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Notes from the SARB Economic Roundtable Discussion – 18 August 2017

The following were brief notes from the SARB Economic Roundtable discussion which took place on 18 August 2017 and is attended by economists, industry experts, research analysts and policymakers.

Topic: Competition Policy in SA Banking

- Despite the topic, competition policy was discussed in general - it was noted, however, that SA's financial services sector has the highest concentration rate (relative to other sectors) at 62%. However, there is a trade-off between competition and regulation – loosening barriers to entry into the financial services sector would inevitably mean that the social cost of exit is high. This is the reason why the SARB and other regulators guard against bank failures and disruptive exits, hence the reason that the sector is highly regulated.
- Some of the reasons for concentration (in general) are: large SOE monopolies, dominance through state support, a lack of innovation and investment, a lack of financing and skills and persistent economic exclusion. A lack of investment in many key industries is viewed as a key hindrance to competition. **It was noted that a lack of investment breeds industry concentration and a lack of innovation. Hence the need for the competition policy, which focuses on reducing concentration, increasing economic participation, improving efficiency and promoting free competition.**

SARB turned bearish on growth in July 2017

SARB's forecast - July 2017				
	Actual	Projections		
	2016	2017	2018	2019
GDP	**0.3**	**0.5**	**1.2**	**1.5**
May 2017		*1.0*	*1.5*	*1.7*
March 2017		*1.2*	*1.7*	*2.0*
January 2017		*1.1*	*1.6*	
November 2016		*1.2*	*1.6*	
Current account % of GDP	**-3.3**	**-2.7**	**-3.4**	**-3.8**
May 2017		*-3.1*	*-4.1*	*-4.4*
March 2017		*-3.2*	*-3.9*	*-4.0*
January 2017		*-3.5*	*-4.1*	
November 2016		*-4.3*	*-4.4*	
Headline inflation	**6.3**	**5.3**	**4.9**	**5.2**
May 2017		*5.7*	*5.3*	*5.5*
March 2017		*5.9*	*5.4*	*5.5*
January 2017		*6.2*	*5.5*	
November 2016		*5.8*	*5.5*	
Core inflation	**5.6**	**4.8**	**4.8**	**4.9**
May 2017		*5.0*	*5.1*	*5.3*
March 2017		*5.4*	*5.2*	*5.3*
January 2017		*5.5*	*5.2*	
November 2016		*5.5*	*5.2*	

Note: May, March and January 2017 and November 2016 refers to previous forecasts

Source: SARB, Nedbank

Consequently, the inflation profile was lowered

SARB quarterly inflation forecast -July 2017									
		Headline inflation				Core inflation			
Year	Quarter	Jul'17	May'17	Mar'17	Jan'17	Jul'17	May'17	Mar'17	Jan'17
2017	**1**	**6.4**	6.4	**6.4**	6.6	5.2	5.2	5.4	5.7
Forecast	**2**	**5.3**	**5.5**	**5.8**	6.2	4.8	5.0	5.5	5.7
	3	**4.8**	5.5	**5.8**	6.2	4.6	5.0	5.4	5.5
	4	**4.7**	5.4	**5.6**	**5.9**	4.5	4.9	5.3	5.3
2018	**1**	**4.6**	5.1	**5.2**	5.4	4.7	5.0	5.1	5.1
	2	**4.8**	5.2	**5.4**	5.4	4.8	5.0	5.1	5.2
	3	**5.2**	5.4	**5.5**	5.5	4.8	5.1	5.2	5.2
	4	**5.2**	5.5	**5.5**	5.6	4.8	5.2	5.3	5.3
2019	**1**	**5.1**	5.5	**5.5**	5.4	4.9	5.3	5.3	5.1
	2	**5.2**	5.5	**5.5**	5.4	4.9	5.3	5.3	5.2
	3	**5.2**	5.5	**5.5**	5.5	4.9	5.3	5.3	5.2
	4	**5.2**	5.5	**5.5**	5.6	4.9	5.3	5.3	5.3

Source: SARB, Nedbank

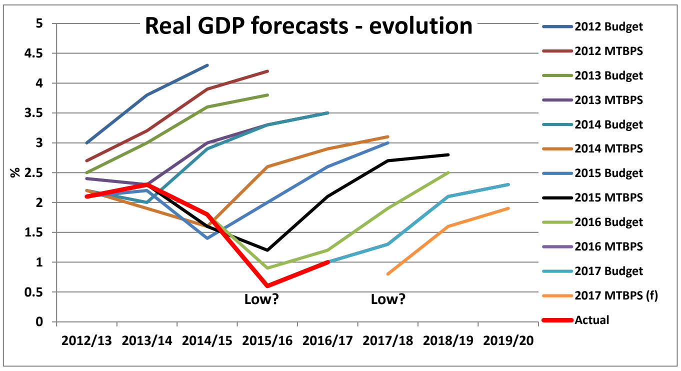
- **In the discussion which ensued, monetary and fiscal policy, credit ratings and investor sentiment were some of the pertinent topics on the participant's minds. This yielded robust discussion with the following being the key takeaways:**

In our opinion, keep a close eye on the SARB assumptions:

- **On monetary policy, there seemed to be a broad consensus that we are in a loosening cycle, but with some risks attached.** The rand remains the key risk to the outlook, along with bond yields that have thus far reflected much complacency among international investors.
- The last eight months have seen political risks rise. This culminated into a cabinet reshuffle, credit ratings downgrades and a deteriorating growth outlook. Despite these risks, the rand has remained fairly strong, with the USDZAR appreciating by 4.3% for the YTD. The concern among participants was that the market is moving in contrast to the macro-economic fundamentals, as a result of the global risk-on sentiment towards EMs overshadowing that of the local fundamentals. Rising uncertainty as a result of the political backdrop does raise the risk of further downgrades. However, if SA averts a downgrade in the short-term, the key reason underpinning such an eventuality may be SA's institutional strength, which is cited by the rating agencies as one of only a handful of strengths in the assessment of SA's credit risk.
- The previous hiking cycle comprised of 200bps of hikes in three years. What then would the current loosening cycle look like in terms of depth and length? This is highly dependent on the SARB forecasts, because monetary policy decisions are indeed data-dependent. In July 2017, the MPC forecasts and assumptions did take a bearish tilt, with the real GDP, potential GDP, headline CPI and core CPI projections all lowered. This was due to sharply lower administered price inflation projected, together with lower oil and commodity prices. **Any further downward revision to these forecasts at the September or November 2017 meetings will probably necessitate a downward revision to Nedbank CIB's repo forecast. We currently expect two to three rate cuts of 25bps each before 1H18. Hence we will be watching these assumptions closely for any changes.**

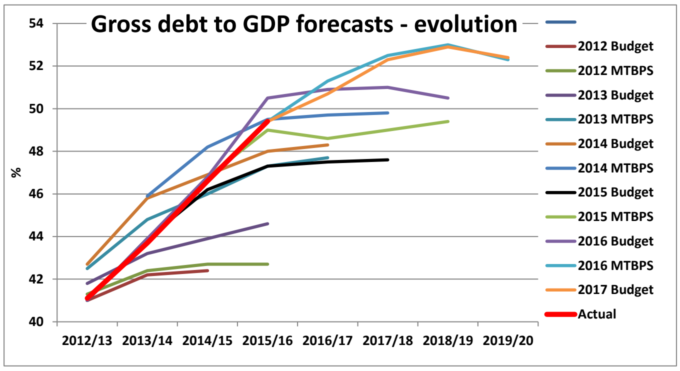
Will fiscal consolidation remain in place at the MTBPS?

Downward bias seems to entrench National Treasury's GDP forecast



Source: National Treasury, Nedbank

…While debt forecasts are tilted to the upside, threatening fiscal consolidation

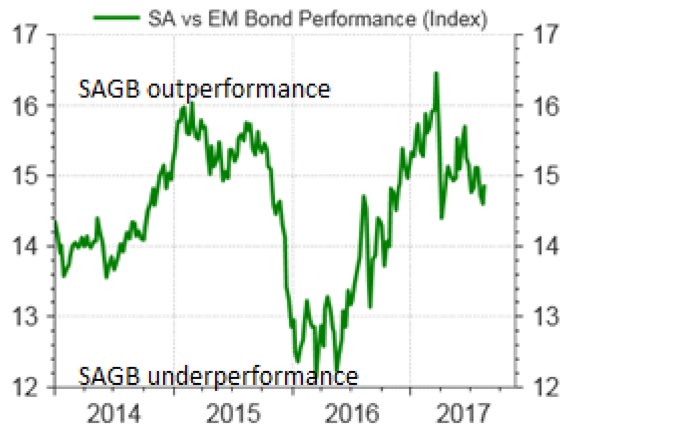


Source: National Treasury, Nedbank

- Concerns were raised over fiscal policy, given the upcoming MTBPS speech in October 2017, which the ratings agencies will keep a close eye on. The current path of fiscal consolidation is highly dependent on the expenditure target being met. The expenditure ceiling was implemented in 2012 and premised on a growth forecast of 3.5%, hence only a 3.5% potential growth rate (or a close-enough growth rate) would sustain the expenditure ceiling. We are currently in a recessionary environment in which even our long-term potential growth rate has been revised well below that level (1.1-1.3% - SARB). This may mean that the expenditure ceiling is unrealistic or unobtainable, unless we see significant expenditure cuts (which are politically unfavourable, particularly as we near an election in 2019). Also, significant expenditure cuts tend to reinforce lower growth. This is why we believe that the Minister of Finance, Malusi Gigaba, is tasked with the most difficult budget yet in recent times – while the expenditure ceiling needs to be calibrated on a lower potential growth rate, this could mean the end to the Treasury's commitment to fiscal consolidation and will likely yield a downgrade.
- For fiscal consolidation to work in its entirety, a country needs complete political commitment to propel austerity. This means that the Finance Minister requires full support from the Cabinet and the NEC, including President Jacob Zuma himself. We believe that this has not been the case since the start of fiscal consolidation. **We believe that fiscal consolidation has at best, taken a piece-meal approach in the last four years which has seen SA's gross debt to GDP rise from 43.7% in 2013/14 to the projected 52.9% by 2018/19 and revenue under-collection of (a cumulative) R47 billion in the same period.**

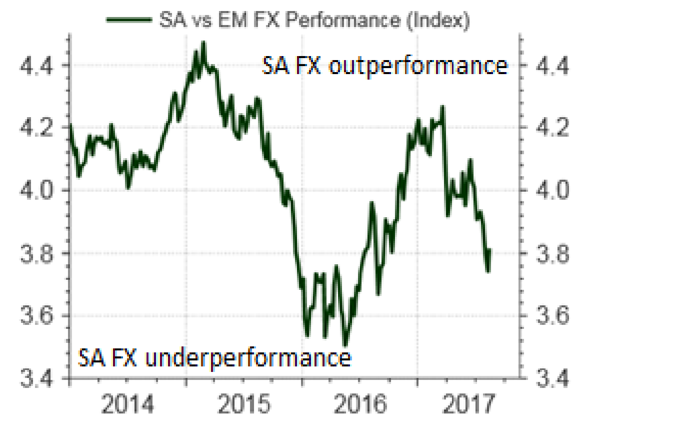
What about foreign investor complacency?

SAGBs underperform relative to EM peers



Source: Datastream, Nedbank

…Along with FX underperformance relative to peers



Source: Datastream, Nedbank

- In contrast to the above fundamentals, widespread investor complacency is evident. Foreign investors have indicated that many EMs have already experienced ratings downgrades since the 2008 recession, hence there has been a broad-based decline in the ratings quality in the EM universe. Despite this, foreign investors are of the view that SA remains an attractive investment destination because of its attractive real yield. Hence we may see continued investment and flows, even if SA is removed from the Citi World Government Bond Index (Citi WGBI).
- On the other hand, it was debated that had there not been sub-investment grade downgrades, SA's financial markets would have maintained its outperformance relative to its peers. The indices illustrate the relative performance of SA vs EM in the bond and FX markets. South Africa has underperformed its peers since Finance Minister Pravin Gordhan was recalled overshadowing the risk-on sentiment/reflation/easier global financial conditions that had aided other emerging markets, implying that SA FX and bonds could have been stronger.
- **Overall, a downgrade and exclusion from the WGBI seems as though it is a foregone conclusion among participants. However, global conditions have changed enough that we may be cushioned from any blow from a downgrade in the near-term. In our opinion, the concern thereafter is the domestic problems which will start surfacing when liquidity starts to dry up as global monetary policy tightening accelerates.**

SA's local currency credit rating

Sovereign and Nedbank LC rating

Moody's		S&P		Fitch		
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
Aa1		AA+		AA+		High grade
Aa2		AA		AA		
Aa3		AA-		AA-		
A1		A+	A-1	A+	F1	Upper medium grade
A2		A		A		
A3	P-2	A-	A-2	A-	F2	
Baa1		BBB+		BBB+		Lower medium grade
Baa2	P-3	BBB	A-3	BBB	F3	
Baa3 (negative)		BBB- (negative)		BBB-		
Ba1	Not prime	BB+	B	BB+ (stable)	B	Non-investment grade speculative
Ba2		BB		BB		
Ba3		BB-		BB-		
B1		B+		B+		Highly speculative
B2		B		B		
B3		B-		B-		
Caa1		CCC+	C	CCC	C	Substantial risks
Caa2		CCC				Extremely speculative
Caa3		CCC-				Default imminent with little prospect for recovery
Ca		CC				
		C				
C		D	/	DDD	/	In default
/				DD		
Source: Fitch, S&P ratings, Moody's, Nedbank						

Source: Ratings agencies, Nedbank

SA's foreign currency credit rating

Sovereign and Nedbank FC rating

Moody's		S&P		Fitch		
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
Aa1		AA+		AA+		High grade
Aa2		AA		AA		
Aa3		AA-		AA-		
A1		A+	A-1	A+	F1	Upper medium grade
A2		A		A		
A3	P-2	A-	A-2	A-	F2	
Baa1		BBB+		BBB+		Lower medium grade
Baa2	P-3	BBB	A-3	BBB	F3	
Baa3 (negative)		BBB-		BBB-		
Ba1	Not prime	BB+ (negative)	B	BB+ (stable)	B	Non-investment grade speculative
Ba2		BB		BB		
Ba3		BB-		BB-		
B1		B+		B+		Highly speculative
B2		B		B		
B3		B-		B-		
Caa1		CCC+	C	CCC	C	Substantial risks
Caa2		CCC				Extremely speculative
Caa3		CCC-				Default imminent with little prospect for recovery
Ca		CC				
		C				
C		D	/	DDD	/	In default
/				DD		
Source: Fitch, S&P ratings, Moody's, Nedbank						

Source: Ratings agencies, Nedbank

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