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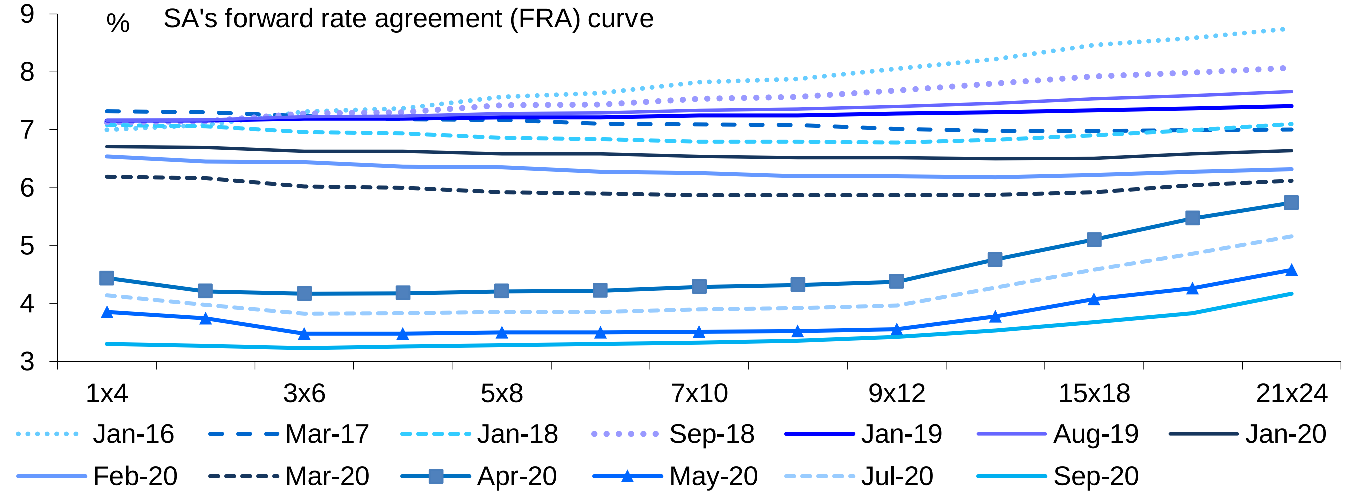
MPC preview: dovish Fed communication would support low rates for longer in SA and the US, with a 50/50 chance of a repo cut in SA this week

Wednesday 16 September 2020

Figure 1: Forward Rate Agreement (FRA) curve



Source: Bloomberg

South Africa faces another interest rate decision this week, on Thursday 17th September, alongside the FOMC (Federal Open Market Committee) tonight. FOMC (the US monetary policy authority's) comments underpinning its dovish stance, particularly continuing to evince zero-bound interest rates and QE "for as long as it takes" tonight will be supportive of a lengthy continuation of accommodative monetary policy in South Africa. The domestic currency gained substantially in the lead up to the August FOMC notation vote meeting on expectations of the FOMC adopting a more tolerant stance towards inflation, and a more supportive one towards lowering inflation. In the event, the Fed's release of its Longer-Run Goals and Policy Strategy provided the gentler approach to future inflation goals that was expected, underpinning some further support for the rand. US rates influence interest rates globally, and lengthy accommodative US monetary policy adds to the likelihood of SA seeing a slow upward trajectory in its repo rate, remaining relatively accommodatory for a number of years. The FOMC said it has updated its monetary policy as the US "economy is always evolving, and the FOMC's strategy for achieving its goals must adapt to meet the new challenges that arise." Appreciating the "benefits of a strong labor market, particularly for many in low- and moderate-income communities, and that a robust job market can be sustained without causing an unwelcome increase in inflation. The FOMC adjusted its strategy for achieving its longer-run inflation goal of 2 percent by noting that it "seeks to achieve inflation that averages 2 percent over time." "(F)ollowing periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time." An increasingly supportive global, and particularly US, interest rate environment may prompt the SARB to cut rates again this week, even though it came close to not cutting at its last meeting in July and also signalled that the rate cut cycle may be over for SA for the time being. A cut in SA's repo rate tomorrow is essentially an equally

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	3.50	3.50	3.75	4.00	4.25	4.25
Prime Overdraft Rate	8.75	7.25	7.00	7.00	7.25	7.50	7.75	7.75

Source: Iress, Investec

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Figure 3: Economic Scenarios: note updated forecasts

		Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Extreme Up case **1%**	USD/Rand (average)	15.38	18.00	15.00	14.00	13.50	13.00	12.50	12.00
	Repo rate (end rate)	5.25	3.75	3.00	3.00	3.00	3.00	3.00	3.00

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.

		Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Up case **2%**	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	3.25	3.25	3.25	3.50	3.50	3.50

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 case **47%**	USD/Rand (average)	15.38	18.00	17.00	16.50	15.75	15.50	15.50	15.10
	Repo rate (end rate)	5.25	3.75	3.50	3.50	3.75	4.00	4.25	4.25

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 retains BB category 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 (domestic) Down case **46%**	USD/Rand (average)	15.38	18.00	18.50	19.50	20.00	18.50	17.00	16.50
	Repo rate (end rate)	5.25	3.75	3.75	3.75	4.00	4.00	4.25	4.25

The international risk sentiment environment is that of the base case. South Africa continues to fail to see its debt projections stabilise 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 down case **4%**	USD/Rand (average)	15.38	18.00	19.50	21.00	22.00	23.00	24.00	22.00
	Repo rate (end rate)	5.25	3.75	4.00	4.00	4.25	4.25	4.75	5.25

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 eventually 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	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	2020	2021	2022
Median	3.50	3.25	3.25	3.25	3.50	3.50	3.25	3.50	4.13
Highest forecast	3.50	3.50	3.75	4.25	4.50	4.50	4.00	4.75	5.50
Lowest forecast	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25
No. of forecasts	24	23	22	22	22	21	24	23	16
									Source: Reuters

weighted possibility to no change.

At the last MPC meeting, 23rd July, the committee said "monetary policy cannot on its own improve the potential growth rate of the economy or reduce fiscal risks. These should be addressed by implementing prudent macroeconomic policies and structural reforms that lower costs generally, and increase investment opportunities, potential growth and job creation. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy." The drop in real GDP in Q2.20, by -51% qqsaa (quarter on quarter, seasonally adjusted, annualised) was unexpected for the economic consensus, and potentially for the SARB. While the GDP outcome may add to the SARB's rational for a September rate cut, of 25bp taking the repo rate down to 3.25%, this is not because the SARB would expect a consequent change in the GDP trajectory as it notes above, but rather to help the indebted. Many are in deep financial distress with lower or no earnings. The SARB adds "(m)onetary policy can ease financial conditions and improve the resilience of households and firms to the economic implications of Covid-19. In addition to continued easing of interest rates, the SARB has relaxed regulatory requirements on banks and has taken important steps to ensure adequate liquidity in domestic markets. These actions are intended to free up more capital for lending by financial institutions to households and firms."

At the July MPC meeting the vote to cut the repo by 25bp or leave it unchanged was fairly evenly split, with the Governor noting this favourably, and with a split also at the time in the market expectations on the MPC stance on the repo rate. A fairly even split is currently prevailing again, with the FRA (forward rate agreement curve) showing a 25bp cut has been partially factored in. The Q2.20 GDP outcome on its own however is unlikely to prompt the SARB to cut by 25bp this month. While the consensus expects the economy to recover robustly in H2.20 and over 2021 and 2022, many structural weaknesses remain that limit economic growth and have not been resolved. Additionally, the consumer is very weakened and unemployment will have elevated sharply in Q2.20, towards 40%, which will cause the ability for recovery to be weakened. A V shaped recovery continues to be highly unlikely for the South African economy, and the U shaped recovery will likely see a more collapsed, tick or swoosh shape (similar to the NIKE emblem), where the second arm of the U is flattened somewhat. Furthermore, risks to even a tick shaped recovery

Figure 5: Reuters June 2020 Econometer poll: CPI % y/y, average for period									
Forecast period	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	2020	2021	2022
Median	3.1	3.3	3.4	4.7	4.3	4.2	3.3	4.2	4.4
Highest forecast	3.4	4.1	4.3	5.1	4.9	5.4	3.6	4.7	4.8
Lowest forecast	2.7	2.2	2.0	3.3	2.7	3.4	2.8	2.8	3.6
No. of forecasts	16	16	16	16	15	15	26	26	21
									Source: Reuters

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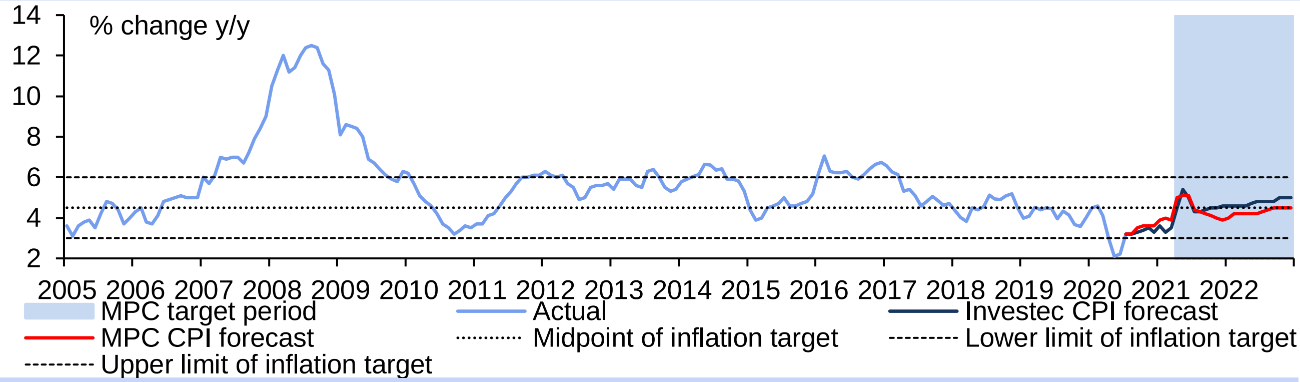
Figure 6: SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

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

	1M	3M	6M	1Y
Release/Effective Date	30-Sep-2020	30-Nov-2020	26-Feb-2021	31-Aug-2021
Median	17.0000	17.1550	17.0500	16.5000
High	18.5000	18.4300	19.1000	20.0500
Low	16.0000	15.8500	15.8000	15.5000
No. of forecasts	27	30	30	27

Source: Reuters

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

Month	Date	Forecast
September 2020	15th – 17th	3.50
November 2020	17th – 19th	3.50

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	29.6	7.5	2.3	2.9	2.6	2.8	-8.5	3.2	1.9	29.6
Highest forecast	50.0	27.0	15.4	6.5	9.8	14.0	-5.8	6.7	4.0	50.0
Lowest forecast	-12.0	-4.0	-0.8	-21.0	-1.1	-2.0	-10.4	-3.1	0.5	-12.0
No. of forecasts	13	13	13	13	12	12	27	27	21	13

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	5.1
Producer Inflation (Av: %)	4.6	2.3	4.0	5.0	5.0	5.1	5.1
Salary & wage increases (%)	4.0	-4.8	6.1	5.3	5.3	6.1	6.4

Source: Investec

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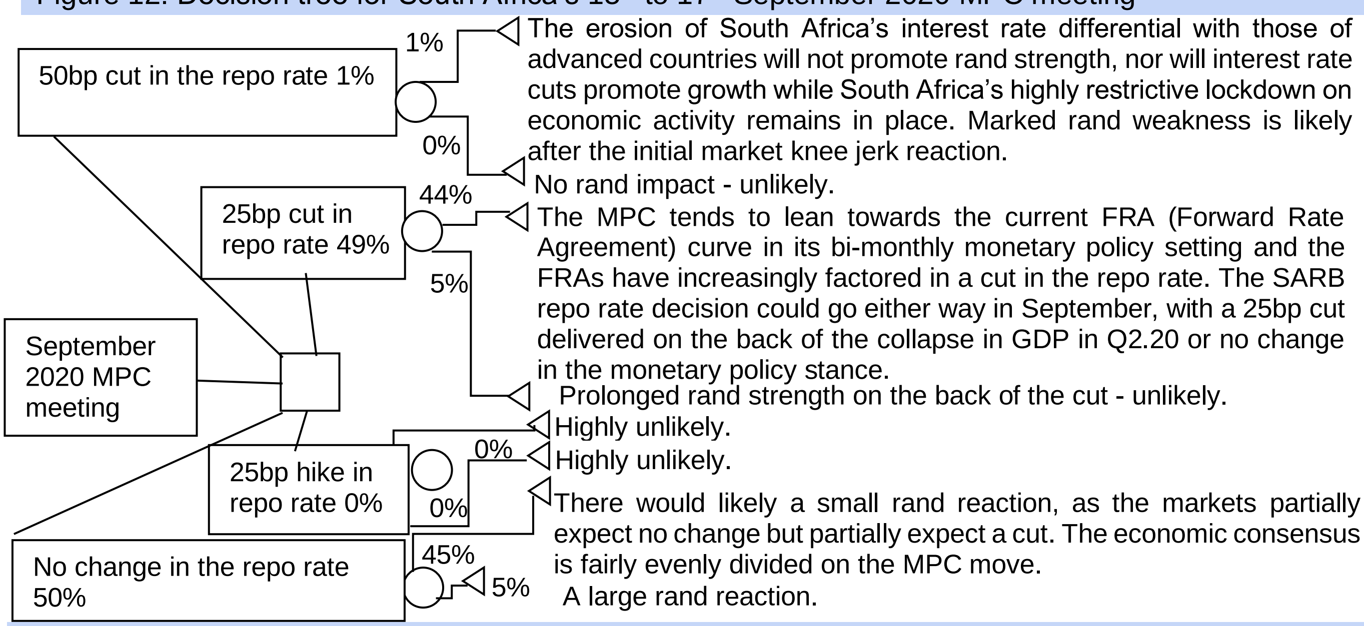
Figure 11: forecasts	2020	2021	2022	2023	2024	2025
Repo Rate	3.50	4.25	5.00	5.00	5.00	5.25
Prime Overdraft Rate	7.00	7.75	8.50	8.50	8.50	8.75
SA rand bond	9.50	10.20	10.50	10.70	11.00	10.90
US Fed funds rate	0.25	0.25	0.25	0.50	0.75	1.00
UK Bank rate	0.10	0.10	0.10	0.25	0.50	0.75

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

for South Africa remain. The SARB may wish to keep some reserve to cut interest rates further if SA's economic recovery falters and looks likely to be W shaped or worse instead. As the differential between SA and US interest rates is narrowed, given US rates are zero-bound, this places structural weakness on the domestic currency and so the SARB is likely to be judicious in its application of further interest rate cuts this year.

The IMF has said that many risks remain and also that "(i)n its severity, the Great Lockdown of 2020 has naturally evoked comparisons to the Great Depression, which began in 1929. But today's crisis is truly like no other. Although it's too early to make a definitive judgment, (the IMF) can already say that the severity and speed of the declines in economic output, employment, and consumption during the Great Lockdown were far greater than at the onset of the Great Depression." "Many countries will face daunting fiscal challenges in trying to reconcile the spending required to fight the crisis with the constraints imposed by higher debt and declining revenues. Low-income countries will require continued financial support from the international community." "The impact on global poverty is expected to be severe, with the World Bank projecting 71 million additional people falling into extreme poverty."

Figure 12: Decision tree for South Africa's 15th to 17th September 2020 MPC meeting



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

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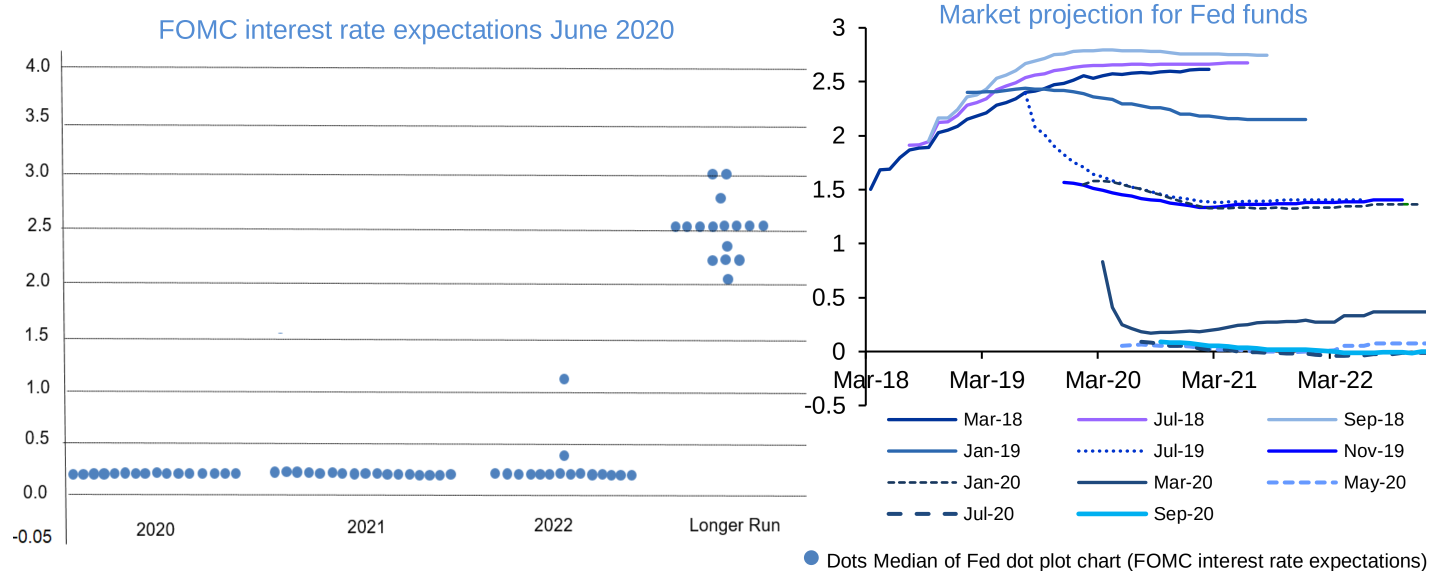
Figure 13: US interest rate projections



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

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	-0.60	0.10
Q3.20	0.00-0.25	0.00	-0.60	0.10
Q4.20	0.00-0.25	0.00	-0.60	0.10
Q1.21		0.00		
Q2.21	0.00-0.25	0.00	-0.60	0.10
Q3.21	0.00-0.25	0.00	-0.60	0.10
Q4.21	0.00-0.25	0.00	-0.60	0.10

Source: Macrobond, Investec

Figure 16: Interest rate forecast end rates

Date	Prime forecast	Prime less Inflation	Repo	Repo less Inflation
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	5.2	3.75	1.7
Jun 2020	7.25	5.0	3.75	1.5
Jul 2020	7.00	3.8	3.50	0.3
Aug 2020	7.00	3.8	3.50	0.3
Sep 2020	7.00	3.7	3.50	0.2
Oct 2020	7.00	3.6	3.50	0.1
Nov 2020	7.00	3.5	3.50	0.0
Dec 2020	7.00	3.7	3.50	0.2
Jan 2021	7.00	3.4	3.50	-0.1
Feb 2021	7.00	3.7	3.50	0.2
Mar 2021	7.25	3.7	3.75	0.2
Apr 2021	7.25	2.7	3.75	-0.8
May 2021	7.75	2.4	4.25	-1.1
Jun 2021	7.75	2.7	4.25	-0.8
Jul 2021	8.00	3.7	4.50	0.2
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
Jan 2022	8.25	3.7	4.75	0.2
Feb 2022	8.25	3.7	4.75	0.2
Mar 2022	8.25	3.7	4.75	0.2
Apr 2022	8.25	3.7	4.75	0.2
May 2022	8.25	3.6	4.75	0.1
Jun 2022	8.25	3.4	4.75	-0.1
Jul 2022	8.50	3.7	5.00	0.2
Aug 2022	8.50	3.7	5.00	0.2
Sep 2022	8.50	3.7	5.00	0.2
Oct 2022	8.50	3.5	5.00	0.0
Nov 2022	8.75	3.7	5.25	0.2
Dec 2022	8.75	3.7	5.25	0.2

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 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	1.2		
Apr 2020	115.0	3.0	-0.5				
May 2020	114.3	2.1	-0.6				
Jun 2020	114.9	2.2	0.5	2.4	-0.2		
Jul 2020	116.4	3.2	1.3				
Aug 2020	116.7	3.2	0.3				
Sep 2020	117.1	3.3	0.3	3.2	1.8		
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	0.6	2020	3.4
Jan 2021	118.2	3.6	0.5				
Feb 2021	119.0	3.3	0.7				
Mar 2021	119.7	3.5	0.6	3.5	1.3		
Apr 2021	120.2	4.5	0.4				
May 2021	120.4	5.4	0.2				
Jun 2021	120.7	5.0	0.2	5.0	1.2		
Jul 2021	121.4	4.3	0.6				
Aug 2021	121.7	4.3	0.3				
Sep 2021	122.2	4.4	0.4	4.3	1.1		
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	0.8	2021	4.3
Jan 2022	123.6	4.6	0.5				
Feb 2022	124.4	4.6	0.7				
Mar 2022	125.2	4.6	0.6	4.6	1.4		
Apr 2022	125.7	4.6	0.4				
May 2022	126.1	4.7	0.3				
Jun 2022	126.4	4.8	0.3	4.7	1.3		
Jul 2022	127.2	4.8	0.6				
Aug 2022	127.6	4.8	0.3				
Sep 2022	128.1	4.8	0.4	4.8	1.2		
Oct 2022	128.6	5.0	0.4				
Nov 2022	128.9	5.0	0.2				
Dec 2022	129.1	5.0	0.2	5.0	1.0	2022	4.8

Source: Stats SA, Investec

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