

South Africa and the downgrade.

SA Economy went into the perfect storm in 2015/6 drought, commodity price declines and policy uncertainty.

South Africa was recovering and growth looked better while inflation concerns eased and the Rand gained in strength.

Now a minister's recall and more uncertainty along with weak growth leads SA back into a storm which we no longer can avoid.

All is not lost or over but things are going to be difficult for a while still.

5/29/2017

SA economy after the downgrade



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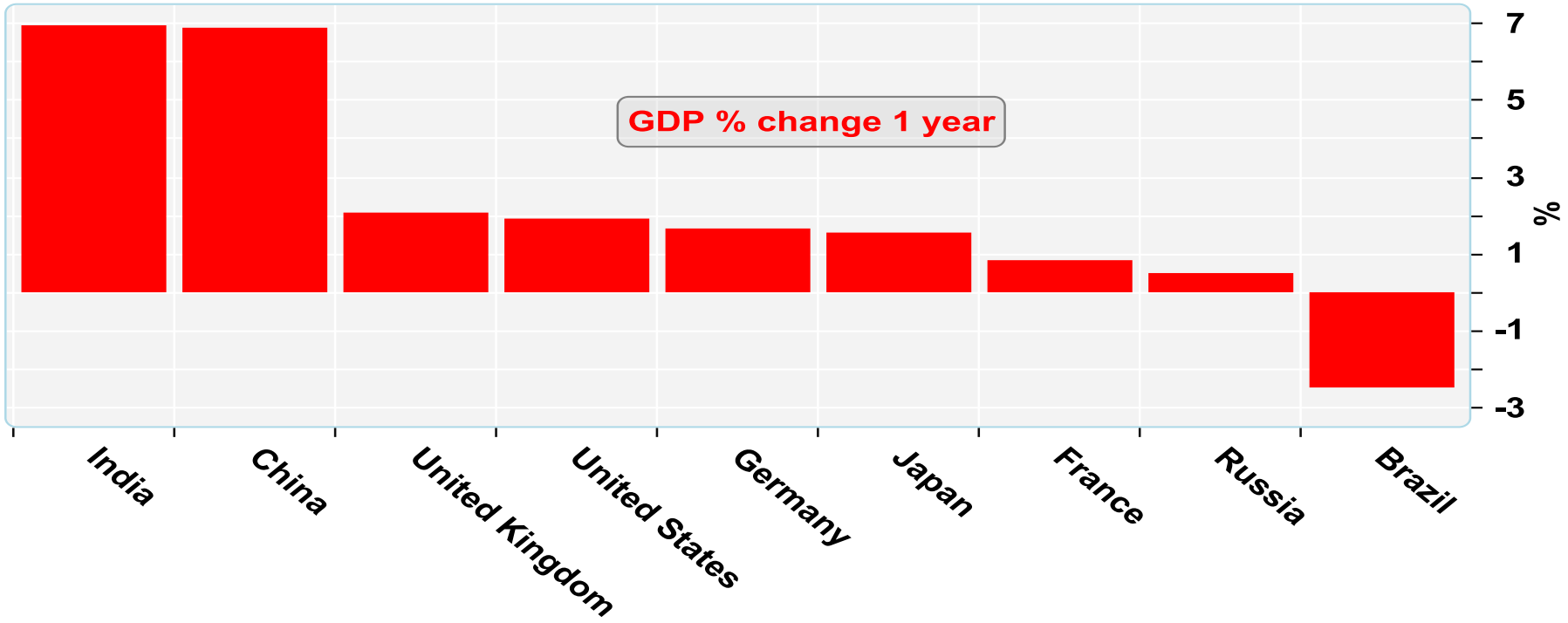


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- Background – World economy.
 - Me 1st world
- Commodities.
 - Super Cycle.
- Africa and World.
- SA economy.
 - Per capita income still down and some sector news.
- The Budget.
- Some forecasts.
 - A thought or two.

Commodity producers struggle.

large economies % change in GDP.



World GDP growth Forecasts.

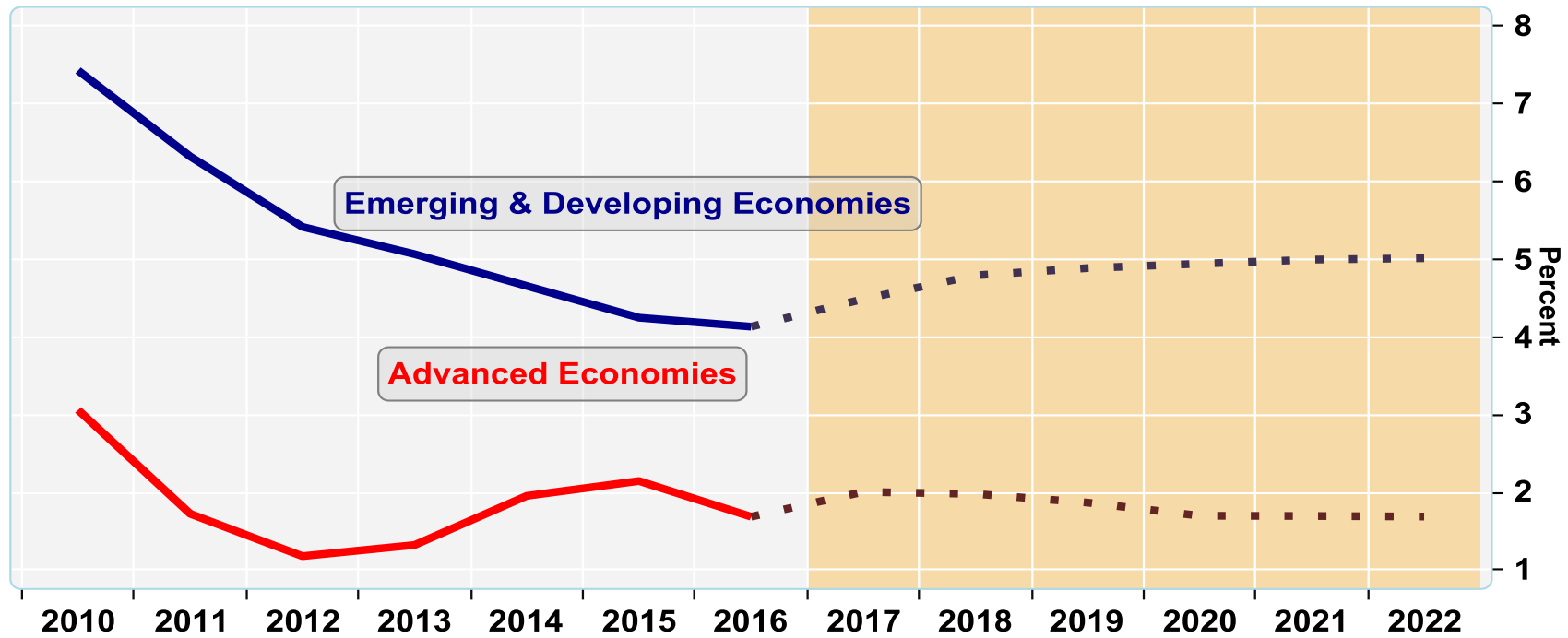


Year/institution	World Bank	IMF	OECD	UN
2015	2.4	3,0	2.9	2,4 (2,9)
2016e	2.3 (2.4)	3.1	3.0 (2.9)	3.0
2017f	2.7 (2.8)	3.5 (3.4)	3.3 (3.1)	3,2
2018f	2.9 (3.0)	3.6 (3,6)	3.6 (3.4)	3.4
2019f	2.9	3.7 (3.8)		
2020f		3.7 (3,8)		
2021f		3.8 (3,9)		

After most forecasts of the official agencies had been downgraded generally now the World Growth rate is picking up on forecast for the first time in about five years.

GDP History and Forecasts.

IMF World Economic Outlook.



The new Me 1st World

America 1st; UK 1st and we forgot about the developed world lower income folks

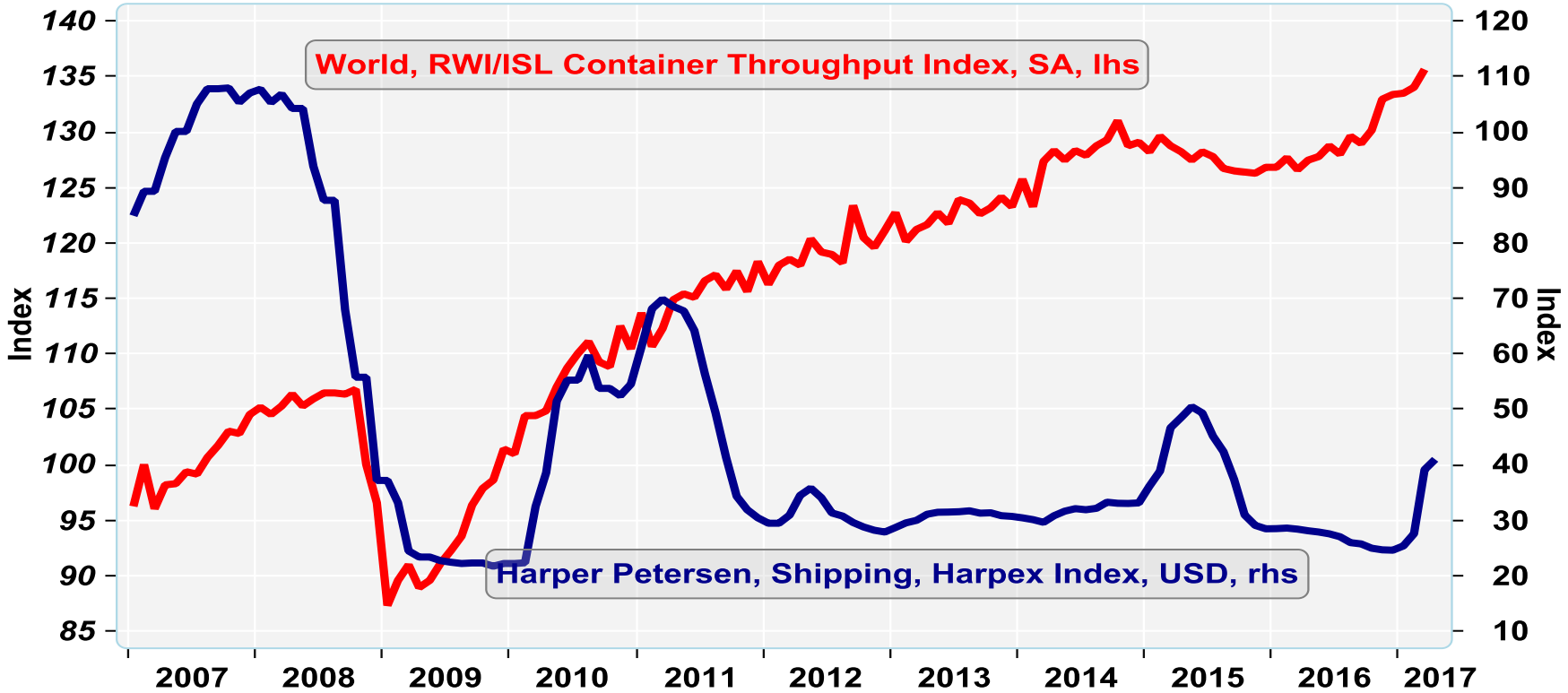




The trend in openness has been long.

- World exports have risen faster than GDP.
- We have seen many more people enter middleclass.
 - About 2 billion people have entered the so-called middle class in the last four decades.
 - That bring the total to over four billion.
 - About 1 billion are considered rich.
- But the rich world has not seen the growth in income they want.

World Trade is still growing however!



The South African commodity price index.

Looking at South African mineral exports and what the effect of that is on SA.

SA commodity prices. (ex diamonds) – 58% fall in US dollars then a 56% bounce!



SA mining commodity index USD

12 year upward march of SA mining commodities. This was a long wave upward cycle. Now a recovery of over 50% takes us to two thirds of the high. The downward wave is not over I believe so we need to keep that in mind.

SA commodity index

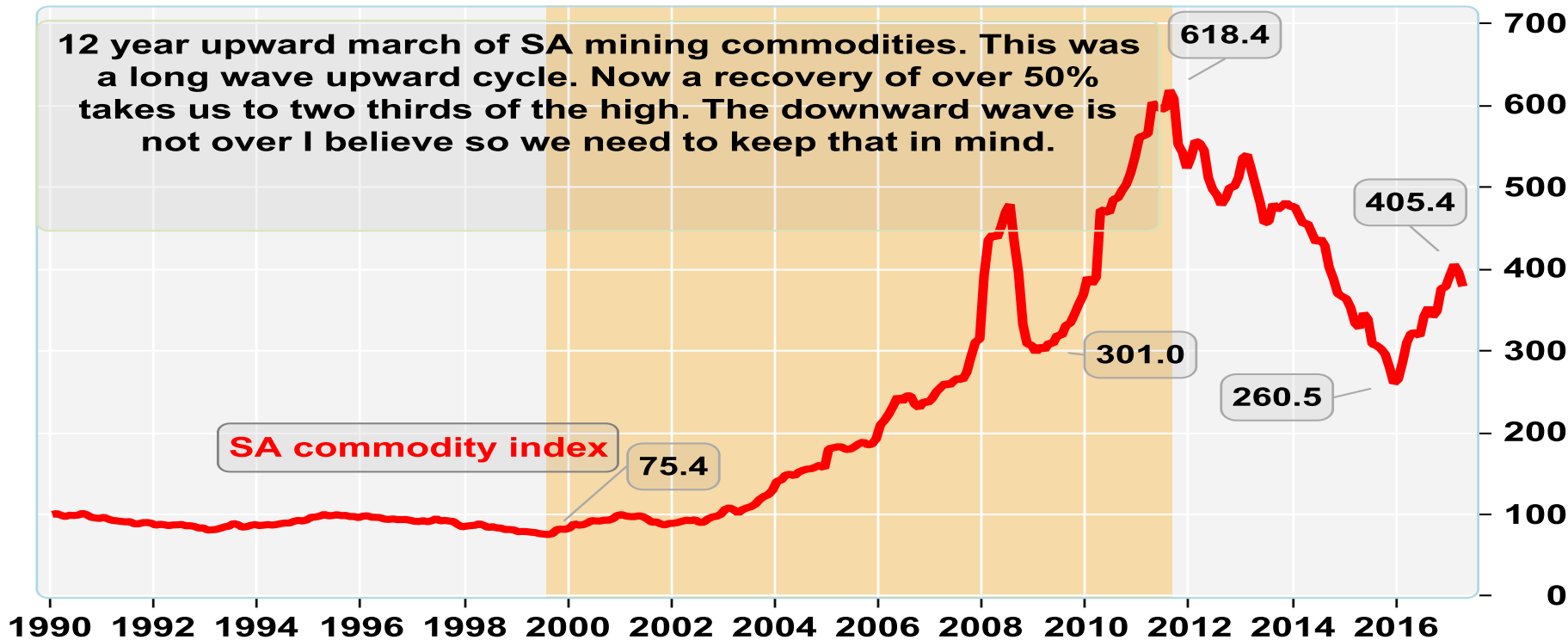
75.4

301.0

260.5

618.4

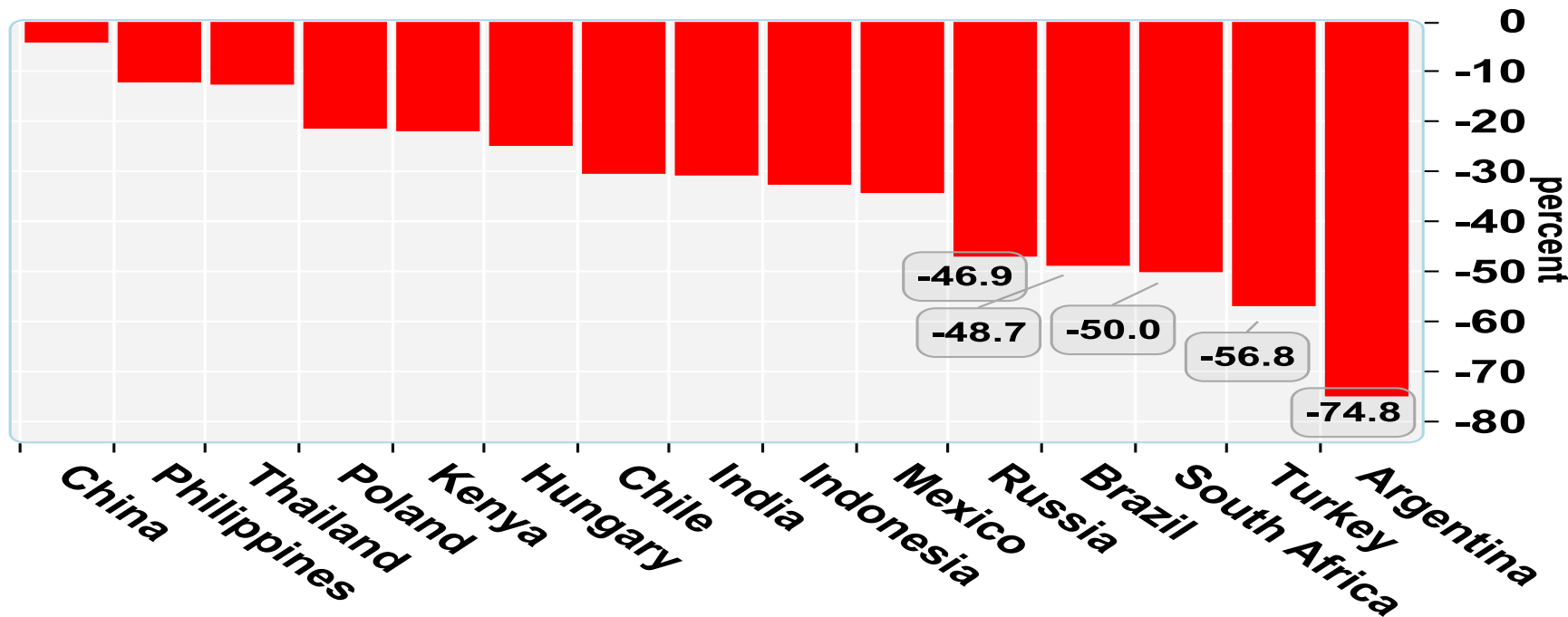
405.4





Change since 2011 (ties into commodity cycle).

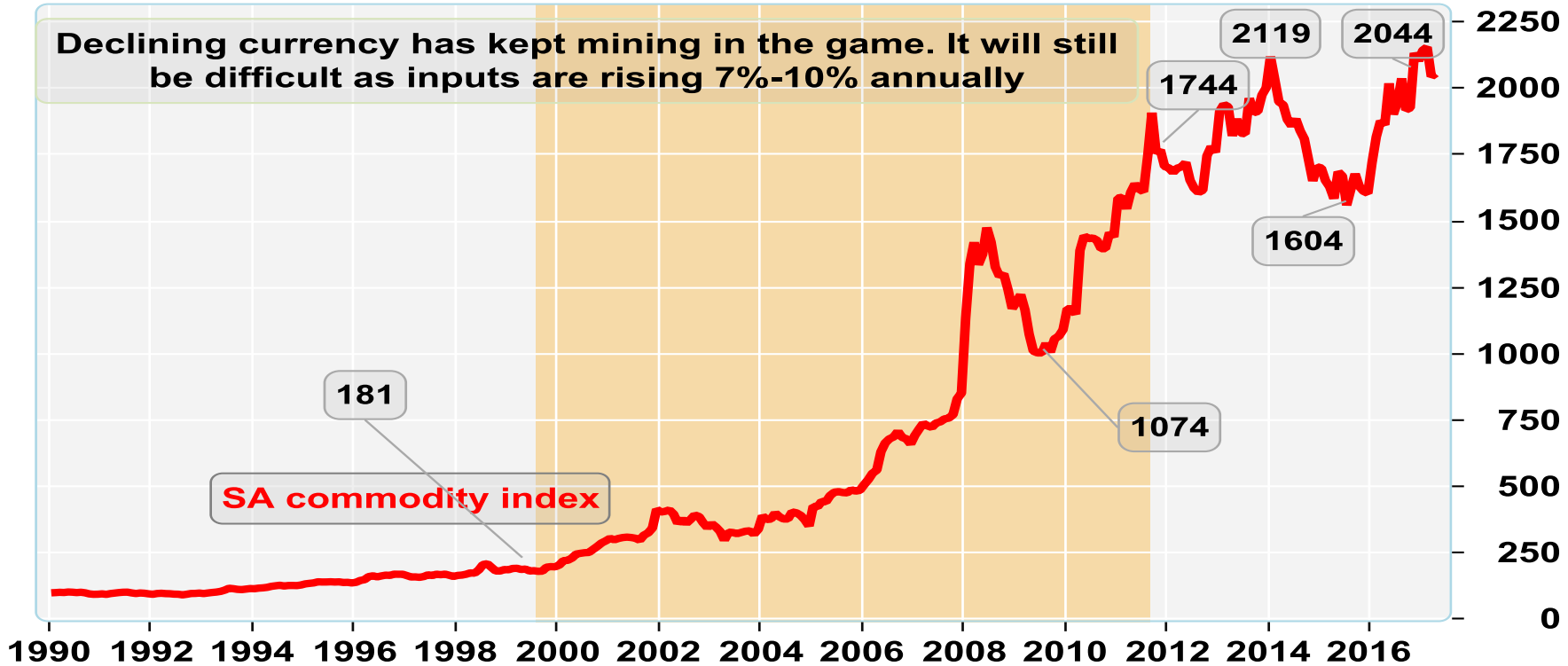
EM currencies to USD since start 2011

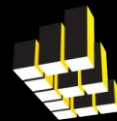


56% fall in USD equals 25% decline in local currency. Weak Rand helps but



SA commodity index





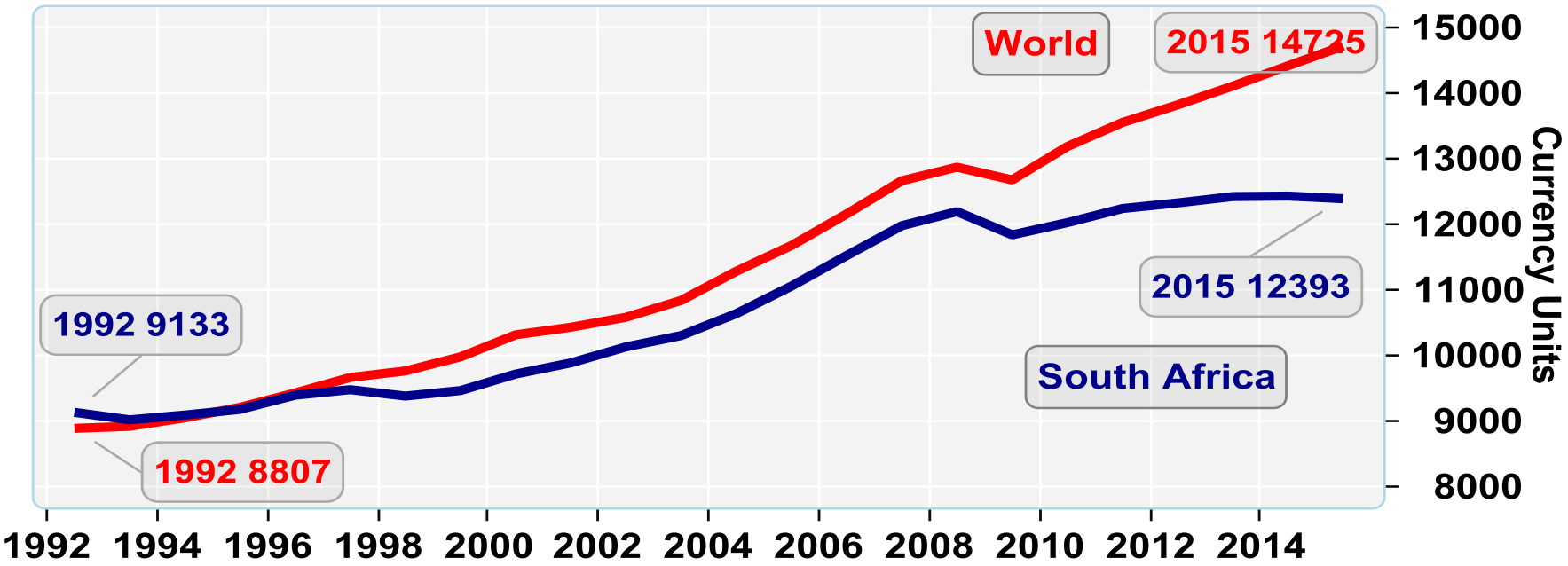
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Why Junk was coming and the market expected it at some stage.....

SA economy. Broad strokes for normal folks

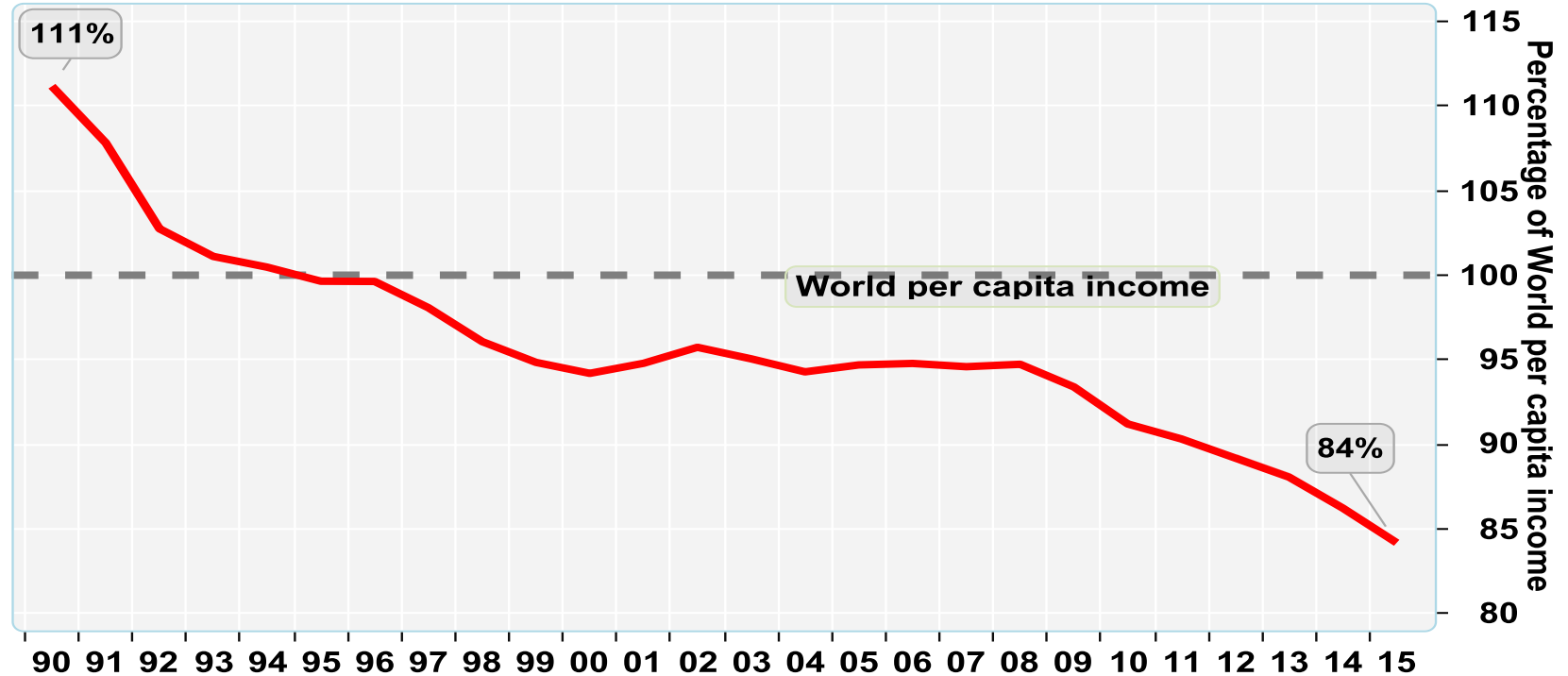
SA slower increase in wealth relatively.

GDP Per Capita: World and South Africa Constant PPP terms in International \$



Per capita income SA vs. World: From 20% richer to 15% poorer

South African per capita income as % of World per capita income





Income per capita growth.

- The most important part of rating agencies is the Income per capita of a country and its growth or decline.
- South Africa has had a declining GDP/Income for a few years now
 - Since 2014 SA growth has been less than population growth.
- No relative improvement foreseen according to long range forecast of IMF and I suspect other agencies and will have similar forecasts.
- The chance of further downgrades on the poor performance of the SA economy is very real.
 - The downgrades did not happen only because of Finance minister change. (They may have speeded up the downgrades and left no time to change direction but they would have happened if growth trend did not change.
 - Growth Trend now looks worse according to IMF and others.

What junk status means.

The Downgrades current and future and what it means. What Rating agencies do.





What Rating agencies do.

- Rating agencies deliver a view that pension funds or other mutual funds and even private investors use as a guide to investments.
 - Pension Funds / Institutions have rules and trustee enforce them on management to only invest limited amounts of money into lower graded investments.
 - These rules were made much tighter after 2008/9 world recession and rating agency's were criticized for not being vigilant enough then.
 - They now also fall under regulators in many big countries where they are based.
- Government / Issuers of debt pay for the review so conflict of interest has been pointed at them for not being tough enough!

SA credit Rating current from big three.



Skaal van die kredietgraderings

MOODY'S		STANDARD & POOR'S		FitchRatings		Vooruitsig:	
Staatskuld in rand	Staatskuld in ander geldeenhede	Staatskuld in rand	Staatskuld in ander geldeenhede	Staatskuld in rand	Staatskuld in ander geldeenhede	 Stabiel  Negatief	
Aaa	Aaa	AAA	AAA	AAA	AAA	BELEGGINGSGRAAD	
Aa1	Aa1	AA+	AA+	AA+	AA+		Prima
Aa2	Aa2	AA	AA	AA	AA		Hoog
Aa3	Aa3	AA-	AA-	AA-	AA-		
A1	A1	A+	A+	A+	A+		Hoër medium
A2	A2	A	A	A	A		
A3	A3	A-	A-	A-	A-		
Baa1	Baa1	BBB+	BBB+	BBB+	BBB+		Laer medium
Baa2	Baa2	BBB	BBB	BBB	BBB		
Baa3	Baa3	BBB-	BBB-	BBB-	BBB-		Niebeleggingsgraad, spekulatief
Ba1	Ba1	BB+	BB+	BB+	BB+		
Ba2	Ba2	BB	BB	BB	BB		
Ba3	Ba3	BB-	BB-	BB-	BB-		
B1	B1	B+	B+	B+	B+	Hoogs spekulatief	
B2	B2	B	B	B	B		
B3	B3	B-	B-	B-	B-		
Caa1	Caa1	CCC+	CCC+	CCC+	CCC+	Aansienlike risiko	
Caa2	Caa2	CCC	CCC	CCC	CCC		
Caa3	Caa3	CCC-	CCC-	CCC-	CCC-	Baie spekulatief Moontlike wanbetaling	
Ca	Ca	CC	CC	CC	CC		
C	C	C	C	C	C		
C	C	RD	RD	DDO	DDO	Wanbetaling	
		SD	SD	DD	DD		
		D	D	D	D		

On average growth forecasts have been downgraded.

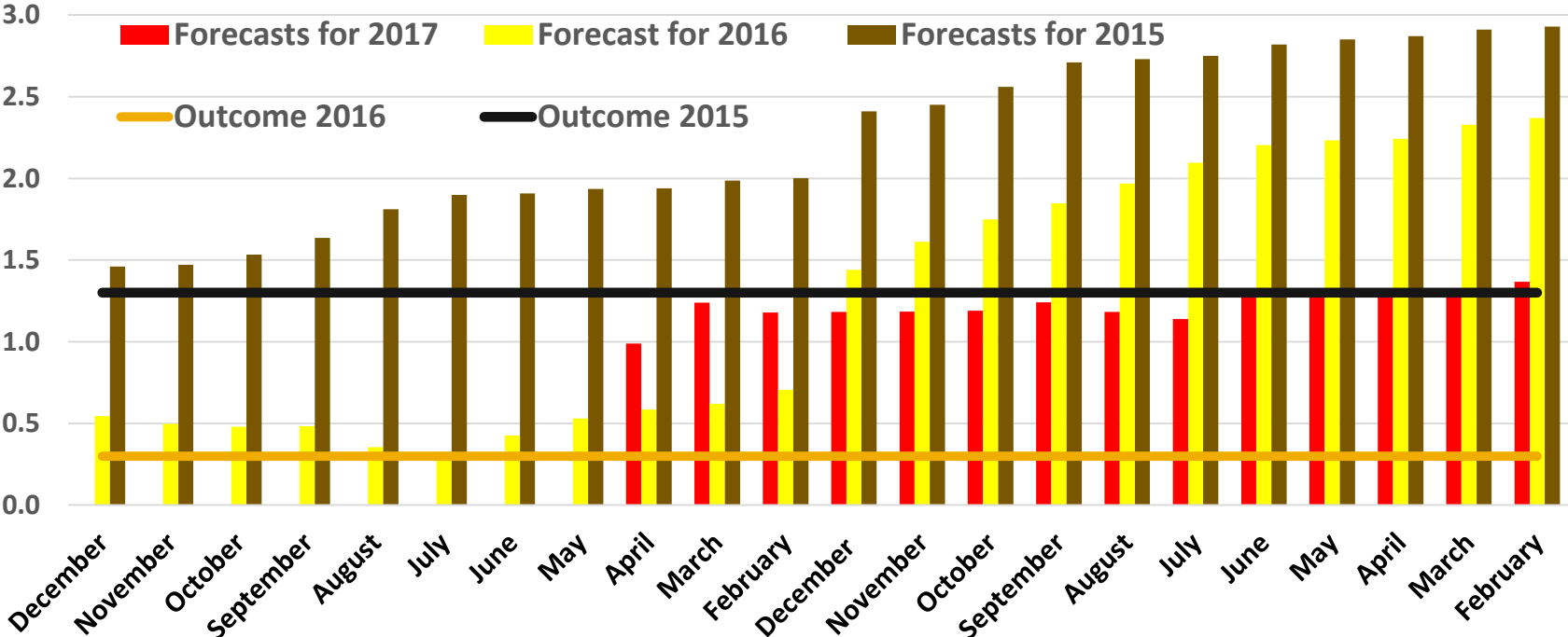


The History of GDP Forecasts

One year ahead

years ahead

Two

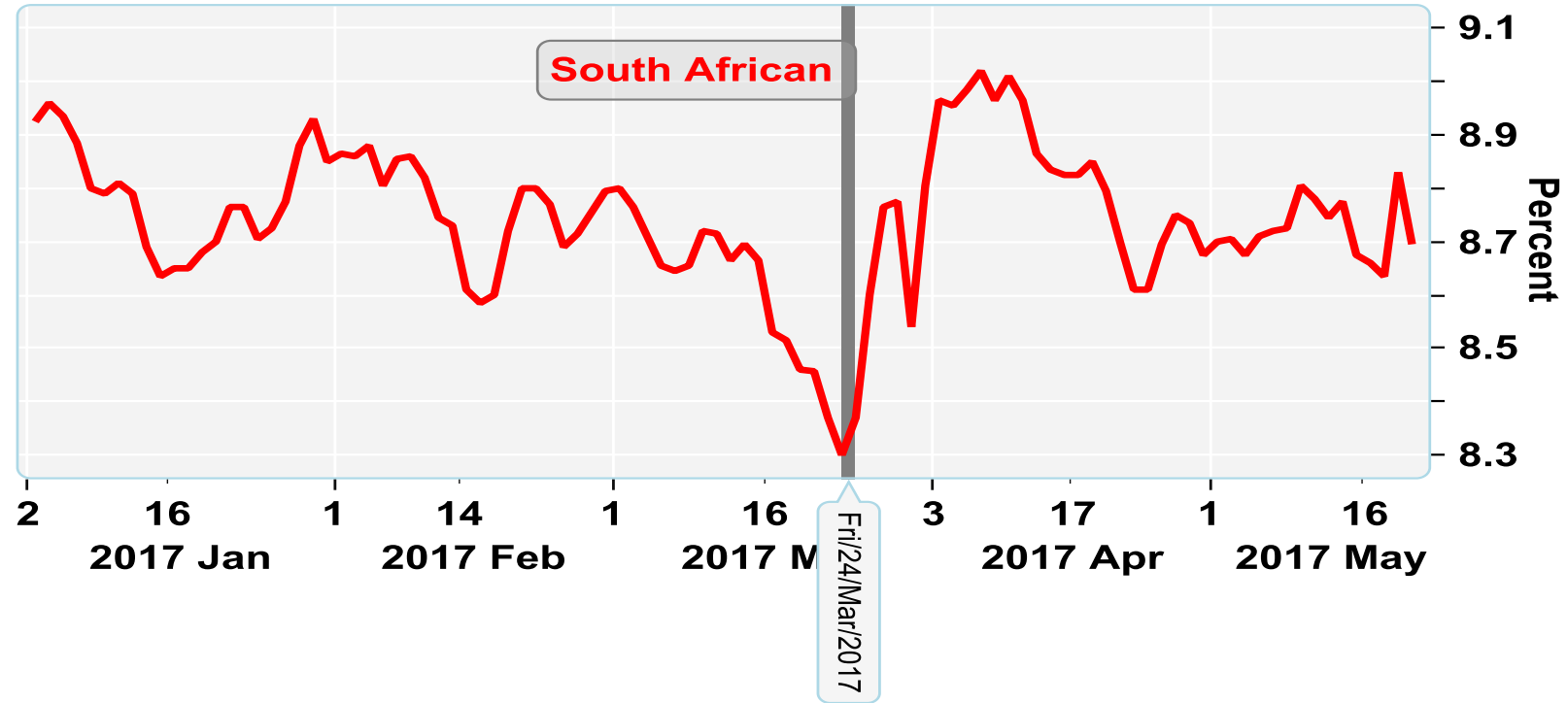




What Junk status will do (Debt and spending)

- The cost of borrowing will be more than before for government and corporates – Government 10 year rate is up to 8.8% from 8.3%.
 - Some Corporates will delay programs and new investment will struggle.
 - Building and infrastructure industry will have tough time.
 - Government will get about R2.5 billion less from current bond sales and therefore will either borrow more or cut back somewhere.
 - State Enterprises will also get substantially less and some programs will be cut back here too.
 - Cities will also pay more for new bond issues.

South African 10 year bond rates





What Junk Status means for consumers.

- Interest rates that would have started to decline this year now have a 70% chance of no decline at all.
 - Even if decline it is debatable if banks will want to lend more to the consumer for a while.
- Consumer confidence will stay lower for longer.
 - This will impact businesses in retail and even industrial side of the economy.
 - I expect more shops to close in malls and mall themselves to struggle in some cases.
 - Revenue for city from business will face pressure as well

What Junk Status means for business....



- Business confidence will decline.
 - Less new projects
 - Less growth – one reason for growth forecasts declining
- Business will have to pay more for capital in bond market and banks will lend less as their cost of capital has now risen.
 - The banks were downgraded as well means that getting capital on the market is more costly and they need to be far stricter than before when lending money out.
- Cost containment will be key!!!!

Junk means consensus forecasts have down the following



- Less Growth...from 1.75% before downgrade to average of 1.41% for 33 economists in 2018 and about 0.2% less in 2017 .
- Higher Interest Rates...expected year end prime of 10% before downgrade increased to close to 10,5%
- Rand Dollar down from R13.38 to R13.64 (Not much actually)
- Inflation also did not jump too much from 5.73% for year to 5.84%
 - Reason is that weaker Rand has been around a while and food price increases are moderating in the main.

General stuff that has happened after downgrade.



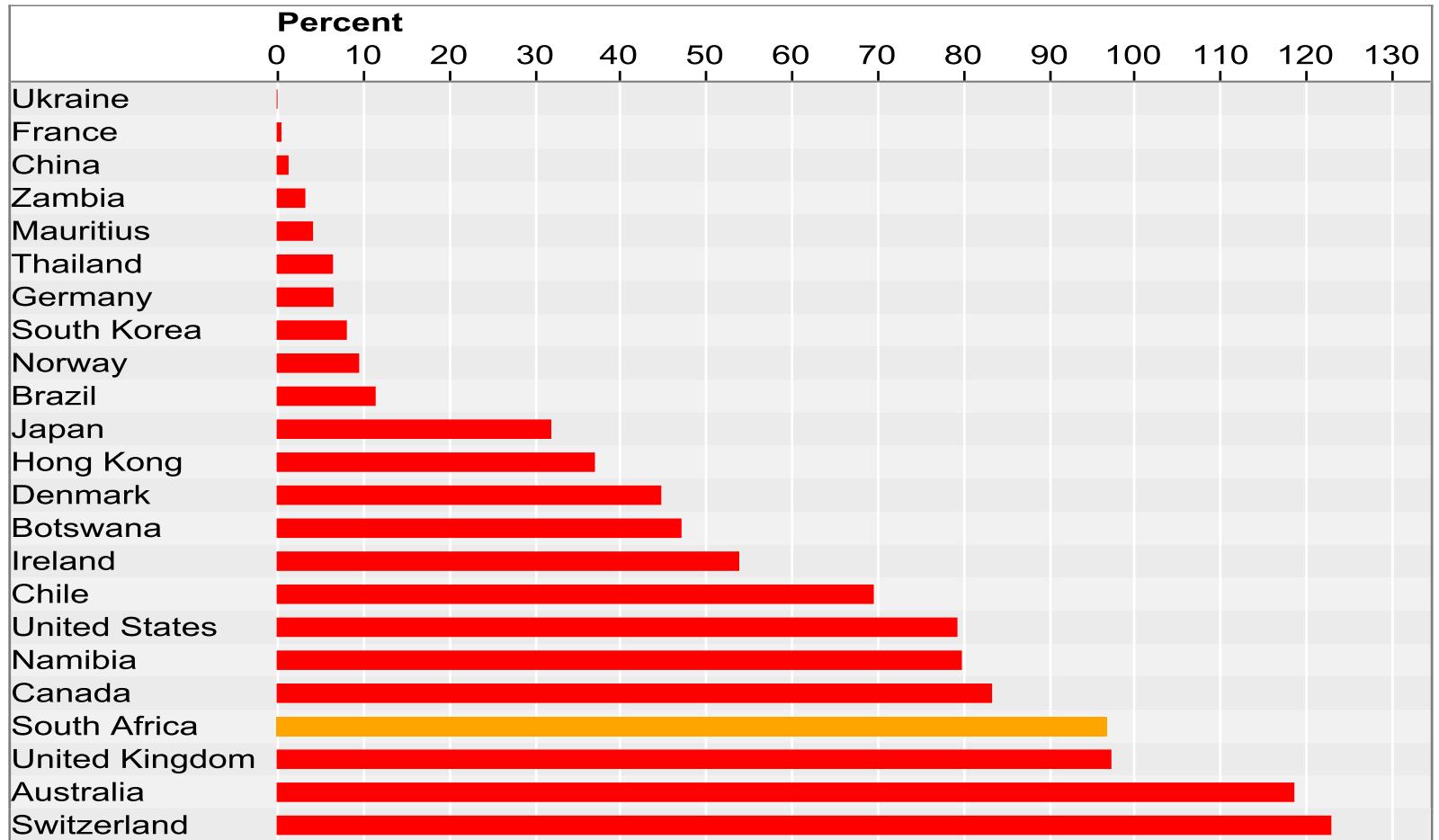
- Lower confidence....Already PMI is down below 50 points i.e. decline in manufacturing.
- Cars sales have declined a lot.
- Less fixed investment.
 - As bond issues are not getting the money
- Less money inflows from overseas portfolio investments
- Transactional shift to cash???
- More firms are in stress.

South Africa is different and here is why.

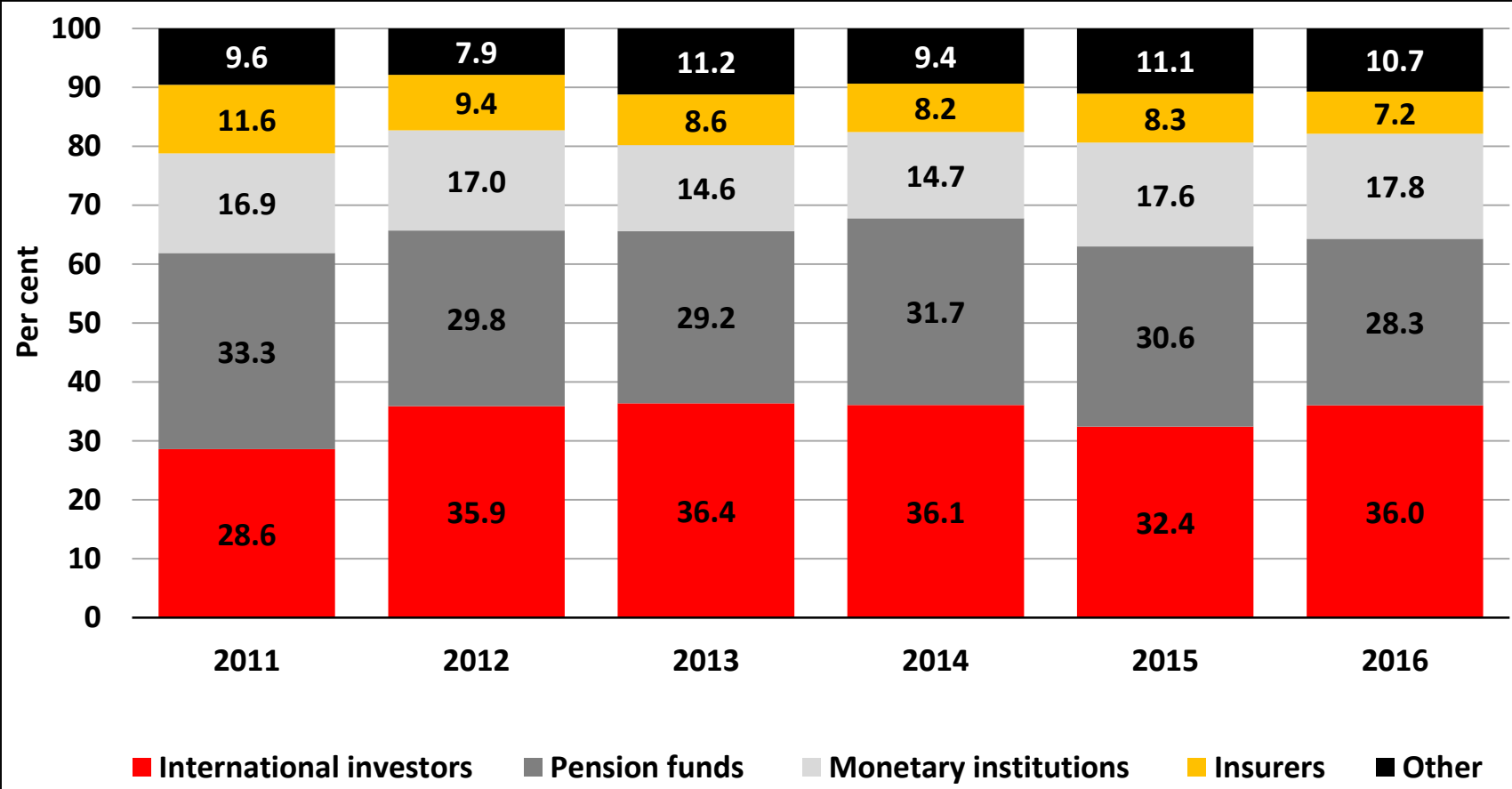
South Africa has the fifth most Pension fund assets to GDP and those pension fund assets are also the 10th largest in the world while our GDP is the 32nd largest.

- We are a highly liquid market in both currency; bonds and even equities.
- We have the 10th largest pension fund savings in the world.
- We are however still very reliant on Foreign Capital in the local debt market and will be for some time.
 - The downgrades will make life more difficult and expensive on the debt market.
 - Equity Market will be affected but much less so.
- We however have a very big state infrastructure program that will now have to pay more for when we make debt for it.

Pensionfund assets as % of GDP

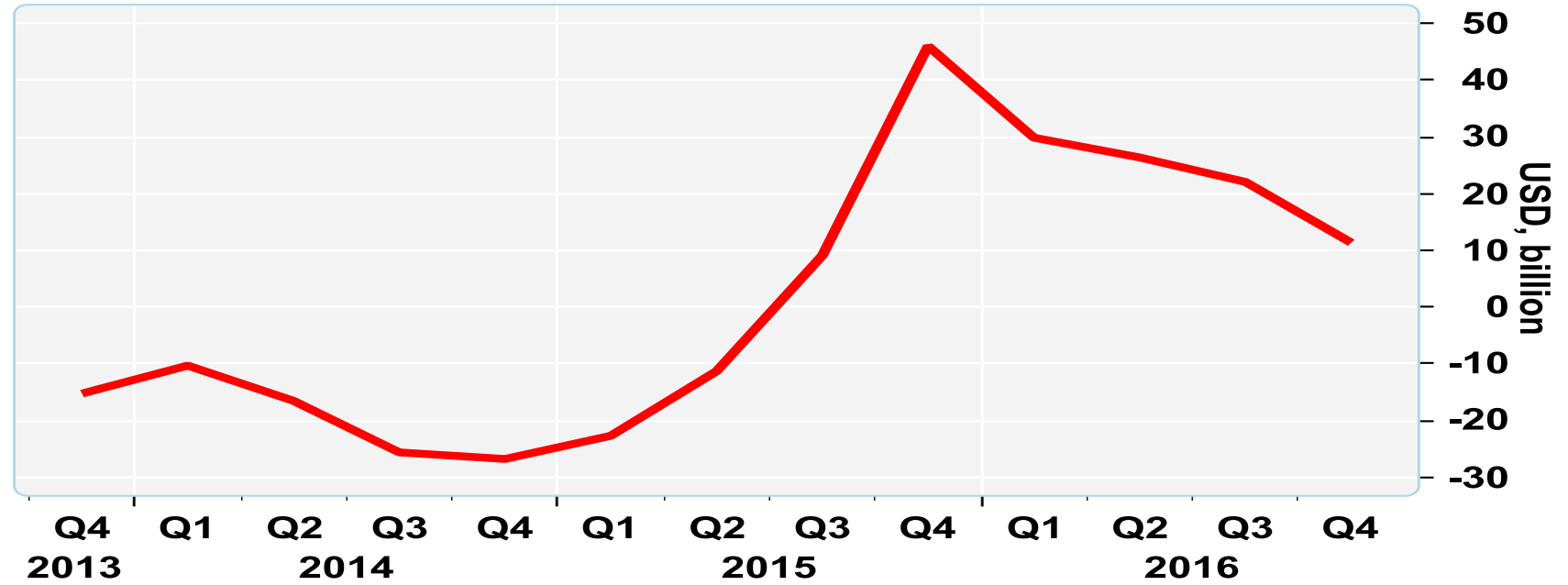


Why ratings are important. Owners of our government debt.



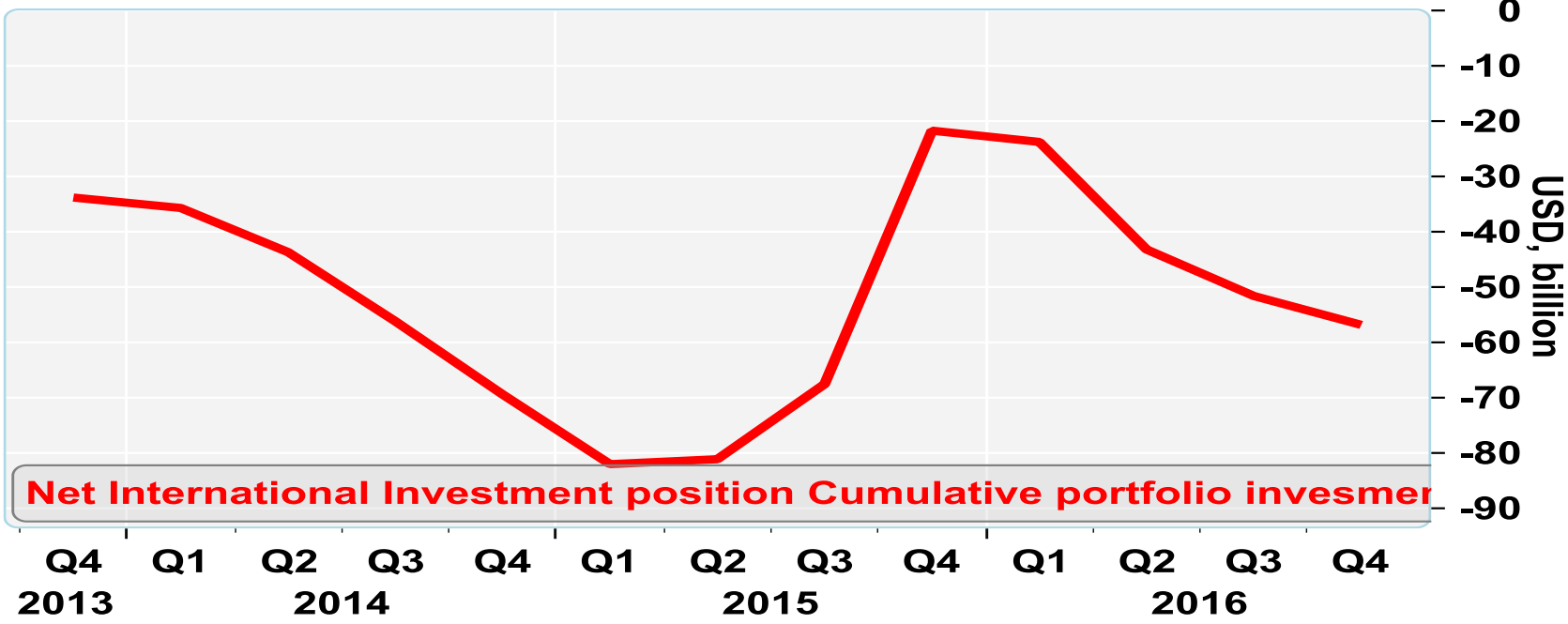
SA has more Assets in other countries than Foreigners have here.

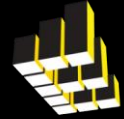
South Africa, Net International Investment Position. (External Financial Assets minus Liabilities), USD



But we rely on short-term portfolio flows and that is a problem.

SA Net International Portfolio position. USD Foreigners own more net portfolio investments in SA

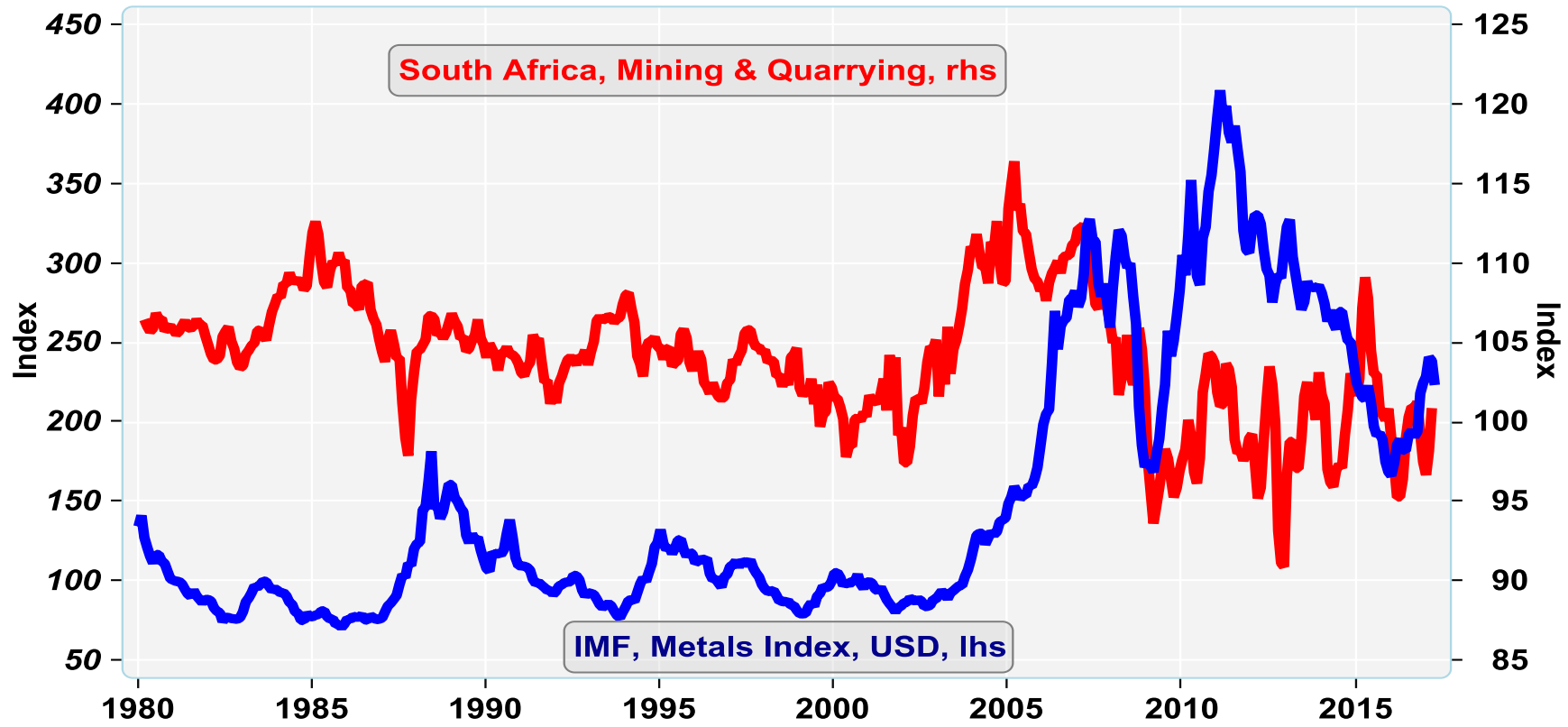




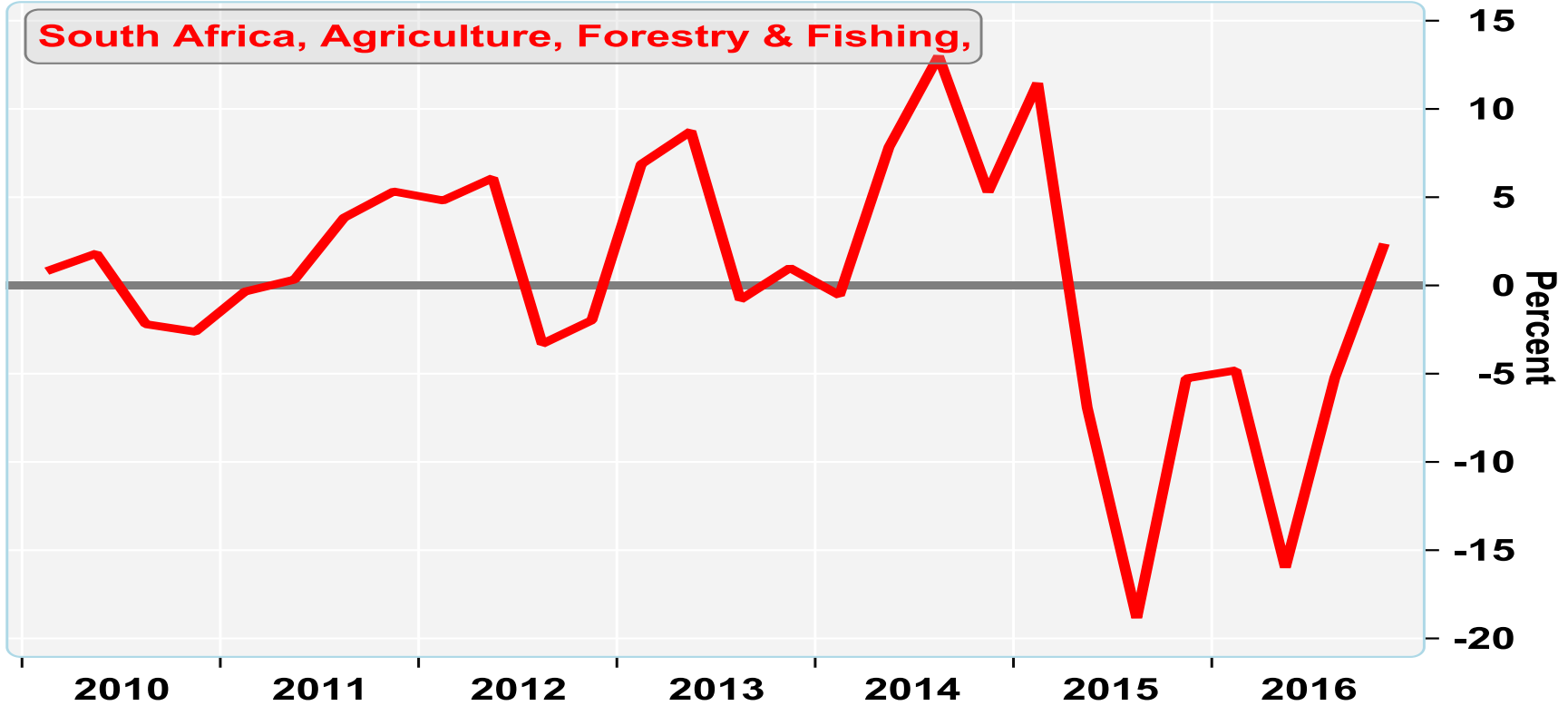
Some sectors are bouncing back but the consumer is tapped out and that is the danger.

SA economy sectors

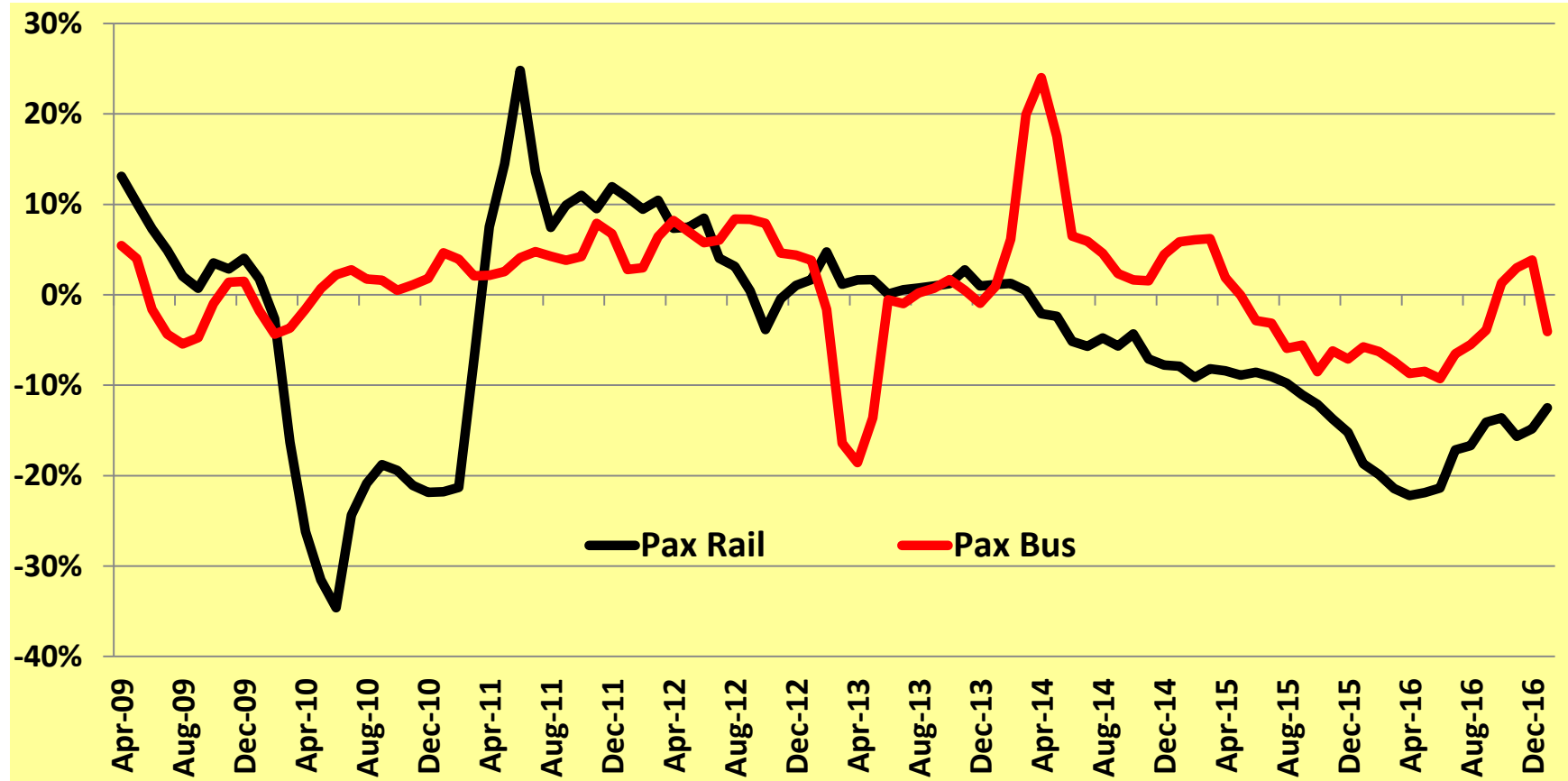
Mining and metal prices.



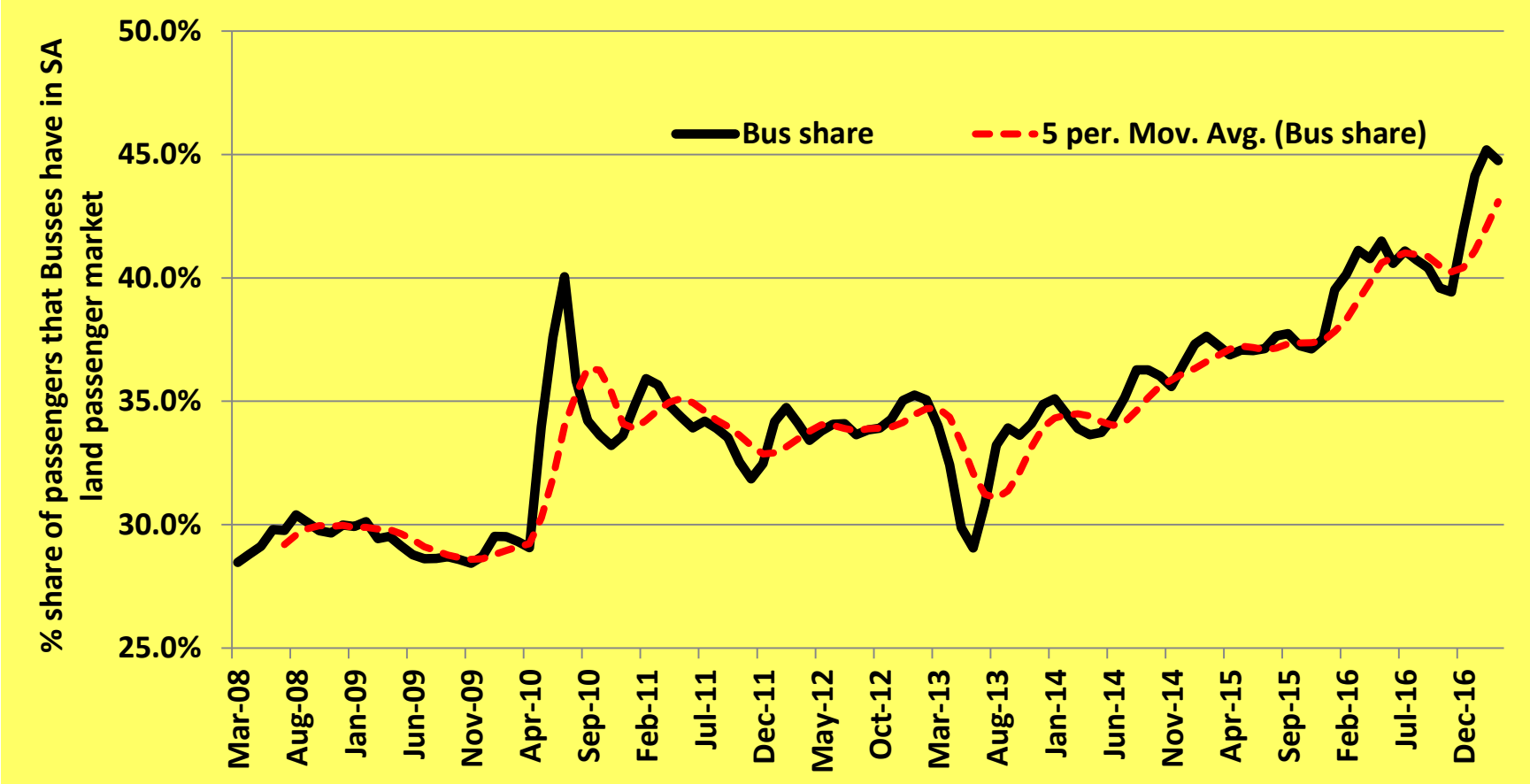
Agriculture is recovering from worst two years in over a decade.



Growth in passenger numbers Big Rail decline.....

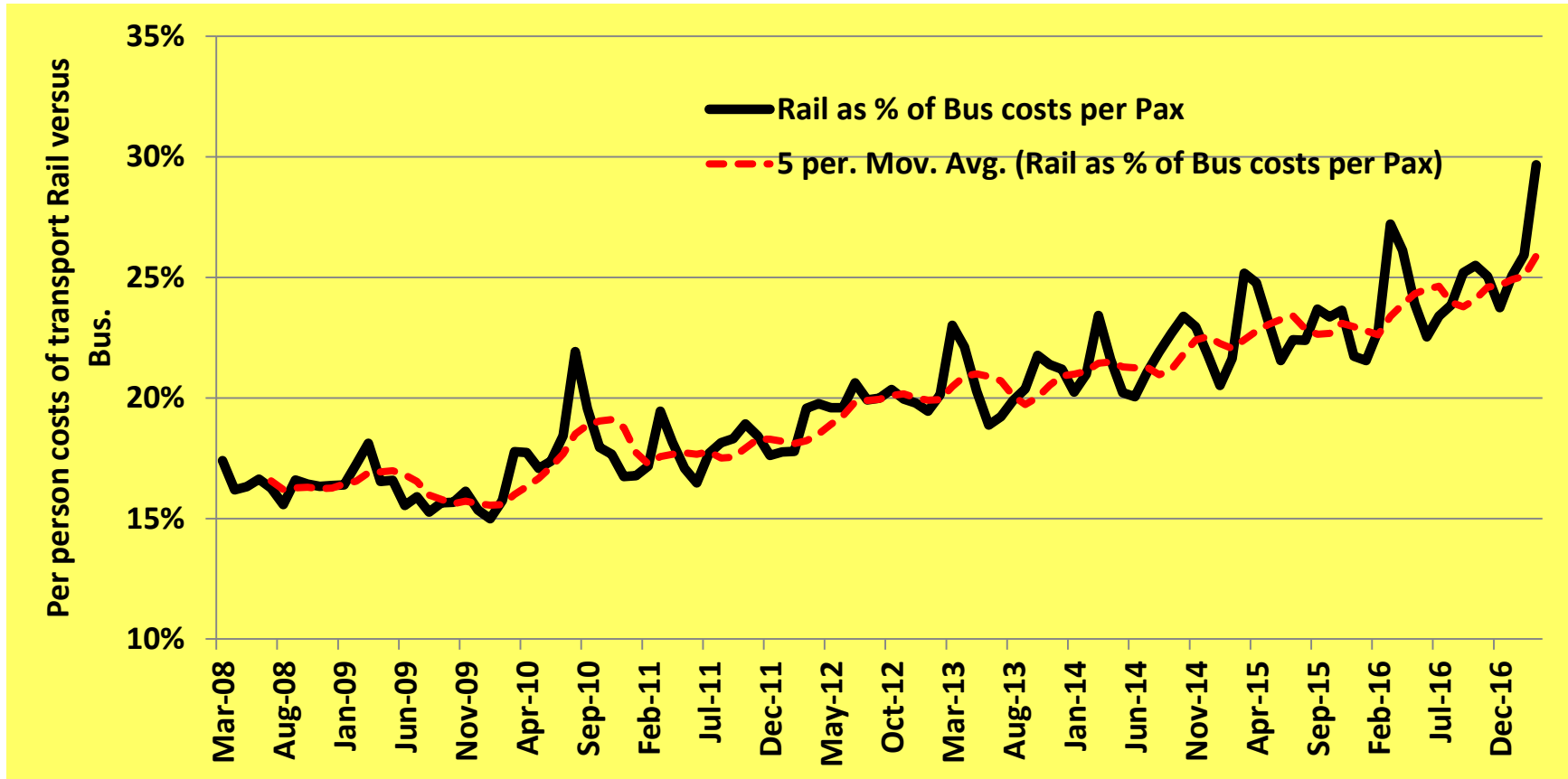


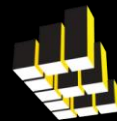
Busses seem to be grabbing Market share.



The reason could be largely costs ...service?

Rail costs per Pax as % of Bus cost per Pax





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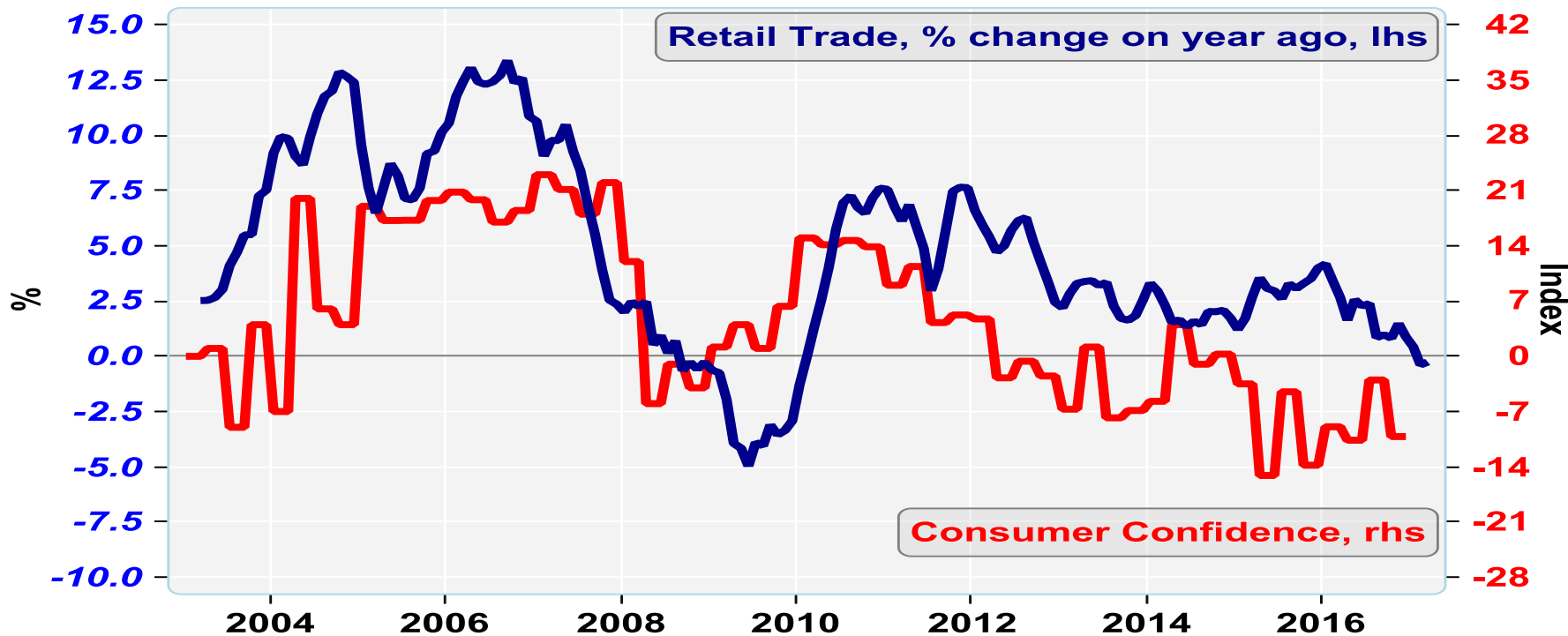
South African Expenditure.

**The Consumer is feeling worse for wear!
Government beware!**



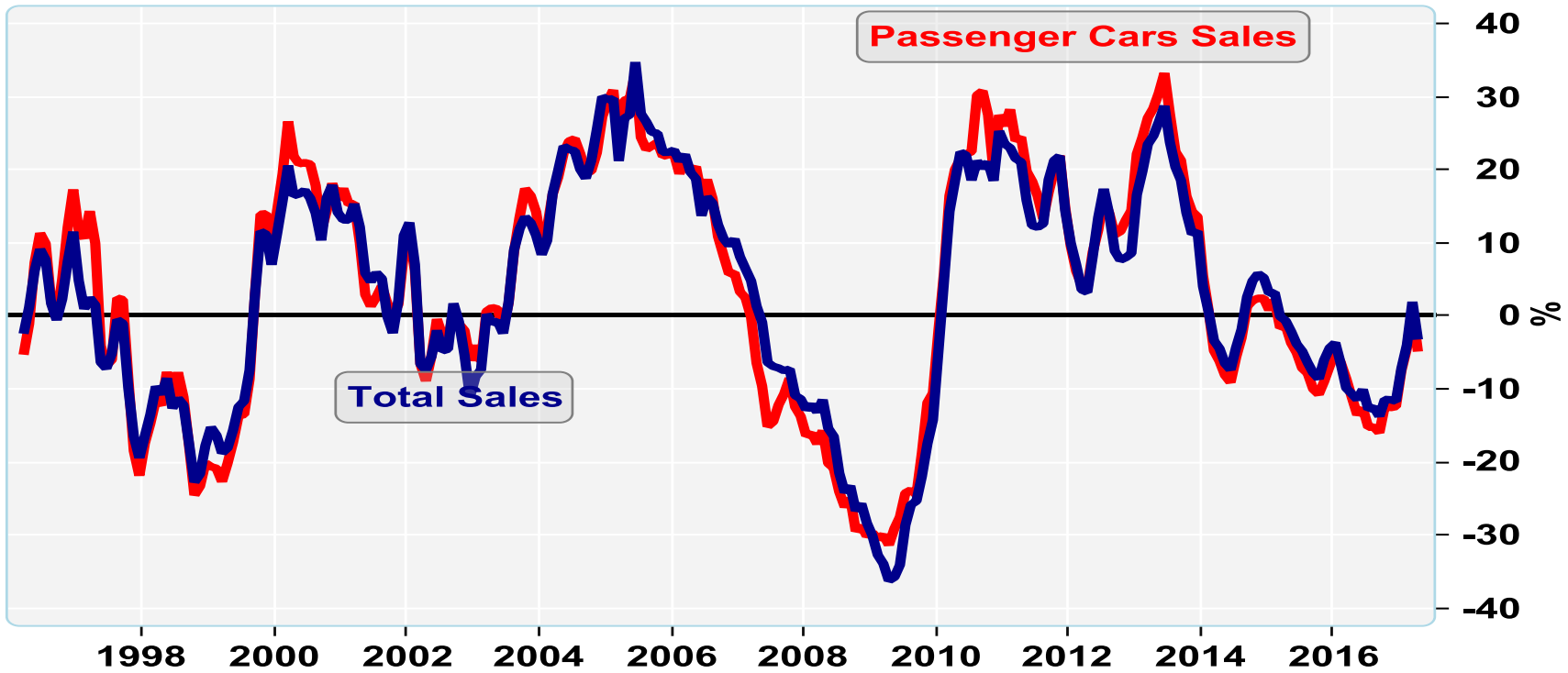
The Consumer has lost confidence and retail sale decline.

Consumer confidence and Retail sales



Change in new vehicles sales

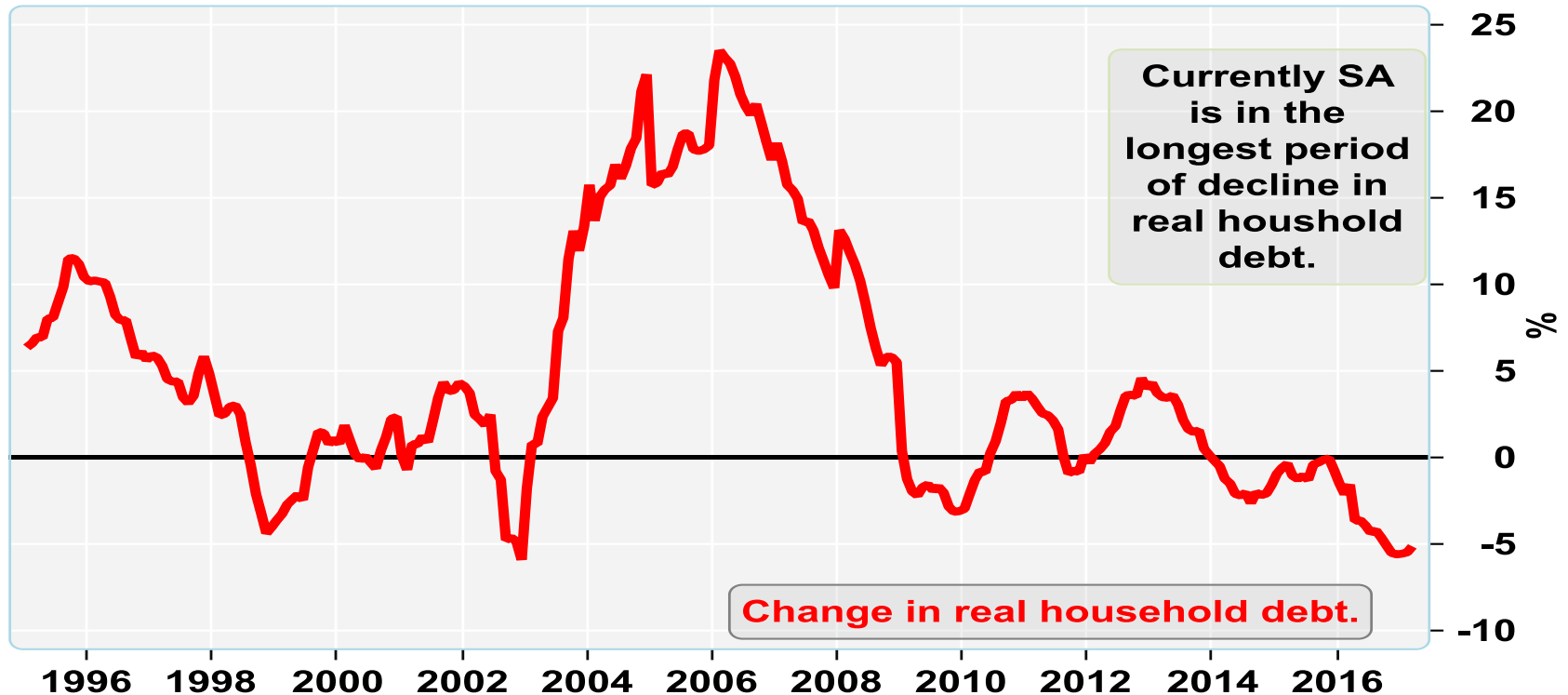
New Vehicle Sales growth total vs. passenger cars only



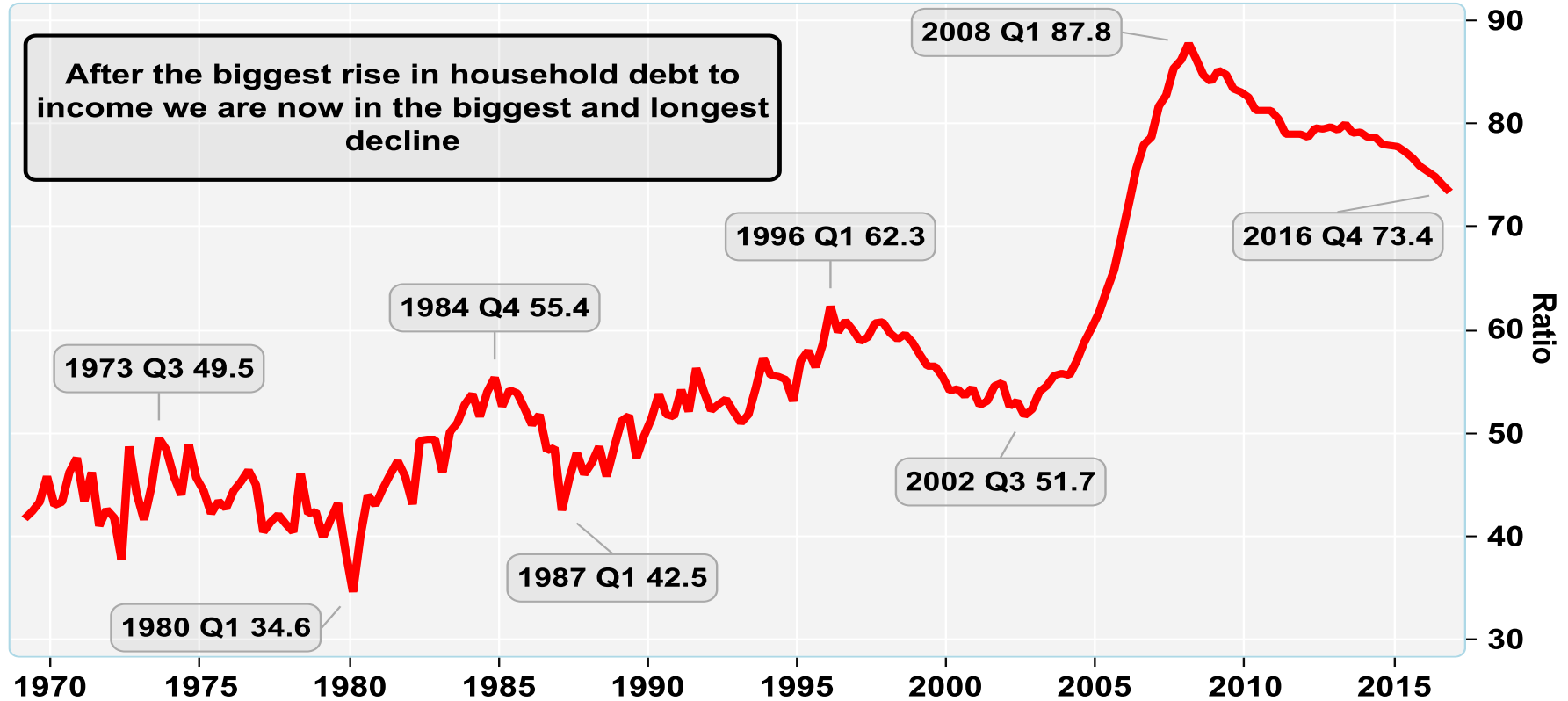
Real change in SA household debt. 39 months of decline so far!



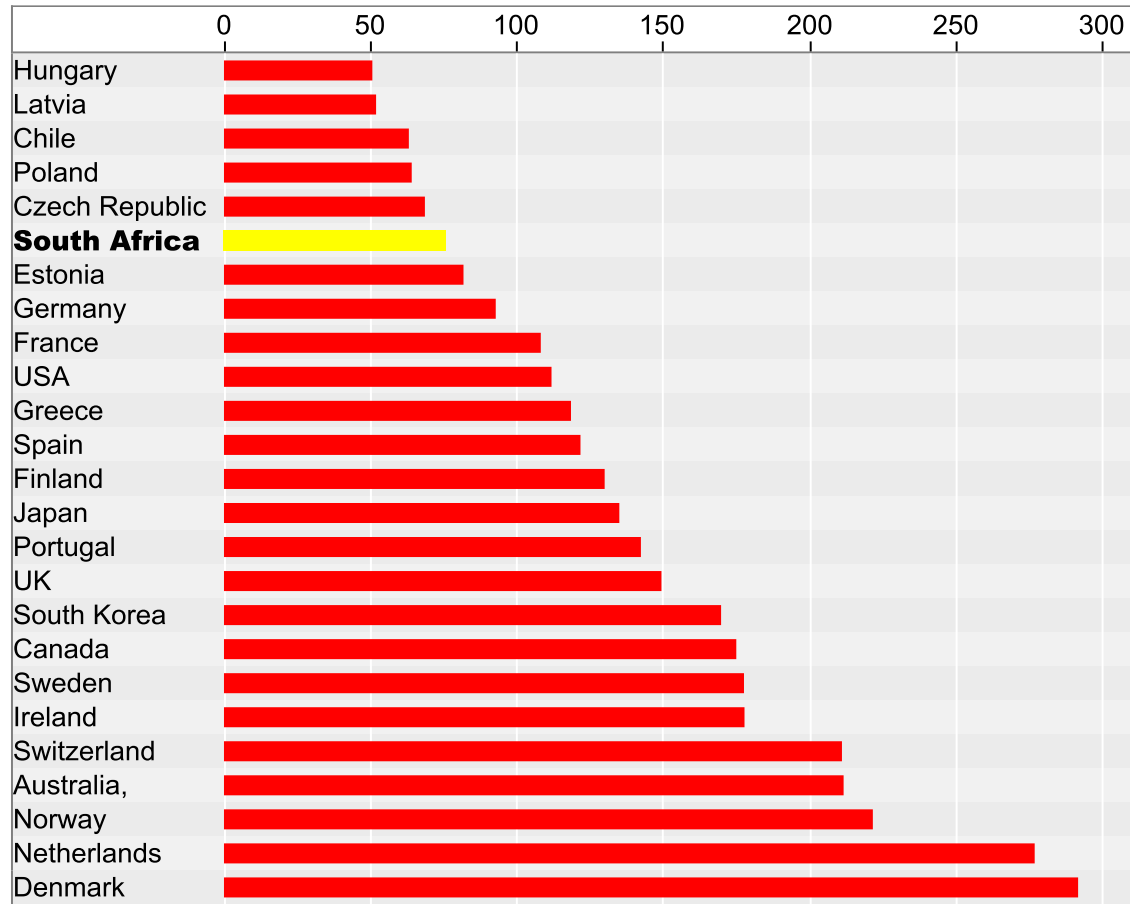
Change in real household debt.



Longest decline will also now be biggest decline in household debt to household income.



Household Debt to Household disposable income



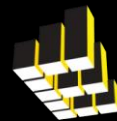
■ Latest debt to disposable income ratio [Close 2013 - 2015, sort asc.]

Soucre: OECD and economistscoza

The recovery of the consumer is a blessing in the longer-run



- The decline and continued decline in consumer debt also makes the down grade substantially less harsh on consumers who will continue to pay off debt and be in a better place than before.
- Consumer debt at lowest level to disposable income in 11 years is certainly helping in that banks are not as at risk as they would have been.
- When the consumer bounce back the growth rate will be substantially higher and help SA get ahead again but NOT NOW.
 - Expect retail and car sales to be lower for longer now but the recovery will be huge.
 - Consumer will be in best place in 13 years before recovery takes place I believe.



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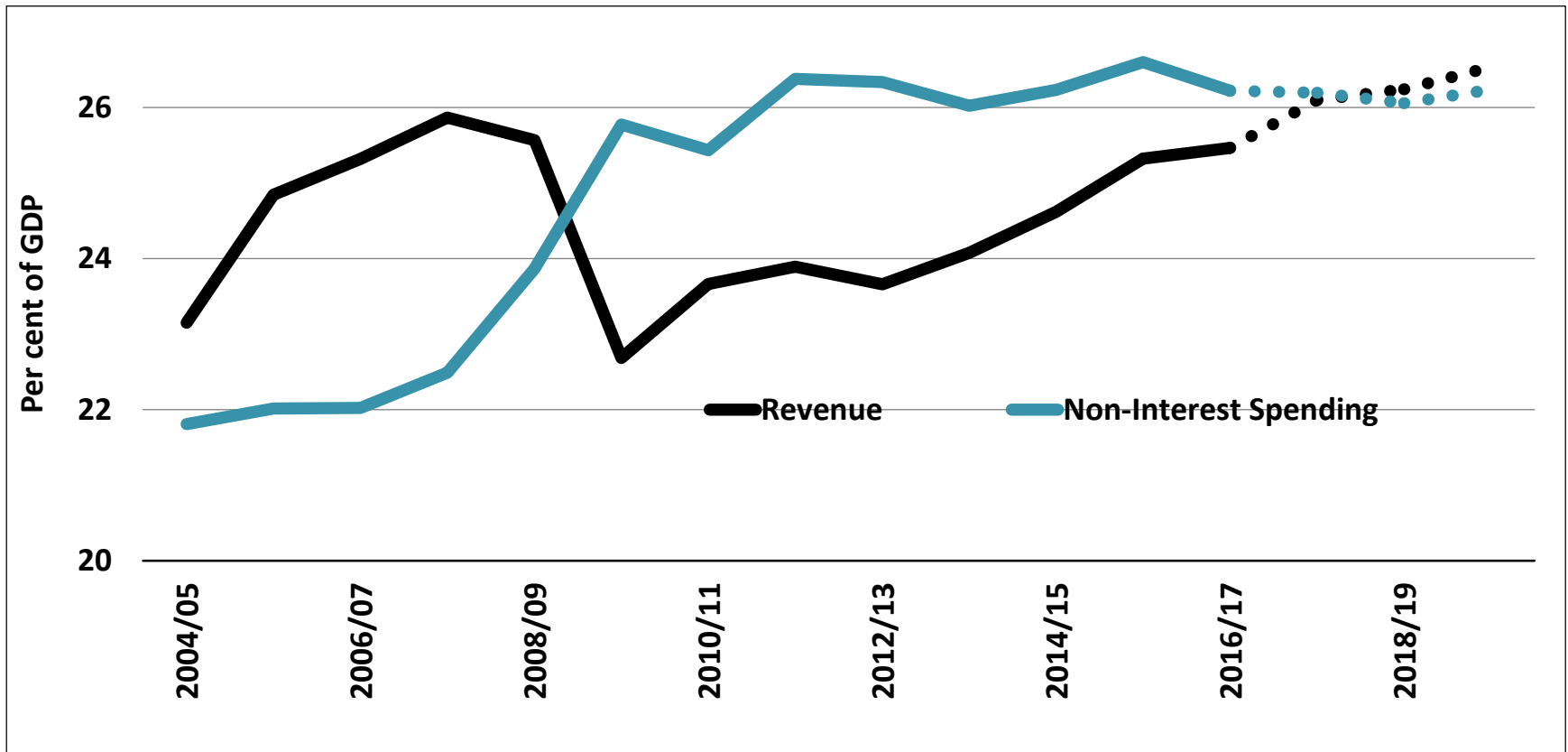
Something on Budget

President does not
always think about what
happens afterwards!

Still our latest
problem –What
can one say...

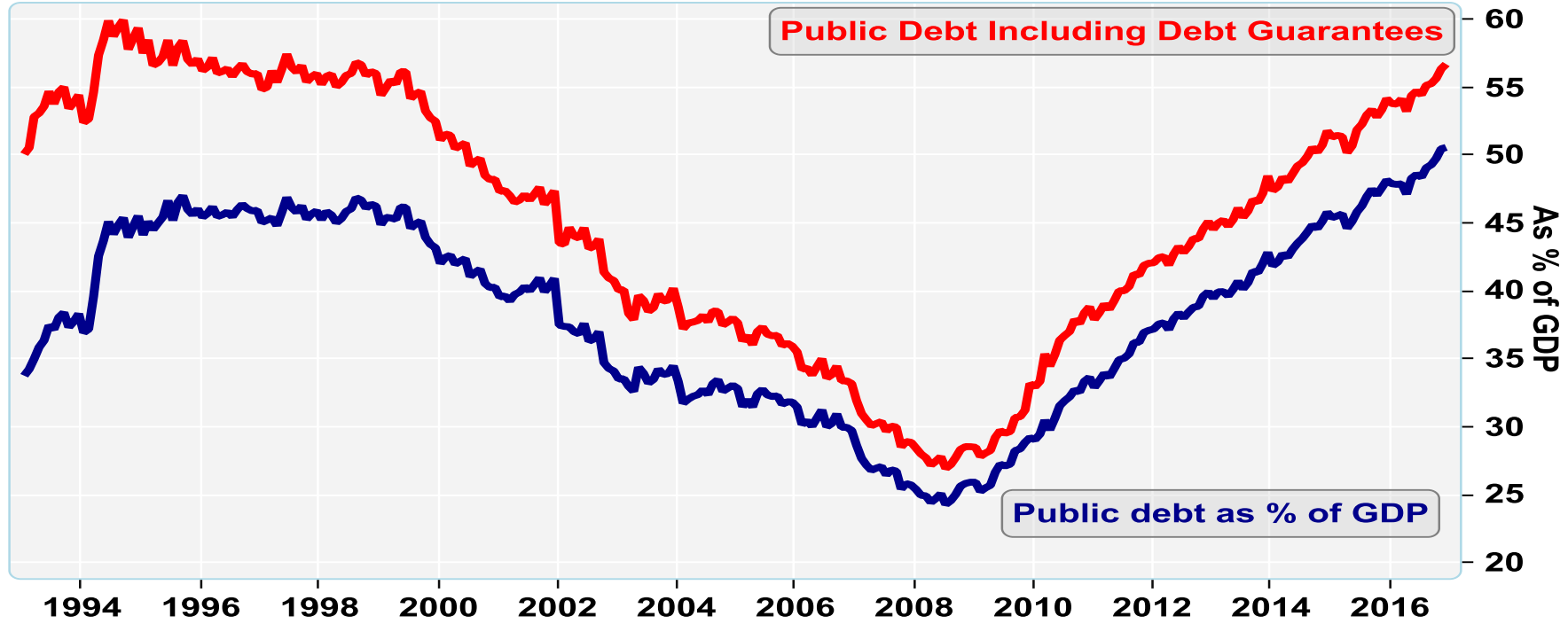


Partly good news non-interest spending flat.



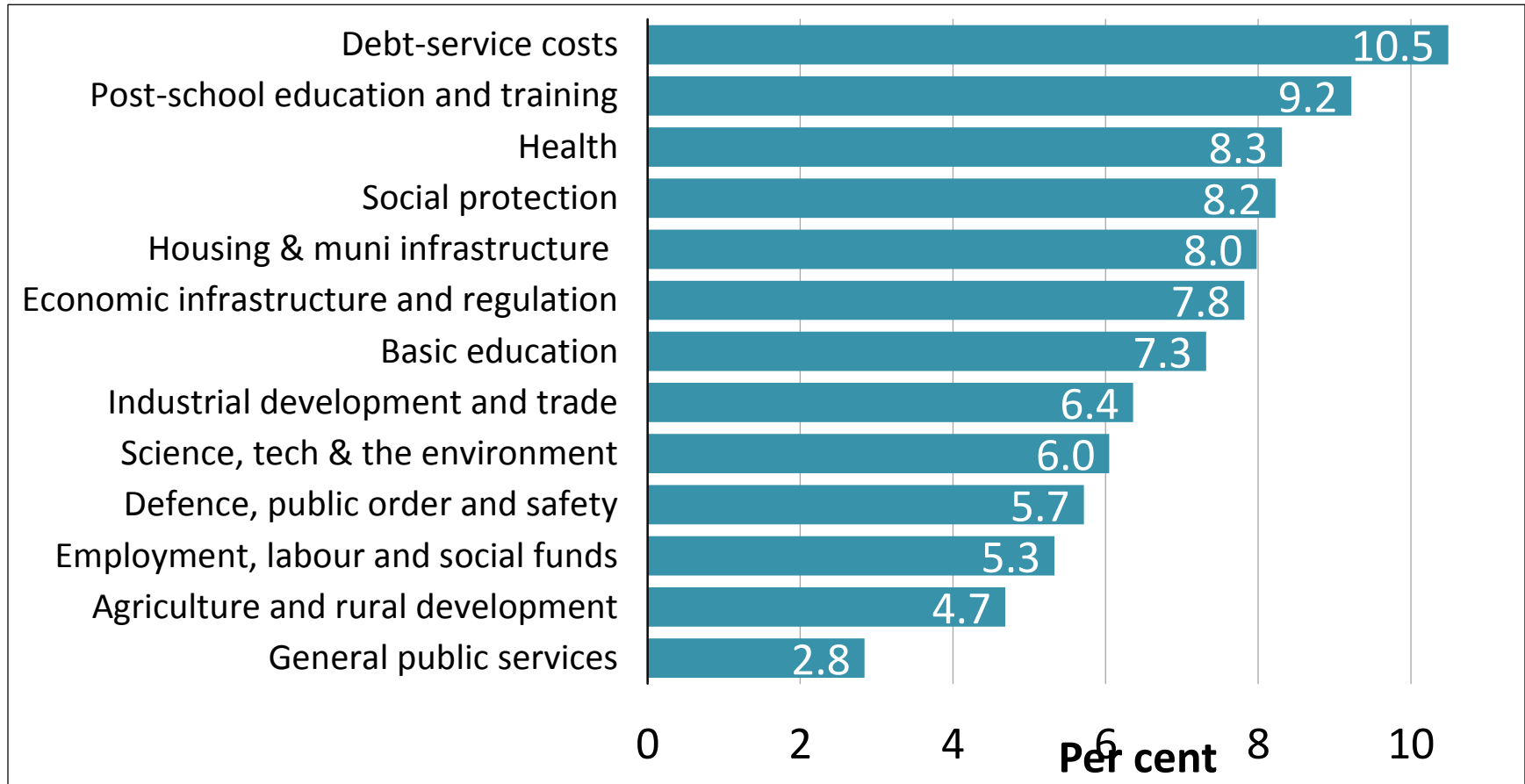
Another reason SA was downgraded.

Public Debt as well Guarantees as % of GDP



Where the spending grows.

Over 6.5% is real growth. Over 8% is growing as share of GDP too.



How will SA economy fare in next few years?

The survival of the crooks!

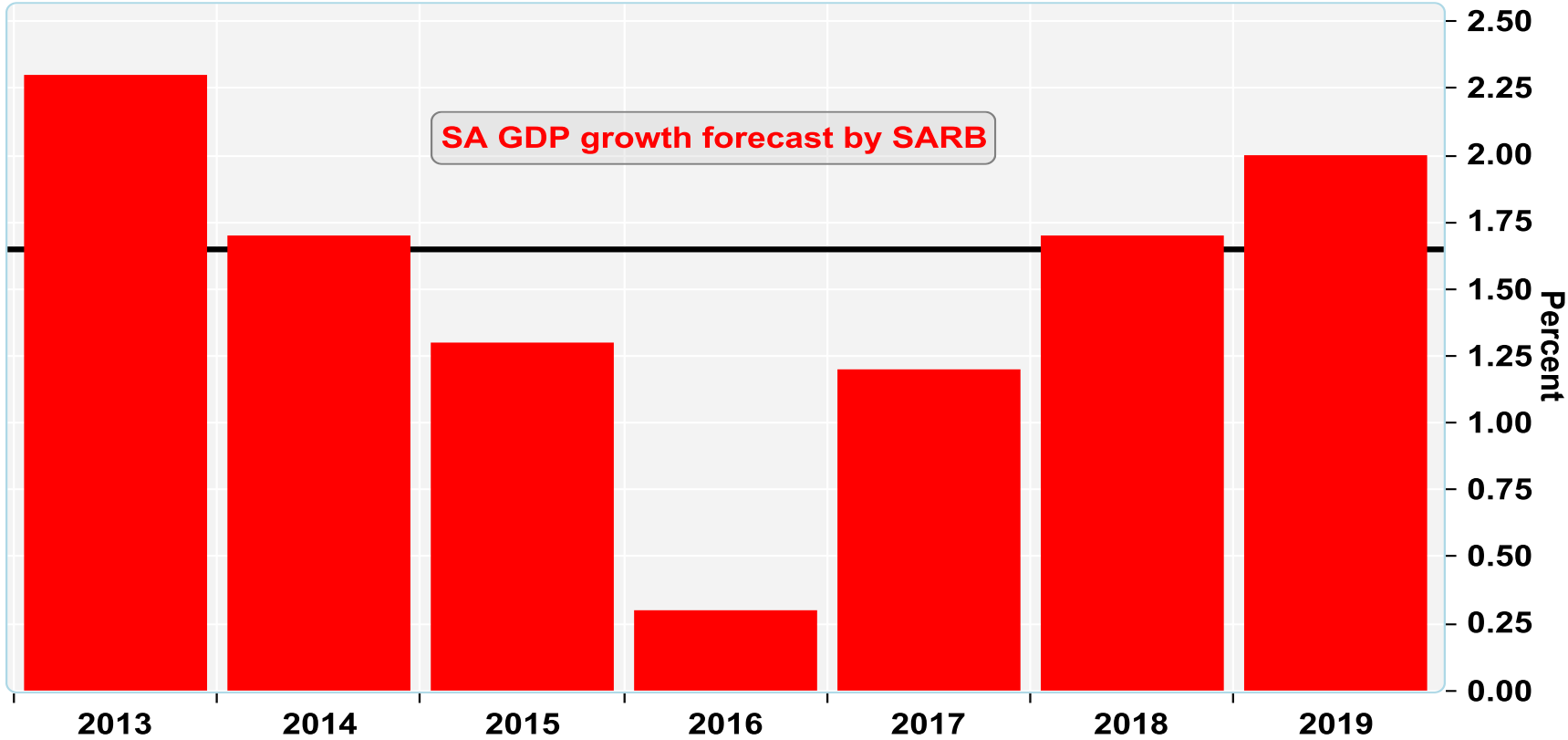
- GDP growth will slow.
 - 2017 will be around 1% or less and a little better in 2018.
 - This year I was more positive than most as agriculture to make good bounce back. (Still better than 2016)
 - Commodity prices have surprised me with bounce – may not last but will still have some positive impact for a while.
 - Still NO growth faster than 2.2% in next 4 years according to the IMF and almost all others.
- Consumer no longer a positive growth factor.
- Interest Rates will not decline!
- Government debt burden will increase and delivery will suffer

GDP forecasts.



Year/ institution	Beeld Consens us.	World Bank	SARB	IMF	National Treasury	Investec
2016e	0.3	0.3	0.3	0.3	0.3	0.3
2017f	1 (1.3)	1,1 (1,6)	1.2 (1.1)	0.8 (1,0)	1,3 (1.7)	1.1 (1,4)
2018f	1.4 (1.8)	2.0	1.7 (1.5)	1.6 (1.9)	2.4 (2.6)	1,5 (1.5)
2019f			2.0	2.0 (2.2)		1.7 (2,2)
2020f				2,2 (2.4)		2.3 (2,5)
2021				2.2 (2.5)		
2022				2.2		

Growth History and Forecast from SARB.



- R18 still very likely in next 2 years. Maybe shifted out for a year or so but commodity cycles still against us.
 - Rand strong at present and may stay at these levels for a few months / quarters but...
- SA will be downgraded again by end 2018 (After Moody's downgrade that is still outstanding).
 - By ALL rating agencies. The cycle and politics is against us at present.

The good news side of the forecasts after the downgrade.

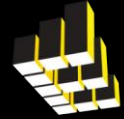


- Inflation more moderate in 2017 and 2018
 - Short-term interest rates flat for now.
- No major interest rate hikes foreseen at present.
- Primary sectors such as agriculture, Mining and some manufacturing could make use of weaker Rand / higher commodity prices.
 - Will have positive impact on transport; exports (not imports) and current account!
- Consumer is recovering and debt burden is declining so next upswing will have strong consumer side – but delayed with a few quarters.

Other good news you need to think about.



- **SA is starting to understand that crooks are governing us and the Emperor is standing naked.**
 - Corruption is clearly visible and being exposed.
 - Opposition is getting stronger and we are moving away from one party dominating state.
- SA can start to build a better export orientated economy while Rand is slightly more weak than usual.
 - It will not be easy but infrastructure in place and new parts have been added. (Not enough but enough to start)
- There are many more opportunities in bad times than you think.
- Growth still higher – albeit it just!



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Thank You.