty over the ANC's electoral outcome. As an illustrative exercise, to help investors, we thought it would be useful to present the consequences for the main macroeconomic variables of two alternative scenarios that we modelled: a one percentage point hike in VAT in April 2018 and a further 50bp of monetary easing in Q1 2018. We modelled each scenario independently as a deviation from our baseline. Unsurprisingly, a VAT hike would appear to

depress GDP growth but boost inflation, but the magnitude of its effect on GDP growth – a blow of 0.4 percentage points in 2019 for example – is perhaps surprising. Again, unsurprisingly, a further 50bp of rate cuts in Q1 would also boost inflation and spur growth although the small magnitude of the growth boost – just 0.1 percentage points in each of 2018 and 2019 for example – might disappoint.

FIGURE 31

Changes assumptions have effects on main macroeconomic variables

		Baseline September 2017 forecast	Deviation from baseline under two alternative scenarios	
			1 pp VAT hike in April 2018	50 bp rate cuts in Q1 18
GDP growth, %y/y	2018	1.1	-0.1	0.0
	2019	1.7	-0.4	0.1
	2020	1.9	-0.2	0.1
Household consumption, % y/y	2018	1.0	-0.2	0.1
	2019	1.6	-0.5	0.2
	2020	1.9	-0.3	0.1
CPI inflation average, % y/y	2018	5.4	0.4	0.1
	2019	5.7	0.2	0.2
	2020	5.6	-0.2	0.1
Current account, % of GDP	2018	-3.0	-0.1	0.0
	2019	-3.4	0.0	-0.1
	2020	-3.6	0.1	-0.1

Source: Absa Research

FIGURE 32

SARB's September MPC assumptions versus Absa's key forecast assumptions

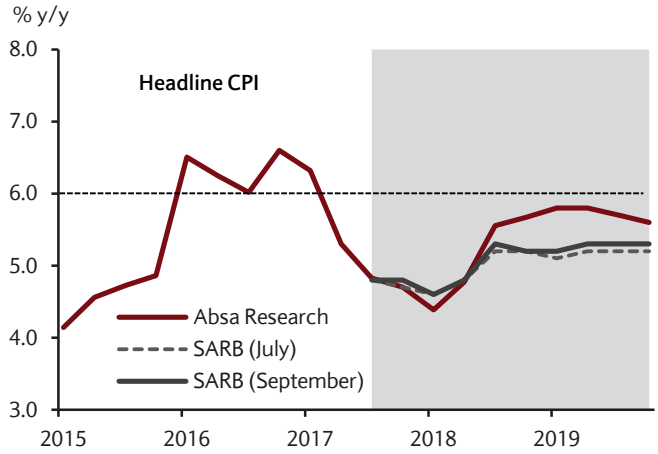
Variable	Absa assumption	SARB assumption (Sept MPC)	General comments and risks to our assumptions
Global growth	G7 growth of 2.0% and 1.9% for 2017 and 2018 respectively and 1.7% p.a. for 2019-20	Growth of SA's main trading partners 2017-19: 3.4%; 3.3%; and 3.3%	Absa and SARB's growth assumptions for model inputs are not strictly comparable. The global economy, particularly in Europe appears to be picking up steam, but demand in neighbouring Africa, which is important for South Africa's export performance but which is not explicitly incorporated into our model, remains weak
Food prices	Good harvests will push domestic food price inflation to a little over 3% by Q1 18 before a base-effect reversal, with faster than expected meat price inflation generating perhaps some upside risk.	World food prices rise in 2017-19: 7.0%, 2.7% and 3.4%, respectively	Absa and SARB's food price assumptions are not strictly comparable. Globally food prices appear well contained for now but climate change suggests more volatility and upside potential risk to food prices in the long run.
Crude oil prices (Brent)	Using Bloomberg consensus forecasts as a base we forecast Brent at $52/bbl, $56/bbl, and $58/bbl in 2017-2019 respectively	Spot Brent averages $52/bbl, $55/bbl, and $56bbl in 2017-2019, respectively	Current spot prices suggest mild upside risks to SARB's and our oil price assumptions, even before potential geopolitical shocks in the Middle East. US shale gas production will keep a lid on any price gains though
Petrol prices	Petrol price forecasts are derived from our ZAR and crude price assumptions. We also assume 10c/l rise in distribution margins each December and 25 c/l increase fuel excise duties each April. This generates annual petrol price hikes of 8.0%, 8.6%, and 11.9% in 2017-19, respectively	Average Increases of 6.9%, 6.4% and 5.6% in 2017-19, respectively	Our petrol price forecasts are higher than SARB's, probably because we have more rand depreciation in our forecast. Notably, the 2018/19 Budget mooted the idea of applying VAT to fuel sales (applied to the retail selling price post excise duties). If implemented in April 2018 without any offsetting drop in the fuel levy, it would push up petrol prices by 14% m/m, as opposed to the currently 2.4% assumption in our model based on 25c/l fuel levy hike
Electricity prices	After the average municipal tariff increase of 2.1% in July this year, we assume a 12% increase in July next year, and 6% the year after. This equates to annual average increases of 4.7%, 7.1%, and 8.8% in 2017-19 respectively.	Average electricity tariff hikes of 4.7%, 5.1% and 8.0% in 2017-19, respectively. These numbers imply that SARB has pencilled in 8% increases for July 2018 and July 2019, but in its last MPC statement it acknowledged that electricity prices were a big upside risk to its forecast.	The risks to the electricity tariff assumptions appear to be strongly on the upside. Eskom has applied to NERSA for an average tariff increase of nearly 20% effective July 2018, even before any upward tariff adjustments through the Regulatory Clearing Account mechanism, and Eskom has confirmed that a 20% average tariff adjustment would translate to a 27% tariff adjustment for municipal customers. However, such high tariff increases will be extremely contentious politically. NERSA is due to announce its decision on Eskom's application by 7 December.
Exchange rate	Our forecast is consistent with a depreciating NEER: 4.3% in 2017, 9.0% in 2018 and 10.3% in 2019. Even assuming a 4.5% inflation differential between South Africa and the currencies of its trading partners, these NEER forecasts imply some REER depreciation.	SARB usually assumes a constant real effective exchange (REER) from the a date two weeks or so before the MPC, which translates into +12.1% in 2017, -0.5% in 2018, and 0% in 2019	The outcomes of the end year electoral conference and consequent rating actions could have a significant impact on the rand, as could sudden shifts in sentiment about the likely pace of Fed tightening.
FX pass through to CPI	Our current long-term coefficient is between 10% and 20%, and the short-term pass through is very small at 5%	20%	The size of FX pass-through to inflation is one of the great debates in South Africa, especially since it is likely to change over time and is likely to be asymmetric and not linear, and can only be teased out of the data with extremely sophisticated econometric techniques
Commodity prices excluding oil	We use Bloomberg consensus forecasts for 2017-19 as a base: Gold in $/oz at 1250, 1270, and 1300; Platinum in $/oz at 931, 848, 850; Coal at $/mt 80, 64, 61; Iron ore in $/mt at 70, 60, 60	SARB does not reveal any specific commodity price assumptions. Instead it assumes international commodity prices up by 14.0% in 2017, -2.5% in 2018, 2.5% in 2019	Absa and SARB commodity price assumptions are not strictly comparable. Coal and iron ore prices have recovered recently but precious metal prices remain subdued. Chinese growth remains key for industrial commodity prices.

Variable	Absa assumption	SARB assumption (Sept MPC)	General comments and risks to our assumptions
Growth in government consumption	We forecast real government consumption (G) growth of 0.3% this year, and 0.8% p.a. for 2018-19	SARB forecasts 0.5% in 2017, and 1.0% p.a. in 2018-19	A public sector wage deal currently under negotiation for to take effect April 2018 could derail the picture of contained government consumption spending without stronger efforts at headcount shrinkage.
Potential growth	We estimate potential growth at 1.0% in 2017, 0.8% in 2018, 1.4% in 2019 and 1.9% in 2020	1.1%, 1.2% and 1.3% in 2017-19 respectively	Estimates of unobservable potential growth are usually statistically derived from recent growth trends. SARB's estimate of potential growth is materially higher than ours for 2018, but materially lower in 2019

Source: SARB, Absa Research

FIGURE 33

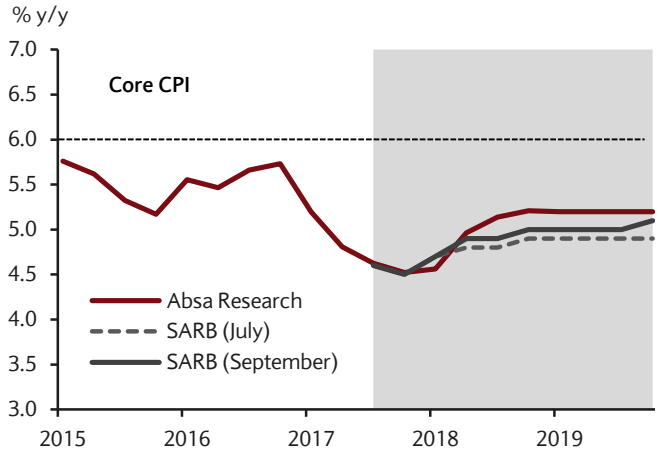
Absa is more pessimistic on headline CPI than SARB…



Source: SARB, Absa Research

FIGURE 34

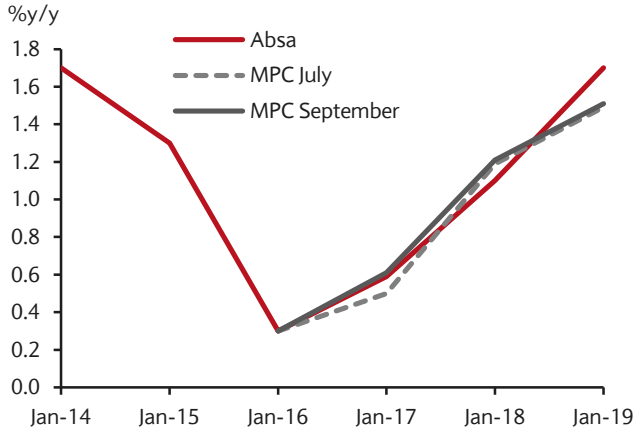
…but close to SARB's view on core CPI



Source: SARB, Absa Research

FIGURE 35

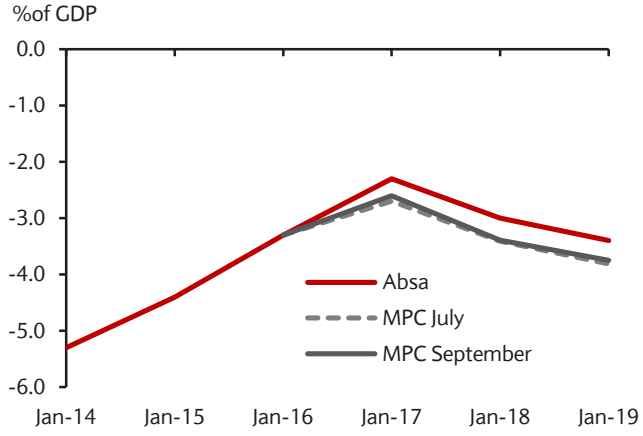
Absa's GDP view is a bit less optimistic near-term



Source: SARB, Absa Research

FIGURE 36

Absa's current account forecast is rosier than the SARB's



Source: SARB, Absa Research

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