ABN·AMRO

Short Insight

Group Economics
Emerging Markets and Commodity Research

19 December 2017

Marijke Zewuster
Head EM&Commodity Research
Tel: +31 20 383 0518
marijke.zewuster@nl.abnamro.com

Georgette Boele
Senior FX Strategist
Tel: +31 20 629 7789
georgette.boele@nl.abnamro.com

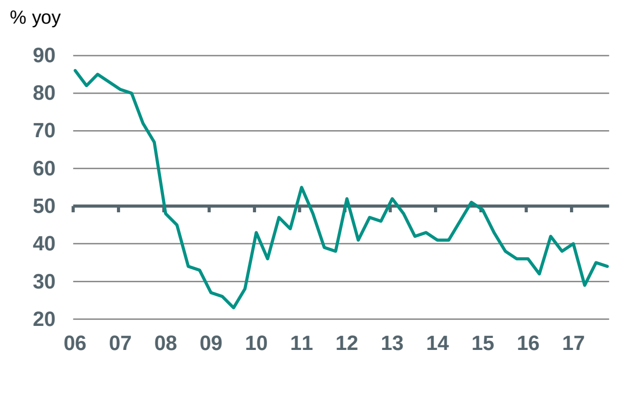
South Africa: Challenging times

- **Election of Cyril Ramaphosa as new ANC leader and presidential candidate brought relief to the markets, but the uncertainty is not over yet**
- **We expect only moderate GDP growth in the coming years**
- **The fiscal situation remains a concern and could lead to more downgrades**
- **Positive sentiment towards the rand to cool and the rand to weaken in 2018**

1. ANC chooses Cyril Ramaphosa as their new leader

The choice of Deputy President Cyril Ramaphosa as the new party leader and presidential candidate (the beleaguered president Zuma is not allowed to run for re-election) for the 2019 presidential elections brought relief to markets. Still, the political situation will remain unstable. It was a close call between him and the other candidate former-minister and ex-wife of president Zuma, Nkosazana Dlamini-Zuma. With Ramaphosa, the ANC will most likely remain the largest party, but probably its majority will fall further. Ultimately this could be positive as a stronger opposition might help to improve the democratic checks and balances, but in the short term this probably means a continuation of political instability..

Business confidence still at low levels

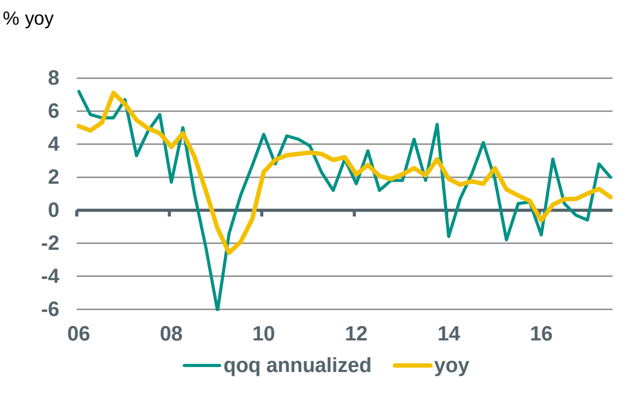


Source: Bloomberg

2. GDP growth remains subdued

Growth has slowed from an annual average of 3.7% between the end of apartheid in 1994 and the global financial crisis in 2008, to 1.7% between 2008 and 2017. Lower commodity prices, a severe drought and disruptive labour strikes resulted in a number of quarters of negative qoq growth. We expect growth to pick up from 1% in 2017 to only 1.5% in the coming two years. Weather conditions are less adverse and commodity prices more supportive, but structural weaknesses plus the uncertain political situation in the run up to the 2019 elections, and the negative impact of recent downgrades will hamper a stronger recovery. Risks remain tilted to the downside.

Out of recession, but growth remains subdued



Source: Bloomberg

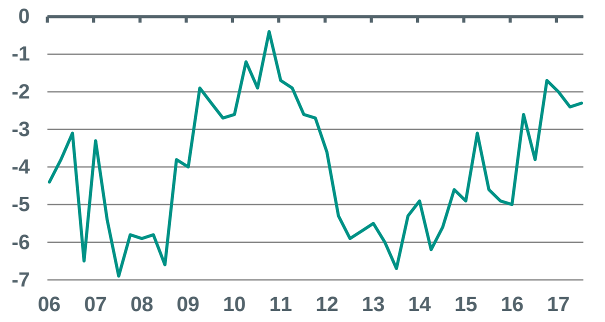
3. Weak fundamentals make situation worse

South Africa is among the emerging markets most sensitive to increased risk aversion. The fiscal situation is worrisome and government debt levels have risen from 26% of GDP in 2008 to over 50% now. The fragile fiscal situation makes it difficult to address structural problems like high (youth) unemployment, which still reflects the legacy of apartheid. A downgrade of S&P and Fitch to sub investment grade in April 2017 made things worse. In November S&P downgraded the country another notch to BB. Moody's still maintains the lowest investment grade rating, but placed the country on a negative watch. On a positive note, inflation has moved back within the target band since April. Moreover, the current account deficit has improved from more than 5% of GDP in 2014 to 2.3% in Q3 2017.

4. FX: Positive sentiment to cool

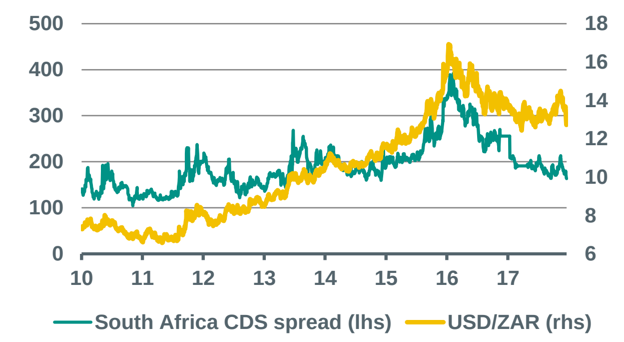
The South African rand already rallied by 5% versus the dollar before the elections result on the anticipation that Cyril Ramaphosa would win the leadership contest. Since the results have been released, the rand has given back some of its gains. There are reasons for currency markets to be optimistic about the likely end of the Zuma era, but actual change may come at a slower pace than currency markets would prefer. Moreover, fundamentals remain negative for the rand. In addition, in 2018 we expect the US dollar to rise at a modest pace in line with higher US Treasury yields and a continuation of Fed rate hikes. These forces will weigh on the rand. Therefore, we expect the rand to weaken versus the dollar to 14.5 at the end of 2018.

Current account improves



Source: Bloomberg

South Africa CDS an important driver for the rand



Source: Bloomberg