IMARA
Asset Management SA

Communiqué

Monthly
South Africa
March 2018

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The Domino Effect

Local

We had a feeling that following the ousting of Robert Mugabe more changes were to come.

The appointment of Cyril Ramaphosa as president of the ANC and the country works as a self-fulfilling prophecy, further aided by his comments in Davos.

Cyril Ramaphosa needed to seize the moment and purge the cabinet which to some extent he has done following a Cabinet reshuffle. He has appointed a compromise Cabinet to lead the government into the 2019 election. To appease a deeply divided ANC, he appointed a mixed bag of ministers from two main factions within the party. Nhlanhla Nene and Pravin Gordhan both made comebacks as finance and public enterprise ministers respectively. A further positive is the replacement of mineral resources minister Mosebenzi Zwane with ANC Chairman Gwede Mantashe.

Hopefully, this could lead to the binning of the mining charter and the expensive nuclear power plans that SA cannot afford and reform the rigid SA labour market. It should bolster the growth outlook on better business confidence (boost taxes revenues/reduce unemployment), with a modest recovery already under way. Sharply lower bond yields following the changes will reduce the servicing cost of government debt, especially foreign denominated and inflation linked bonds. We assume a positive effect of 50bps on real GDP growth and a structural reduction of 100bp in local interest rates in due course.

We expect Moody's SA credit rating to be left unchanged for the moment to provide the new leadership the opportunity to reform and business confidence to pick up. Moody's stated recently that it is closely monitoring the developments in SA with a focus on the policy implications of the leadership change, the response to the economic and fiscal challenges, as well as the progress in implementing reforms.

Moreover, Moody's has said that SA has made a number of credit positive strides since December 2017, and the recent Budget, on its own does not necessarily argue for a credit rating downgrade. Certain components of the Budget are credit positive, especially the marked decline in projected borrowings with the primary balance expected to move into a surplus in 2019 and the current account deficit to trend towards 0%.

In order to narrow the budget deficit and stabilise debt growth, the ministry proposed to raise an additional R36billion in revenue in the coming year which along with expenditure cuts will reduce the budget deficit and provide funding for free education for the poor and working-class students.

The 1% increase in VAT will increase the cost of living for South Africans, and economists (Investec) estimate a rise of at least 0.1% in CPI inflation over the next three quarters of this year although the strength in the rand, following the election and budget, could provide a substantial buffer to the potential rise in inflation

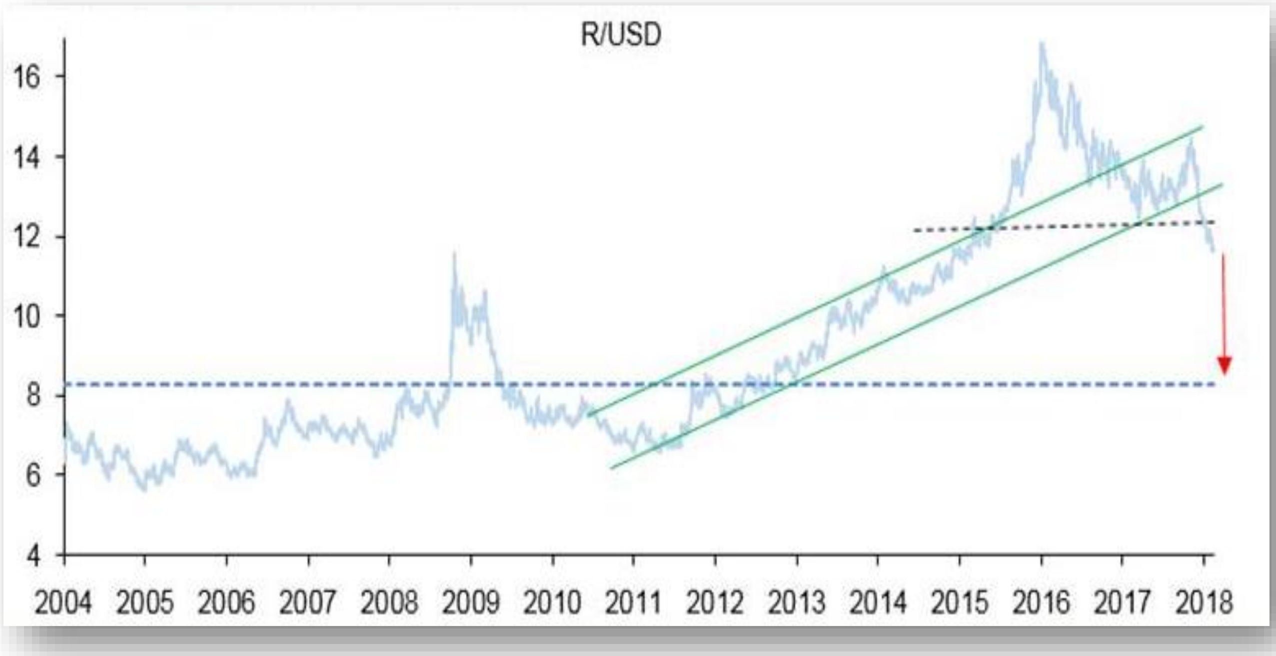
Personal income taxes were left unchanged but bracket creep will be inevitable while estate duty was raised for estates worth more than R30m.

The significant change the country has experienced and swift action by Cyril Ramaphosa to root out corruption have been very positive for the rand. This has also supported renewed interest in our bond and equity markets with most publications now stating that SA is the preferred emerging market destination for foreign investors.

The rand has recouped its losses following the Nenegate saga in December 2015 but has yet to fully recoup the losses of the past. The most recent lengthy crisis of investor confidence for South Africa was domestic, and stretched from 2009 to recently, displayed by the depressed levels of business sentiment. The deterioration of key institutional strengths under Jacob Zuma during the period caused a weakening of the rand, which exacerbated in the lead up to Nenegate and Nenegate itself.

Moreover, the one directional bet on the currency has been broken convincingly of late with the new leadership expected to deliver free market reforms and a supportive economic environment for the private sector which bodes well for an acceleration in GDP growth.

Rand Dollar exchange rate



Source: Investec Bank

We expect the rand to benefit from global support until meaningful signs of data deterioration become evident. South African Q3 '17 GDP confirmed that SA growth has turned positive, and that a cyclical recovery is currently underway. In 2018/19, this acceleration will receive further support from increased confidence driving higher consumer spending and private investment. Growth for 2018 has been revised to 1.4% from 0.9% previously following the changes in the political landscape and the favourable global economic backdrop.

SA Economic Forecasts

Overview	Actual	Q1/18	Q2/18	Q3/18	Q4/18	2020	
GDP Growth Rate	2.00	1.1	1.1	2.7	1.9	2.1	percent
Unemployment Rate	26.70	28	27.8	26.6	26	24	percent
Inflation Rate	4.40	4.6	4.9	5.2	5	5.1	percent
Interest Rate	6.75	6.5	6.5	6.5	6.75	7	percent
Balance of Trade	15720.00	9381	5927	3904	472	-1700	ZAR Million
Government Debt to GDP	51.60	54	54	54	54	53	percent

Source: Tradingeconomics

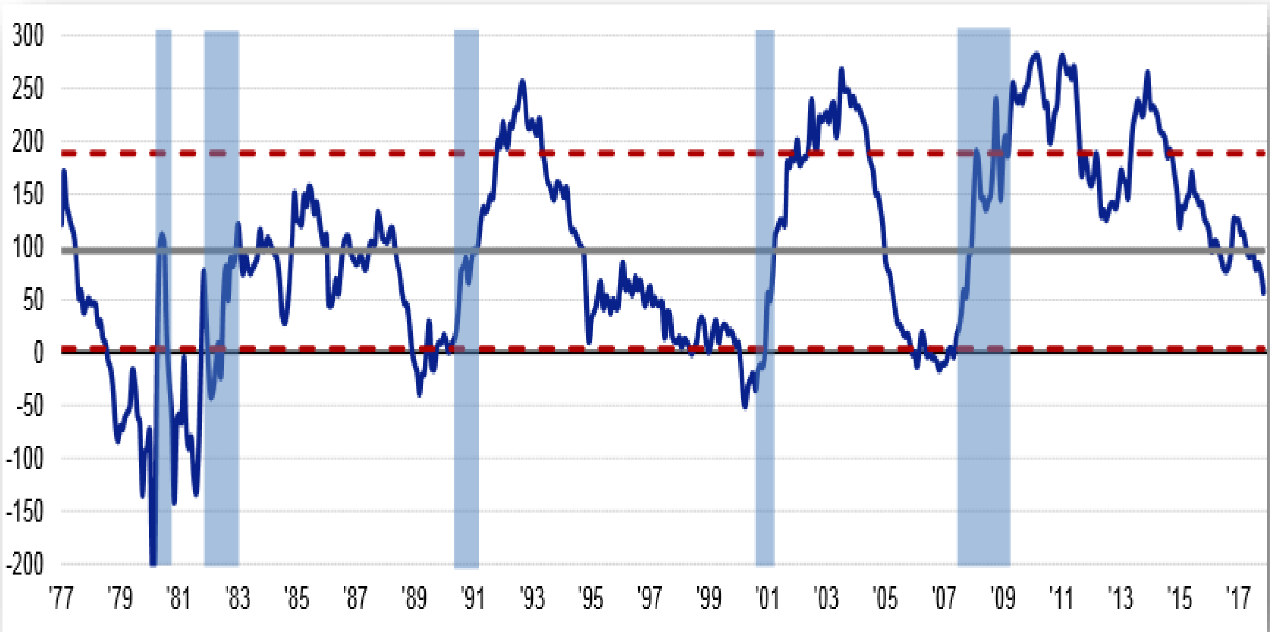
Global growth momentum has carried through into early 2018 and will likely continue to support emerging market economies. Current data is supportive of EM asset returns. Similarly, to 2017, we could see impressive returns in EMs this year, following half a decade of underperformance. However, the key risks of slowing credit growth in China and accelerating inflation in the US remain and could potentially drive a shift in favour of developed markets later in the year in the event of the US hiking interest rates more aggressively than expected.

Global

Developed market bond yields will likely be stuck in a lower for longer range due to secular disinflationary factors such as an aging population and a global economy characterised by excess savings and excess production capacity. However, certain cyclical forces may well move yields temporarily higher such as negative surprises in inflationary expectations. We anticipate that the US yield curve will continue to slowly flatten (short term rates to rise) to reflect a maturing economic cycle. A slowly flattening US yield curve should allow EM assets to continue to outperform.

The yield curve spread in the US, indicated below, indicates that the recovery in the US economy has been underway since 2015. Growth and recession cycles typically last four years in the absence of unique events such as the financial crises and quantitative easing.

US yield curve spread – recession periods marked as blue



Source: Avior Capital Markets

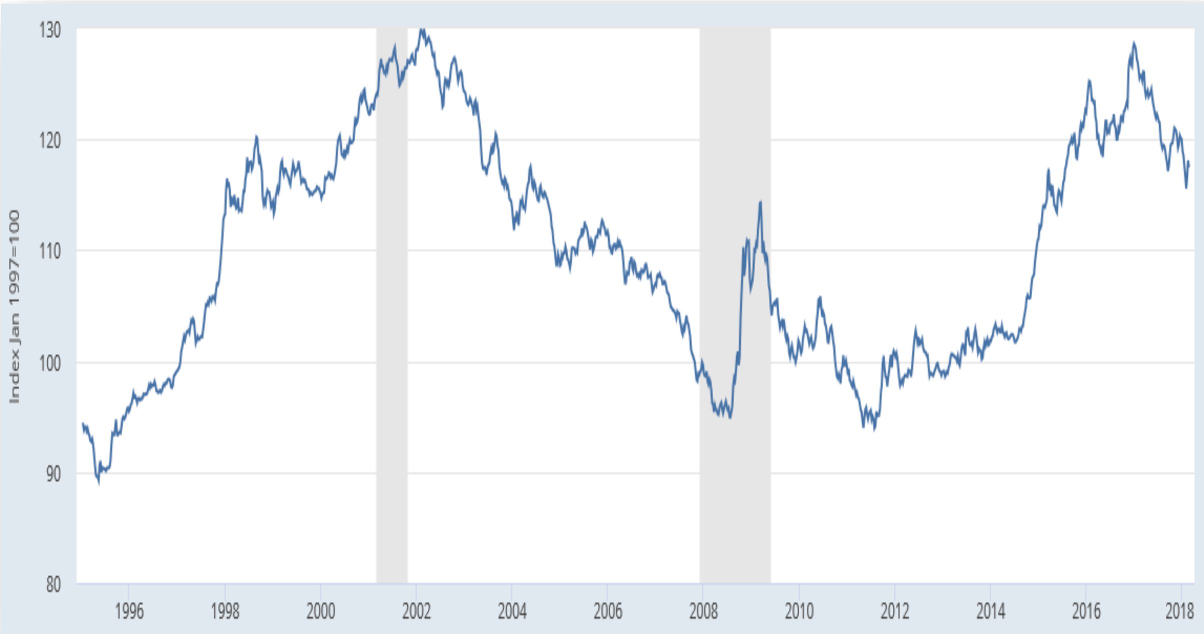
As developed market economic expansion ages, expectations of the trajectories of GDP growth and inflation usually decline due to the anticipation of a looming economic contraction. This is of course in normal economic cycle sans any fiscal or other economic stimulus such as QE. The expected path of deposit rates (short term rates) will become flatter as fewer hikes will be expected from the current interest rate level. If markets expect the central bank to keep rates exactly where they are indefinitely, then there ought to be an upward slope in the yield curve which could become inverted which in turn implies that the FED (or other central banks) is expected to cut interest rate to avert a recession. Yield curve inversion has historically been highly successful in predicting GDP contractions. But, we are not there yet as the current economic expansion is set to continue over the medium term.

ALL	Gross domestic product, % change on a year ago				Industrial production, % change on a year ago	Consumer prices % change on a year ago			Unemployment rate, %
Country	latest	quarter*	2017*	2018*	latest	latest	year ago	2017*	latest
Italy	+1.6 Q4	+1.2	+1.5	+1.5	+4.9 Dec	+0.9 Jan	+1.0	+1.3	10.8 Dec
Latvia	+4.2 Q4	-2.3	+5.1	+3.1	+5.5 Dec	+2.0 Jan	+2.9	+2.9	8.1 Q4*
Lithuania	+3.9 Q4	+6.0	+3.5	+3.4	+7.5 Jan	+4.0 Jan	+2.3	+3.6	9.0 Jan*
Luxembourg	+3.2 Q3	+6.8	+3.0	+3.4	-2.3 Dec	+1.1 Jan	+1.7	+2.1	6.0 Jan*
Netherlands	+2.9 Q4	+3.2	+3.2	+2.8	+5.2 Dec	+1.5 Jan	+1.7	+1.3	5.2 Jan
Portugal	+2.4 Q4	+2.8	+2.6	+2.1	+1.2 Dec	+1.0 Jan	+1.3	+1.6	8.1 Q4*
Slovakia	+3.5 Q4	+5.5	+3.4	+3.7	-1.0 Dec	+2.4 Jan	+0.7	+1.4	5.9 Jan*
Slovenia	+4.5 Q3	*na*	+5.0	+3.7	+5.8 Dec	+1.5 Jan	+1.3	+1.6	9.0 Dec*
Spain	+3.1 Q4	+2.8	+3.1	+2.7	+2.8 Dec	+1.0 Feb	+3.0	+2.0	16.4 Dec
Czech Republic	+4.7 Q3	+2.0	+4.5	+3.3	+2.7 Dec	+2.2 Jan	+2.2	+2.5	2.4 Dec*
Denmark	+1.4 Q3	+3.6	+2.0	+2.0	-3.1 Dec	+0.7 Jan	+0.9	+1.1	4.2 Dec
Hungary	+4.4 Q4	+5.3	+3.9	+3.6	+4.6 Dec	+2.1 Jan	+2.3	+2.4	3.8 Jan*
Iceland	+3.1 Q3	+9.2	+3.6	+4.1	*na*	+2.2 Feb	+1.9	+1.8	2.4 Jan*
Norway	+1.4 Q4	-1.1	+1.9	+1.7	-3.2 Dec	+1.6 Jan	+2.8	+1.9	4.1 Dec*
Poland	+5.1 Q3	+4.1	+4.6	+3.8	+8.6 Jan	+1.9 Jan	+1.7	+2.0	6.9 Jan*
Russia	+1.8 Q3	*na*	+1.7	+2.0	+2.8 Jan	+2.2 Jan	+5.0	+3.5	5.2 Jan*
Sweden	+2.9 Q3	+3.1	+2.7	+2.7	+8.1 Dec	+1.6 Jan	+1.4	+1.8	7.0 Jan*
Switzerland	+1.2 Q3	+2.5	+1.0	+2.0	+8.7 Q4	+0.7 Jan	+0.3	+0.5	3.0 Jan
Turkey	+11.1 Q3	*na*	+6.7	+3.8	+6.5 Dec	+10.3 Jan	+9.2	+11.1	10.3 Nov*
Ukraine	+1.8 Q4	+0.7	+2.2	+3.0	+3.0 Jan	+14.1 Jan	+12.6	+14.4	1.4 Jan*
Australia	+2.8 Q3	+2.4	+2.3	+2.8	+3.5 Q3	+1.9 Q4	+1.5	+1.9	5.5 Jan
Hong Kong	+3.6 Q3	+2.0	+3.7	+2.6	+0.4 Q3	+1.6 Jan	+1.3	+1.5	2.9 Jan*
India	+6.3 Q3	+8.7	+6.4	+7.2	+7.1 Dec	+5.1 Jan	+3.2	+3.5	5.0 Jan
Indonesia	+5.2 Q4	*na*	+5.1	+5.4	+3.4 Dec	+3.3 Jan	+3.5	+3.8	5.5 Q3*
Malaysia	+5.9 Q4	*na*	+6.0	+5.5	+2.8 Dec	+3.5 Dec	+1.7	+3.8	3.3 Dec*
New Zealand	+3.0 Q3	+3.8	+2.4	+3.0	+1.6 Q3	+1.6 Q4	+1.3	+1.9	4.5 Q4
Pakistan	+5.7 2017*	*na*	+5.7	+5.3	-1.4 Dec	+4.4 Jan	+3.7	+4.1	5.9 2015
Philippines	+6.6 Q4	+6.1	+6.7	+6.1	-9.7 Dec	+4.0 Jan	+2.7	+3.2	5.0 Q4*
Singapore	+3.6 Q4	+2.1	+3.5	+3.0	+17.9 Jan	*nil* Jan	+0.6	+0.6	2.1 Q4
South Korea	+3.0 Q4	-0.9	+3.1	+3.0	-6.0 Dec	+1.0 Jan	+2.0	+2.0	3.7 Jan*
Taiwan	+3.3 Q4	+4.3	+2.9	+2.4	+1.2 Dec	+0.9 Jan	+2.2	+0.6	3.7 Jan
Thailand	+4.0 Q4	+1.8	+3.7	+3.8	+2.3 Dec	+0.7 Jan	+1.6	+0.7	1.0 Dec*
Vietnam	+6.8 2017	*na*	+6.8	+6.7	+20.9 Jan	+2.7 Jan	+5.2	+3.5	2.3 2016
Argentina	+4.2 Q3	+3.6	+2.9	+3.2	+1.1 Jan	+25.4	*na*	+25.2	8.3 Q3*
Brazil	+1.4 Q3	+0.6	+1.0	+2.7	+4.4 Dec	+2.9 Jan	+5.4	+3.3	11.8 Dec*
Chile	+2.2 Q3	+6.0	+1.4	+3.0	+0.2 Dec	+2.2 Jan	+2.8	+2.2	6.4 Dec*
Colombia	+1.6 Q4	+1.1	+1.6	+2.5	-0.8 Dec	+3.7 Jan	+5.5	+4.3	8.6 Dec*
Mexico	+1.5 Q4	+3.2	+2.1	+2.1	-0.7 Dec	+5.5 Jan	+4.7	+6.0	3.4 Dec
Peru	+2.2 Q4	-1.3	+2.5	+3.7	-12.5 Dec	+1.3 Jan	+3.1	+2.8	6.9 Dec*
Venezuela	-8.8 Q4*	-6.2	-13.6	-13.9	*na*	*na*	*na*	+1123.3	7.3 Apr*
Egypt	*na*	*na*	+4.2	+5.0	+27.1 Nov	+17.1 Jan	+28.2	+29.5	11.3 Q4*
Israel	+2.9 Q4	+3.6	+3.0	+3.7	+1.5 Dec	+0.1 Jan	+0.1	+0.2	4.0 Dec
Saudi Arabia	-0.7 2017	*na*	-0.7	+1.0	*na*	+3.0 Jan	-0.6	-0.2	5.8 Q3
South Africa	+0.8 Q3	+2.0	+0.9	+1.4	+2.8 Dec	+4.4 Jan	+6.6	+5.3	26.7 Q4*

Source: The Economist: 27 February 2018

The trade-weighted dollar is likely to remain weak despite accelerating growth in the US and more rate hikes to come. With the rest of the global economy "catching up" with the US investor sentiment has turned to emerging market currencies and buoyant commodity prices. A weak dollar is of course good for the US economy due to their large export base. The dollar will likely strengthen towards the end of the current expansionary phase or in the event of a material deterioration in global macro data becomes evident.

Trade Weighted US Dollar Index



Source: Federal Reserve Bank of ST. Louis

To Conclude

- Cyril Ramaphosa needed to seize the moment and purge the cabinet which to some extent he has done following a Cabinet reshuffle
- Hopefully, this could lead to the binning of the mining charter and the expensive nuclear power plans that SA cannot afford and reform the rigid SA labour market
- Sharply lower bond yields following the changes will reduce the servicing cost of government debt, especially foreign denominated and inflation linked bonds
- Moody's has said that SA has made a number of credit positive strides since December 2017, and the recent Budget, on its own does not necessarily argue for a credit rating downgrade
- The 1% increase in VAT will increase the cost of living for South Africans, and economists estimate a rise of at least 0.1% in CPI inflation over the next three quarters of this year
- Developed market bond yields will likely be stuck in a lower for longer range due to secular disinflationary factors
- The yield curve spread in the US indicates that the recovery in the US economy has been underway since 2015
- Yield curve inversion has historically been highly successful in predicting GDP contractions but we are not there yet
- We anticipate that the US yield curve will continue to slowly flatten (short term rates to rise) to reflect a maturing economic cycle

Sincerely

Chris

Chris Botha