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## Economic Review and Outlook 2016

**Nicky Weimar**

**May 2016**

<http://www.barnowl.co.za/videos/>

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# South Africa faced more than its fair share of headwinds in 2015

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Xenophobic attacks



Drought



Load shedding



New visa regulations starts to bite

China stumbles



#FeesMustFall



Finance minister fiasco



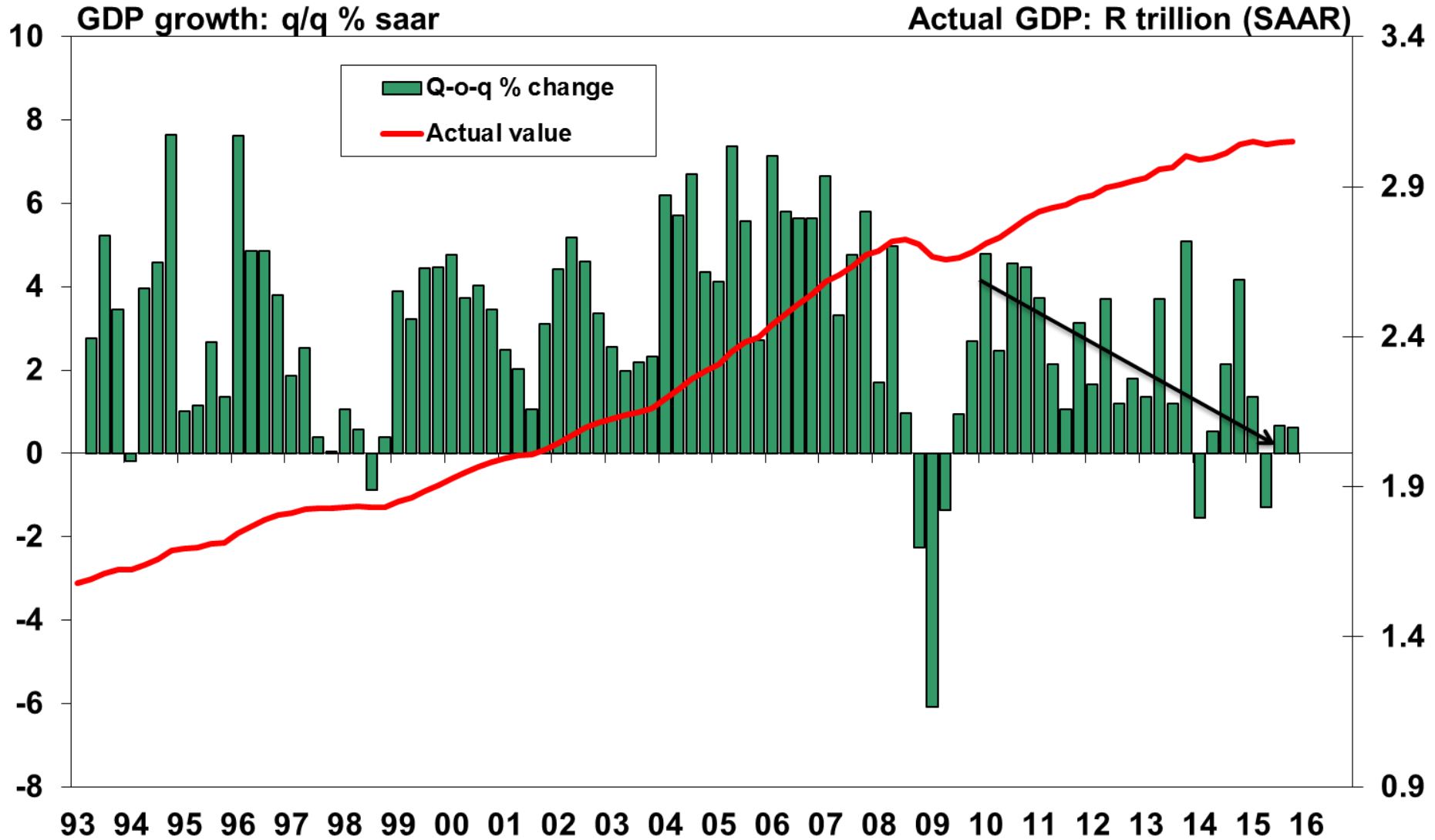
#ZumaMustFall



downgrade



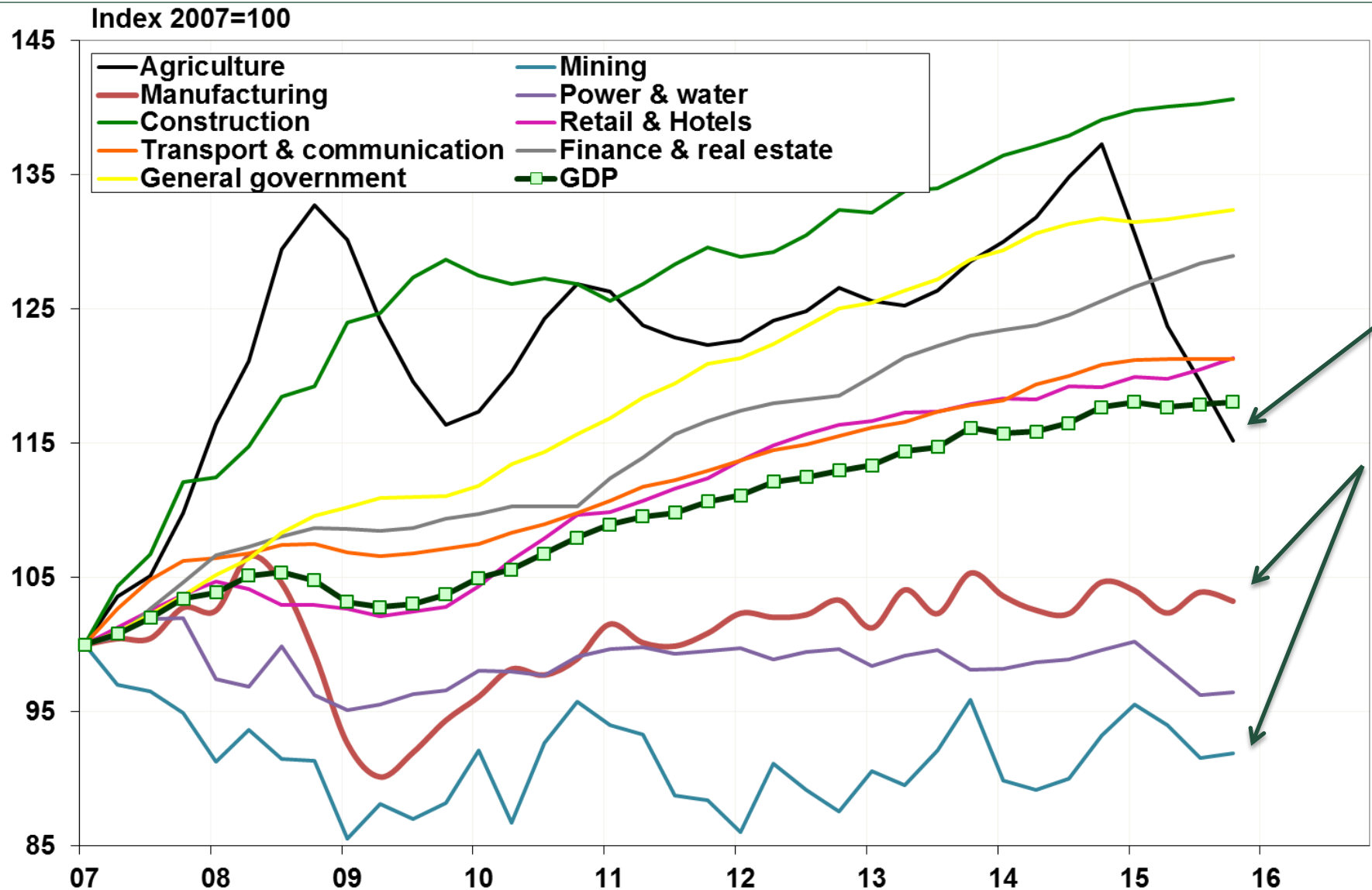
# But fundamentally the economy remains weak and vulnerable – growing by less than 1.5% in 2015



Source: Stats SA & Nedbank calculations

# In 2015 the drag came from weak to shrinking output in the mining, manufacturing and agricultural sectors

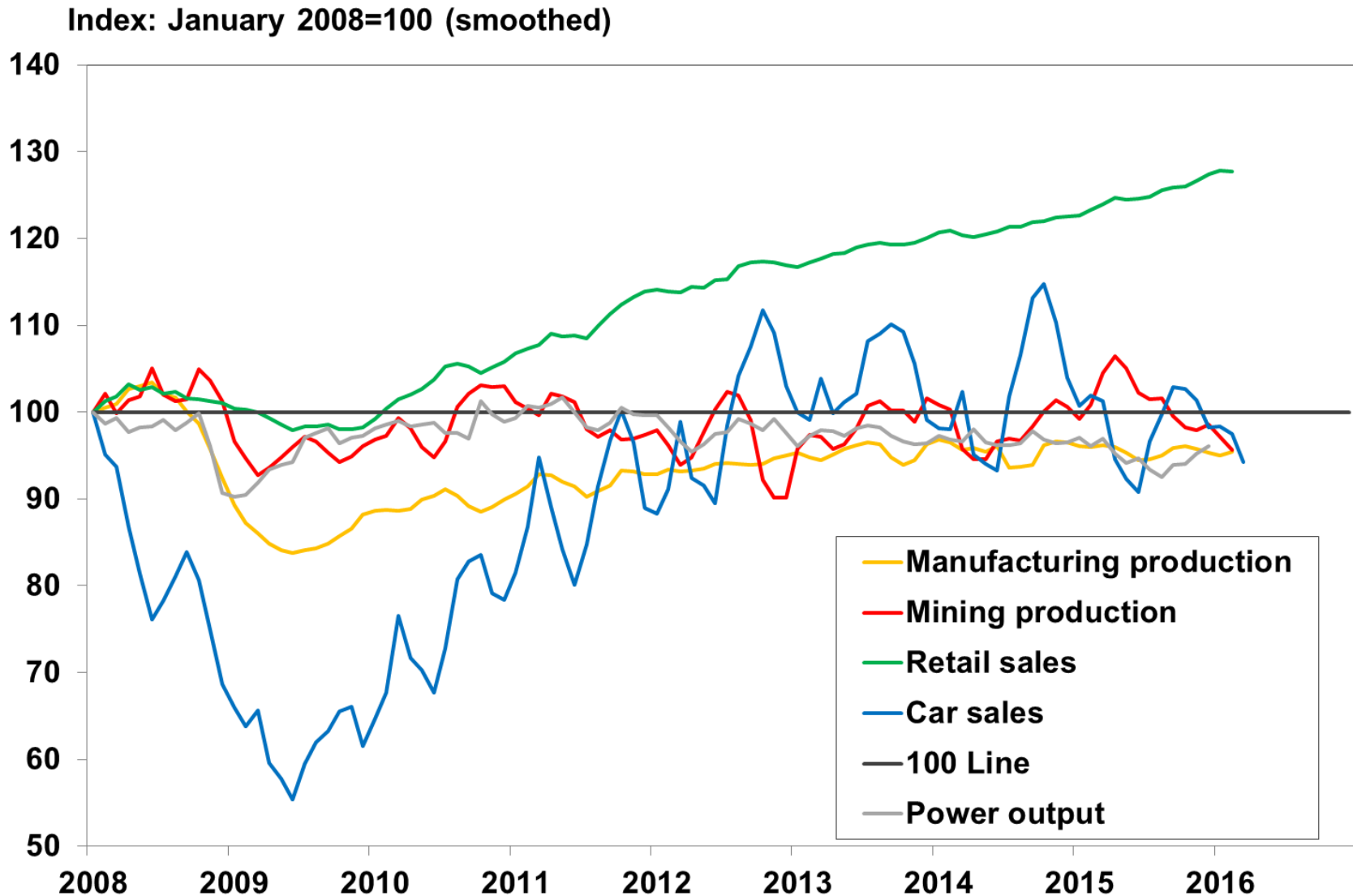
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Source: Stats SA

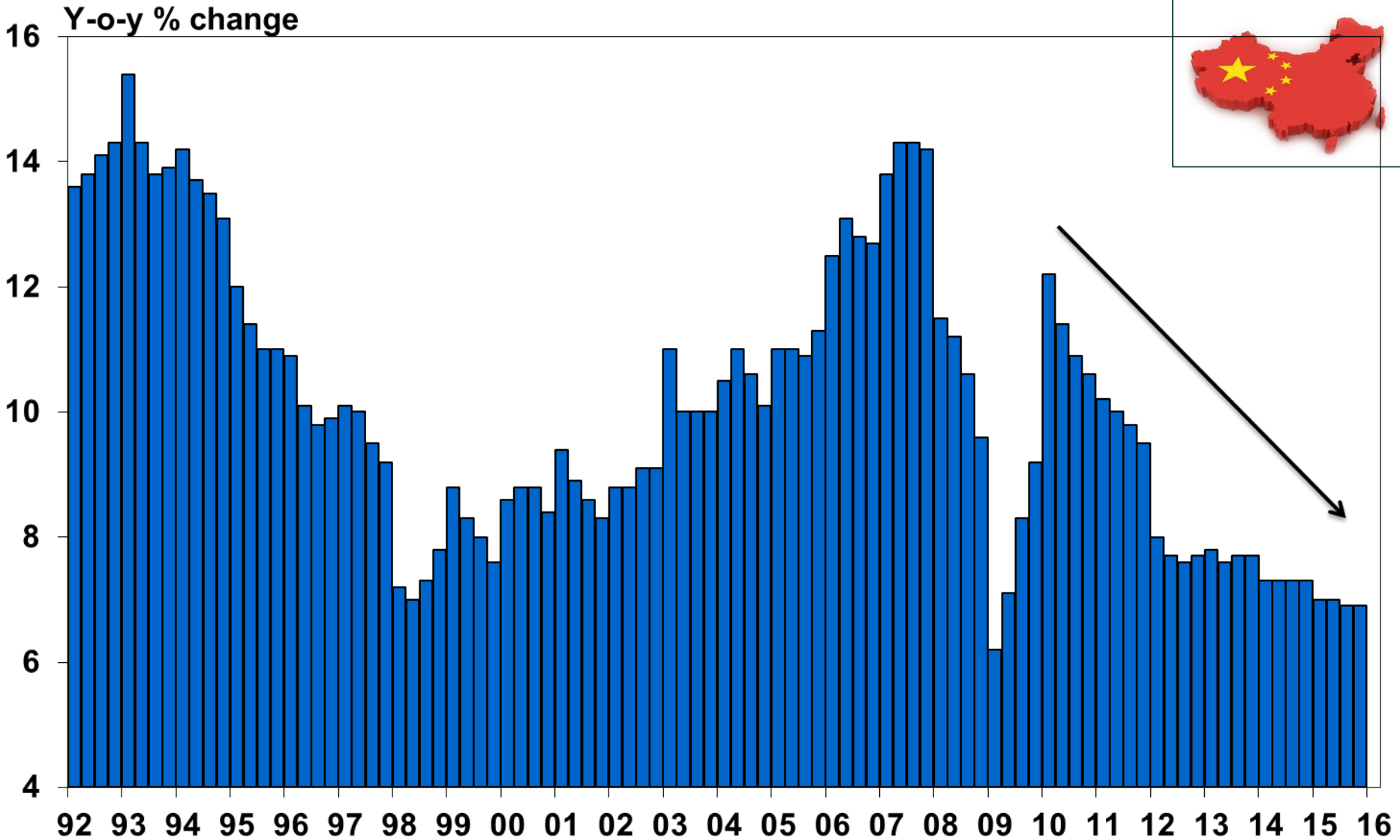
# In early 2016 not much has changed

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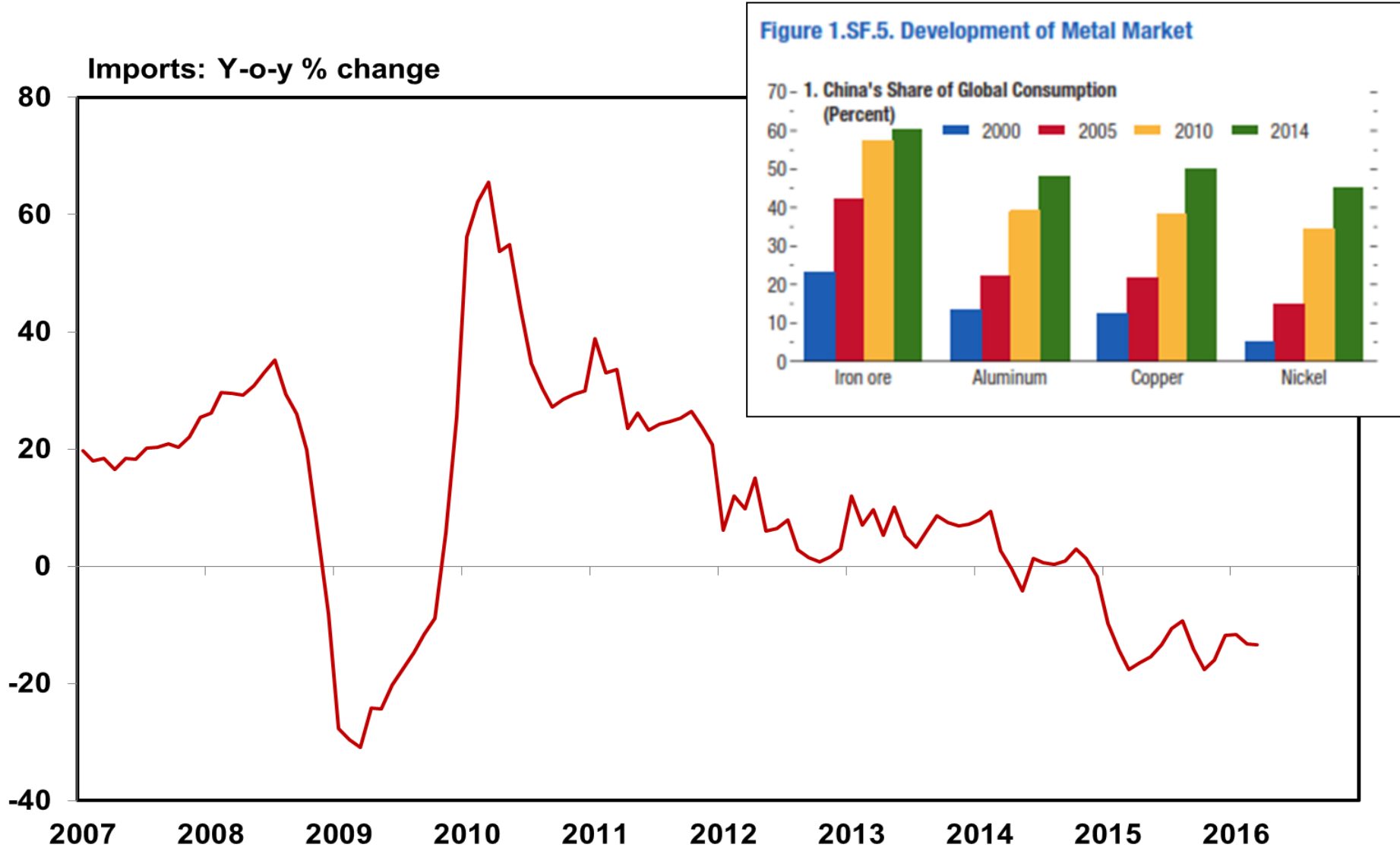
Source: Stats SA & Nedbank calculations

# Mining and large parts of manufacturing are feeling the pain caused by slower growth in China



Source: Reuters Thompson Datastream

# Falling Chinese imports have hurt global growth, particularly demand for commodities



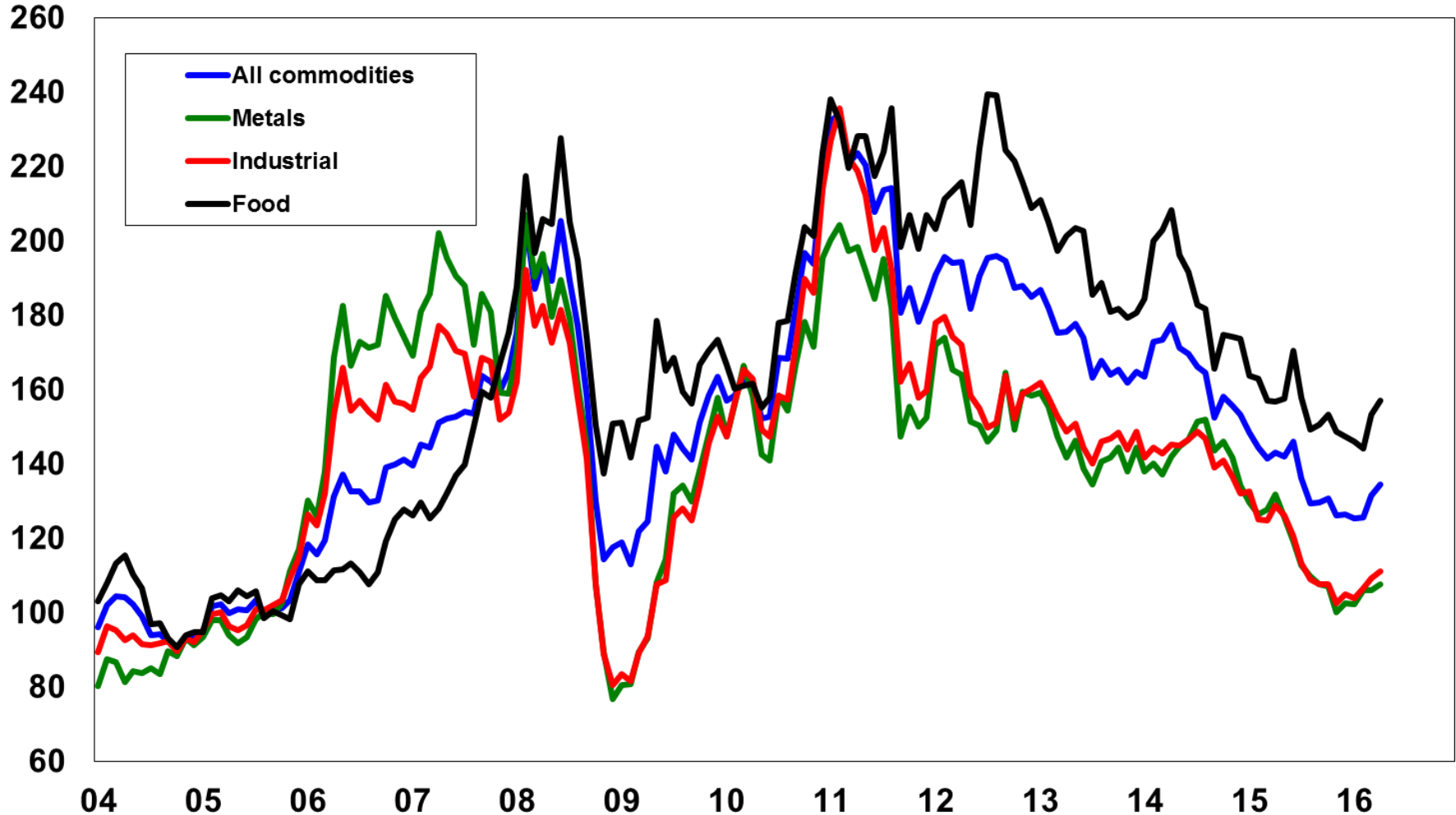
Source: Reuters Thompson Datastream

# The recent bounce in global commodity prices may prove short-lived

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Economist commodity indices in US\$: 2005=100

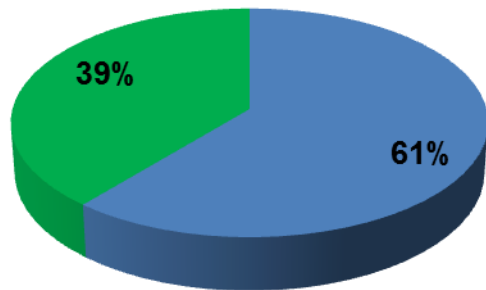


Source: Stats SA & Nedbank calculations



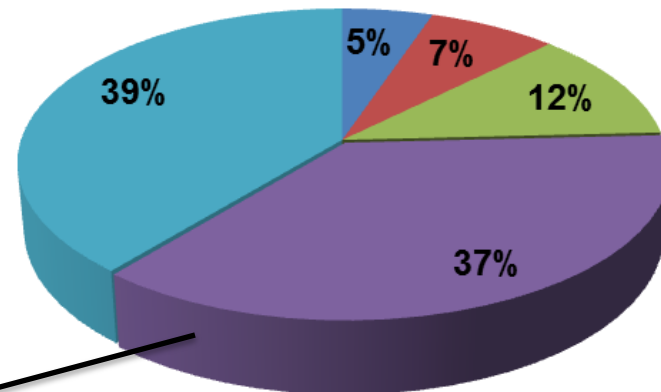
# How exposed is South Africa?

## Breakdown of SA exports



■ Commodity-related ■ Other

## Breakdown of commodity exports



■ Agriculture ■ Chemicals  
■ Basic metals ■ Mining

### 4 commodities feature strongly

	% of total exports
Coal	6.8
Gold	6.0
Iron ore	8.1
Platinum	14.1
	35.0

Source: Customs & Excise

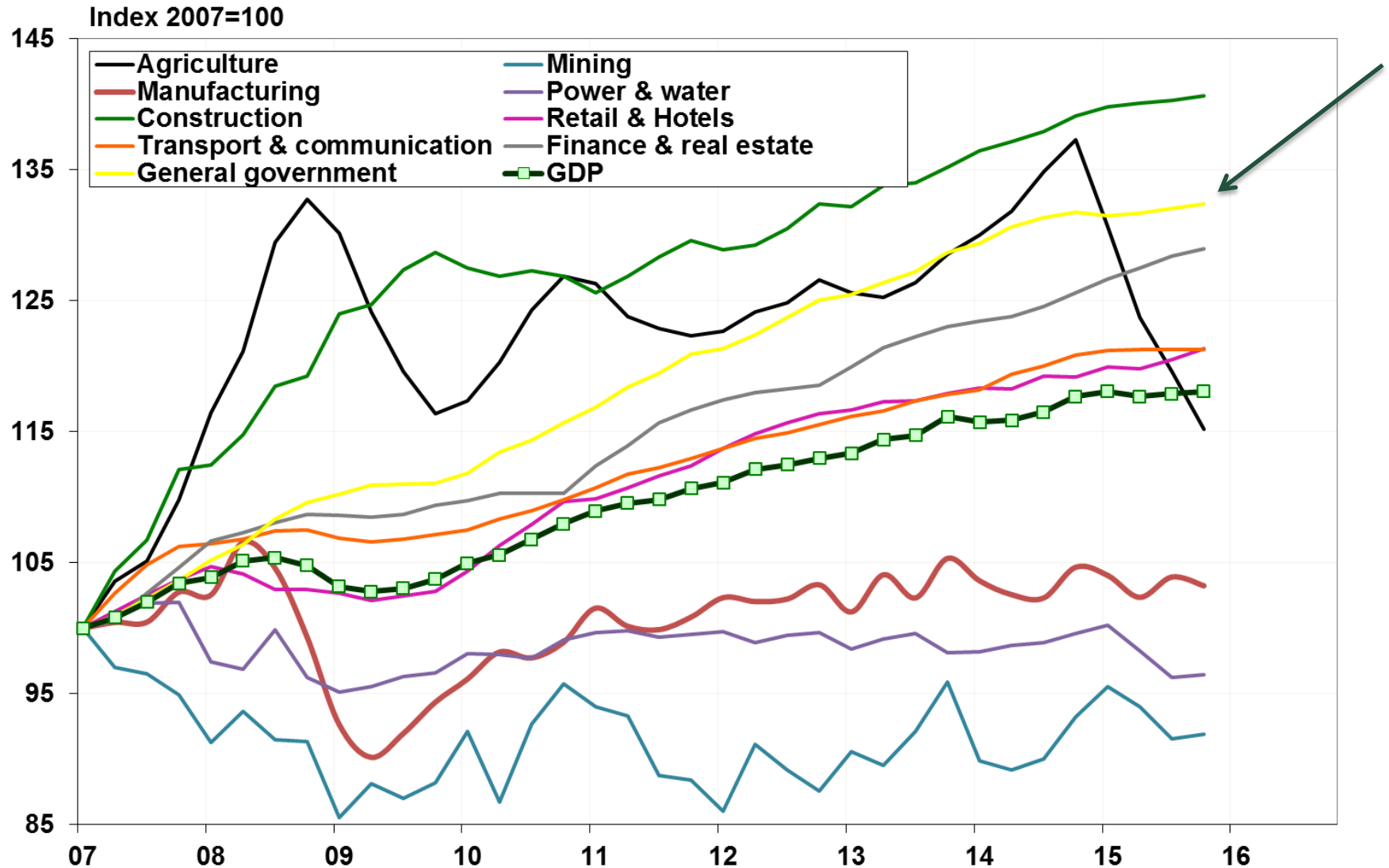
# SA is made even more vulnerable by numerous competitive challenges and structural constraints

- **Mounting cost pressures and erosion of global cost competitiveness**
  - Negative relationship between cost and productivity of labour
  - Surging costs of utilities and basic economic services – power, transport (road, rail, ports), water, telecommunications
- **Capacity constraints amplifying costs pressures & constraining expansion**
  - Lack of power generating capacity
  - Limited and ageing road, rail and port infrastructure
  - Insufficient social infrastructure – public transport, health, education, water
- **Increased policy uncertainty & political turmoil**

**Mining & manufacturing are not expected to stage a strong recovery in 2016**

- **Sharp reductions in capital expenditure**
- **Moderate increase in retrenchments**

# Increased government spending has supported services & consumer spending, propping up the economy in this business cycle



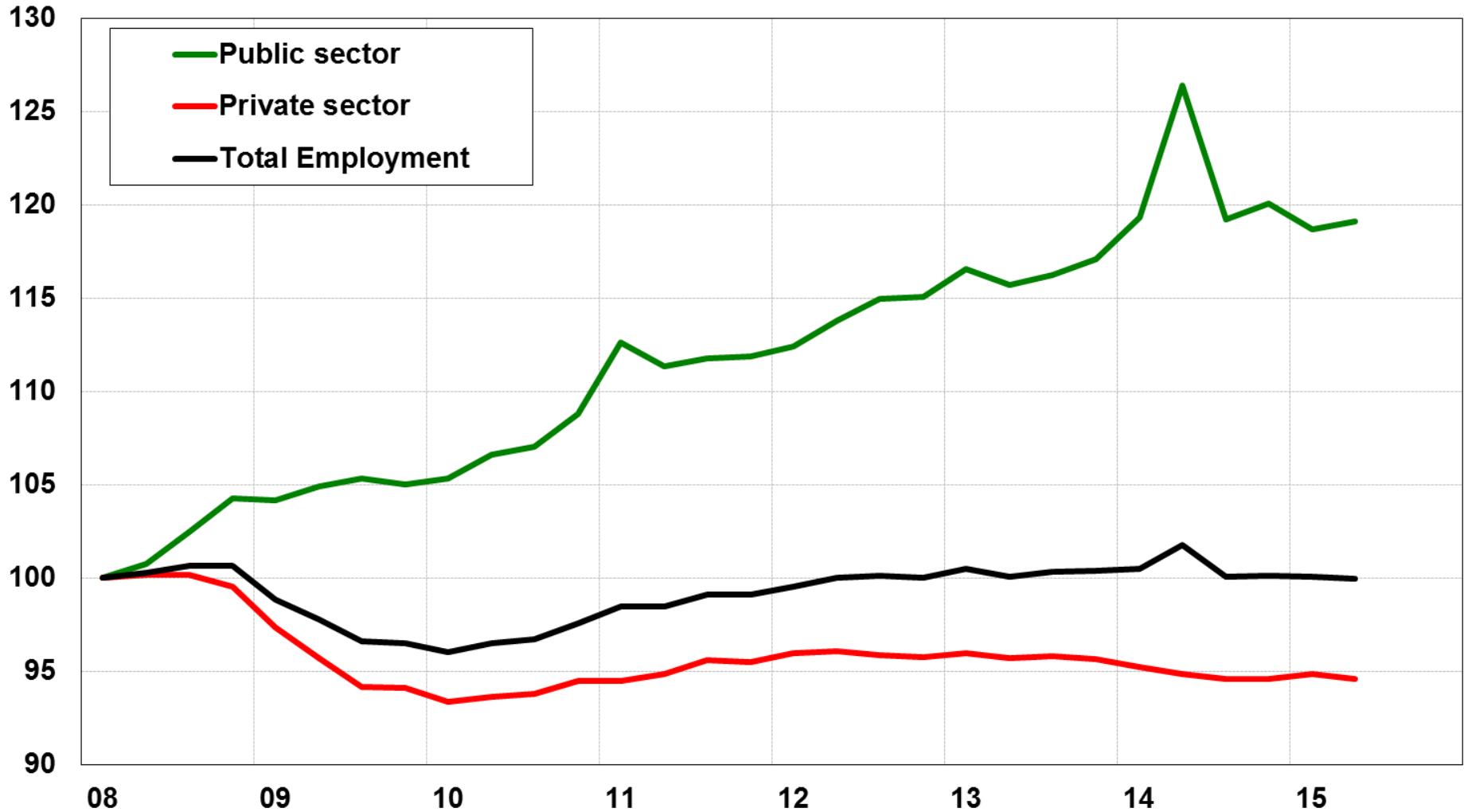
Source: Stats SA

# Government will have to scale back the size of the civil service

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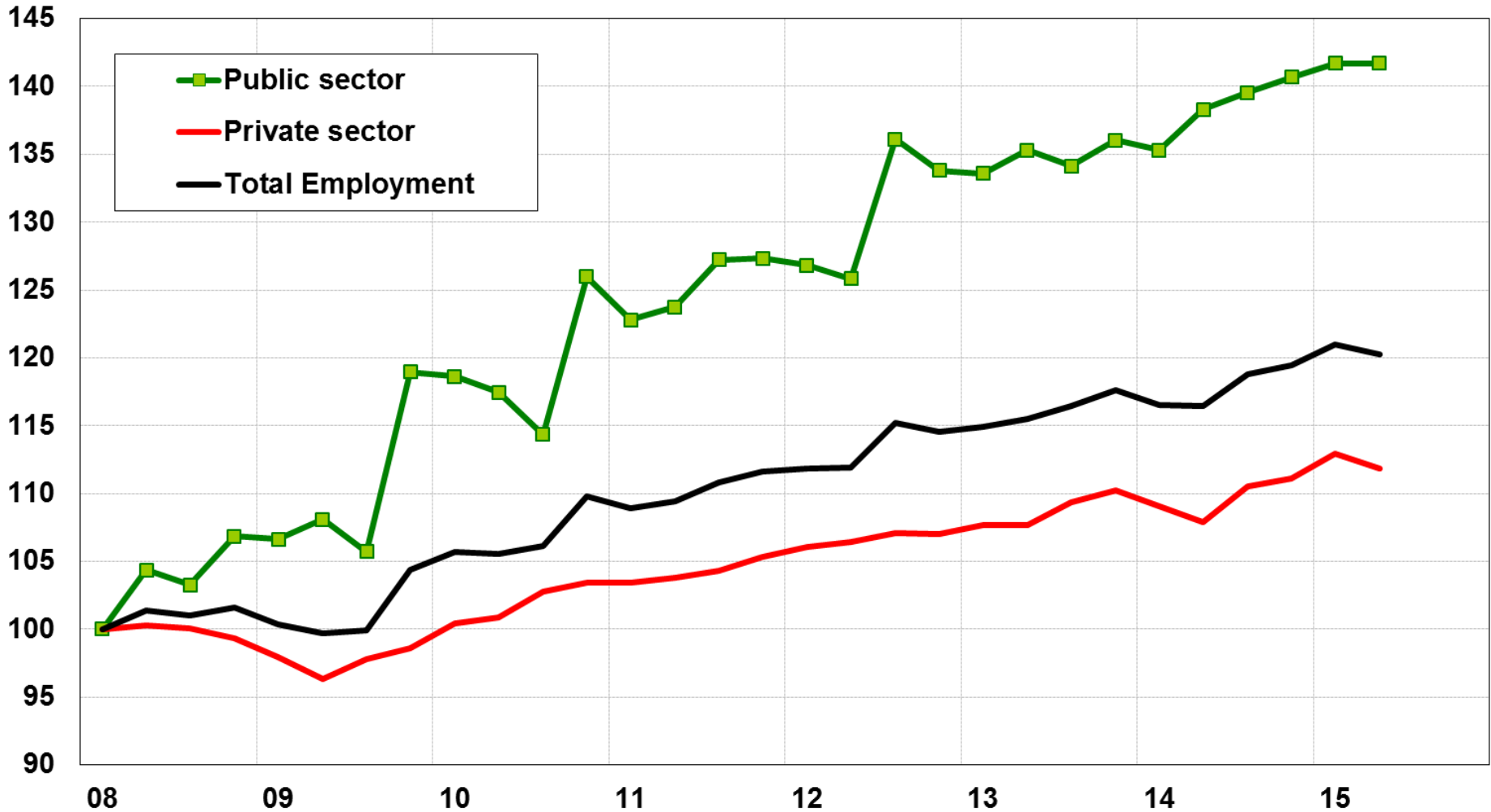


## Employment trends: Index 2008=100



Source: South African Reserve Bank

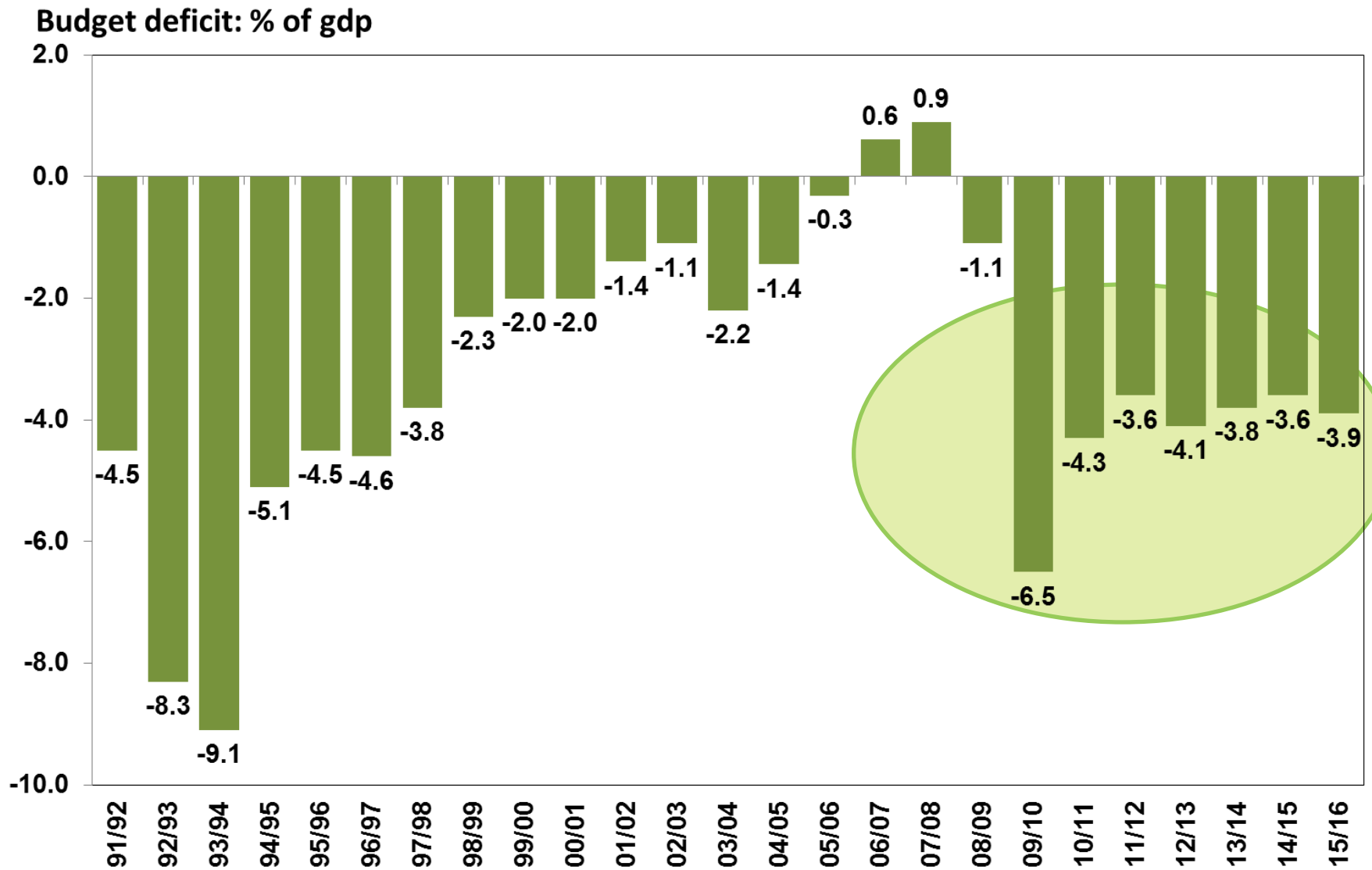
Real total wage bill: Index 2008=100



Source: South African Reserve Bank

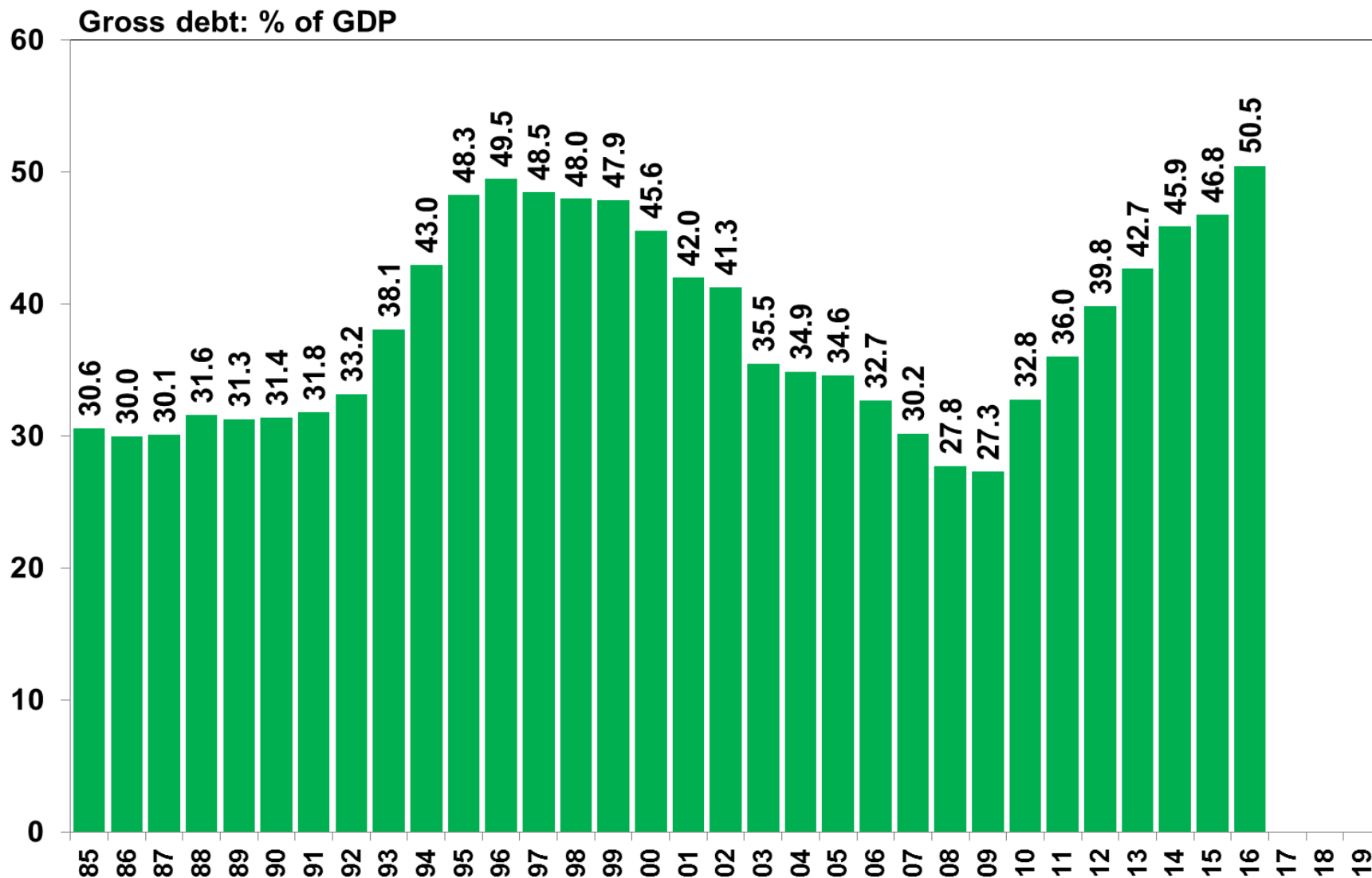
# SA has simply been borrowing at a too alarming rate

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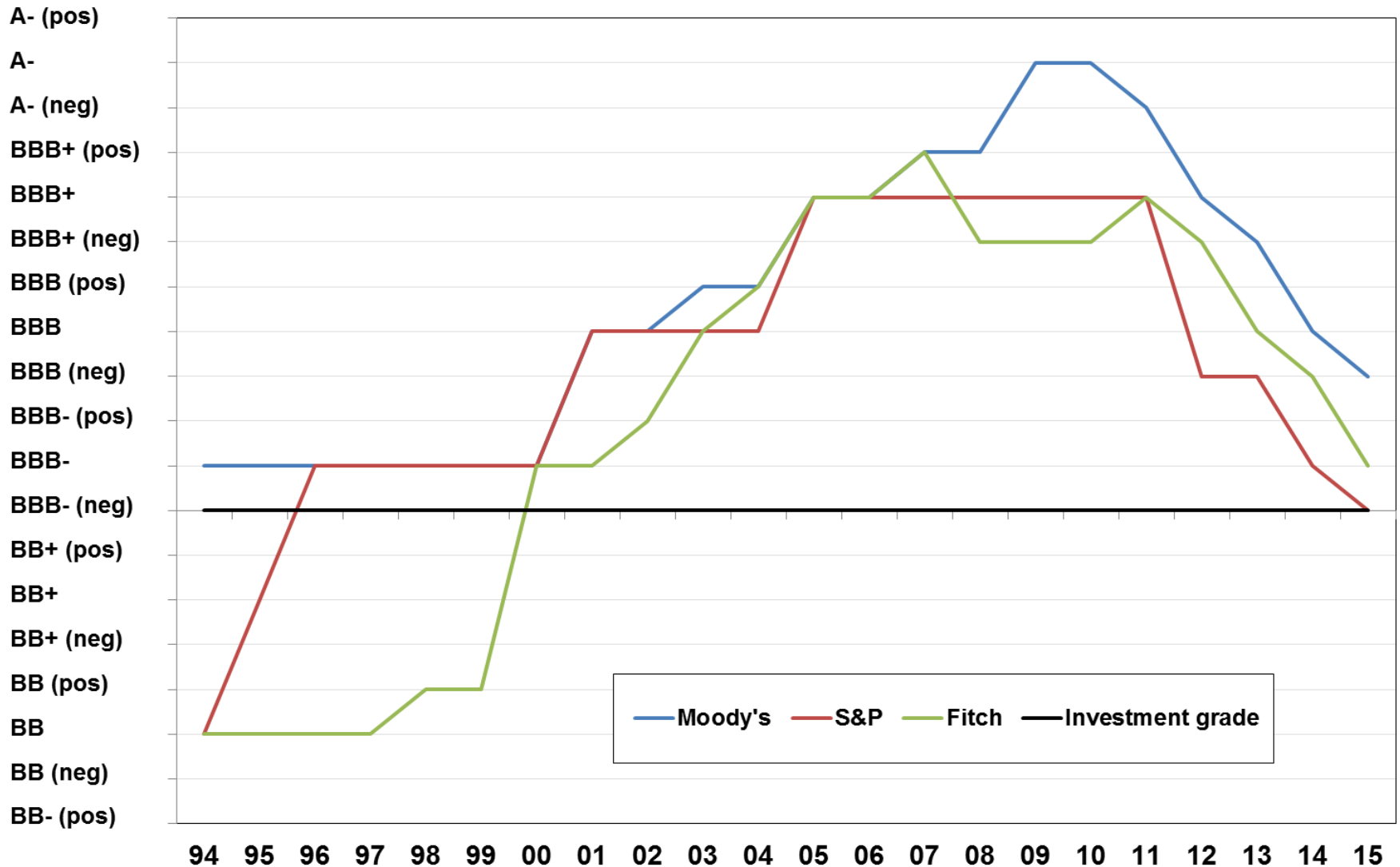
Source: 2015 MTBPS

# This has resulted in steep rise in government debt – there is no ammunition left



Source: 2015 MTBPS

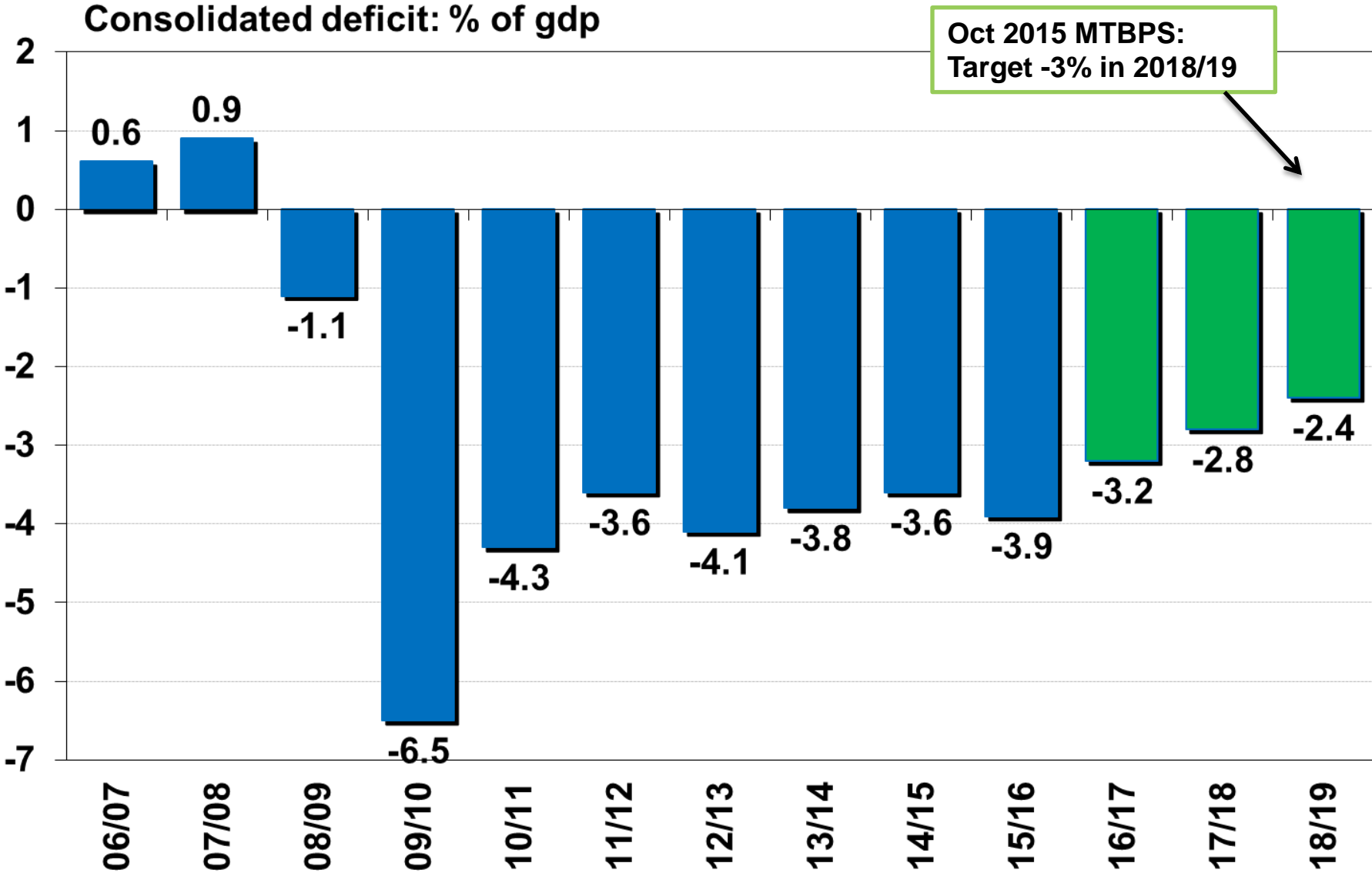
# Fading economic growth, relatively large current and fiscal deficits have resulted in a series of sovereign rating downgrades



Source: Various credit rating agencies

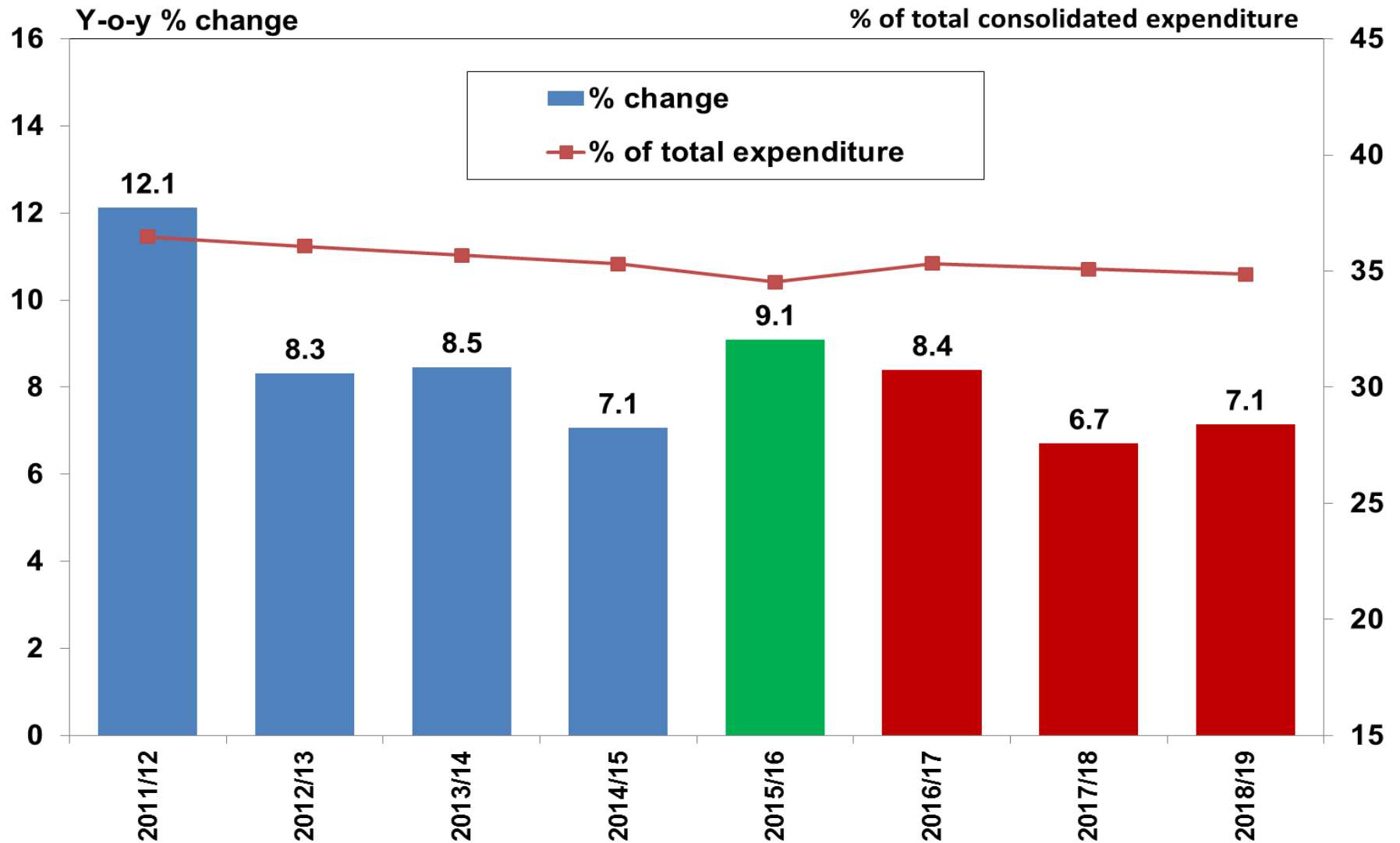


# Minister Gordhan produced a faster pace of deficit reduction



Source: 2015 MTBPS

# The big boost provided to household disposable income by public sector employment and pay is likely to fade in the years ahead

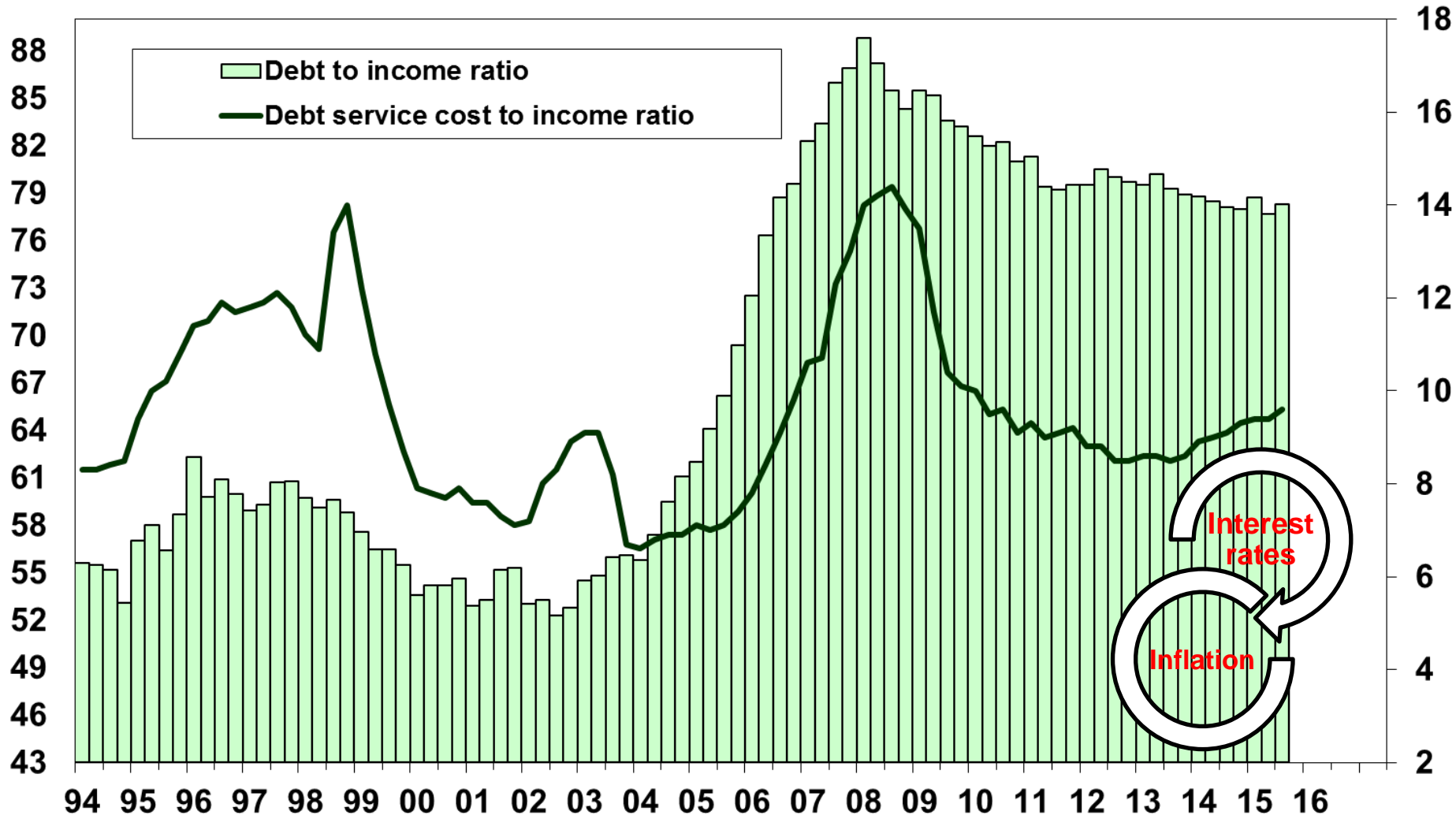


Source: National Budget Review 2016

# Rising interest rates are placing further strain on households with high debt burdens

### Debt as % of income

### Debt service costs as % of income



Source: SARB QB December 2015

## ■ Rising food inflation

- Worst drought in 25 years are expected to result in 30% drop in field crop production
- Weaker rand will push up the cost of increased food imports

## ■ A vulnerable rand

- The rand fell by over 25% against the US dollar in 2015, but has recovered some lost ground in recent weeks
- Downside risks remain:
  - SA sovereign risk rating downgrade to speculative status
  - Domestic political developments
  - Changes in global risk appetites – Risk aversion likely to be triggered by a loss in economic momentum in China, renewed downward pressure on commodity prices and signs of that US interest rates are set to increase faster than currently expected

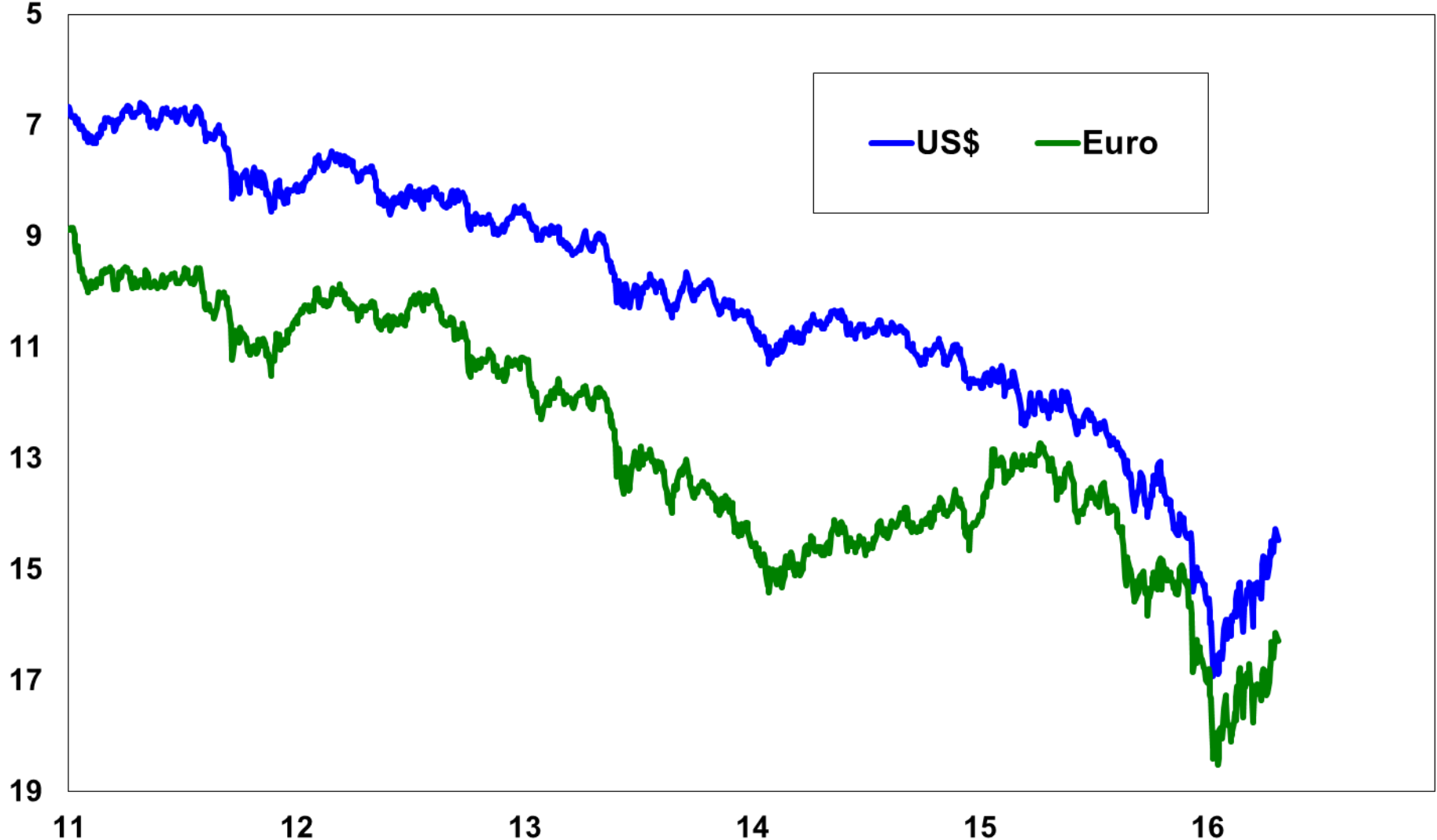
## ■ A turnaround in global oil prices

# The rand have been very vulnerable and extremely volatile

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Rand/ US\$ and euro



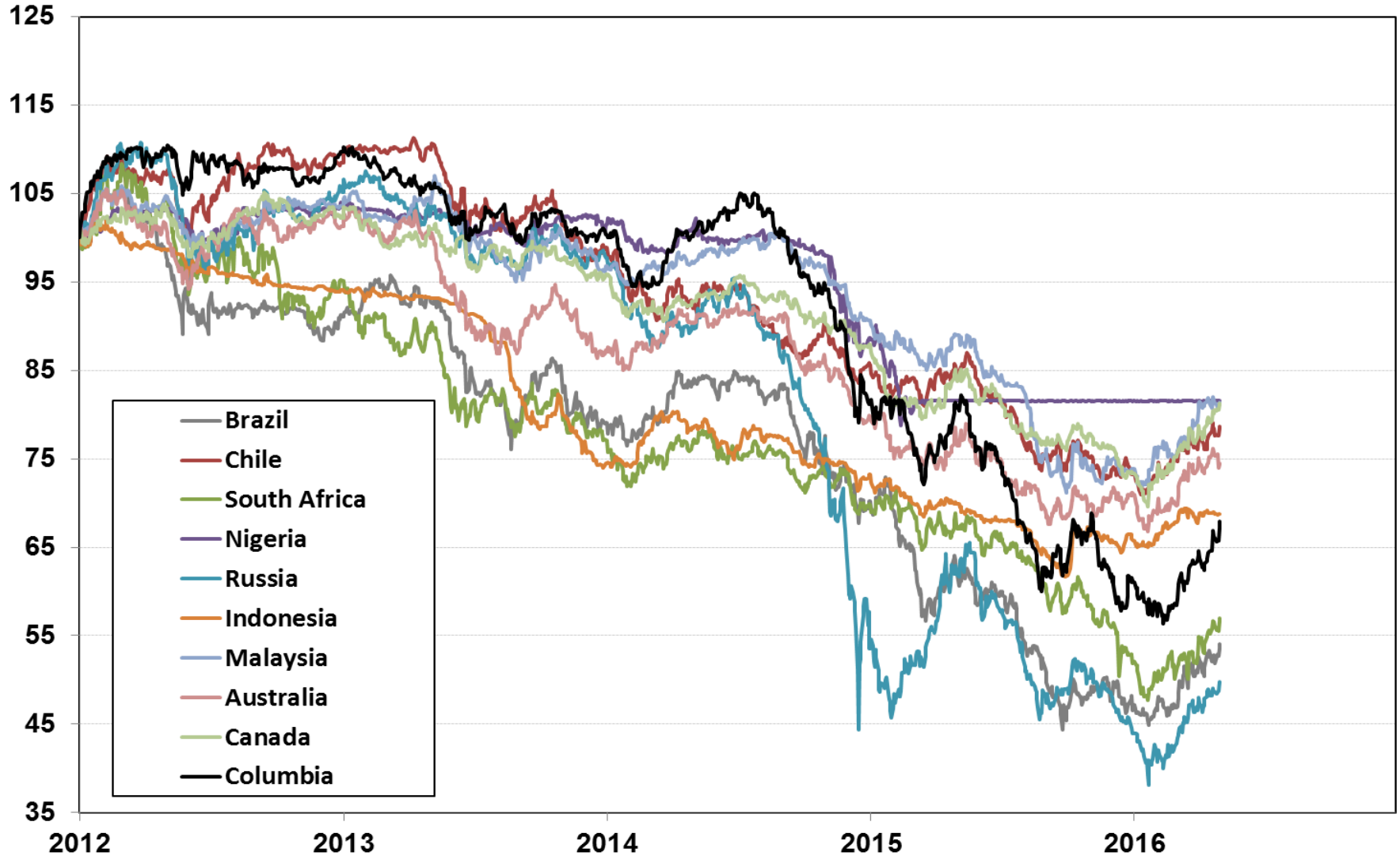
Source: Reuters

# Most emerging market currencies have been punished on bad news on China & commodities, but supported by signs of weak growth in US

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## Currencies against the US\$: Index 2012=100



Source: Stats SA & Nedbank calculations

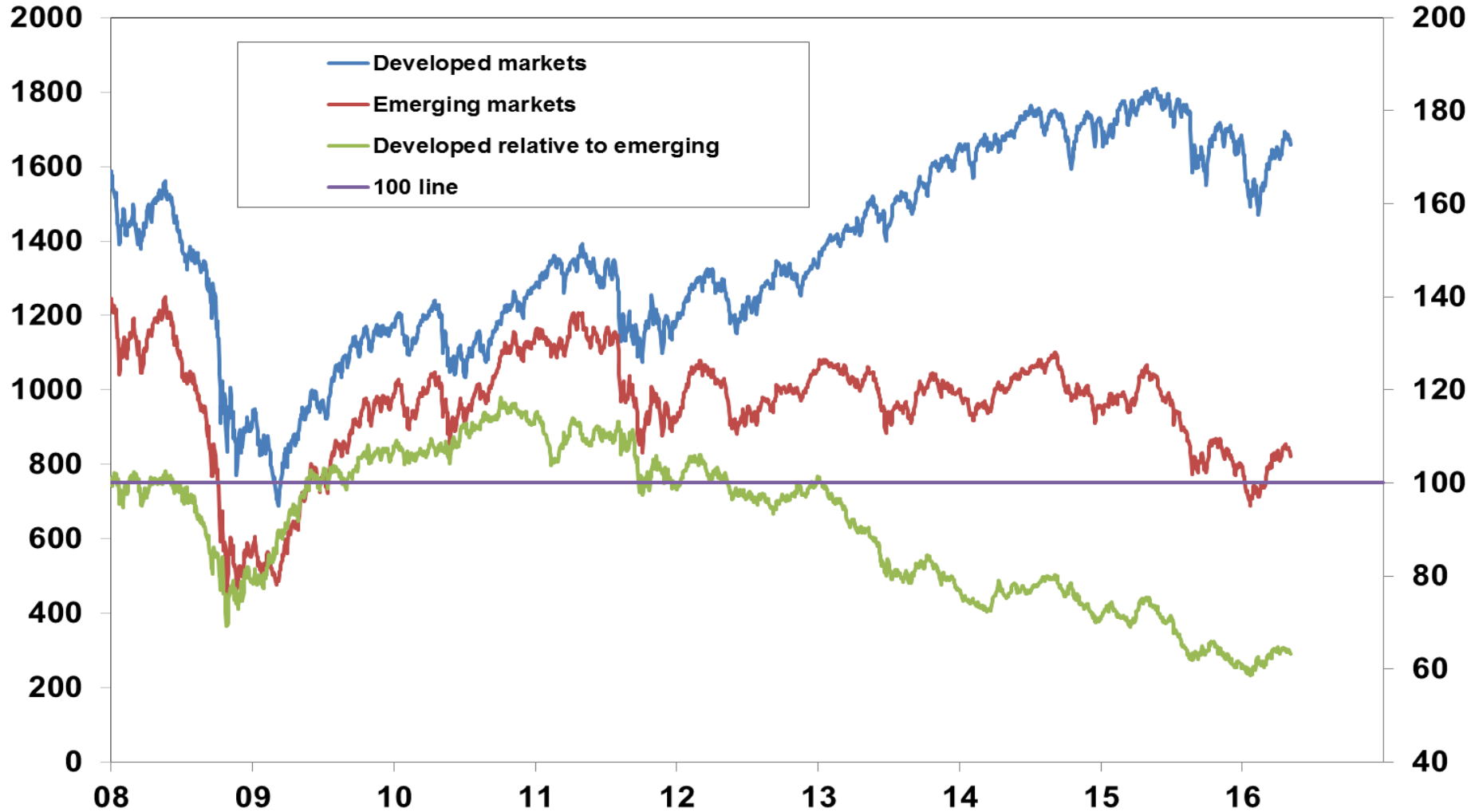
# Capital flows have been primarily influenced by global risk perceptions

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## MSCI equity indices

## Relative performance



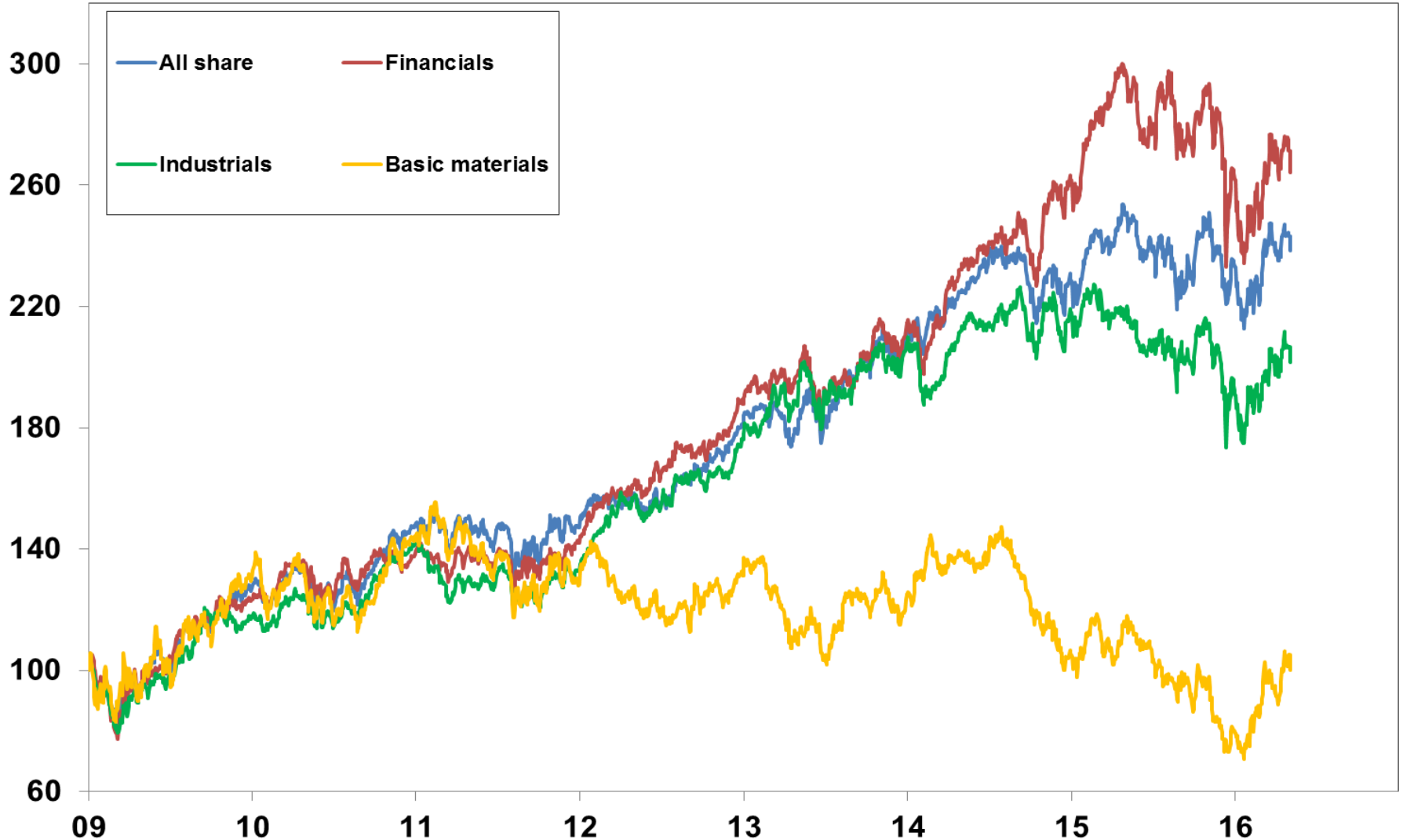
Source: Thompson Reuters Datastream

# Hope floats again...the stock market is bouncing back

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Index 2009=100



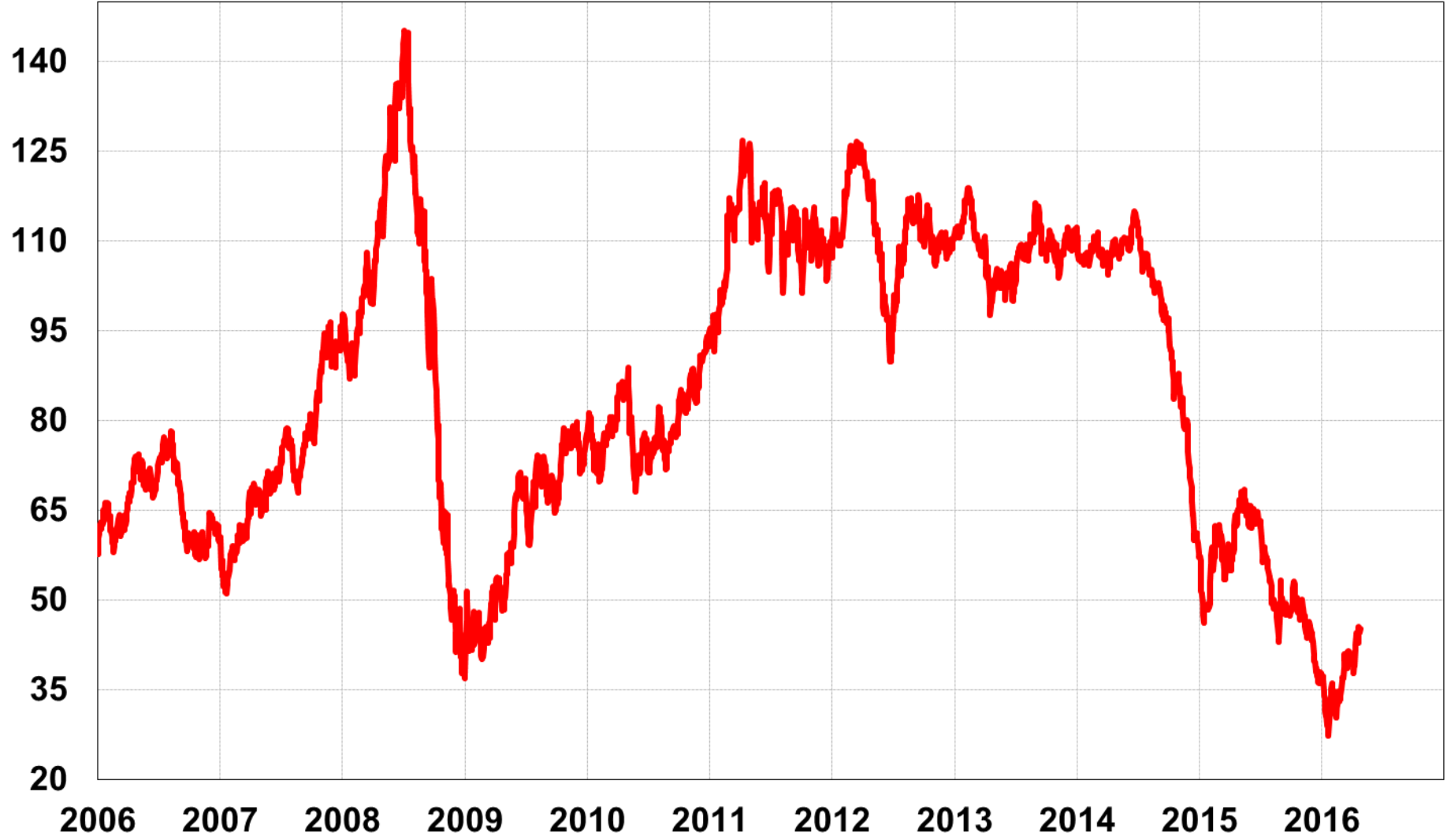
Source: INET & Nedbank calculations



# The worst of the decline in oil prices is probably over, which also add upward pressure to inflation

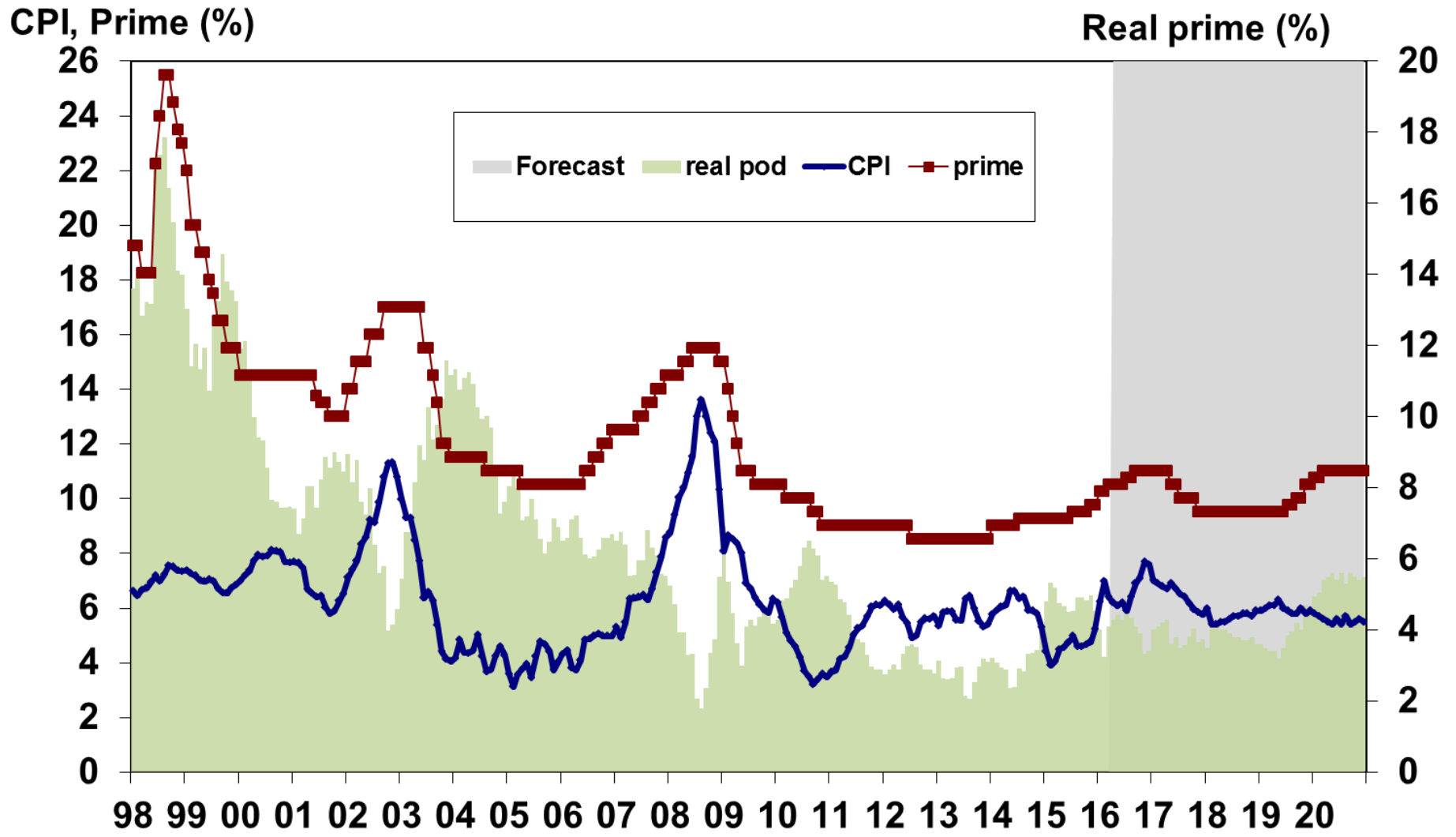


\$ per barrel



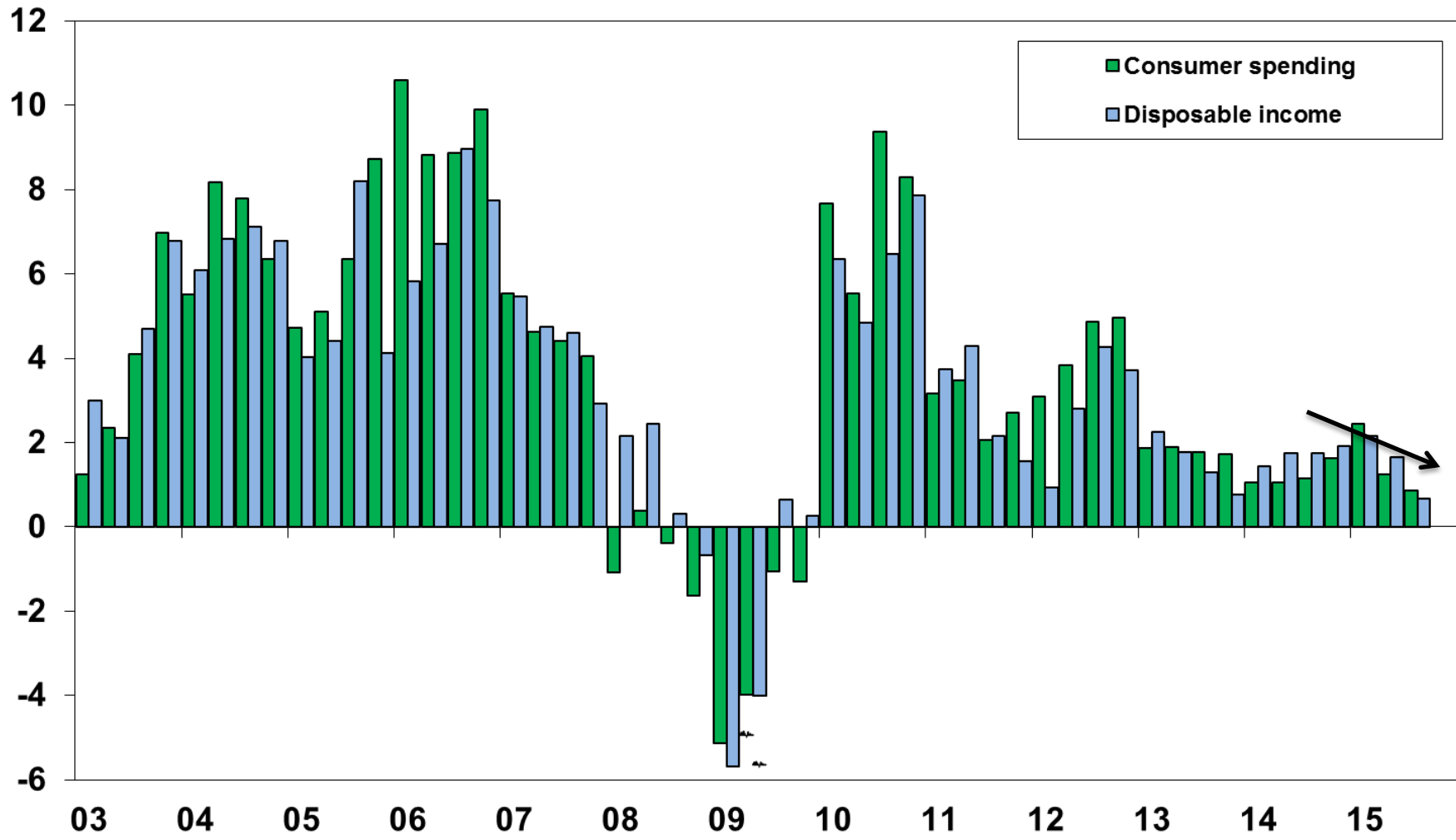
Source: Reuters

# A deteriorating inflation outlook has already resulted in higher interest rates and the upward trend is expected to continue

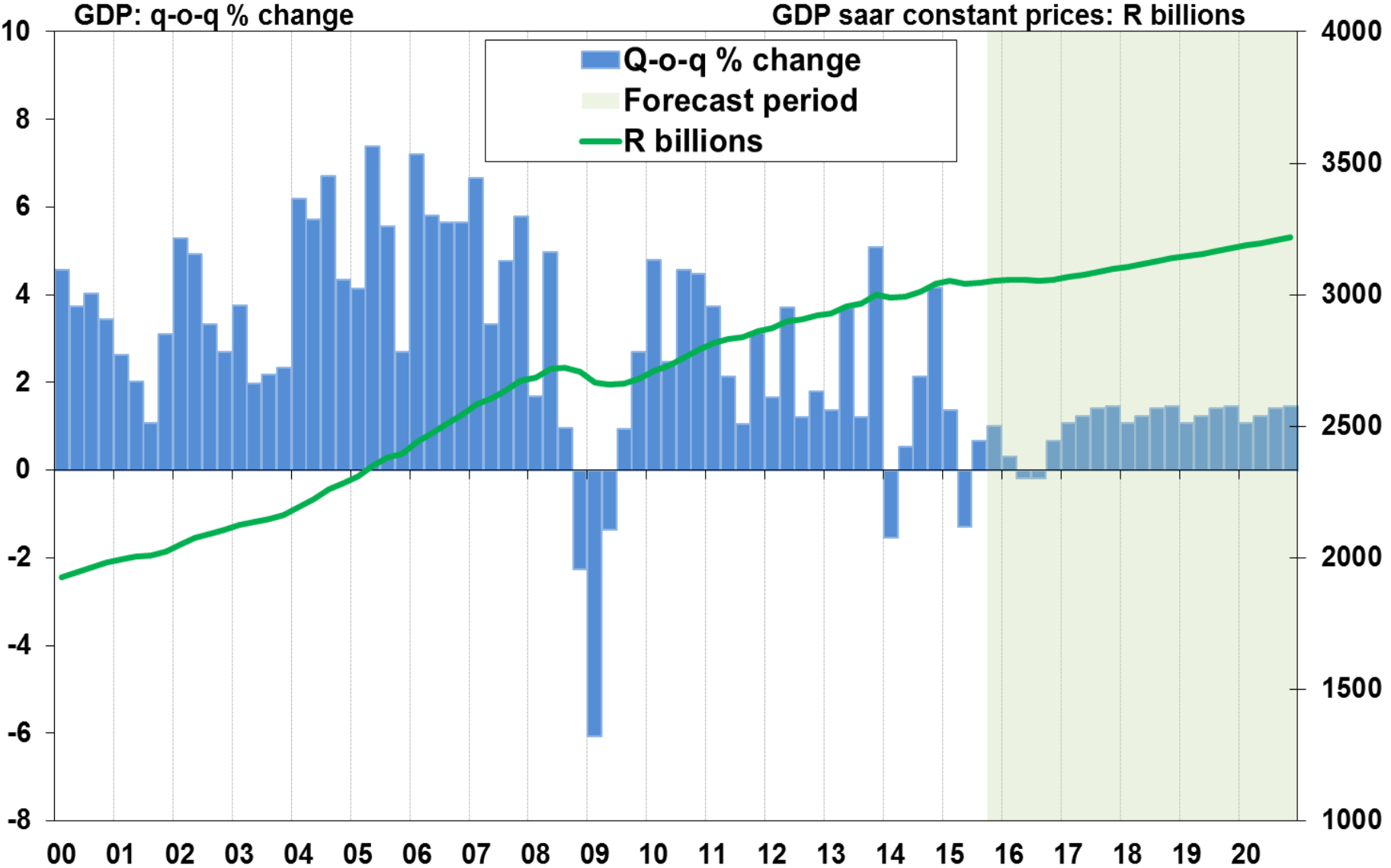


# Slowdown in consumer spending is likely to intensify (only 0.7% growth in 2016)

### Spending & Income: Q-o-q % change (saar)



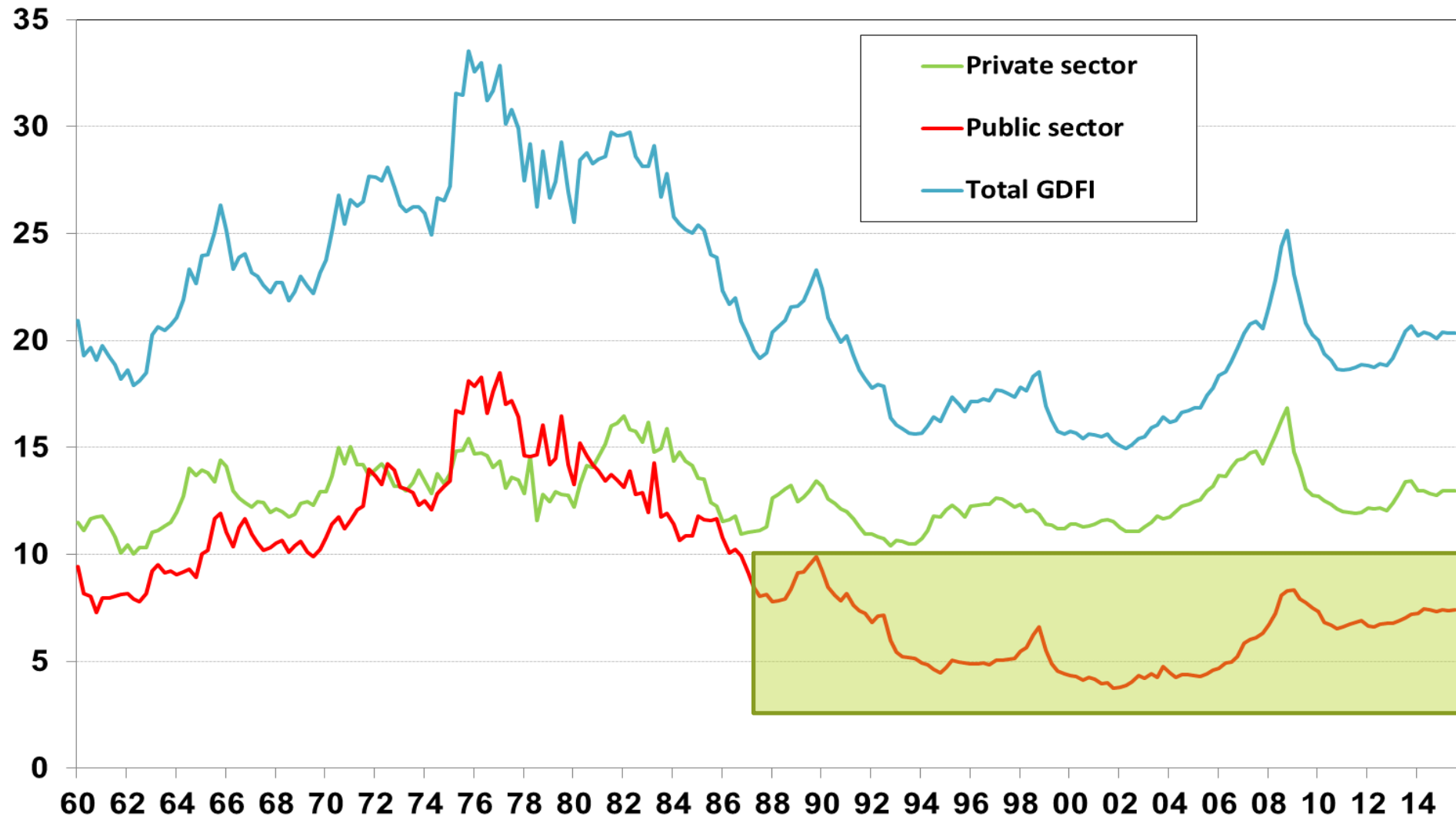
# Economic growth forecast to weaken even further – slipping into short & shallow recession Q2 and Q3



	2011	2012	2013	2014	2015	2016	2017	2018
<b>Economic growth - Annual growth rates (%)</b>								
Consumer spending	4.9	3.4	2.9	1.4	1.6	0.7	1.0	1.4
Fixed investment	5.7	3.6	7.6	-0.4	1.4	-2.5	0.5	2.1
Exports	4.3	0.1	4.6	2.6	9.0	2.7	3.1	4.3
Imports	10.5	6.0	1.8	-0.5	5.7	2.1	4.3	5.6
GDP	3.2	2.2	2.2	1.5	1.3	0.2	0.9	1.5
<b>Balance of Payments</b>								
Current Account (R'bn)	-65.3	-161.7	-203.8	-206.6	-174.3	-151.1	-136.9	-152.7
As % of gdp	-2.2	-5.0	-5.8	-5.4	-4.4	-3.5	-2.9	-2.9
<b>Interest rates - Year-end rates</b>								
3-month JIBAR	5.6	5.1	5.2	6.1	6.6	7.6	5.9	5.9
Prime	9.0	8.5	8.5	9.3	9.8	11.0	9.5	9.5
Long bond	8.1	6.8	8.0	7.9	9.7	9.9	8.5	8.5
<b>Exchange rates - Annual averages</b>								
Rand/US\$	7.27	8.22	9.66	10.85	12.93	15.50	16.53	17.23
Rand/Euro	10.12	10.57	12.83	14.33	14.28	17.21	17.81	18.16
Rand/GBP	11.66	13.09	15.14	17.83	19.73	22.10	23.34	23.79
CHF/Rand	0.122	0.114	0.096	0.085	0.075	0.061	0.059	0.058
Yen/Rand	10.96	9.74	10.04	9.82	9.35	7.31	6.86	6.60
<b>Inflation - Annual averages</b>								
New CPI	5.0	5.7	5.8	6.1	4.6	6.6	6.5	5.7

# Although allocating large sums to capital expenditure to improve infrastructure, delivery has been frustratingly slow

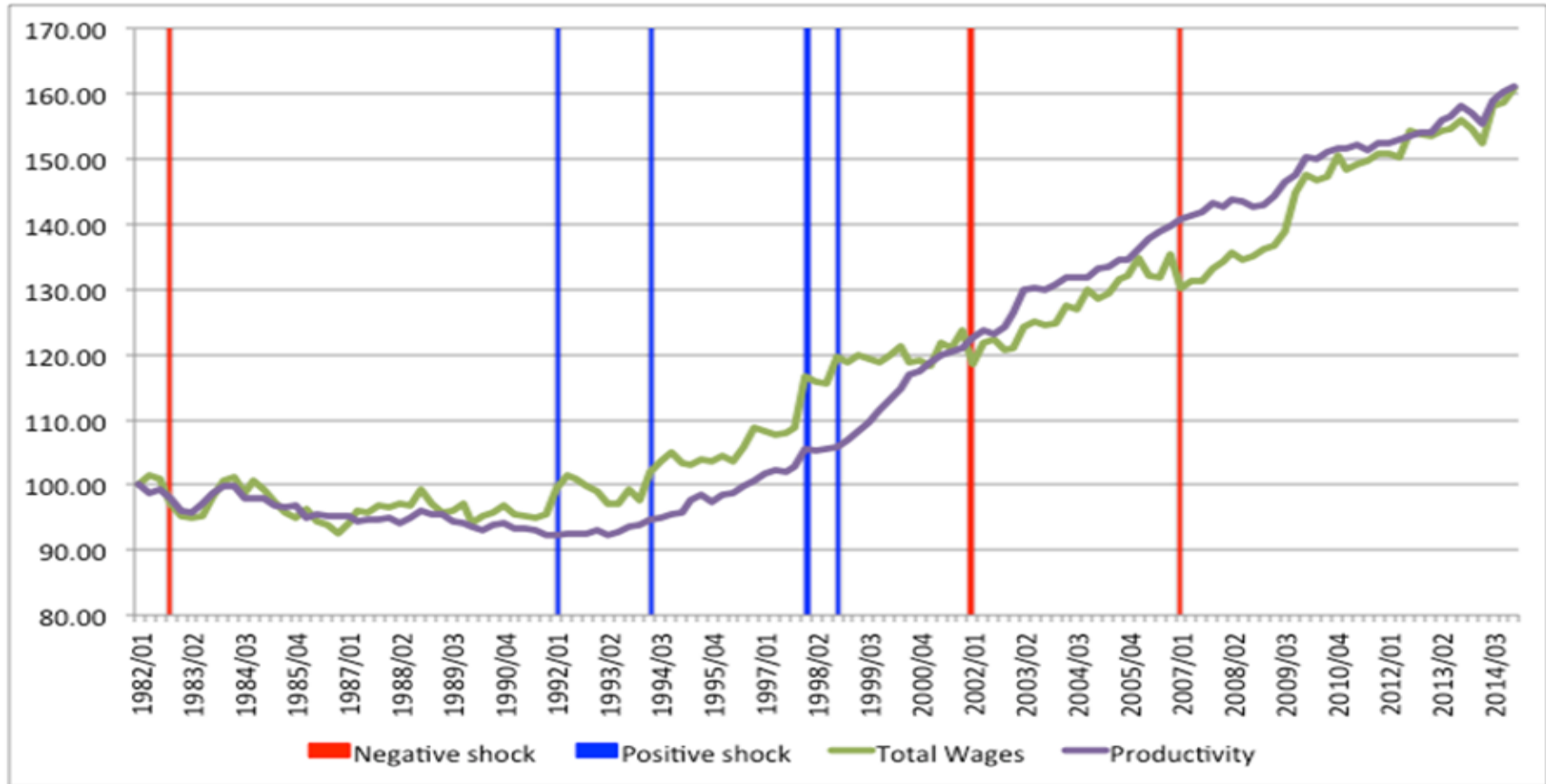
## Capital formation as % of GDP at current prices



Source: SARB QB & Nedbank calculations

**On average since 1982, a 1% increase in productivity has been associated with a 1% increase in real wages.**

**Figure 1. Real wages and productivity**



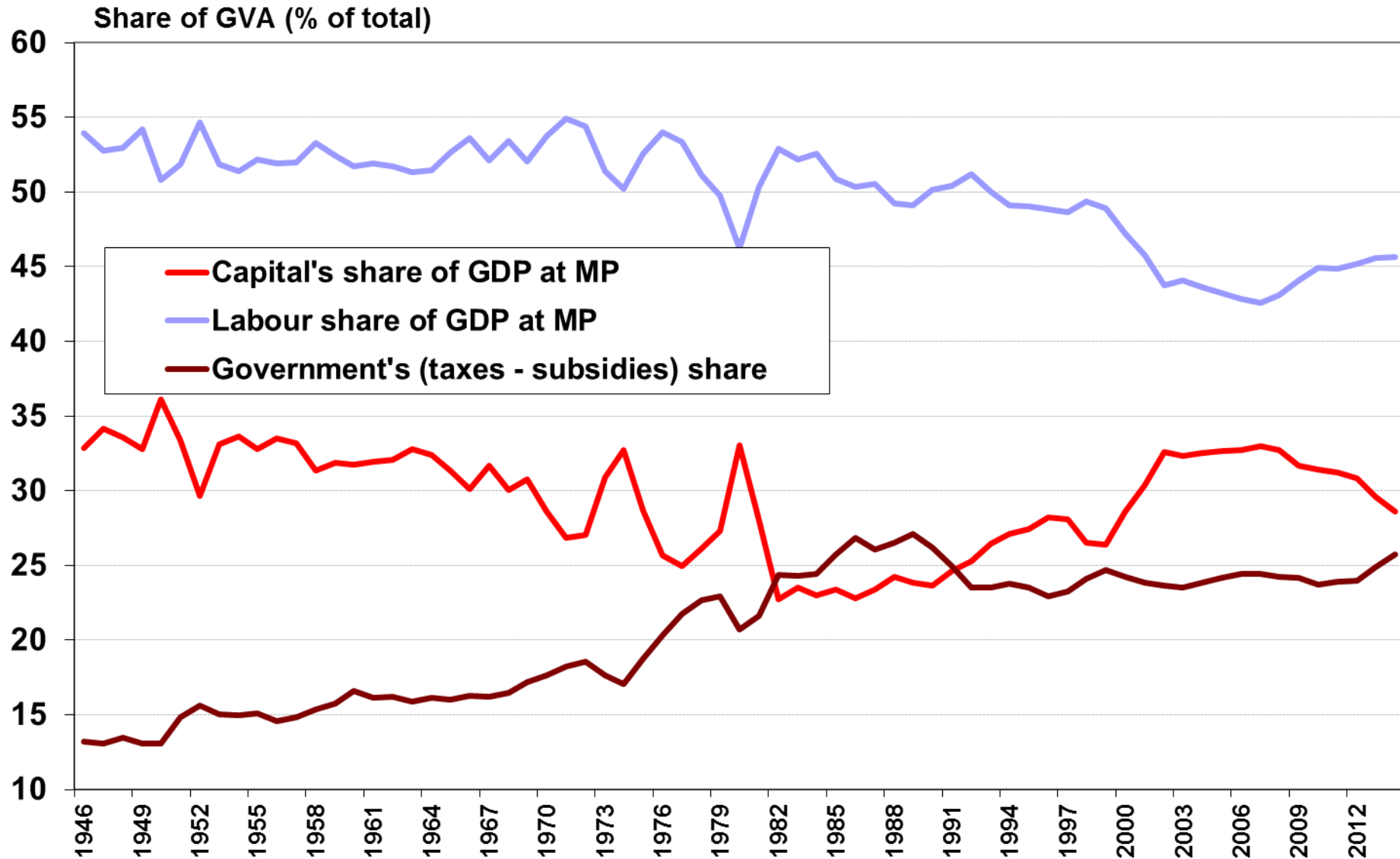
*Source:* SARB online download facility (2015) and author's calculations.

*Note:* The SARB data on the levels of wages and value-added contain breaks. To overcome this, the data on percentage changes in these variables were used to generate new 'level series'.

***Source: Research by Philippe Burger of the University of the Free State***

# Both labour and government's share have increased since 2009

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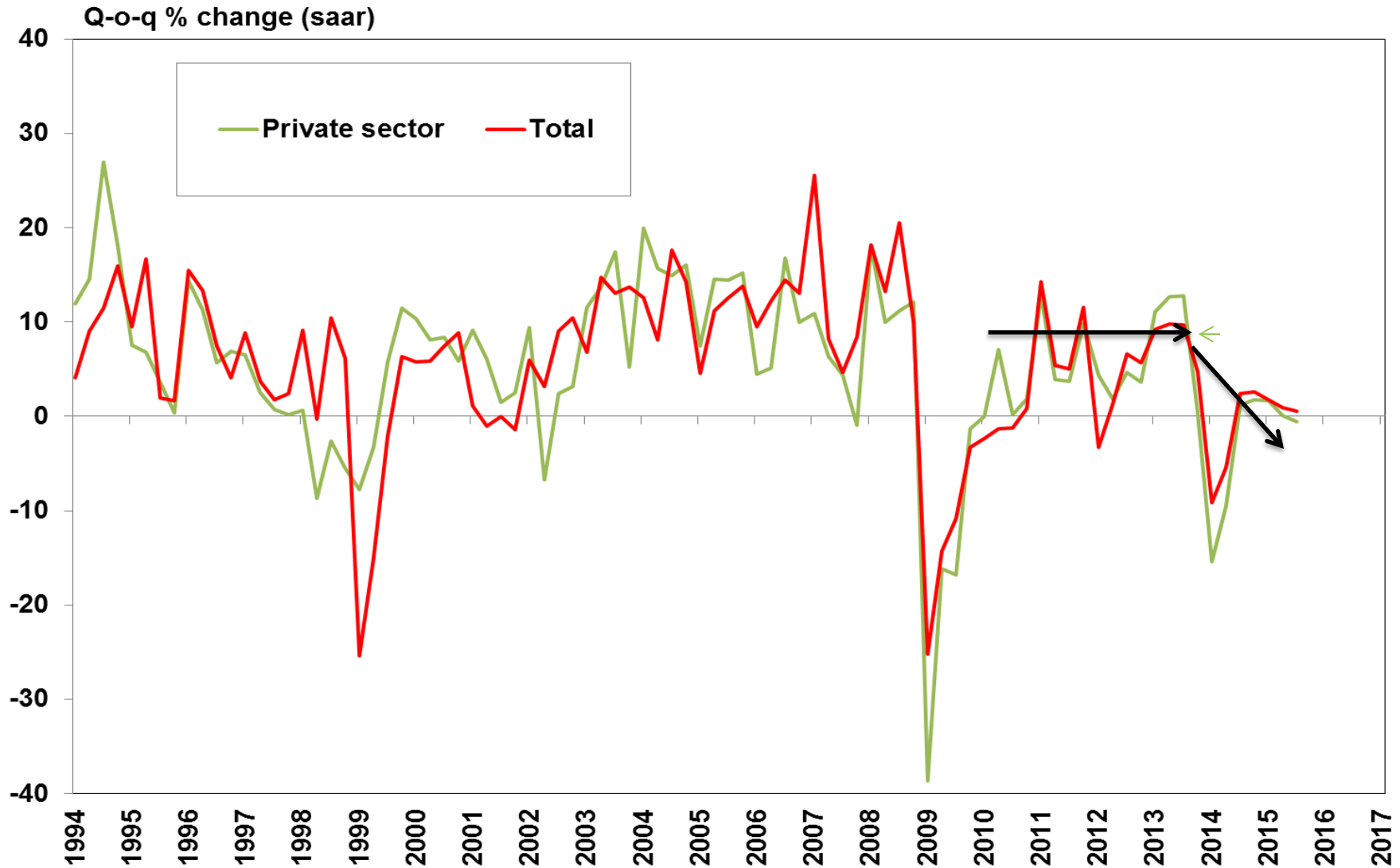


Source: SARB QB December 2015



# Capital expenditure by the private sector has been weak or contracting throughout this cycle

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Source: SARB QB December 2015

# What are the implications of a downgrade to speculative or junk status for SA?

## ■ Capital outflows

- Most foreign funds have rules that prohibit investment in non-investment grade government bonds
- Rand-denominated government bonds totals R2 trillion rand, and global investors hold about 32.4% or around R650bn
- Foreign-currency government debt amounts to about R230bn
- The cost of borrowing to government to government will increase sharply
- Debt service costs will eat up more and more tax revenue, making it very difficult for government to delivery social services and cut the deficit at the same time

## ■ Capital outflows will trigger further rand weakness

- Place pressure on SARB's foreign exchange reserves
- Given a current account deficit of around 4% of GDP, vicious capital outflows may force the country to approach the IMF for assistance

## ■ Inflation will rise sharply

- The SARB will have little option but to increase interest rates. The peak in interest rates can be easily 200-300 basis points higher than it would have been with an investment grade rating

## ■ All these factors together all likely to trigger recession

# National Treasury first wants to fix SOEs & then step up infrastructure spending

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## Public-sector infrastructure expenditure and estimates, 2012/13 – 2018/19

	2015/16		2016/17		2017/18		2018/19		MTEF	% ann avg	% of total
		%		%		%		%			
Energy	69.7	2.7	50.8	-27.1	49.9	-1.8	79.9	60.2	180.7	4.7	20.9
Water and sanitation	35.2	19.4	43.1	22.4	43.1	-0.0	45.9	6.5	132.1	9.2	15.3
Transport and logistics	99.5	9.4	96.2	-3.2	105.3	9.5	90.0	-14.5	291.6	-3.3	33.7
Other economic services	16.6	27.9	17.2	3.8	14.4	-16.0	14.5	0.4	46.2	-4.4	5.3
Health	9.2	17.0	8.8	-4.0	9.4	7.0	9.8	4.4	28.1	2.4	3.2
Education	17.4	12.9	17.7	2.1	17.8	0.3	18.4	3.5	53.9	2.0	6.2
Human settlements <sup>1</sup>	18.3	7.1	18.3	-0.1	21.1	15.2	22.3	5.8	61.6	6.8	7.1
Other social services	16.6	26.4	16.0	-3.9	16.2	1.6	17.0	5.0	49.2	0.8	5.7
Administration services	8.0	52.0	6.6	-17.1	7.6	14.8	7.8	3.4	22.0	-0.5	2.5
<b>Total</b>	<b>290.4</b>	<b>11.7</b>	<b>274.8</b>	<b>-5.4</b>	<b>284.9</b>	<b>3.7</b>	<b>305.8</b>	<b>7.3</b>	<b>865.4</b>	<b>1.7</b>	
National departments	17.3	28.1	19.6	13.4	16.4	-16.3	18.3	11.5	54.3	1.9	6.3
Provincial departments	62.7	11.1	63.6	1.5	69.8	9.8	72.9	4.3	206.3	5.1	23.8
Local government	56.6	6.3	58.2	2.8	57.5	-1.1	59.9	4.1	175.6	1.9	20.3
Public entities <sup>3</sup>	28.7	49.5	26.2	-8.6	29.4	12.0	30.4	3.5	86.0	1.9	9.9
Public-private partnerships	1.7	-1.6	1.9	11.6	2.0	4.6	2.1	3.3	6.1	6.5	0.7
State-owned companies <sup>3</sup>	123.4	6.5	105.2	-14.8	109.7	4.3	122.2	11.4	337.0	-0.3	38.9
<b>Total</b>	<b>290.4</b>	<b>11.7</b>	<b>274.8</b>	<b>-5.4</b>	<b>284.9</b>	<b>3.7</b>	<b>305.8</b>	<b>7.3</b>	<b>865.4</b>	<b>1.7</b>	

1. Human settlements includes public housing to households and bulk infrastructure amounting to R61.6 billion over the MTEF period

2. Administration services include infrastructure spending by the Department of International Relations, the Department of Home Affairs, the Department of Public Works, Statistics South Africa and their entities

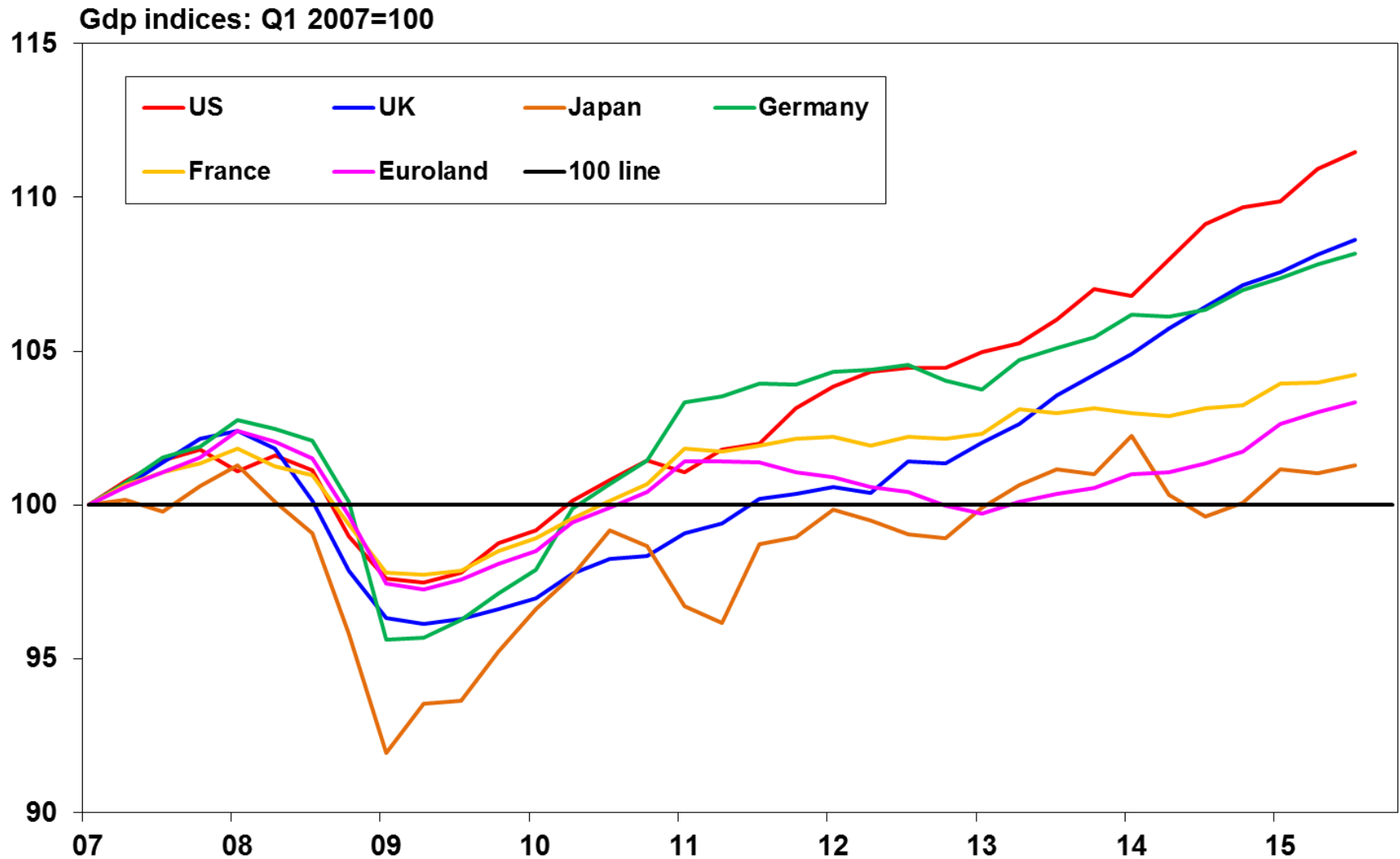
3. Public entities are financed by capital transfers from the fiscus and state-owned companies are financed from a combination of own revenue, borrowings and private funding

Source: National Treasury

**Source: National Budget February 2016**

# The US recovery has outpaced most other major economies

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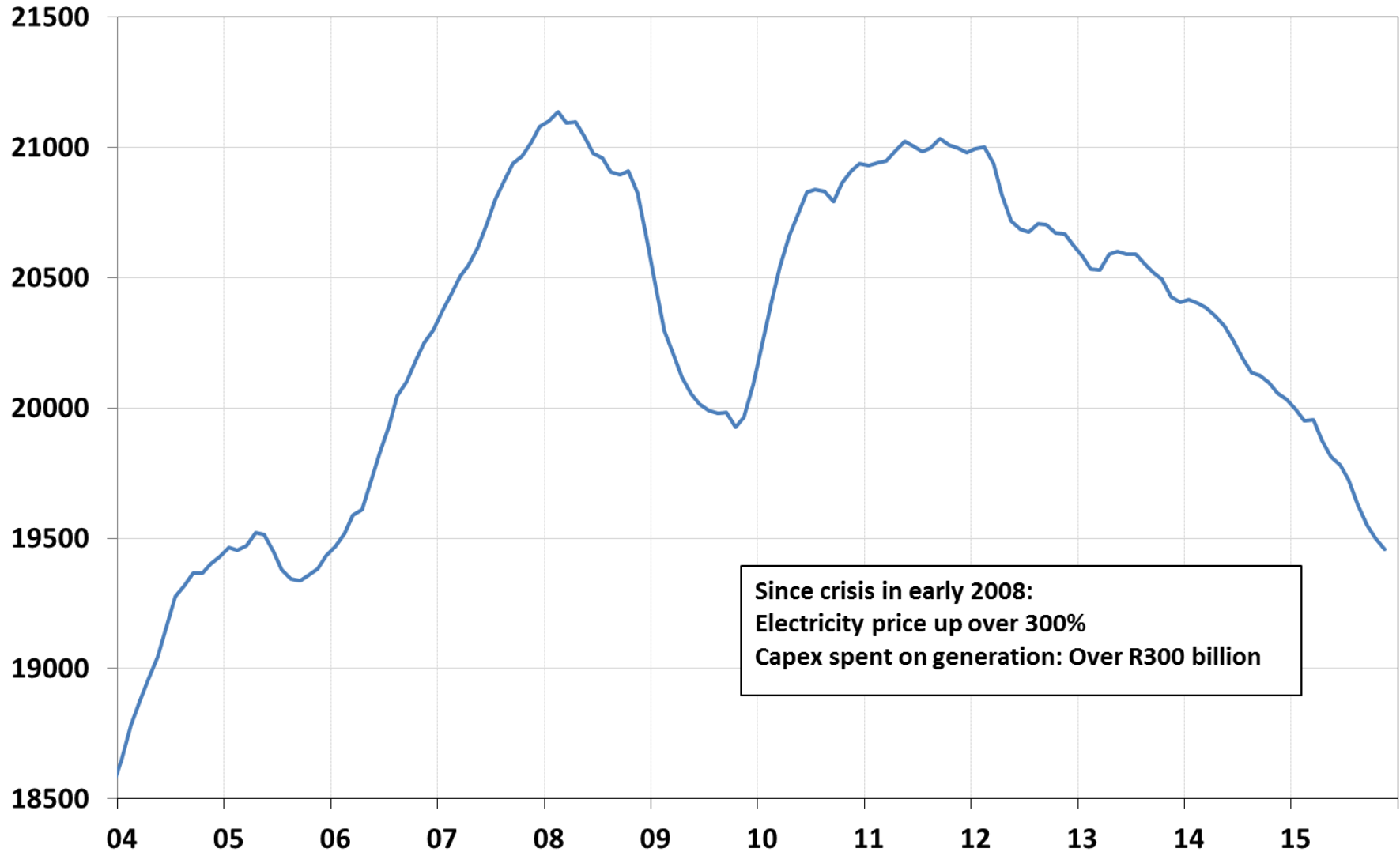
Source: *Thompson Reuters*

# SA now produce less electricity than in 2007

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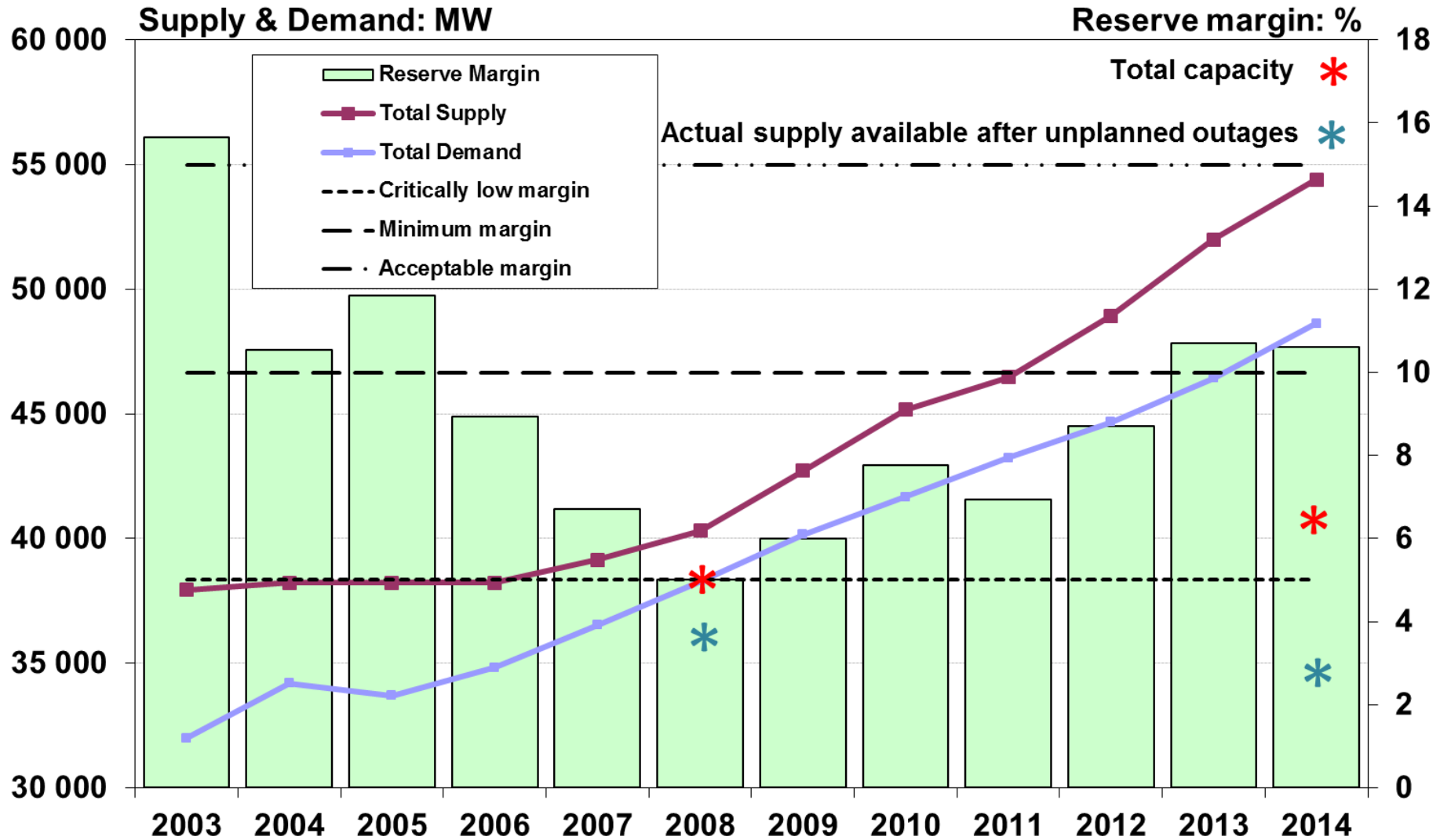
## Electricity produced by Eskom: GWh (12-month moving average)



Since crisis in early 2008:  
Electricity price up over 300%  
Capex spent on generation: Over R300 billion

Source: Statistics SA

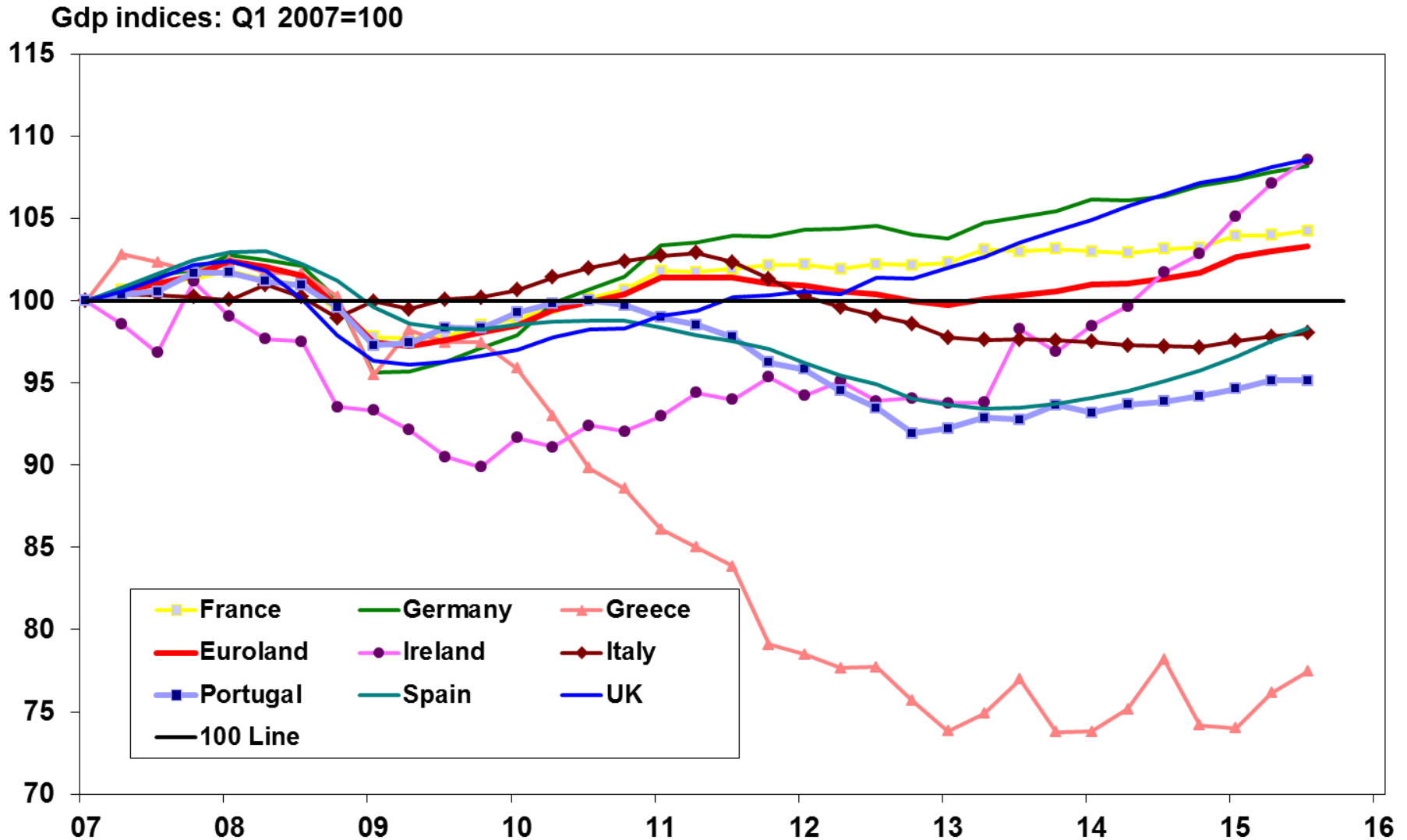
# Unsurprisingly, electricity shortages have hurt both business and consumer confidence



Source: Nedbank calculations

# Although the Eurozone still face considerable obstacles, the region's economy is slowly healing

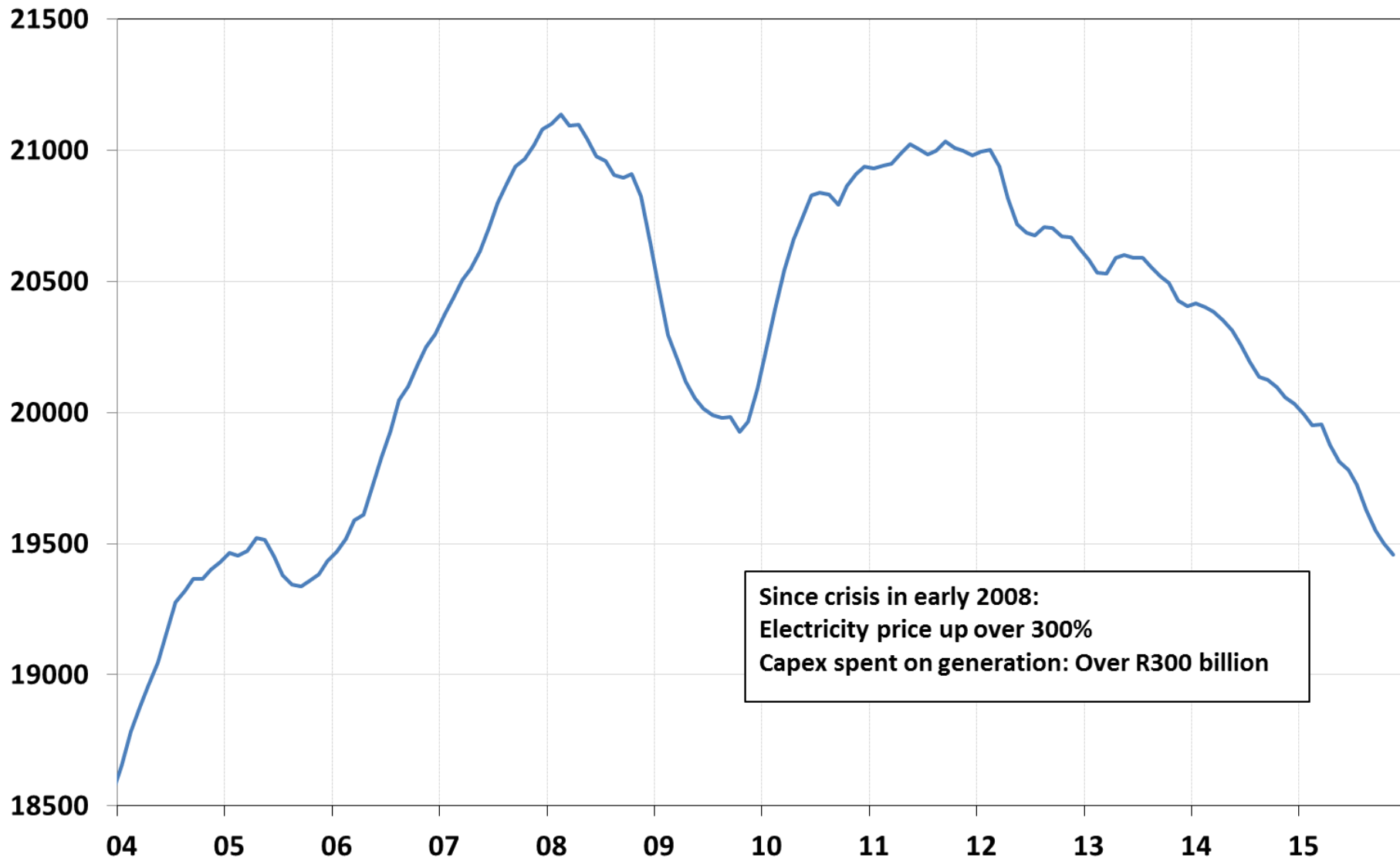
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Source: IMF WEO October 2015

# Despite spending over R300bn on largely two new power plants since 2008 and paying over 300% more for electricity, we produce less than in 2006

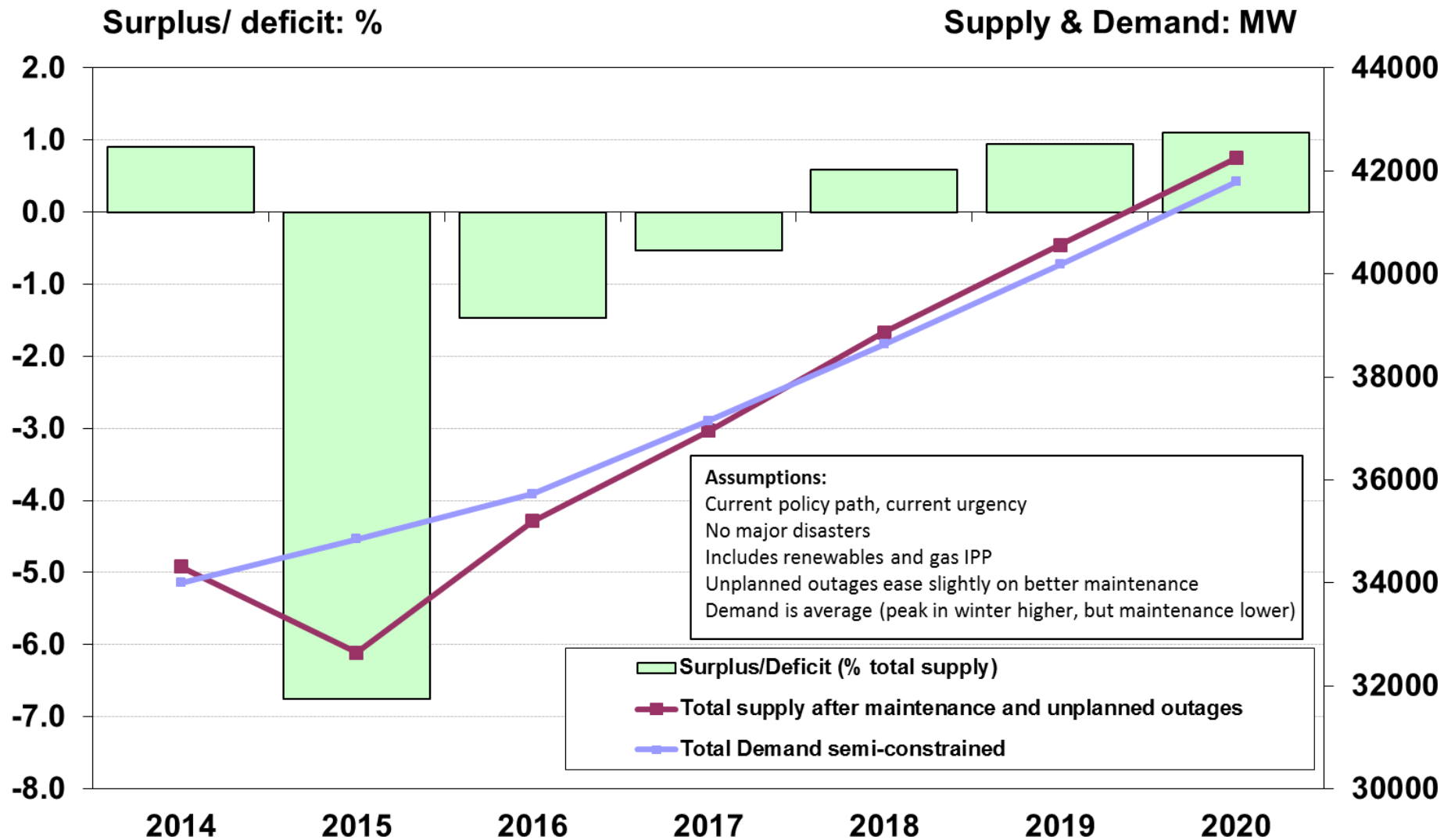
## Electricity produced by Eskom: GWh (12-month moving average)



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# The electricity deficit is likely to persist despite slower growth

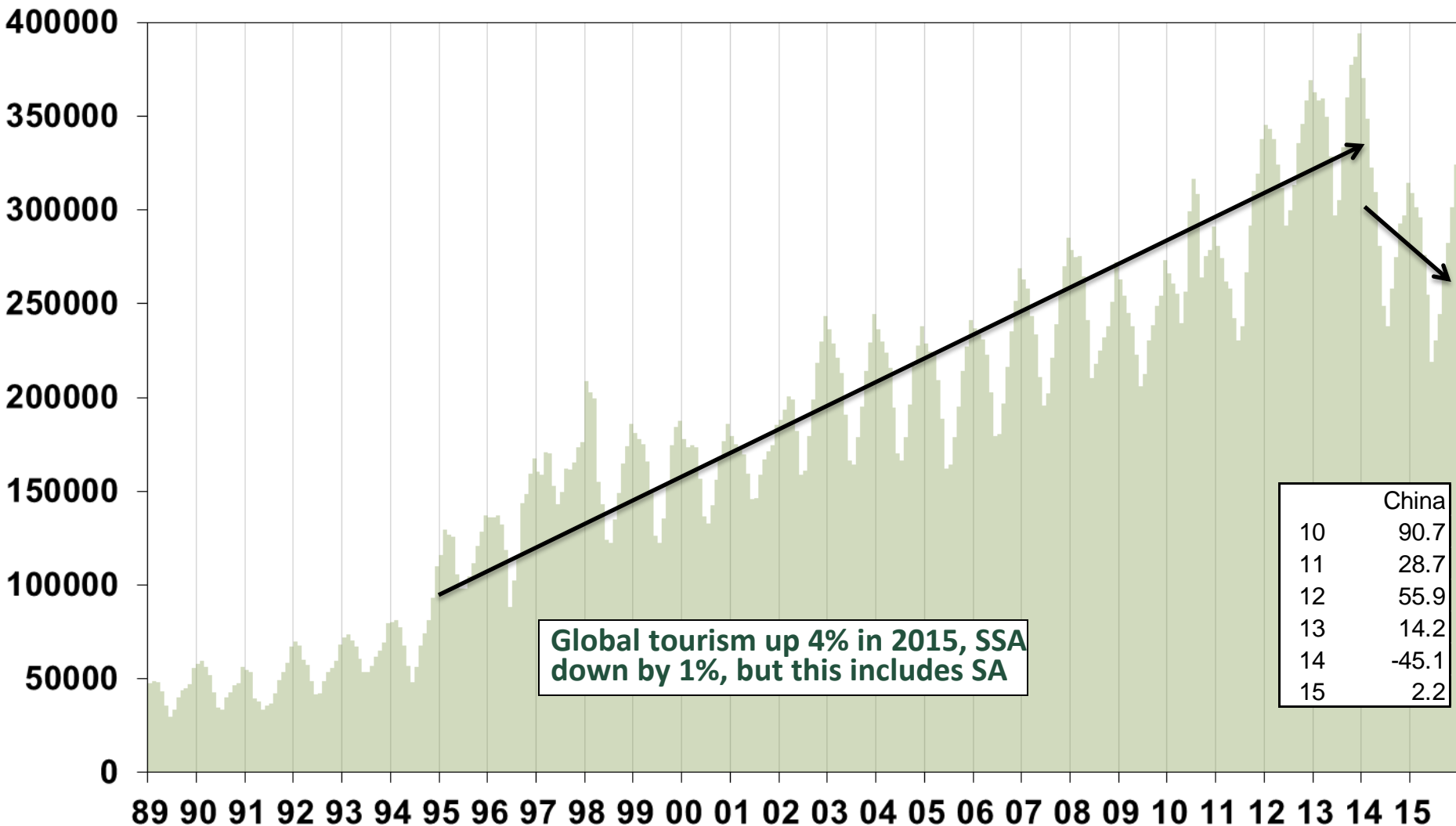


Source: GEU calculations

- **Mounting cost pressures and erosion of global cost competitiveness**
  - Negative relationship between cost and productivity of labour
  - Inadequate and inefficient public services, legislative burden, red tape and corruption
  - Surging costs of utilities and basic economic services – power, transport (road, rail, ports), water, telecommunications
- **Capacity constraints amplifying costs pressures & constraining expansion**
  - Lack of power generating capacity
  - Limited and ageing road, rail and port infrastructure
  - Insufficient social infrastructure – public transport, health, education, water
- **Increased policy uncertainty & political turmoil**

# Legislative and regulatory changes also to blame for weak confidence, weak activity and fading fixed investment... One example: the visa fiasco.

## Foreign arrivals (number 3-month moving average)



From  
concern

To outright  
suspicion

Weak growth

Persistent current  
account deficit

Power & other  
constraints

Abrupt changes in  
finance ministers

Ratings  
downgrades

Uncertain  
economic policies

Mounting  
government debt

## Measurable costs of the fiasco

