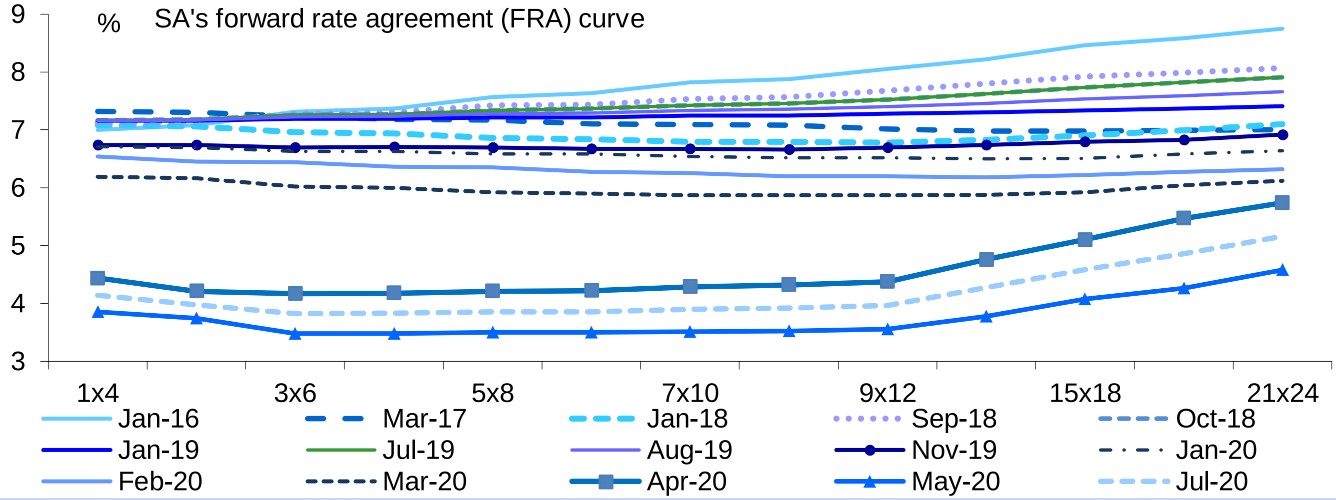
Investec

# MPC preview: interest rates are likely to remain low this year, while the improving global environment is likely to bring the MPC some cheer

Tuesday 14 July 2020

Figure 1: Forward Rate Agreement (FRA) curve




Source: Bloomberg

The global economy is in the process of a patchy recovery, with markedly strengthening data readings coming out from April's many data lows, and is likely now in the process of attempting to return positive growth for July, although this does not mean the recovery will be linear, or across all areas. Lags will occur for many variables, while the recovery itself is likely to be stop and start in nature in many areas, and the Covid-19 pandemic has not come to an end globally, or even has an end in sight. However, lockdown measures have eased substantially, the global supply chain recovery is beginning, although itself will be patchy and does not see sufficient demand to support it yet. While Covid-19 is showing some second waves of infections, and is likely to see multiple waves, most economies have decided against additional hard lockdown measures, and the large scale monetary, fiscal and other support measures put in place have aided sentiment in financial markets, with more policy support likely from advanced economies if the recovery looks to falter sharply or halt. We have reduced the probability of the extreme down case from 10% to 4%, as the likelihood of a lengthy global recession on the impact of Covid-19 has diminished further, substantial monetary and other policy support measures to global growth have both occurred, and further are likely if needed. The probability of only a temporary sharp global slowdown has risen, with the expected case probability now at 46% from 43% last quarter, while the lite down case probability has also risen, to 45% from 42% as the potential for further credit rating downgrades has increased for SA.

The Reserve Bank is expected to leave its interest rates unchanged at its MPC meeting next week gaining some cheer from the improving global economic environment, although the SARB is also likely to highlight that the risks are to the downside, even if lessening somewhat on the global front, potentially increasing

Figure 2: Forecasts

| Period end rate % | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | Q4.21 |
|---|---|---|---|---|---|---|---|---|
| Repo Rate | 5.25 | 3.75 | 3.75 | 3.75 | 4.00 | 4.25 | 4.50 | 4.50 |
| Prime Overdraft Rate | 8.75 | 7.25 | 7.25 | 7.25 | 7.50 | 7.75 | 8.00 | 8.00 |

Source: Iress, Investec



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**Figure 3: Economic Scenarios: note updated forecasts, probabilities**

| | | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | Q4.21 |
|---|---|---|---|---|---|---|---|---|---|
| **Extreme** | USD/Rand (average) | 15.38 | 18.00 | 15.00 | 14.00 | 13.50 | 13.00 | 12.50 | 12.00 |
| Up case | Repo rate (end rate) | 5.25 | 3.75 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 |
| **1%** | | | | | | | | | |

Impact of Covid-19 pandemic very rapidly resolved - economic growth of 3–5%, then 5-7% for SA. Good governance, growth-creating reforms (structural constraints overcome), strengthening of property rights - individuals obtain title deeds in EWC – no nationalisation. High business confidence and fixed investment growth, substantial FDI inflows, strong fiscal consolidation (government debt falls back to low ratios of 2000s). Strong global growth, commodity boom. Stabilisation of credit ratings, then credit rating upgrades.

| **Up** case | | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | Q4.21 |
|---|---|---|---|---|---|---|---|---|---|
| **4%** | USD/Rand (average) | 15.38 | 18.00 | 16.00 | 15.00 | 14.00 | 13.50 | 12.00 | 11.50 |
| | Repo rate (end rate) | 5.25 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |

Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems worked down. No further credit rating downgrades, rating outlooks move to stable and eventually positive, strong fiscal consolidation (government debt projections fall substantially). Global risk-on, global demand quickly returns to trend growth. Limited impact of expropriation without compensation) to abandoned, unused, labour tenants'' and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation.

| | | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | Q4.21 |
|---|---|---|---|---|---|---|---|---|---|
| **Base** | USD/Rand (average) | 15.38 | 18.00 | 17.50 | 16.50 | 15.75 | 15.50 | 15.50 | 15.00 |
| case | Repo rate (end rate) | 5.25 | 3.75 | 3.75 | 3.75 | 4.00 | 4.25 | 4.50 | 4.50 |
| **46%** | | | | | | | | | |

Temporary sharp global slowdown and global financial turmoil from Covid-19 pandemic (severe currency depreciation, low interest rates) – eventually sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises. South Africa exits recession in Q3.20. Market unfriendly policies like expropriation of private sector property put on hold in the crisis. SA remains BB+ rating from Moody's - government debt projections stabilise.

| | | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | Q4.21 |
|---|---|---|---|---|---|---|---|---|---|
| **Lite** | USD/Rand (average) | 15.38 | 18.00 | 18.50 | 19.50 | 20.00 | 18.50 | 17.00 | 16.50 |
| (domestic) | Repo rate (end rate) | 5.25 | 3.75 | 4.00 | 4.00 | 4.25 | 4.25 | 4.50 | 4.50 |
| Down case **45%** | | | | | | | | | |

The international risk sentiment environment is that of the base case. South Africa continues to fail to see its debt projections stabilise and loses its BB+ rating from Moody's and falls towards B ratings from all three rating agencies. More severe recession in SA over 2020 than in the expected case. Expropriation of some private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed even further, significant rand weakness, significant load shedding and weak investment growth until substantial fiscal repair ultimately effected.

| | | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | Q4.21 |
|---|---|---|---|---|---|---|---|---|---|
| **Severe** | USD/Rand (average) | 15.38 | 18.00 | 19.50 | 21.00 | 22.00 | 23.00 | 24.00 | 22.00 |
| down | Repo rate (end rate) | 5.25 | 3.75 | 4.25 | 4.25 | 4.50 | 4.50 | 5.00 | 5.50 |
| case **4%** | | | | | | | | | |

Lengthy global recession on impact of Covid-19 – global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness. Nationalisation of private sector property (title deeds not transferred to individuals). SA rated single B from all three key agencies, with further rating downgrades occurring into C grade as government finances deteriorate (debt projections elevate even further - fail to ever stabilise. Government borrows from increasingly wider sources as it sinks deeper into a debt trap), eventually include widespread services load shedding, strike action and civil unrest.

**Note:** Event risk begins Q3.20. Source: Investec



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Figure 4: Reuters June 2020 Econometer poll: Repo rate end period %

| Forecast period | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|
| Median | **3.75** | **3.75** | **3.75** | **3.75** | **3.75** | **3.75** | **3.63** | **4.25** | **5.00** |
| Highest forecast | 3.80 | 3.80 | 3.80 | 4.00 | 4.50 | 5.00 | 3.75 | 5.40 | 6.00 |
| Lowest forecast | 3.75 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | -3.30 | 3.50 | 4.00 |
| No. of forecasts | 15 | 14 | 15 | 14 | 14 | 13 | 18 | 17 | 12 |

Source: Reuters

on the domestic front. The deteriorated government finances make credit rating downgrades more likely for South Africa, and hence rand weakness, which will place upwards pressure on inflation, particularly as QE unwinds globally, which could be as early as the end of next year. Shorter-term too, the lift in global economic activity, already seen to be underway, is likely to exceed SA's economic recovery in both speed and pace. Many structural weaknesses also remain domestically, while the ongoing weak ability of SA to meet the electricity needs of an economy growing at over 1.0% y/y will be a key limitation to economic recovery in H2.20 and into 2021.

At the last MPC meeting, which was on 19th to 21st May, the MPC forecast CPI inflation at 3.4% y/y for this year and 4.4% y/y for next year, with 4.4% also for 2022, lowering its forecasts from 3.6% y/y, 4.5% y/y and 4.4% y/y respectively except for 2022 which remained unchanged. We continue to forecast CPI inflation at 3.4% y/y for this year, and forecast 4.3% y/y for 2021, with 4.8% y/y for 2022 as our rand exchange rate forecasts have weakened longer-term. The SARB is likely to lower its CPI inflation forecasts somewhat, along with its GDP predictions of -7.0% y/y for 2020, 3.8% y/y for 2021 and 2.9% y/y for 2022. The SARB could revise its outlook for this year closer to -8.0% y/y, but for next year closer to 2.0% y/y and in 2021 nearer to 2.5% y/y. We forecast -10.1% y/y, 1.6% y/y and 1.9% y/y respectively. While there has been marked easing of restrictions, the return to the level of economic activity experienced at the end of 2019 (R3.14 trillion in real terms (adjusted for inflation), or R5.2 trillion in nominal (actual) terms)) is only anticipated by the end of 2025 in real terms, and by 2023 in actual terms (due to quickening inflation). The slow pace of economic growth experienced before the lockdown, of 0.2% y/y in 2019, and 1.4% in 2018, after a dismal 0.4% y/y in 2017, and 1.2% y/y in 2016, is unlikely to be broken in the next few years, unless substantial regulatory reform occurs to dramatically improve the ease of doing business in South Africa. The already slow pace of economic growth, with high levels of state control and interventions in the economy, including a substantial rise in red tape over the past decade, is also a risk to the post Covid-19 recovery in the economy, while lingering restrictions, even under level 3, 2 and 1 will also quell the potential for a rebound. SA's recovery this year will be threatened by Eskom's weak supply capacity, given the ongoing weak ability of SA to meet the electricity needs of an economy growing at over 1.0% y/y.

Figure 5: Reuters June 2020 Econometer poll: SARB CPI, unadjusted % ch y/y, avg for period

| Forecast period | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|
| Median | 2.7 | 3.1 | 3.1 | 3.6 | 4.3 | 4.5 | 3.5 | 4.1 | 4.3 |
| Highest forecast | 3.6 | 3.9 | 3.5 | 4.2 | 5.2 | 4.9 | 4.7 | 4.8 | 4.9 |
| Lowest forecast | 2.3 | 2.3 | 2.4 | 2.8 | 3.7 | 3.6 | 2.0 | 3.1 | 3.3 |
| No. of forecasts | 12 | 12 | 12 | 12 | 12 | 12 | 23 | 23 | 13 |

Source: Reuters



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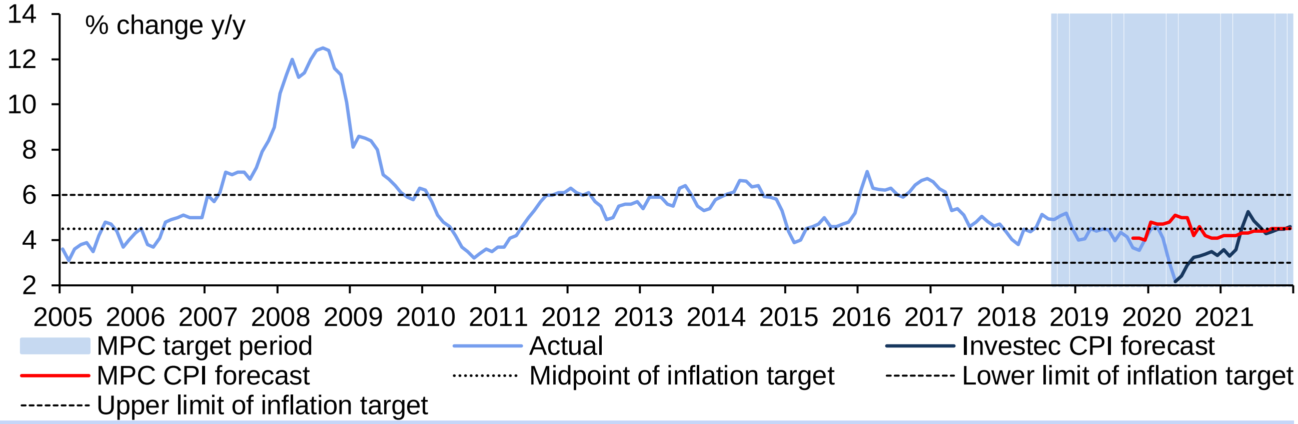
Figure 6: SA Consumer Inflation: history and forecasts




Source: Stats SA, SARB, Investec

Figure 7: Reuters May 2020 Foreign exchange rates poll: USDZAR

| | 1M | 3M | 6M | 1Y |
|---|---|---|---|---|
| Release/Effective Date | 31 July 2020 | 30 Sep 2020 | 31 Dec 2020 | 30 Jun 2021 |
| Median | 17.2700 | 17.0000 | 17.0000 | 16.5000 |
| High | 21.0000 | 18.5000 | 18.9000 | 19.5000 |
| Low | 15.8300 | 15.5000 | 15.5000 | 15.5000 |
| No. of forecasts | 23 | 28 | 29 | 27 |

Source: Reuters

Figure 8: SA Monetary Policy Committee (MPC) meeting dates for 2020

| Month | Date | Forecast |
|---|---|---|
| July 2020 | 21st – 23rd | 3.75 |
| September 2020 | 15th – 17th | 3.75 |
| November 2020 | 17th – 19th | 3.75 |

Source: SA Reserve Bank, Investec

Figure 9: Reuters June 2020: Econometer poll: SARB GDP end period

| Forecast period | Q1.20 | Q2.20 | Q3.20 | Q4.20 | Q1.21 | Q2.21 | Q3.21 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| Median | -0.8 | -39.3 | 12.9 | 4.3 | 4.6 | 4.7 | 3.3 | -8.0 | 3.1 | 1.8 |
| Highest forecast | -0.3 | -10.0 | 52.6 | 17.4 | 10.6 | 12.0 | 8.0 | -5.4 | 6.5 | 3.1 |
| Lowest forecast | -2.7 | -53.9 | -8.0 | -2.0 | -0.5 | -2.3 | -1.5 | -10.4 | 0.4 | 0.1 |
| No. of forecasts | 12 | 10 | 10 | 10 | 10 | 10 | 10 | 24 | 24 | 14 |

Source: Reuters

| Figure 10: Inflation forecasts | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|
| Consumer Inflation (Av: %) | 4.1 | 3.4 | 4.3 | 4.8 | 5.0 | 5.0 | 5.0 |
| Producer Inflation (Av: %) | 4.6 | 2.3 | 3.8 | 5.0 | 5.0 | 5.1 | 5.1 |
| Salary & wage increases (%) | 4.0 | 1.0 | 3.1 | 5.2 | 5.3 | 6.3 | 6.6 |

Source: Investec



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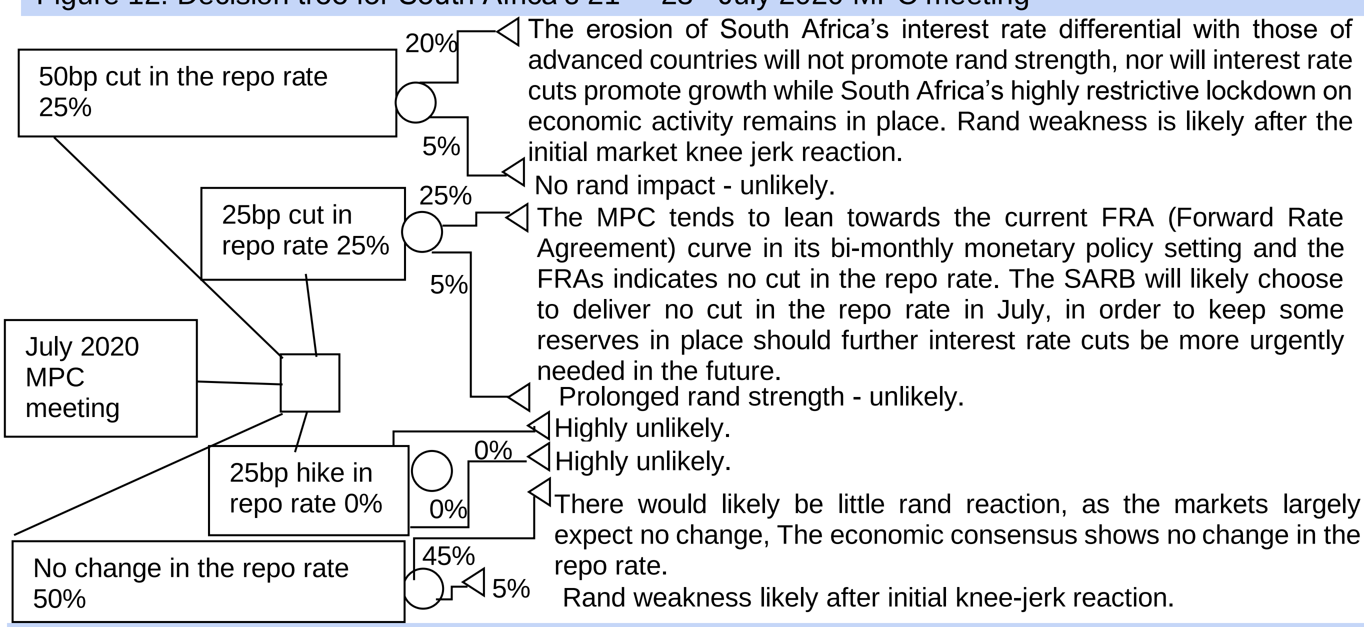
| Figure 11: forecasts | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|
| Repo Rate | 3.75 | 4.50 | 5.25 | 5.25 | 5.25 | 5.25 |
| Prime Overdraft Rate | 7.25 | 8.00 | 8.75 | 8.75 | 8.75 | 8.75 |
| SA rand bond | 8.95 | 9.30 | 9.61 | 9.50 | 9.30 | 9.09 |
| US Fed funds rate | 0.25 | 0.25 | 0.25 | 0.50 | 0.75 | 1.25 |
| UK Bank rate | 0.10 | 0.10 | 0.10 | 0.25 | 0.50 | 0.75 |

Note: forecasts are *% year-end.* Source: Investec, SARB, IRESS

The SARB will be in no rush to hike interest rates, as the economy is both depressed in South Africa and its recovery will be slow and fragile. Indeed, the SARB is likely still leaning towards further interest rate cuts as opposed to hikes directionally if it moved again this year or next year. However, SA's interest rates are at a historical low, and as such are unlikely to be cut again unless there is a strong reason. The current low interest levels are showing some, if nascent, signs of stimulating borrowings among corporates, and as such the moderation in debt servicing costs is enticing some activity. The Reserve bank is likely to keep interest rates low for this year in order to foster a lift in economic activity through stimulating borrowings, and indeed may even delay interest rate hikes next year if it moderates its quite high GDP growth forecast for 2021 – we only expect GDP growth of 1.6% y/y in 2021.

The low level of demand in the economy will take quite a while to turn, and this also will likely prompt the MPC to be reticent in looking to hike rates. Should the SARB's GDP forecast for 2021 moderate much closer to ours we will look to revise our interest rate forecasts for 2021 lower.

Figure 12: Decision tree for South Africa's 21st - 23rd July 2020 MPC meeting




Key: squares are decision nodes, circles chance nodes and triangles end nodes. Source: Investec



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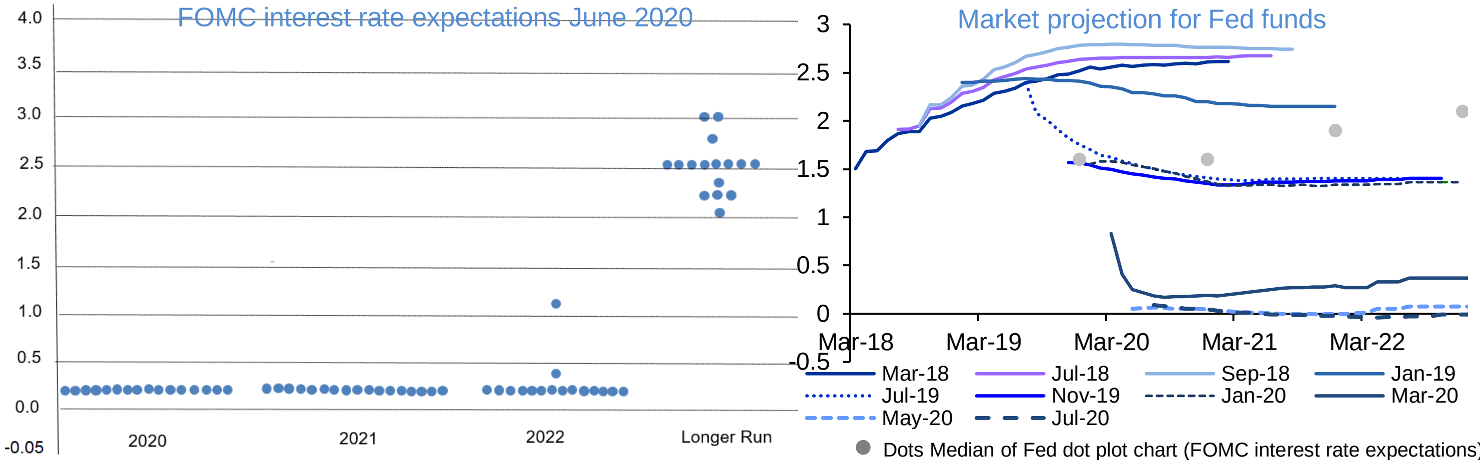
Figure 13: US interest rate projections




Source: FOMC, Bloomberg
Note: in left graph each circle/dot is individual's judgement of appropriate fed funds rate per period

Figure 14: FOMC 2020 Meeting Schedule

| | |
|---|---|
| July | 28th – 29th |
| September | 15th-16th* |
| November | 4th – 5th |
| December | 15th – 16th* |

Source: Federal Reserve Bank

*Meeting associated with a Summary of Economic Projections

Figure 15: Forecast of international interest rates (%, end quarter)

| | US Fed funds | Euro zone Refi rate | Euro zone deposit rate | UK Bank Rate |
|---|---|---|---|---|
| Current | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q1.20 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q2.20 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q3.20 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q4.20 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q1.21 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q2.21 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q3.21 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |
| Q4.21 | 0.00-0.25 | 0.00 | -0.50 | 0.10 |

Source: Macrobond, Investec

Figure 16: Interest rate forecast end rates

| Date | Prime forecast | Prime less Inflation | Repo | Repo less Inflation |
|---|---|---|---|---|
| Jan 2019 | 10.25 | 6.3 | 6.75 | 2.8 |
| Feb 2019 | 10.25 | 6.2 | 6.75 | 2.7 |
| Mar 2019 | 10.25 | 5.7 | 6.75 | 2.2 |
| Apr 2019 | 10.25 | 5.9 | 6.75 | 2.4 |
| May 2019 | 10.25 | 5.8 | 6.75 | 2.3 |
| Jun 2019 | 10.25 | 5.8 | 6.75 | 2.3 |
| Jul 2019 | 10.00 | 6.0 | 6.50 | 2.5 |
| Aug 2019 | 10.00 | 5.7 | 6.50 | 2.2 |
| Sep 2019 | 10.00 | 5.9 | 6.50 | 2.4 |
| Oct 2019 | 10.00 | 6.3 | 6.50 | 2.8 |
| Nov 2019 | 10.00 | 6.4 | 6.50 | 2.9 |
| Dec 2019 | 10.00 | 6.0 | 6.50 | 2.5 |
| Jan 2020 | 9.75 | 5.3 | 6.25 | 1.8 |
| Feb 2020 | 9.75 | 5.1 | 6.25 | 1.6 |
| Mar 2020 | 8.75 | 4.6 | 5.25 | 1.1 |
| Apr 2020 | 7.75 | 4.8 | 4.25 | 1.3 |
| May 2020 | 7.25 | 5.1 | 3.75 | 1.6 |
| Jun 2020 | 7.25 | 4.8 | 3.75 | 1.3 |
| Jul 2020 | 7.25 | 4.3 | 3.75 | 0.8 |
| Aug 2020 | 7.25 | 4.0 | 3.75 | 0.5 |
| Sep 2020 | 7.25 | 4.0 | 3.75 | 0.5 |
| Oct 2020 | 7.25 | 3.9 | 3.75 | 0.4 |
| Nov 2020 | 7.25 | 3.7 | 3.75 | 0.2 |
| Dec 2020 | 7.25 | 3.9 | 3.75 | 0.4 |
| Jan 2021 | 7.25 | 3.7 | 3.75 | 0.2 |
| Feb 2021 | 7.25 | 3.9 | 3.75 | 0.4 |
| Mar 2021 | 7.50 | 3.9 | 4.00 | 0.4 |
| Apr 2021 | 7.50 | 3.0 | 4.00 | -0.5 |
| May 2021 | 7.75 | 2.5 | 4.25 | -1.0 |
| Jun 2021 | 7.75 | 2.9 | 4.25 | -0.6 |
| Jul 2021 | 8.00 | 3.4 | 4.50 | -0.1 |
| Aug 2021 | 8.00 | 3.7 | 4.50 | 0.2 |
| Sep 2021 | 8.00 | 3.6 | 4.50 | 0.1 |
| Oct 2021 | 8.00 | 3.5 | 4.50 | 0.0 |
| Nov 2021 | 8.00 | 3.5 | 4.50 | 0.0 |
| Dec 2021 | 8.00 | 3.4 | 4.50 | -0.1 |

Source: IRESS, Investec



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Figure 17: CPI forecast averages

| Date | Index Base 2016 | Annual y/y | Monthly m/m | Quarterly y/y | Calendar year y/y | |
|---|---|---|---|---|---|---|
| Jan 2019 | 109.2 | 4.0 | -0.2 | | | |
| Feb 2019 | 110.1 | 4.1 | 0.8 | | | |
| Mar 2019 | 111.0 | 4.5 | 0.8 | 4.2 | | |
| Apr 2019 | 111.7 | 4.4 | 0.6 | | | |
| May 2019 | 112.0 | 4.5 | 0.3 | | | |
| Jun 2019 | 112.4 | 4.5 | 0.4 | 4.4 | | |
| Jul 2019 | 112.8 | 4.0 | 0.4 | | | |
| Aug 2019 | 113.1 | 4.3 | 0.3 | | | |
| Sep 2019 | 113.4 | 4.1 | 0.3 | 4.1 | | |
| Oct 2019 | 113.4 | 3.7 | 0.0 | | | |
| Nov 2019 | 113.5 | 3.6 | 0.1 | | | |
| Dec 2019 | 113.8 | 4.0 | 0.3 | 3.7 | 2019 | 4.1 |
| Jan 2020 | 114.1 | 4.5 | 0.3 | | | |
| Feb 2020 | 115.2 | 4.6 | 1.0 | | | |
| Mar 2020 | 115.6 | 4.1 | 0.3 | 4.4 | | |
| Apr 2020 | 115.0 | 3.0 | -0.5 | | | |
| May 2020 | 114.4 | 2.2 | -0.5 | | | |
| Jun 2020 | 115.1 | 2.4 | 0.6 | 2.5 | | |
| Jul 2020 | 116.1 | 2.9 | 0.8 | | | |
| Aug 2020 | 116.8 | 3.2 | 0.6 | | | |
| Sep 2020 | 117.1 | 3.3 | 0.3 | 3.1 | | |
| Oct 2020 | 117.2 | 3.4 | 0.1 | | | |
| Nov 2020 | 117.5 | 3.5 | 0.2 | | | |
| Dec 2020 | 117.6 | 3.3 | 0.1 | 3.4 | 2020 | 3.4 |
| Jan 2021 | 118.2 | 3.6 | 0.5 | | | |
| Feb 2021 | 119.0 | 3.3 | 0.7 | | | |
| Mar 2021 | 119.7 | 3.6 | 0.6 | 3.5 | | |
| Apr 2021 | 120.2 | 4.5 | 0.4 | | | |
| May 2021 | 120.4 | 5.3 | 0.2 | | | |
| Jun 2021 | 120.7 | 4.8 | 0.2 | 4.9 | | |
| Jul 2021 | 121.4 | 4.6 | 0.6 | | | |
| Aug 2021 | 121.8 | 4.3 | 0.3 | | | |
| Sep 2021 | 122.3 | 4.4 | 0.4 | 4.4 | | |
| Oct 2021 | 122.5 | 4.5 | 0.2 | | | |
| Nov 2021 | 122.7 | 4.5 | 0.2 | | | |
| Dec 2021 | 123.0 | 4.6 | 0.2 | 4.5 | 2021 | 4.3 |

Source: Stats SA, Investec



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