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Economics WEEKLY

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Content

Highlights

- **SA**: The economic outlook since the delivery of the Budget review early this year has been more disappointing than the National Treasury (NT) had anticipated. NT now expects GDP to slow to 0.5% in 2016, down from 0.9% previously.
- **SSA**: The Central Bank of Mozambique hiked the repo rate by an astonishing 600 bps to 23.25%. This is the fifth rate hike this year and puts the year-to-date increase up 1350bps.
- **Global**: Japan recorded a trade surplus of JPY 498.3 billion in September, however, headline inflation remained unchanged at -0.5% y/y. US durable goods orders contracted 0.1% m/m in September; and lastly, China's property market continues to surge as housing prices of newly built homes accelerated 11.2% y/y in September compared to 9.2% in August.

The key data in review

Date	Country	Release/event	Period	Actual	Prior
Oct 21	China	Newly built housing prices (% y/y)	Sep	11.2	9.2
Oct 24	Japan	Trade balance (JPY billion)	Sep	498.3	-19.2
Oct 25	SA	Leading Indicator	Aug	93.3	91.9
Oct 26	SA	Net loan debt (% of GDP)	16/17	45.8	44.2
	SA	Budget balance (% of GDP)	16/17	-3.4	-3.7
Oct 27	SA	PPI (% y/y)	Sep	6.6	7.2
	US	Durable goods orders (% m/m)	Sep	-0.1	0.3
Oct 28	Japan	CPI (% y/y)	Sep	-0.5	-0.5

Financial Market Indicators	Close	1-week	1-month	1 Year
All Share	51139.66	-0.5%	-1.1%	-2.3%
USD/ZAR	13.86	0.5%	-3.1%	-1.0%
EUR/ZAR	15.11	0.8%	-0.2%	-0.9%
GBP/ZAR	16.87	1.2%	3.6%	19.4%
Platinum US$/oz	965.00	3.2%	-6.2%	-3.6%
Gold US$/oz	1265.70	0.2%	-4.1%	9.5%
Brent US$/oz	52.51	2.2%	5.4%	7.0%
SA 10 year bond yield	8.91	0.15	0.27	0.71

Source: I-Net, FNB (data as at Thursday's close)

South African Economy

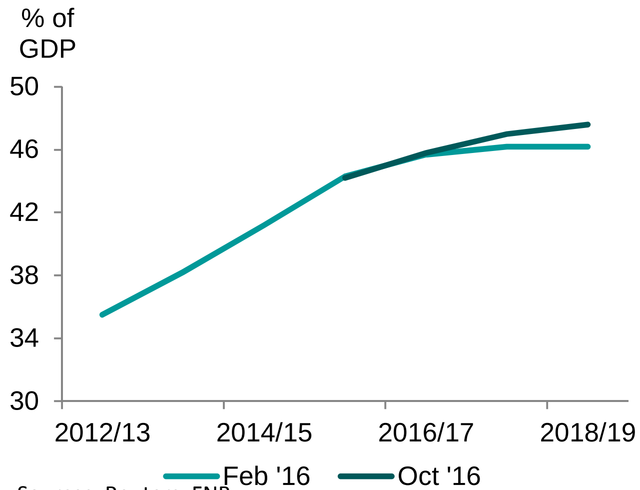
Attention fell on the delivery of the MTBPS this week. In our assessment the additional consolidation measures announced in the MTBPS provide further evidence of a strong commitment to reduce the fiscal deficit and stabilize debt. However, fiscal consolidation is only part of the problem. Growth initiatives that generates tax resources, rendering the fiscal adjustment process less painful and more sustainable, were lacking. Further, there is nothing in the MTBPS that suggests we should revise up our admittedly low medium term growth expectations.

The economic outlook since the delivery of the Budget review early this year has been more disappointing than the National Treasury had anticipated. NT now expects GDP to slow to 0.5% in 2016 down from 0.9% previously. GDP Growth in the outer-years of the three year budget cycle has also been downwardly revised and is expected to increase to 2.2% in 2019, supported by improved electricity supply, labour relations and business confidence.

The unfavourable economic outlook has not swayed government from its fiscal consolidation path. While the pace of consolidation may not be as fast as initially proposed, the government warns that aggressive fiscal consolidation raises the possibility of a low growth trap. The measured consolidation proposed by NT includes further reductions to the expenditure ceiling. Spending is expected to be reduced by a further R26 billion in 2017/18 and 2018/19. Tax measures are expected to add R13 billion to 2017/18 revenue and yield total revenue increases of R43billion over the next two years. These efforts are expected to help reduce the consolidated budget deficit from 3.4% of GDP in 2016/17 to 2.5% in 2019/20. However, slower economic growth inhibits a faster reduction in the debt to GDP ratio. National debt is now expected to stabilise at 47.9% of GDP in 2019/20 slightly higher than the 46.2% projected in February, reflecting lower GDP growth, higher borrowing costs and currency depreciation. The primary deficit is expected to continue to narrow and record a surplus next year. *Please see the MTBPS review on https://blog.fnb.co.za/2016/10/mtbps-2016/*

The **producer price index** (PPI) for manufactured goods rose 6.6% y/y in September from 7.2% in August, recording the lowest reading since May this year. The deceleration in transport equipment (2.9% y/y from 5% in August), metals, machinery, equipment and computing equipment (6.3% y/y from 7%) and persistent decline in coal and petroleum products (-1.7% y/y in September) all contributed to the downturn in the headline reading. Even though food inflation eased slightly to 13.1% y/y in September from 13.4% the month before, it remains stubbornly high. However, with the rains we have had recently, and more rainfall expected this year, crop yields should be higher next year pushing down food prices significantly.

Figure 1: Net government debt % of GDP



Sources: Reuters, FNB

Figure 2: PPI for manufactured goods

Sub-Saharan Africa

In September, the International Monetary Fund (IMF) called for another rate hike in Mozambique to stabilise both inflation and a depreciating currency. Correspondingly, Mozambique appointed an IMF official, Rogerio Zandamela, as the new Central Bank Governor. In October, the IMF's request for another rate hike was fulfilled as the **Central Bank of Mozambique hiked the repo rate** by an astonishing 600 bps to 23.25%. This is the fifth rate hike this year and puts the year-to-date increase up 1350bps. A number of additional monetary policy measures were taken: the Central Bank deposit rate also moved up 600 bps to 16.25%; the cash reserve requirement increased in local currency terms from 13% to 15.5%; and the cash reserve requirement in foreign currency terms edged up 0.5% to 15.5%. The changes in the cash reserve requirement ratios take effect from 22 November; however, all other amendments have taken place effective immediately. In an attempt to increase transparency, the Central Bank of Mozambique also requires commercial banks to report their foreign exchange rates three times a day from once previously. The repo window has also been shortened to twice a week compared to every working day previously.

The Mozambique Central Bank Governor took a rather hawkish stance on recent monetary policy proceedings stating that this is "the minimum we could do" and that negative real interest rates could have "serious implications for financial intermediation." However, real rates are still negative. With this in mind and with rising levels of inflation, we have penciled in one more rate hike of 200bps with inflation expected to peak in November.

The Namibian budget review shows insufficient levels of frugality despite deeper fiscal consolidation measures culminating in the suspension of N$5.5bn in expenditure. The sharp downward revisions for the 2016 outlook attests to business revenue slowing down. In lieu of this, new tax streams have been proposed for the next fiscal year to lift the revenue line over the MTEF period. These include a more definitive stance on the much debated presumptive tax and the redesign of the Solidarity Wealth tax into a high income based wealth tax - signaling a more redistributive tax system to narrow the gap between the wealthy few and the poor majority. There was a broad based reduction in government expenditure during the first half of the fiscal year. Tighter spending rules and aggressive cost containment were responsible for most of the under expenditure. Government revenues were revised downwards by 11.1% to N$51.5bn (previously N$57.9bn) due to a slowdown in economic activity impacting the various tax streams. Despite deep expenditure cuts to realign expenditure to revenue realities, the budget falls short of its fiscal consolidation promise.

Figure 3: Mozambique policy rate

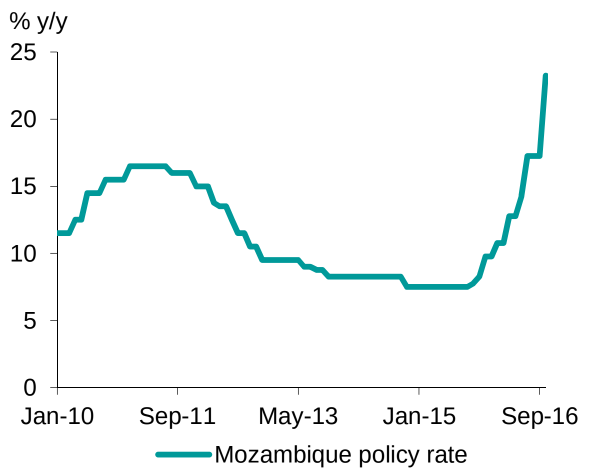
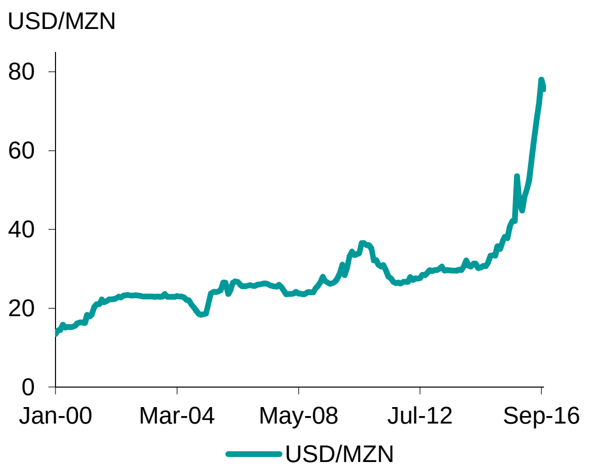


Figure 4: USD/MZN



Sources: Reuters, FNB

Global Snapshot

Japan recorded a **trade surplus** of JPY 498.3 billion in September from a deficit of JPY 19.2 billion in August. Japan's trade openness remained subdued as exports (-6.9% y/y) and imports (-16.3% y/y) continued to fall. Exports of manufactured goods (-13.3% y/y), electrical machinery (-9.9% y/y) and transport equipment (-6% y/y) were amongst the largest contributors to the downfall—broadly in line with subdued manufacturing PMI readings this year. A downturn in mineral fuels (-33.6% y/y), clothing and accessories (-20.9% y/y) and electrical machinery (-11% y/y) were the main culprits dragging down overall imports. It is likely that the trend of a decline in openness will continue on the back of weak domestic spending and lower global growth.

Japan headline inflation remained unchanged at -0.5% y/y in September. Inflation has remained in contractionary territory since February this year as weak consumer spending drives down inflation. However, recent unorthodox monetary policy measures, i.e. controlling the yield curve to incentivise bank lending, will likely take time to filter through to higher prices.

China's property market continues to surge as housing prices of newly built homes accelerated 11.2% y/y in September compared to 9.2% in August. To curb the exorbitant price increases we have seen recently, tighter home purchasing criteria have been instituted at the beginning of this month. This should see housing prices taper in the short to medium term, and closely linked segments such as building materials will likely drop off. The expected downturn in real estate investment and closely linked sectors will act as a drag on GDP growth; although significant evidence of a transition to a services-led economy should ease some of these concerns.

US durable goods orders contracted 0.1% m/m in September from an increase of 0.3% the month before. This was led by to a downturn in computers and electronic products (-1% m/m) and fabricated metal products (-0.4% m/m) as well as a dip in the volatile transport category (-0.8% m/m). However, new machinery orders (+1.2% m/m), electrical equipment, appliances, and components (+1.5% m/m) and other durable goods (0.7% m/m) provided some upward momentum. Nondefense capital goods excluding aircrafts—a proxy for business investment—shrunk 1.2% in September after expanding significantly in recent months. Future data releases are likely to be volatile as the manufacturing sector struggles to recover on the back of a global slowdown in economic activity, a strong dollar and underinvestment in the energy sector.

Figure 5: China newly built housing prices

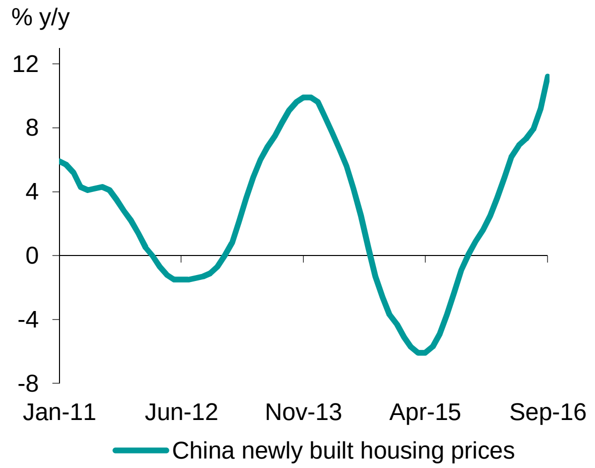
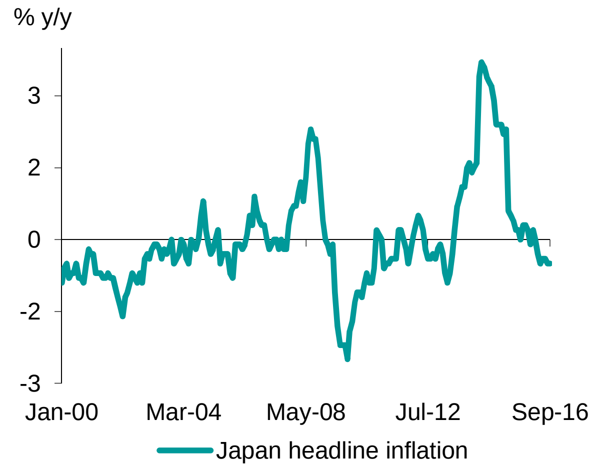


Figure 6: Japan headline inflation



Sources: Reuters DataStream, FNB

The Week Ahead

Local / Light on data

The week ahead is fairly light on macroeconomic data. The few data points expected for the week ahead will likely confirm that economic activity remains weak. The persistent weakness of the Barclays PMI leading indicator suggests that output in the manufacturing sector should remain muted, as such we do not anticipate much of an improvement in the overall index in October. We doubt business activity and sales orders will show much of an improvement given the bearish economic outlook. Trade statistics should show a narrower deficit, following the large negative surprise in (-R8.6bn) recorded in August. This will roundup third quarter data and give an indication on whether progress has been made in narrowing the current account deficit. On PSCE, corporates remain the main driver behind growth in aggregate credit demand, while higher debt levels, stricter lending criteria and rising service costs continue to weigh on household credit growth. We do, however, expect the pace of acceleration in corporate credit demand to moderate somewhat. The persistent decline in vehicle sales should have continued in October. Finally, expect approximately a 60 cents increase in fuel prices next week.

Data to watch out for next week…

Date	Country	Release/event	Period	Survey	Prior
Oct 28	SA	Budget balance (rand billion)	Sep	-	-16.68
Oct 31	SA	Private sector credit (% y/y)	Sep	5.94	6.15
	SA	Trade balance (rand billion)	Sep	-	-8.6
Nov 1	SA	Barclays Manufacturing PMI	Oct	-	49.5
	SA	Naamsa Vehicle Sales (% y/y)	Oct	-	-14.3
	China	NBS manufacturing PMI	Oct	50.3	50.4
	UK	Markit manufacturing PMI	Oct	54.4	55.4
	US	ISM manufacturing PMI	Oct	51.5	51.5
Nov 2	Eurozone	Markit manufacturing PMI	Oct	53.3	53.3
	US	FOMC rate announcement	Nov	0.5	0.5
Nov 3	UK	Bank of England rate decision	Nov	0.25	0.25

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

FNB SA Economic Forecasts

Economic Indicator	2013	2014	2015	2016f	2017f	2018f
Household consumption expenditure %y/y	2.0	0.7	1.7	0.2	1.1	1.1
Government consumption expenditure %y/y	3.5	1.8	0.2	0.8	1.0	1.3
Gross fixed capital formation %y/y	7.0	1.5	2.5	-2.2	-1.1	1.1
Real GDP %y/y	2.3	1.6	1.3	0.2	1.0	1.6
Total exports %y/y	3.6	3.3	4.1	2.0	2.2	2.9
Total Imports %y/y	5.0	-0.5	5.3	0.5	1.3	2.2
Current account (% of GDP)	-5.9	-5.3	-4.3	-4.0	-3.1	-2.7
CPI (average) %y/y	5.8	6.1	4.6	6.2	5.5	5.3
CPI (year end) %y/y	5.4	5.3	5.2	7.1	5.6	5.3
Repo rate (year end) %p.a.	5.0	5.75	6.25	7.00	7.00	7.00
Prime (year end) %p.a.	8.5	9.25	9.75	10.25	10.25	10.25
USD/ZAR (average)	9.6	10.8	12.8	15.4	15.6	16.1

Source: FNB

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