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Economics Weekly.

Moody's on SA: effective policy changes necessary to stop sovereign credit profile erosion

Ratings agency Moody's released a credit statement on South Africa, following the outcome of the national elections. The agency highlighted key strengths and vulnerabilities of the country's sovereign credit profile. Importantly, emphasis was placed on how vital the implementation of effective policy change – which would go a long way in halting further erosion of the credit profile – will be.

- The **main challenges** that were highlighted by Moody's include SA's *low growth*, which has been weakened by the deterioration in productivity and investment growth. Over the long term, the agency expects growth to remain constrained (mostly by social and labour market rigidities) and among the lowest in the Baa3-rated sovereigns. Erosion in the government's fiscal strength and the rising *government debt burden* were also highlighted as a credit challenge, with contingent liabilities posing additional risks. Disconcertingly, several factors pose even further upside risk to government debt with the possibility of an increase to over 70% of GDP. These include: persistent spending pressures; poor tax revenue collection in line with slow nominal economic growth; highly leveraged state-owned companies and the increasing exposure of government-guaranteed debt to these entities.
- On the positive side, Moody's identified some **strengths** that are expected to insulate the economy from external financial shocks. The *government's debt maturity and currency structure* were assessed to be favourable for government liquidity risks. In cases where foreign investor demand weakens and yields rise, the *large pool of domestic investors* helps cushion this risk by increasing their investment in government securities. Furthermore, the *economy is well diversified* with well-developed sectors, as well as sound macroeconomic policies. The combination of a *floating exchange rate regime*, mostly rand-denominated external liabilities, as well as the adequate levels of accumulated foreign currency reserves makes SA resilient to external shocks.
- The agency emphasised that the lack of **implementation of effective policies** that can restore fiscal and economic strength would eventually diminish the country's resilience to external shocks. Effective policies would need to target the following areas: raising potential growth primarily through increased productivity, enhanced competition and higher levels of investment; limiting and ultimately reversing the current government debt trajectory; as well as rebuilding the credibility of key governance institutions.

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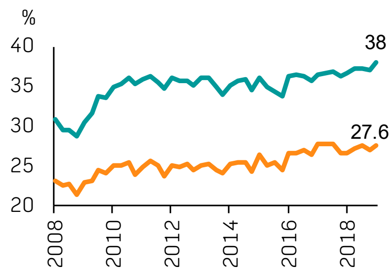
Weekly highlights

Labour market conditions deteriorate

Figure 1: Narrow unemployment rate



Source: EconoStat, Stats SA

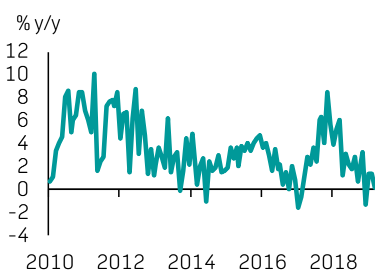
- The Quarterly Labour Force Survey (QLFS) for 1Q19 revealed that the unemployment rate picked up to 27.6% during 1Q19, after falling to 27.1% in 4Q18. This was in line with weak economic data releases during the quarter.

- The formal sector lost 126 000 jobs, while the informal sector shed 68 000. This, combined with decreased employment in agriculture (-12 000) and private households (-31 000), led to a fall of 0.7% q/q in total employment. Discouragingly, the number of unemployed persons increased by 62 000, while the number of discouraged work-seekers also climbed higher.

- At the sectoral level, the biggest declines were seen in construction (-142 000), finance (-94 000), and community and social services (-50 000). Meanwhile, the largest gains were seen in transport (59 000) and trade (25 000). It is worth noting that jobs were shed in all nine provinces, with the most significant losses registered in Limpopo (-75 000), the Eastern Cape (-67 000), KwaZulu-Natal (-50 000) and Mpumalanga (-36 000).

Retail sales soften

Figure 2: Retail sales



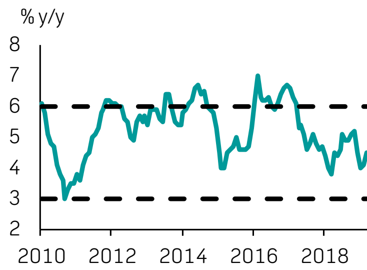
Source: Reuters, Stats SA

- Retail sales for March 2019 recorded muted growth of just 0.2% y/y, from an upwardly revised 1.4% in February (previously 1.1%). This outcome was in line with our expectation, against the backdrop of a 74 c/l increase in the petrol price and slightly higher inflation, which eroded consumers' discretionary income during the month. All but three types of retailers saw a decline in volumes, namely Furniture and appliances retailers (+1.9% y/y); General dealers (+1.8% y/y) and Other retailers (+1.5% y/y). Food and beverages as well as Pharmaceutical retailers were the hardest hit, with volumes declining by 3.6% and 4% y/y respectively in March.
- Seasonally adjusted retail trade sales declined by 0.7% in March compared to February this year, from a slightly upwardly revised uptick of 0.6% m/m (revised from 0.5%) in February. This can be attributed to severe load-shedding in March, which resulted in a loss of tradable hours for retailers and impacted negatively on shopping activity. Worryingly, the March print takes the 1Q19 seasonally adjusted sales volume growth 0.7% below 4Q18 levels, which bodes ill for 1Q19 GDP growth.
- We expect headwinds from the sharp increase in the petrol price since January (a cumulative R2.64/l increase), which has also translated into public transport costs creeping up and further eroding (lower-income) consumers' discretionary income, to have kept shopping activity relatively muted to date. However, the gradually increasing unsecured credit uptake, mainly by higher-income consumers, could provide auxiliary support to retail sales volumes in the coming months. Further support may also stem from the anticipated transitory improvement in sentiment post elections.

Week ahead

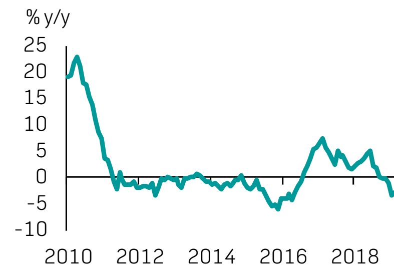
Growth expectations, inflation and MPC in focus

Figure 3: CPI



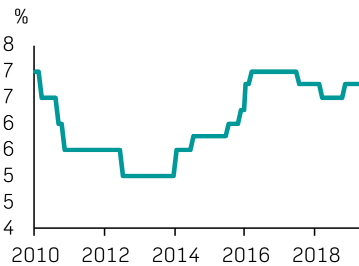
Source: Reuters, Stats SA

Figure 4: SARB leading indicator



Source: SARB

Figure 5: Repo rate



Source: Reuters, SARB

Next week will see the release of the March SARB leading indicator on Tuesday, followed by April inflation data on Wednesday, and the SARB MPC meeting on Thursday.

The SARB leading indicator has contracted for five consecutive months – the longest streak since early 2016. We expect another subdued print in the March release, which would corroborate our lacklustre 2019 full-year GDP forecast of 0.9%.

We anticipate the April inflation print to edge up 0.1 of a percentage point to 4.6% y/y. Much of the upward pressure will likely stem from the R1.31/l petrol price increase. We anticipate core inflation (excluding volatile food and non-alcoholic beverages, petrol and energy subcomponents) to register a relatively low 4.1% y/y in April as retailers struggle to pass on higher costs to the consumer amid a deterioration in household balance sheets.

On the back of muted expectations for inflation, we expect the SARB MPC to keep the repo rate unchanged at 6.75%. We anticipate that the SARB will lower their inflation forecasts closer to our projections amid a widening output gap, keeping core inflationary pressures well contained. As such, we expect a more dovish tilt in the Governor's statement.

Tables

The key data in review

Date	Country	Release/Event	Period	Act	Prev
10 May	US	CPI (% y/y)	Apr	2.0	1.9
14 May	Eurozone	Industrial production (% m/m)	Mar	-0.3	-0.1
	SA	Unemployment (%)	1Q19	27.6	27.1
15 May	SA	Retail sales (% y/y)	Mar	0.2	1.4
	China	Industrial output (% y/y)	Apr	5.4	8.5
	US	Industrial output (% m/m)	Apr	-0.5	0.2

Data to watch out for this week

Date	Country	Release/Event	Period	Survey	Prev
17 May	Eurozone	CPI (% y/y)	Apr	1.7	1.7
20 May	Japan	GDP (% q/q annualised)	1Q19	-0.2	1.9
21 May	SA	SARB leading indicator	Mar	-	104.9
	US	Existing home sales (% m/m)	Apr	2.6	-4.9
22 May	SA	CPI (% y/y)	Apr	4.6	4.5
	UK	CPI (% y/y)	Apr	2.2	1.9

Source: Bloomberg ("Survey" is the consensus forecast)

Financial market indicators

Indicator	Close	1 W	1 M	1 Y
All Share	56 537.72	0.1%	-1.1%	-3.6%
USD/ZAR	14.29	-0.4%	0.6%	14.9%
EUR/ZAR	15.97	-0.7%	0.3%	8.8%
GBP/ZAR	18.29	-2.0%	-2.0%	9.0%
Platinum US$/oz	834.32	-1.7%	-2.0%	-6.5%
Gold US$/oz	1 286.72	0.2%	-0.4%	-0.3%
Brent US$/oz	72.62	3.2%	4.7%	-8.4%
SA 10-year bond yield	8.43	-1.3%	-0.9%	-0.4%

FNB SA Economic Forecast

Economic Indicator	2016	2017	2018	2019f	2020f	2021f
Household consumption expenditure %y/y	0.6	2.1	1.8	1.5	1.6	1.8
Government consumption expenditure %y/y	2.2	0.2	1.9	0.4	1.1	1.2
Gross fixed capital formation %y/y	-3.5	1	-1.4	0.2	0.5	1.1
Real GDP %y/y	0.4	1.4	0.7	0.9	1.2	1.2
Total exports %y/y	0.4	-0.7	2.6	2.2	1.4	1.8
Total imports %y/y	-3.9	1	3.3	2.1	2.2	2.4
Current account (% of GDP)	-2.8	-2.5	-3.5	-3.4	-3.6	-3.7
CPI (average) %y/y	6.3	5.3	4.6	4.7	4.9	4.9
CPI (year end) %y/y	6.7	4.7	4.5	5.1	4.7	4.9
Repo rate (year end) %p.a.	7	6.75	6.75	6.75	6.75	6.75
Prime (year end) %p.a.	10.5	10.25	10.25	10.25	10.25	10.25
USD/ZAR (average)	14.7	13.3	13.3	14.1	14.8	15.6

Source: FNB

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