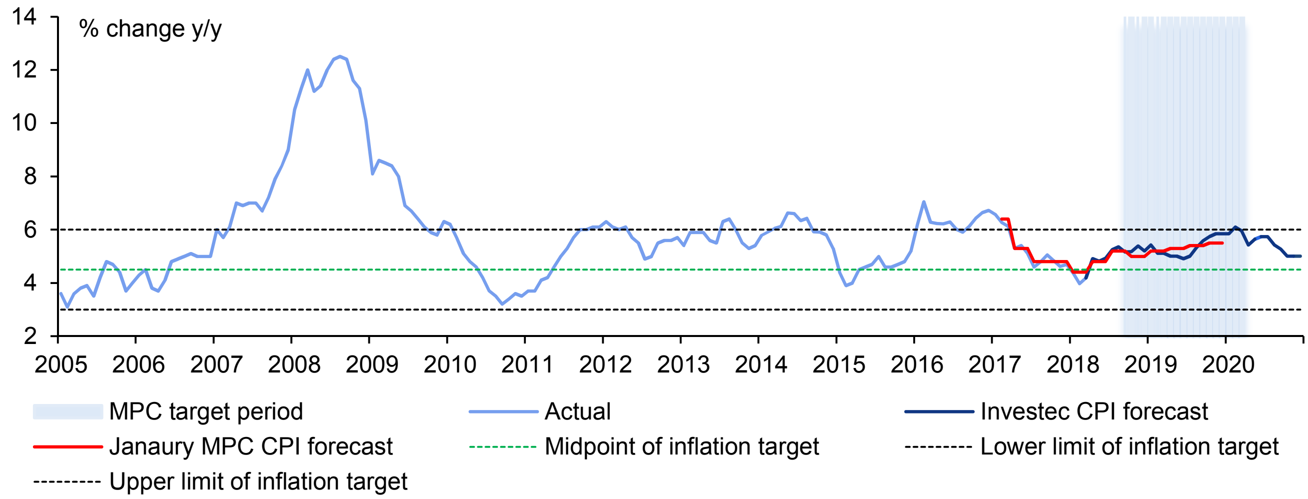
Investec

# MPC outlook: the tone is likely to have become more dovish now Moody's has upgraded SA's outlook to stable with no rating change

26th March 2018

Figure 1: SA Consumer Inflation: history and forecasts




Source: Stats SA, SARB, Investec

Moody's recent country review of South Africa's credit ratings saw a stabilisation at the last rung of sub-investment grade (Baa3 – see figures 3 and 4), completing the process after the country was placed on review for a downgrade (to sub-investment grade) on 24th December 2018. SA consequently escaped a downgrade by all three key agencies to sub-investment grade (Fitch and S&P have SA on BB+ for the local currency long-term sovereign rating, and BB+ and BB respectively for the country's foreign currency long-term sovereign rating). Specifically, in its rationale to keep SA on investment grade Moody's said "(t)he South African government's credit profile is supported by a diversified economy, a sound macroeconomic policy framework and deep financial markets. Credit constraints include the rising debt burden and fiscal risks stemming from contingent liabilities as well as persistently low growth, which nevertheless shows signs of a gradual recovery." We expect no credit rating downgrades for South Africa this year from any of the key agencies (see "SA retains its investment grade status from Moody's while the change to a stable outlook signals a stabilisation of the rating - an improvement as the country was placed on review for downgrade last year on 24th November", 24th March 2018, see website address below). Moody's has also outlined reasons for a future upgrade, which tie in with the objective of the Ramaphosa Presidency (see "Economic outlook 2017–2023: Global growth is expected to strengthen somewhat further; for SA's growth free market policies are key", 5th January 2018). The rand has strengthened to R11.60/USD, R14.35/EUR and R16.21/GBP from R11.90/USD, R14.67/EUR and R17.02/GBP on Friday on relief a Moody's downgrade was avoided, with markets anticipating further strength. The immediate market cheer was seen to be limited however, as EWC (Expropriation without Compensation) proceedings

Figure 2: Forecasts

| Period end rate % | Q1.18 | Q2.18 | Q3.18 | Q4.18 | Q1.19 | Q2.19 | Q3.19 | Q4.19 |
|---|---|---|---|---|---|---|---|---|
| Repo Rate | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 |
| Prime Overdraft Rate | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 |

Source: IRESS, Investec



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Figure 3: Foreign Currency – Long term

| | S&P | Moody's | Fitch |
|---|---|---|---|
| Brazil | BB- | Ba2 | BB- |
| Russia | BBB- | Ba1 | BBB- |
| India | BBB- | Baa2 | BBB- |
| Turkey | BB | Ba2 | BB+ |
| Mexico | BBB+ | A3 | BBB+ |
| **South Africa** | **BB** | **Baa3** | **BB+** |
| China | A+ | A1 | A+ |
| Nigeria | B | B2 | B+ |
| Kenya | B+ | B2 | B+ |
| Namibia | NR | Ba1 | BB- |
| Ghana | B- | B3 | B |
| Botswana | A- | A2 | NR |
| Mozambique | SD | Caa3 | RD |
| Zambia | B | B3 | B |
| Ethiopia | B | B1 | B |
| Rwanda | B | B2 | B+ |
| Uganda | B | B2 | B+ |
| Angola | B- | B2 | B |
| Rep of Congo | CCC+ | Caa2 | CC |

Source: Rating Agencies

Figure 4: Local Currency – Long term

| | S&P | Moody's | Fitch |
|---|---|---|---|
| Brazil | BB- | Ba2 | BB- |
| Russia | BBB | Ba1 | BBB- |
| India | BBB- | Baa2 | BBB- |
| Turkey | BB+ | Ba2 | BBB- |
| Mexico | A- | A3 | BBB+ |
| **South Africa** | **BB+** | **Baa3** | **BB+** |
| China | A+ | A1 | A+ |
| Nigeria | B | B2 | B+ |
| Kenya | B+ | B2 | B+ |
| Namibia | NR | Ba1 | BB+ |
| Ghana | B- | B3 | B |
| Botswana | A- | A2 | NR |
| Mozambique | B- | Caa3 | CC |
| Zambia | B | B3 | B |
| Ethiopia | B | B1 | B |
| Rwanda | B | B2 | B+ |
| Uganda | B | B2 | B+ |
| Angola | B- | B2 | B |
| Dem. Rep of Congo | CCC+ | B3 | NR |

Source: Rating Agencies

Figure 5: Reuters March 2018 Econometer poll: Repo rate end period %

| Forecast period | Q2.18 | Q3.18 | Q4.18 | Q1.19 | Q2.19 | Q3.19 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Median | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 | 6.75 |
| Highest forecast | 6.75 | 6.75 | 6.75 | 7.00 | 6.75 | 6.75 | 6.75 | 7.25 |
| Lowest forecast | 6.25 | 6.00 | 6.00 | 6.00 | 5.50 | 5.00 | 5.00 | 5.00 |
| No. of forecasts | 21 | 21 | 21 | 21 | 18 | 18 | 18 | 13 |

Source: Reuters



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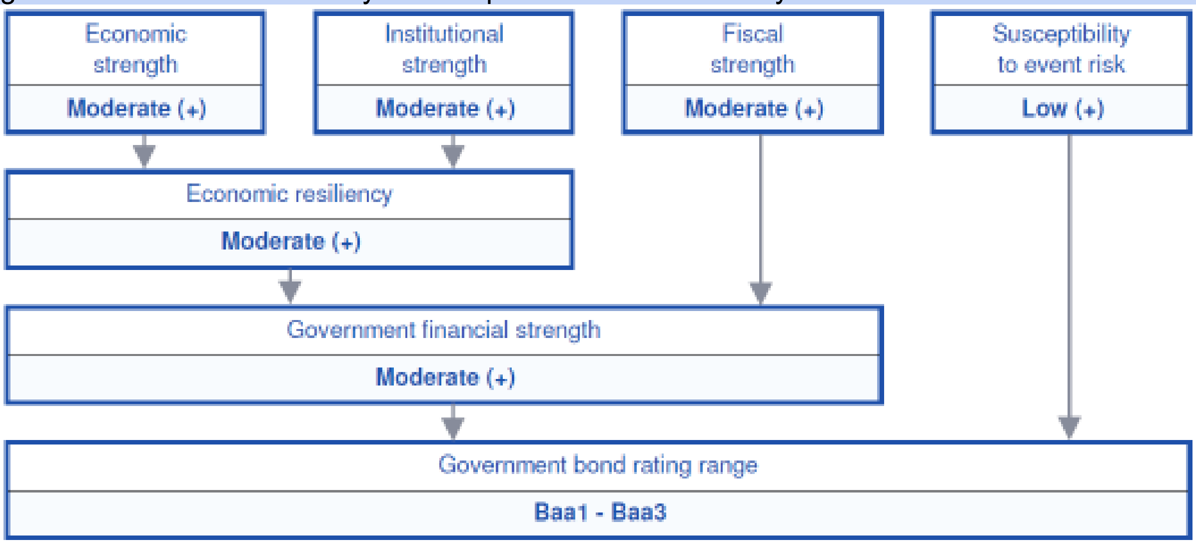
Figure 6: South Africa's Moody's credit profile is determined by four factors




Source: Moody's Investor Service

kick off tomorrow in Johannesburg, and investors remain uncertain ahead of this Land Summit. A "Codesa-like" summit is planned, with key members from SA's political parties on the committee, as well as farmers, including representatives from SA's large scale, commercial farming sector. Pre-summit key players have commented again that there should be no fears about land grabs, specifying that the process will not be allowed to destabilise. The constitutional review committee will attend the summit and use it as a starting point before embarking on its nationwide consultation process. The summit is not, in itself, expected to result in any resolutions, but aims to reduce emotions around the issue.

Also up this week is the MPC's second meeting of the year, with economists' expectations shifting to those of a 25bp cut, while the market shows an unchanged repo rate on balance currently. We believe the possibility of a 25bp cut is running at 50/50 currently, with the market showing an expectation of closer to 40%. Indeed, the MPC inflation forecast in 2019 should fall from 5.4% y/y to around 5.1% y/y, as the SARB strengthens its rand forecast materially, but at the same time it will need to increase its oil price forecast, and also the impact from the 2018 Budget. The 1% VAT increase will take place from

Figure 7: Moody's – South Africa's credit strengths and challenges

Credit strengths

- Sustained strength of core institutions such as the judiciary and the Reserve Bank
- Deep domestic financial markets and a well-capitalized banking sector
- A low share of foreign-currency debt in total public debt

Credit challenges

- Protracted political and social divisions that generate policy uncertainty and could impede growth-oriented structural reforms
- Low growth and high unemployment, reflecting persistent structural bottlenecks
- Accumulation of public debt and government contingent liabilities

Figure 8: Ratings methodology and scorecard factors – Moody's rating factors grid for SA

| Rating factors | Sub-factor weighting | Indicator | Indicative factor score | Final factor score |
|---|---|---|---|---|
| **Factor 1: Economic strength** | | | M+ | M+ |
| **Growth Dynamics** | 50% | | | |
| Average real GDP growth (2012-2021F) | | 1.8 | | |
| Volatility in real GDP growth (standard deviation, 2007-2016) | | 1.9 | | |
| WEF Global Competitiveness index (2017) | | 4.3 | | |
| **Scale of the economy** | 25% | | | |
| Nominal GDP (US$ billion, 2016) | | 295.4 | | |
| **National income** | 25% | | | |
| GDP per capita (PPP, US$, 2016) | | 12,321 | | |
| **Automatic adjustments** | [-3; 0] | Scores applied | | |
| Credit boom | | 0 | | |
| **Factor 2: Institutional strength** | | | H- | M+ |
| **Institutional framework and effectiveness** | 75% | | | |
| Worldwide Government Effectiveness index (2016) | | 0.3 | | |
| Worldwide Rule of Law index (2016) | | 0.1 | | |
| Worldwide Control of Corruption index (2016) | | 0.0 | | |
| **Policy credibility and effectiveness** | 25% | | | |
| Inflation level (%, 2012-2021F) | | 5.6 | | |
| Inflation volatility (standard deviation, 2007-2016) | | 1.9 | | |
| **Automatic adjustments** | [-3; 0] | Scores applied | | |
| Track record of default | | 0 | | |
| **Economic Resiliency (F1xF2)** | | | **H-** | **M+** |
| **Factor 3: Fiscal strength** | | | M+ | M+ |
| **Debt burden** | 50% | | | |
| General government debt/GDP (2016) | | 52.5 | | |
| General government debt/revenue (2016) | | 144.6 | | |
| **Debt affordability** | 50% | | | |
| General government interest payments/revenue (2016) | | 9.8 | | |
| General government interest payments/GDP (2016) | | 3.6 | | |
| **Automatic adjustments** | [-6; +4] | Scores applied | | |
| Debt trend (2013-2018F) | | 0 | | |
| Foreign currency debt/general government debt (2016) | | 0 | | |
| Other non-financial public sector debt/GDP (2016) | | -1 | | |
| Public sector assets/general government debt (2016) | | 0 | | |
| **Government financial strength (F1xF2xF3)** | | | **H-** | **M+** |
| **Factor 4: Susceptibility to event risk** | **Max. function** | | L+ | L+ |
| **Political risk** | | | *L+* | *L+* |
| Worldwide voice & accountability index (2016) | | 0.6 | | |
| **Government liquidity risk** | | | *L* | *L* |
| Gross borrowing requirements/GDP | | 7.2 | | |
| Non-resident share of general government debt (%) | | 33.7 | | |
| Market-Implied Ratings | | Ba1 | | |
| **Banking sector risk** | | | *L+* | *L* |
| Average baseline credit assessment (BCA) | | baa3 | | |
| Total domestic bank assets/GDP | | 112 | | |
| Banking system loan-to-deposit ratio | | 95 | | |
| **External vulnerability risk** | | | *L* | *L* |
| (Current account balance + FDI Inflows)/GDP | | -2.5 | | |
| External vulnerability indicator (EVI) | | 85.8 | | |
| Net international investment position/GDP | | 7.5 | | |
| **Government bond rating range (F1xF2xF3xF4)** | | | **A2 - Baa1** | **Baa1 - Baa3** |
| **Assigned foreign currency government bond rating** | | **Baa3** | | |

**Note:** While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. For more information please see our Sovereign Bond Rating Methodology.

Footnotes: **(1) Indicative factor score:** rating sub-factors combine with the automatic adjustments to produce an Indicative factor score for every rating factor, as detailed in Moody's Sovereign Bond Methodology. **(2) Final factor score:** where additional analytical considerations exist, Indicative factor scores are augmented to produce a Final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Bond Methodology; details on country-specific considerations are provided in Moody's research. **(3) Rating range:** Factors 1: Economic strength, and Factor 2: Institutional strength, combine with equal weight into a construct we designate as Economic Resiliency or ER. An aggregation function then combines ER and Factor 3: Fiscal strength (FS), following a non-linear pattern where FS has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's susceptibility to event risk, is a constraint which can only lower the preliminary government financial strength rating range as given by combining the first three factors. **(4) 15 Ranking categories:** VH+, VH, VH-, H+, H, H-, M+, M, M-, L+, L, L-, VL+, VL, VL- **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Source: Moody's Investor Service



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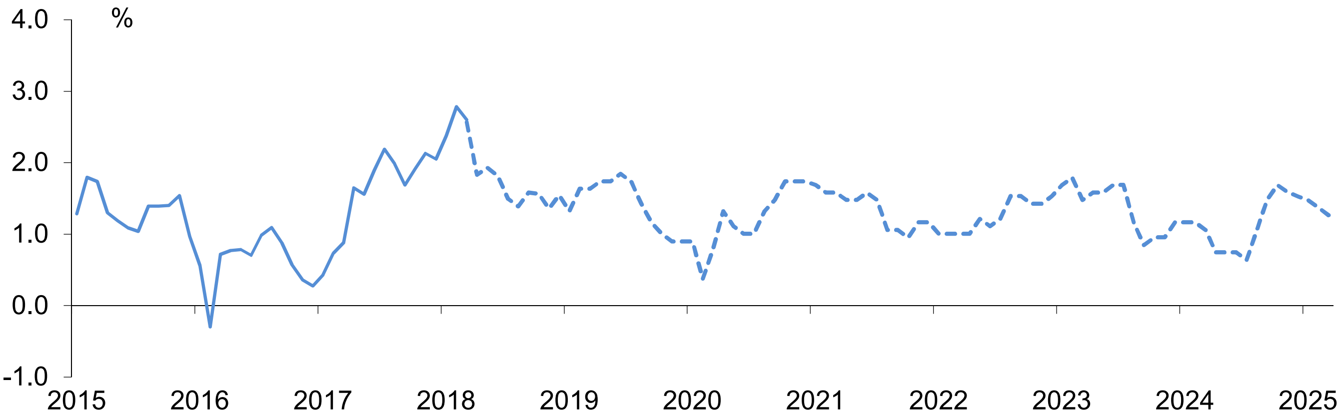
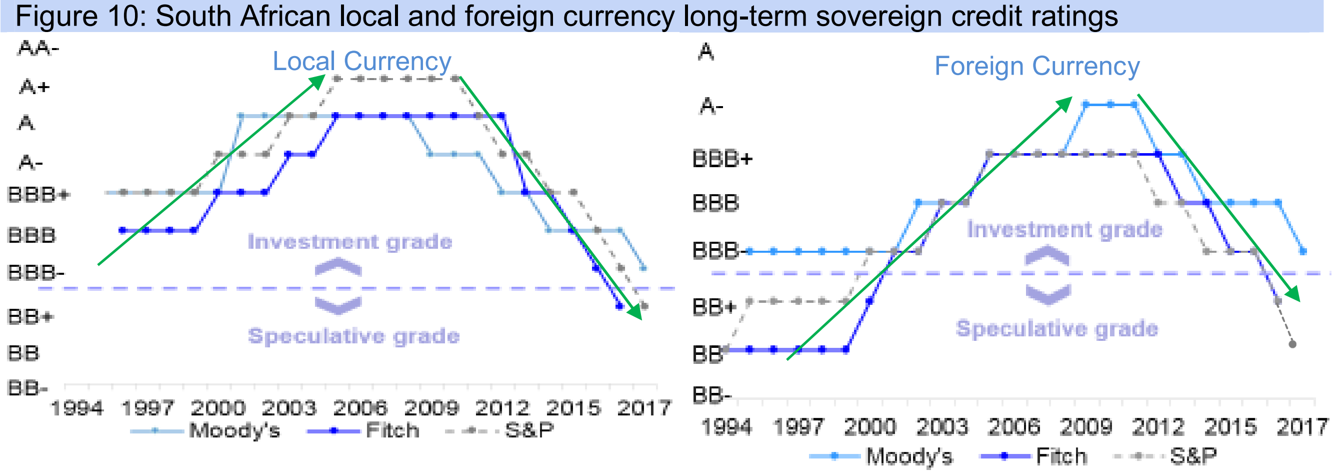
Figure 9: South Africa's real interest rate projections: (Investec CPI and repo forecasts)




Source: Investec, IRESS

1st April 2018, which will add about 0.5% y/y to the CPI inflation rate for the rest of 2018, bringing it up to around 5.0% y/y for the 2018 year as a whole, along with increases for ad valorem tax, fuel levies, alcohol and tobacco, while a sugar tax will be instituted, all of which will likely add a further 0.1% y/y. Coming in from 1st April, these tax increases will impact inflation for twelve months, from Q2.18 to end of Q1.19, and so elevate the CPI outcome. The Monetary Policy Committee targets CPI inflation only in the six to twenty four month period, which currently translates to the last quarter of 2018 and the whole of 2019, and the first quarter of 2020. It has specific focus on the twelve to eighteen month period (2019), where inflation is likely to be running closer to 5.0 to 5.5% y/y, rather than averaging 4.5% y/y. Previously, the SARB has explained that its CPI inflation forecast would need to fall below 4.5% y/y over the six to twenty-four month period (but specifically over twelve to twenty four months) for it to consider a cut. The SARB does not target historical CPI inflation, but rather future inflation outcomes. While we expect CPI inflation will bottom around 4.0% y/y in Q1.18, it is likely to climb over Q2.18 and

Figure 10: South African local and foreign currency long-term sovereign credit ratings




Source: Moody's, Fitch, Standard and Poor's



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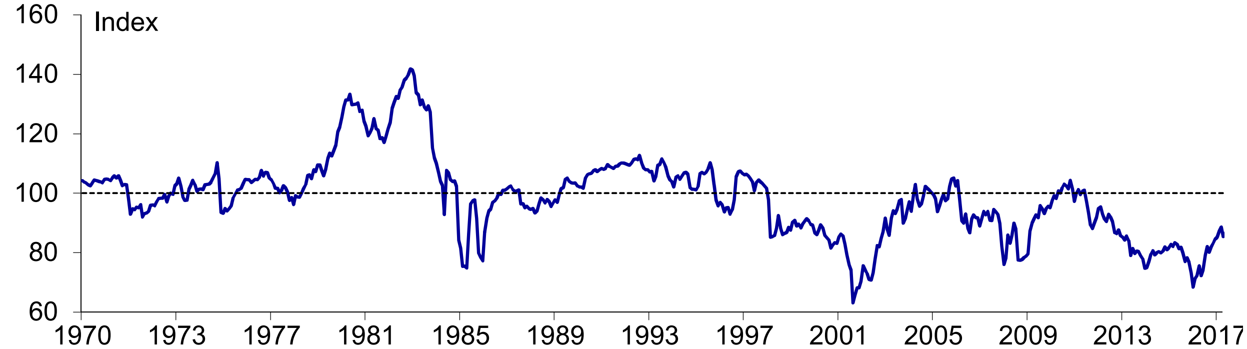
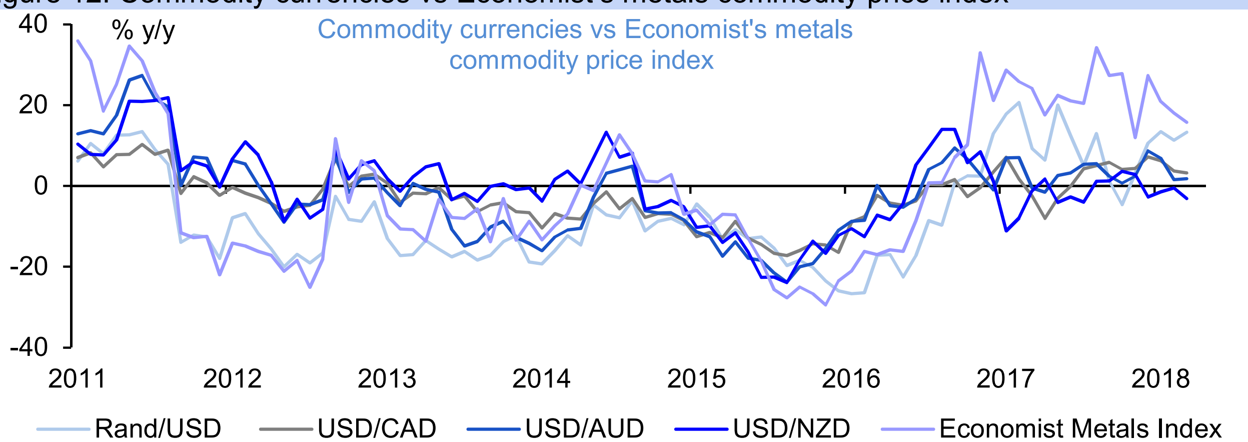
Figure 11: SA's real effective exchange rate



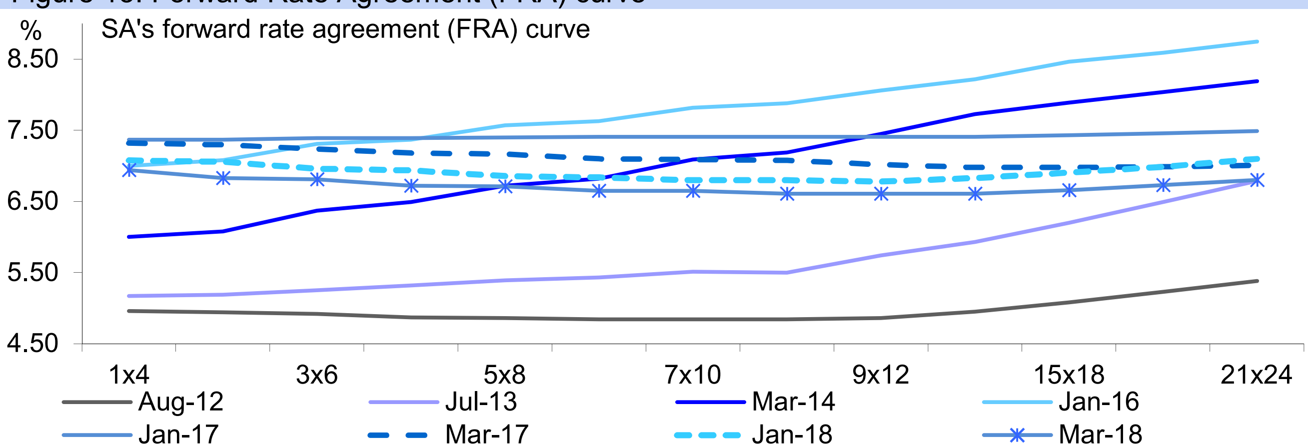

Source: Reserve Bank

Figure 12: Commodity currencies vs Economist's metals commodity price index




Source: IRESS

Figure 13: Forward Rate Agreement (FRA) curve




Source: Reuters



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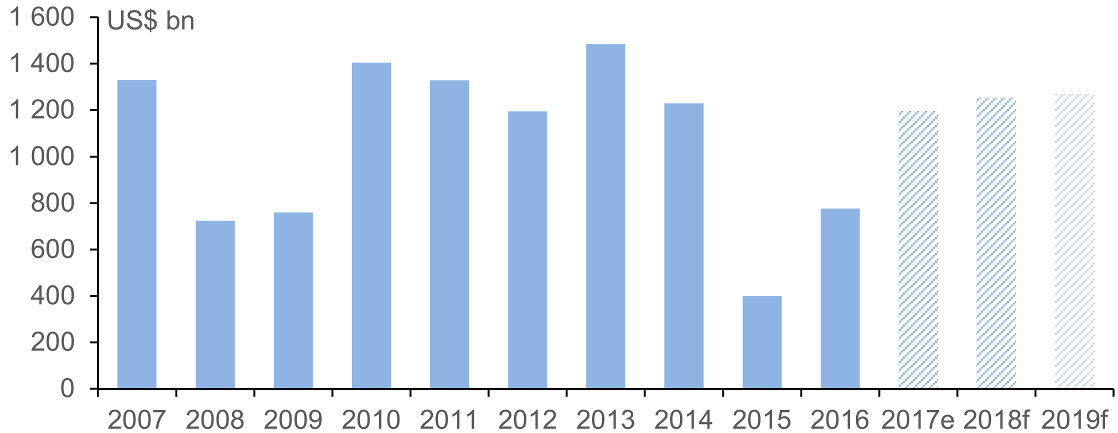
Figure 14: Capital to emerging markets – EM net capital inflows

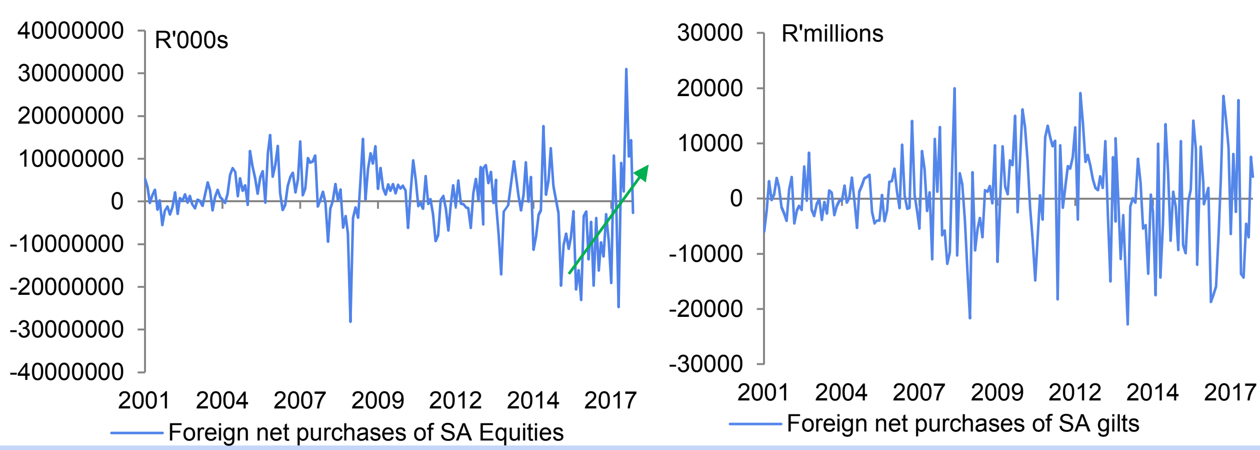



Source: IIF

H2.18on base effects, higher commodity prices with little further marked rand strength and tax pressures from the budget, leading to a higher departure point for 2019.

The rand's recent strength has yet to be maintained, moving back above R12.00/USD recently, and the domestic currency could weaken just as quickly as it has strengthened over the turn of the year, should markets experience a marked risk-off period. Concerns are building again that global stock markets are overvalued, and could be due another correction, while expectations are now building that the US could hike interest rates up to four times this year (by 25bp each), which would likely have a negative impact on global risk sentiment towards emerging markets (see figure 18). Indeed, Moody's says "Persistent current account deficits, which rely mostly on portfolio and other non-FDI flows for funding, represent a secondary vulnerability. While high non-FDI inflows pose a risk, the external balance has proven resilient to shocks, with a flexible exchange rate and low foreign-currency debt serving as buffers. With

Figure 15: Foreign net purchases(+) /sales(-) of SA equities and bonds




Source: IRESS



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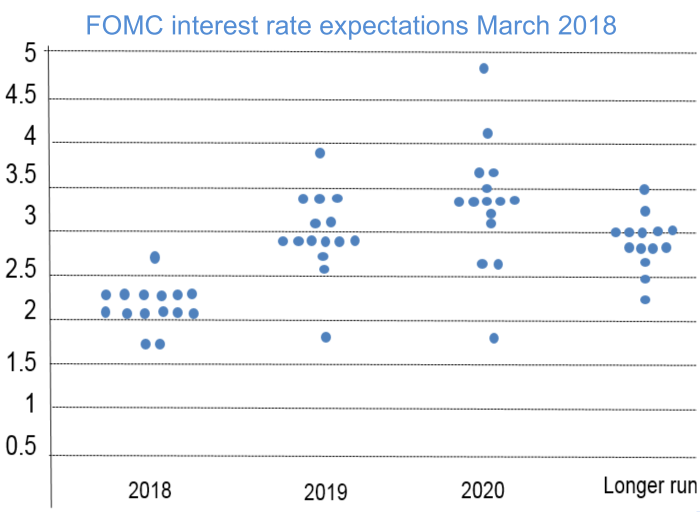
| Figure 16: FOMC 2018 Meeting Schedule | |
|---|---|
| May 1st - 2nd | September 25th 26th |
| June 12th -13th | November 7th – 8th |
| July/Aug 31st – 1st | December 18th – 19th |
| | Source: Federal Reserve Bank |

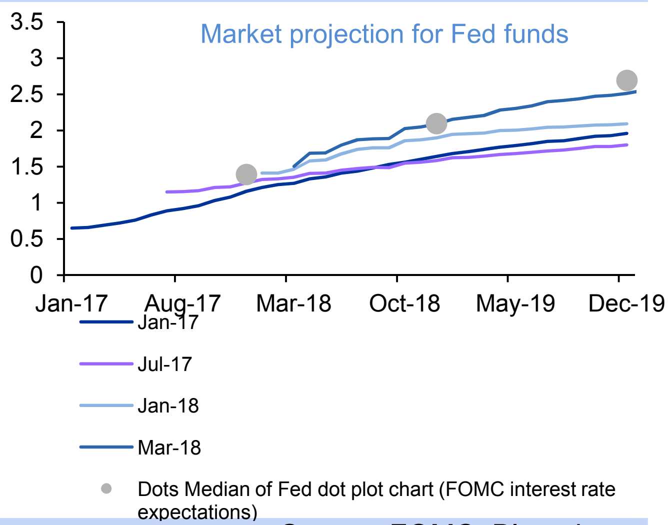
Figure 17: Forecast of international interest rates (%, end quarter)

| | US Fed funds | Euro zone Refi rate | Euro zone deposit rate | UK Bank Rate |
|---|---|---|---|---|
| Current | 1.25-1.50 | 0.00 | -0.40 | 0.50 |
| Q1.18 | 1.50-1.75 | 0.00 | -0.40 | 0.50 |
| Q2.18 | 1.75-2.00 | 0.00 | -0.40 | 0.75 |
| Q3.18 | 2.00-2.25 | 0.00 | -0.40 | 0.75 |
| Q4.18 | 2.25-2.50 | 0.00 | -0.40 | 1.00 |
| Q1.19 | 2.50-2.75 | 0.00 | -0.40 | 1.00 |
| Q2.19 | 2.75-3.00 | 0.00 | -0.20 | 1.25 |
| Q3.19 | 2.75-3.00 | 0.25 | 0.00 | 1.25 |
| Q4.19 | 2.75-3.00 | 0.50 | 0.25 | 1.25 |
| End year 2020 | 2.75-3.00 | 1.00 | 0.75 | 1.50 |

Source: Macrobond, Investec

Figure 18: Evolution of US interest rate expectations




Source: FOMC, Bloomberg

Note: in left graph each circle/dot is individual's judgement of appropriate fed funds rate per period



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Figure 19: Reuters Mar 2018: Econometer poll: SARB GDP end period

| Forecast period | Q1.18 | Q2.18 | Q3.18 | Q4.18 | Q1.19 | Q2.19 | Q3.19 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Median | 1.1 | 1.4 | 1.5 | 1.7 | 1.9 | 2.0 | 2.1 | 1.6 | 1.9 | 2.3 |
| Highest forecast | 2.5 | 2.6 | 2.1 | 2.8 | 2.7 | 3.7 | 2.7 | 2.3 | 2.5 | 2.8 |
| Lowest forecast | -1.2 | 0.2 | 0.4 | 1.2 | 0.3 | 0.8 | 1.2 | 1.3 | 1.0 | 1.8 |
| No. of forecasts | 15 | 15 | 15 | 15 | 14 | 14 | 12 | 26 | 26 | 13 |

Source: Reuters

almost 90% of the government's debt being rand-denominated and raised in the local capital market, the exchange rate risk to the debt portfolio is low. While total (both private and public) external debt continues to rise gradually (approximately 53% of GDP at end-2017) and external liabilities are material, the net international position is marginally positive. Accordingly, we assess South Africa's external vulnerability as 'low'."

While Moody's warns that "(l)ow real GDP growth and high unemployment are South Africa's key economic challenges", it adds that "2017 was the second year in a row when growth exceeded our forecast. Even if the improvement was largely cyclical, driven by external demand and by one-off factors such as the easing of a drought, it offers the government the opportunity to undertake the reforms that could return the economy to a higher and sustained growth path." The agency adds "Our 2018 and 2019 growth projections (1.4% and 1.9%, respectively) are still close to population growth (1.6% according to Statistics South Africa), held back by long-standing structural bottlenecks that include limited competition in key network sectors, skills shortages and mismatches, among others. Despite South Africa's abundant natural resources, the contribution of the mining sector to growth and foreign-exchange earnings continues to be dampened by the uncertainty created by the absence of agreement on the proposed Mining Charter and by the general lack of stable and investment-supportive regulations in the sector." "Possible downside risks to our growth forecast stem from a possible shock to the external environment (trade, financial conditions) and/or from a failure to capitalize on the positive momentum and undertake key growth-enhancing structural reforms, which undermines confidence and investment intentions."

South Africa saw economic growth of around 2.0% to 3.0% in the last three quarters of published data, while the nominal trade weighted rand has strengthened by about 2.9% since the previous MPC meeting, and CPI inflation is at 4.0% y/y, versus the mid-point of the 3-6% inflation target of 4.5%. While

Figure 20: SA Monetary Policy Committee (MPC) meeting dates for 2018

| Month | Date | Forecast |
|---|---|---|
| March 2018 | 26th – 28th | 6.75 |
| May 2018 | 22nd – 24th | 6.75 |
| July 2018 | 17th – 19th | 6.75 |
| September 2018 | 18th – 20th | 6.75 |
| November 2018 | 20th – 22nd | 6.75 |

Source: SA Reserve Bank, Investec



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Figure 21: CPI forecast averages

| Date | Index Base 2010 | Annual y/y | Monthly m/m | Quarterly y/y | Calendar year y/y | | y/y | |
|---|---|---|---|---|---|---|---|---|
| Jan 2017 | 100.6 | 6.6 | 0.6 | | | | | |
| Feb 2017 | 101.7 | 6.3 | 1.1 | | | | | |
| Mar 2017 | 102.3 | 6.1 | 0.6 | 6.3 | | | Mar 2016/17 | 6.2 |
| Apr 2017 | 102.4 | 5.3 | 0.1 | | | | | |
| May 2017 | 102.7 | 5.4 | 0.3 | | | | | |
| Jun 2017 | 102.9 | 5.1 | 0.2 | 5.3 | | | | |
| Jul 2017 | 103.2 | 4.6 | 0.3 | | | | | |
| Aug 2017 | 103.3 | 4.8 | 0.1 | | | | | |
| Sep 2017 | 103.8 | 5.1 | 0.5 | 4.8 | | | | |
| Oct 2017 | 104.1 | 4.8 | 0.3 | | | | | |
| Nov 2017 | 104.2 | 4.6 | 0.1 | | | | | |
| Dec 2017 | 104.7 | 4.7 | 0.5 | 4.7 | 2017 | 5.3 | | |
| Jan 2018 | 105.0 | 4.4 | 0.3 | | | | | |
| Feb 2018 | 105.7 | 4.0 | 0.7 | | | | | |
| Mar 2018 | 106.6 | 4.2 | 0.8 | 4.2 | | | Mar 2017/18 | 4.7 |
| Apr 2018 | 107.4 | 4.9 | 0.8 | | | | | |
| May 2018 | 107.6 | 4.8 | 0.2 | | | | | |
| Jun 2018 | 108.0 | 4.9 | 0.3 | 4.9 | | | | |
| Jul 2018 | 108.6 | 5.3 | 0.6 | | | | | |
| Aug 2018 | 108.8 | 5.4 | 0.2 | | | | | |
| Sep 2018 | 109.2 | 5.2 | 0.3 | 5.3 | | | | |
| Oct 2018 | 109.5 | 5.2 | 0.3 | | | | | |
| Nov 2018 | 109.8 | 5.4 | 0.3 | | | | | |
| Dec 2018 | 110.1 | 5.2 | 0.3 | 5.3 | 2018 | 4.9 | | |
| Jan 2019 | 110.7 | 5.4 | 0.5 | | | | | |
| Feb 2019 | 111.1 | 5.1 | 0.4 | | | | | |
| Mar 2019 | 112.0 | 5.1 | 0.8 | 5.2 | | | Mar 2018/19 | 5.2 |
| Apr 2019 | 112.8 | 5.0 | 0.7 | | | | | |
| May 2019 | 113.0 | 5.0 | 0.2 | | | | | |
| Jun 2019 | 113.3 | 4.9 | 0.2 | 5.0 | | | | |
| Jul 2019 | 114.1 | 5.0 | 0.7 | | | | | |
| Aug 2019 | 114.6 | 5.3 | 0.5 | | | | | |
| Sep 2019 | 115.3 | 5.6 | 0.6 | 5.3 | | | | |
| Oct 2019 | 115.8 | 5.7 | 0.5 | | | | | |
| Nov 2019 | 116.2 | 5.8 | 0.4 | | | | | |
| Dec 2019 | 116.6 | 5.8 | 0.3 | 5.8 | 2019 | 5.3 | | |

Source: Stats SA, Investec

| Figure 22: Reuters Mar 2018 Econometer poll: SARB CPI, unadjusted % ch y/y, average for period | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Forecast period | Q1.18 | Q2.18 | Q3.18 | Q4.18 | Q1.19 | Q2.19 | Q3.19 | 2018 | 2019 | 2020 |
| Median | 4.2 | 4.9 | 5.2 | 5.1 | 5.4 | 5.1 | 5.1 | 5.0 | 5.1 | 5.5 |
| Highest forecast | 4.5 | 5.2 | 5.5 | 5.7 | 5.8 | 5.5 | 5.7 | 5.4 | 5.5 | 5.8 |
| Lowest forecast | 1.4 | 1.8 | 1.1 | 0.9 | 1.3 | 1.6 | 1.4 | 3.7 | 3.3 | 4.1 |
| No. of forecasts | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 25 | 25 | 14 |

Source: Econometer

the figures do not look poor on face value, the GDP figures were led by the recovery in most areas from SA's drought, while CPI inflation has moved lower on the severe moderation in food price inflation, and the rand's strength has yet to feed through with second round effects into CPI inflation. Indeed, many retailers will likely use the domestic currency's strength to claw back the impact of their absorption of price pressures following previous marked currency depreciation.

The positive effects of drought alleviation are expected to wear out mostly in the first half of year, with Agbiz worrying that "(t)his season, weather conditions are once again playing a bigger role with the drought in the Western Cape and the delayed onset of rainfall in Free State and North-West provinces which affected production negatively." … "Climate change is one critical mega-trend that is affecting global agriculture in general and South Africa's agro-industry in particular." Indeed, Agbiz highlights that "(t)he country now receives average annual rainfall that is comparatively lower than past trends. South Africa received an average of 526 mm of rainfall per year over the past 60 years. However, the recent past has seen a progressive decline in annual average rainfall, with the post-2010 average being 7% lower than the previous three decades (1970-2010)."

Secondly, Agbiz says "evidence suggests a delay in the onset of the summer season. ... Recent rainfall patterns have seen a three- to six-week delay, which translates to a shift in optimal planting dates for summer crops such as maize and soybean. … "the farming sector has struggled not only due to the uncertainty in the onset of the seasonal peak (intra-seasonal variation), but also because of erratic and progressively lower rainfall (inter-seasonal variation). Therefore, the changes in the rainfall patterns mean that farmers will also need to adjust the planting dates. The weather has been a major risk factor in the past few seasons, as rainfall patterns did not only change, but were erratic, making it difficult for farmers to plan the planting schedules properly."

While the recent strength in the rand has fed through into CPI inflation fairly immediately in Q1.18 via the petrol price, it will likely have less impact on CPI inflation longer-term, as per above.

| Figure 23: Forecasts | | | | | | | |
|---|---|---|---|---|---|---|---|
| Period end rate % | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| Repo Rate (year-end: %) | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 | 6.75 |
| Prime Overdraft Rate (year-end: %) | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 | 10.25 |

Source: Investec



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http://www.investec.co.za/research-and-insights/economy/economic-research-v1.html •

Figure 24: Interest rate forecast: end rates

| Date | Prime forecast | Prime less Inflation | Repo | Repo less Inflation |
|---|---|---|---|---|
| Jan 2018 | 10.25 | 5.9 | 6.75 | 2.4 |
| Feb 2018 | 10.25 | 6.3 | 6.75 | 2.8 |
| Mar 2018 | 10.25 | 6.1 | 6.75 | 2.6 |
| Apr 2018 | 10.25 | 5.3 | 6.75 | 1.8 |
| May 2018 | 10.25 | 5.4 | 6.75 | 1.9 |
| Jun 2018 | 10.25 | 5.3 | 6.75 | 1.8 |
| Jul 2018 | 10.25 | 5.0 | 6.75 | 1.5 |
| Aug 2018 | 10.25 | 4.9 | 6.75 | 1.4 |
| Sep 2018 | 10.25 | 5.1 | 6.75 | 1.6 |
| Oct 2018 | 10.25 | 5.1 | 6.75 | 1.6 |
| Nov 2018 | 10.25 | 4.9 | 6.75 | 1.4 |
| Dec 2018 | 10.25 | 5.0 | 6.75 | 1.5 |
| Jan 2019 | 10.25 | 4.8 | 6.75 | 1.3 |
| Feb 2019 | 10.25 | 5.1 | 6.75 | 1.6 |
| Mar 2019 | 10.25 | 5.1 | 6.75 | 1.6 |
| Apr 2019 | 10.25 | 5.2 | 6.75 | 1.7 |
| May 2019 | 10.25 | 5.2 | 6.75 | 1.7 |
| Jun 2019 | 10.25 | 5.3 | 6.75 | 1.8 |
| Jul 2019 | 10.25 | 5.2 | 6.75 | 1.7 |
| Aug 2019 | 10.25 | 4.9 | 6.75 | 1.4 |
| Sep 2019 | 10.25 | 4.7 | 6.75 | 1.2 |
| Oct 2019 | 10.25 | 4.5 | 6.75 | 1.0 |
| Nov 2019 | 10.25 | 4.4 | 6.75 | 0.9 |
| Dec 2019 | 10.25 | 4.4 | 6.75 | 0.9 |

Source: IRESS, Investec

| Figure 25: Inflation forecasts | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| Consumer Inflation (Av: %) | 5.3 | 4.9 | 5.3 | 5.5 | 5.4 | 5.5 | 5.4 |
| *(year-end: %)* | *4.7* | *5.2* | *5.8* | *5.0* | *5.6* | *5.2* | *5.6* |
| Producer Inflation (Av: %) | 4.9 | 3.9 | 4.4 | 5.6 | 5.1 | 5.4 | 5.3 |
| *(year-end: %)* | *5.2* | *2.5* | *5.9* | *5.2* | *5.0* | *5.3* | *5.3* |
| Salary & wage increases (%) | 6.7 | 6.6 | 6.7 | 7.1 | 7.0 | 7.3 | 7.3 |

Source: Investec



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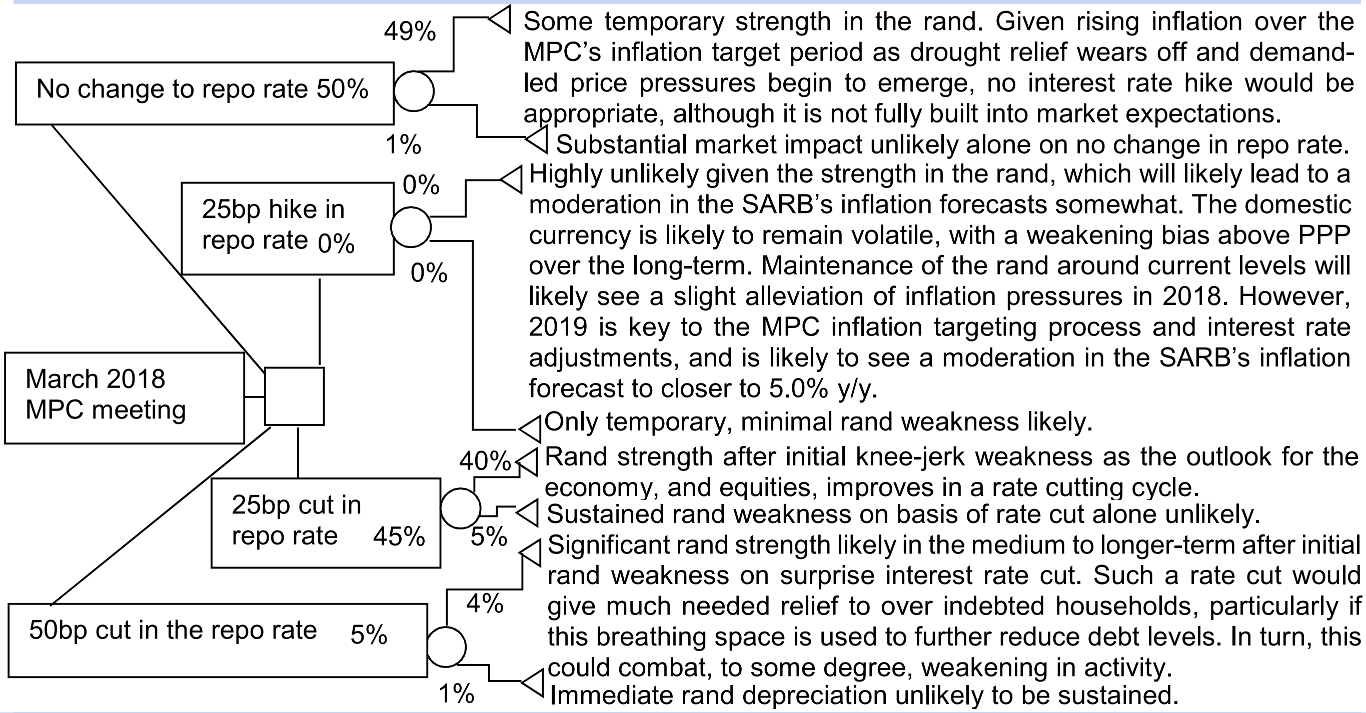
Figure 26: Decision tree for South Africa's 26th to 28th March 2018 MPC meeting




Key: squares are decision nodes, circles chance nodes and triangles end nodes. Source: Investec

Additionally, commodity prices are seeing modest growth, and this is expected to continue this year and next limiting the moderation in inflation, even though international commodity prices are not expected to move into a super-cycle in this period.

The SARB has communicated most recently that "(t)he endogenous interest rate path generated by the QPM has changed slightly since the previous meeting. Whereas three increases of 25 basis points by the end of 2019 were indicated previously, the third increase is now a marginal call. Furthermore, the timing of the first increase has been pushed out to later in the period. The implied path remains a broad policy guide and could change in either direction by the next meeting in response to new developments and changing risks." We believe the March MPC meeting will see both of these forecast 25bp QPM interest rate hikes removed as the MPC strikes a more dovish tone, although more than one member will likely vote for an interest rate cut in March. While the risk posed to the currency from a Moody's downgrade has been alleviated, the commodity price lift still poses a concern, as do the tax increases for the inflation outlook. Additionally, wage growth is expected to remain elevated above the 6.0% upper limit of the inflation target range, and as such is expected to continue to place upward pressure on inflation expectations. The MPC has also previously noted as well that while inflation is lower currently, it could well be temporary and a reduction in long-run inflation expectations would provide a better support for lower interest rates. However, should the rand strengthen notably further this year, and the new levels look to be maintained, the SARB may consider an interest rate cut from Q2.18 on consequent expected lower inflation for 2019, and in 2020 as well. While the SARB is likely to revise down its rand forecast, this is unlikely to be substantially below R12.00/USD.

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