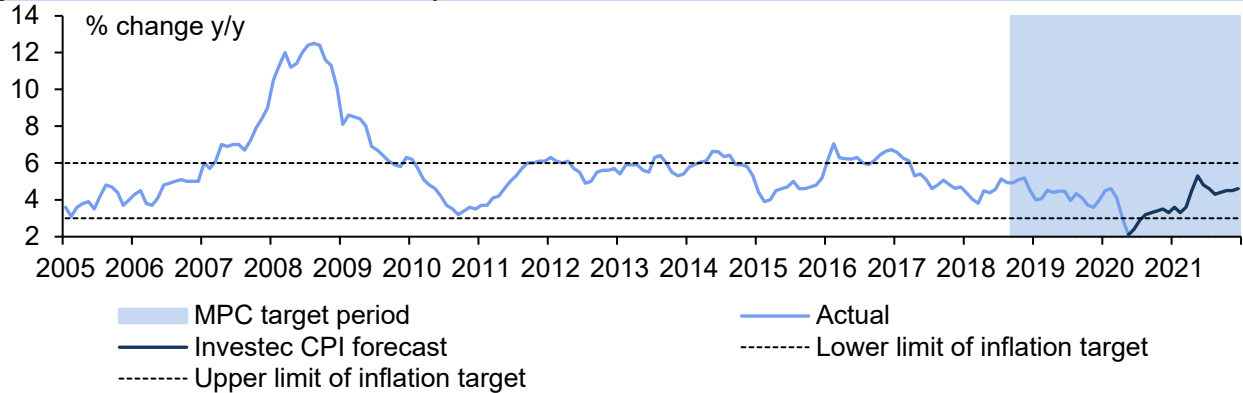




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Figure 1: SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

- The SARB’s monetary policy committee (MPC) announced a further 25bp cut this afternoon, taking the repo rate to 3.50%. The decision was split and follows a 50bp cut in May.
- The Reserve Bank has kept its average headline CPI inflation forecast for 2020 unchanged at 3.4%, while its 2021 (which is key to its inflation targeting process) and 2022 estimates have both been lowered slightly to 4.3% from 4.4% previously.
- Overall risks to the inflation trajectory are now deemed to be balanced, according to the SARB. Specifically, while international producer price and food inflation “(a)ppear to have bottomed out,” domestic food inflation is likely to remain well contained. Indeed, “(a)cross all major subsectors of agriculture, namely, livestock, field crops and horticulture production, activity is a lot more buoyant this year compared to the past two seasons,” according to Agbiz.
- Additionally, any risks to inflation from a depreciation of the rand are “(e)xpected to be muted while pass-through remains slow.” The domestic currency has depreciated by 15.2% against the greenback since January’s MPC meeting, however it has gained 8.8% since May’s meeting. Thus the implied starting point for the rand forecast has been adjusted to R17.93/USD, versus R18.40/USD at May’s meeting.
- Conversely, upside risks to the inflation trajectory include electricity and other administered prices, while “(h)eightedened fiscal risks and sharp reductions in the supply of goods and services,” could also place upside pressure on the inflation readings.

Figure 2: SARB CPI inflation forecasts (% y/y)

	2018	2019	2020	2021	2022
SARB 23 rd July 2020	4.6	4.1	3.4	4.3	4.3
SARB 21 st May 2020	4.6	4.1	3.4	4.4	4.4
SARB 14 th April 2020	4.6	4.1	3.6	4.5	4.4
SARB 19 th March 2020	4.6	4.1	3.8	4.6	4.4
SARB 16 th January 2020	4.6	4.1	4.7	4.6	4.5
SARB 21 st November 2019	4.6	4.2	5.1	4.7	

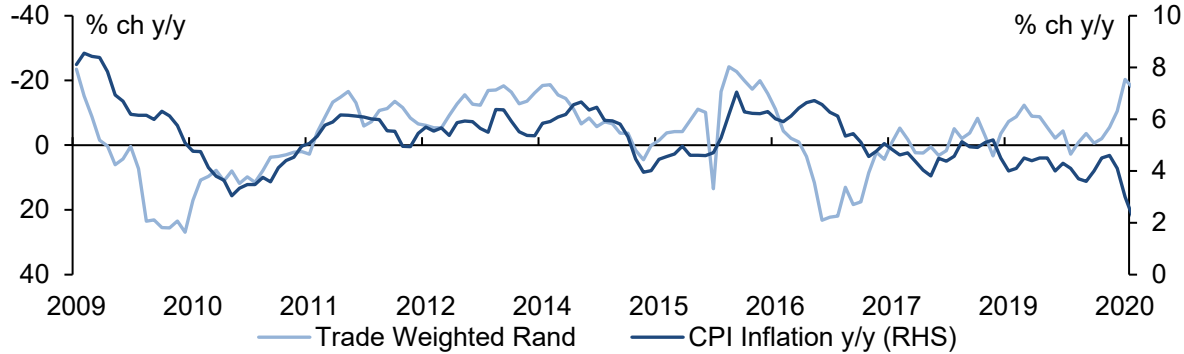
Source: SA Reserve Bank



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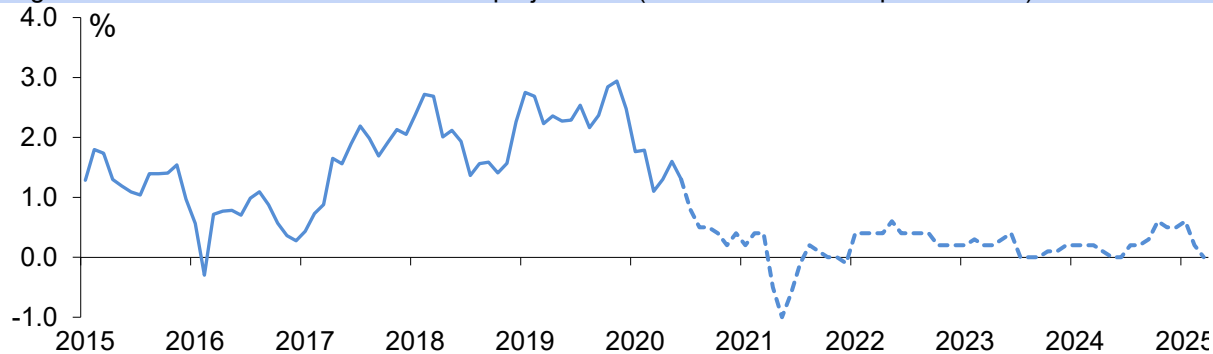
Figure 3: Trade weighted rand movements vs CPI inflation (both % change y/y)



Source: Stats SA, Iress

- Lockdown measures have eased substantially and the global economy is in the process of a patchy recovery, with markedly more positive data readings coming out. However, risk aversion remains elevated, with “(e)xtreme volatility in financial asset prices.” As such, the IMF is anticipating a sharp 4.9% global contraction for this year. While policy responses to the pandemic by advanced economies have been favourable, uncertainty remains regarding the length and severity of the crisis, with second waves of infection apparent in many countries.
- The lift in global economic activity is likely to exceed SA’s economic recovery in both speed and pace. Many structural weaknesses 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.
- The Reserve Bank projects the economy to now contract by 7.3% in 2020, versus the 7.0% estimated at the previous MPC meeting, with widespread job losses anticipated as businesses continue to close or downscale. GDP is then forecast to lift by 3.7% y/y (3.8% May forecast) in 2021 and 2.8% (2.9% May forecast) in 2022.
- Globally, conditions are expected to remain unpredictable during this unprecedented time. Accordingly, the SARB stressed once again that in “(t)his highly uncertain environment, future decisions will continue to be highly data dependent and sensitive to the balance of risks to the outlook.”
- “The implied path of policy rates over the forecast period generated by the Quarterly Projection Model indicates one repo rate cut of 25 basis points in the fourth quarter of 2020, remaining unchanged in the first quarter of 2021.”

Figure 4: South Africa’s real interest rate projections: (Investec CPI and repo forecasts)



Source: Investec, Iress

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Figure 5: Foreign sector assumptions

Percentage changes (unless otherwise indicated)	2017	Actual 2018	2019	Forecast 2020	2021	2022
1. Real GDP growth in South Africa's major trading partner countries	3.4% (3.2%)	3.2% (3.3%)	2.2% (2.3%)	-4.7% (-3.4%)	4.3% (4.3%)	4.0% (3.7%)
2. Output gap in South Africa's major trading partner countries	0.0% (0.1%)	0.1% (0.1%)	-0.1% (-0.1%)	-4.2% (-3.0%)	-2.9% (-3.1%)	-1.0% (-2.0%)
3. International commodity prices in US\$ (excluding oil)	18.2% (18.2%)	11.2% (11.0%)	-0.9% (-0.9%)	9.3% (2.0%)	-3.9% (-6.0%)	3.1% (3.2%)
4. Brent crude (US\$/Barrel)	\$54.2 (\$54.2)	\$71.0 (\$71.0)	\$64.4 (\$64.4)	\$40.0 (\$37.4)	\$45.0 (\$45.0)	\$50.0 (\$50.0)
5. World food prices (US\$)	8.1% (8.1%)	-3.5% (-3.5%)	1.8% (1.8%)	-3.0% (-3.4%)	4.5% (5.1%)	1.5% (1.5%)
6. International consumer prices	1.7% (1.7%)	2.0% (2.0%)	1.4% (1.4%)	0.5% (0.5%)	1.4% (1.4%)	1.3% (1.3%)
7. International policy interest rate	0.5% (0.5%)	0.9% (0.9%)	1.1% (1.1%)	0.1% (0.1%)	0.0% (0.0%)	0.0% (0.0%)

Source: SA Reserve Bank

Figures in blue represents the previous MPC assumption

Foreign Sector Assumptions

- Trading partner GDP growth:** is broadly determined via the Global Projection Model "GPM" which is adjusted to aggregate the GDP growth rates of South Africa's major trading partners on a trade weighted basis. Individual projections are done for the four largest trading partners (euro area, China, United States and Japan), while the remaining trading partners are grouped into three regions: Emerging Asia (excluding China), Latin America and the Rest of Countries bloc. The assumption takes account of country specific "consensus" forecasts as well as regional growth prospects.
- Output gap:** as with GDP growth the output gap is determined via the GPM and is similarly adjusted. The output gap is driven by a combination of country-specific domestic factors, external factors, and financial-real linkages (beyond interest rate and exchange rate effects). Domestic factors include expectations of future demand and medium-term interest rates. External factors include exchange rate impacts on demand, direct spillovers through trade with trading partner countries, and foreign demand.
- International consumer prices:** are also broadly determined via the GPM, the index is an aggregate of the consumer price indices of the G3 countries (euro area, United States and Japan) weighted by their relative trade weights. Consumer prices are determined for each region discussed above by accounting for expected future price inflation, demand pressures, and pass-through from changes in the relevant exchange rate. Other institutional forecasts for international consumer prices are also considered.
- Commodity price index:** is a weighted aggregate price index of the major South African export commodities based on 2010 prices. The composite index represents the total of the individual commodity prices multiplied by their smoothed export weights. Commodity price prospects generally remain commensurate with global liquidity as well as commodity demand/supply pressures as reflected by the pace of growth in the trading partner countries.
- Brent crude oil price:** is expressed in US Dollars per barrel. The assumption incorporates the analysis of factors of supply, demand (using global growth expectations) and inventories of oil (of all grades), as well as the expectations of the US Energy Information Administration (EIA), OPEC and Reuters.
- World food prices:** is the composite food price index of the Food and Agriculture Organization of the United Nations (FAO) in US dollars. It is weighted via average export shares, and represents the monthly change in the international prices of a basket of five food commodity price indices (cereals, vegetable oil, dairy, meat and sugar). World food price prospects incorporate selected global institution forecasts for food prices as well as imbalances from the anticipated trend in international food supplies relative to expected food demand pressures.

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7. **International policy interest rate:** is again broadly determined via the GPM. Interest rates are an aggregate of the policy rates of the G3 countries (euro area, United States and Japan). They are individually determined by a "Taylor-type" monetary policy rule. The communications of the relevant central banks and other institutional forecasts are also considered.

Figure 6: Domestic sector assumptions

Percentage changes (unless otherwise indicated)	2017	Actual 2018	2019	2020	Forecast 2021	2022
1. Electricity price	4.7% (4.7%)	5.2% (5.2%)	9.6% (9.6%)	9.6% (9.6%)	6.7% (6.7%)	6.0% (6.0%)
2. Fuel taxes and levies	8.3% (8.3%)	8.9% (8.9%)	5.8% (5.8%)	3.2% (5.8%)	4.5% (5.2%)	5.1% (5.0%)
3. Potential growth	1.2% (1.4%)	0.8% (0.8%)	0.6% (0.6%)	-2.1% (-2.1%)	1.1% (1.1%)	1.3% (1.3%)
4. Inflation target midpoint	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)
5. Neutral real interest rate	1.7% (1.7%)	1.9% (1.9%)	2.1% (2.1%)	2.1% (2.1%)	2.2% (2.2%)	2.3% (2.3%)

Source: SA Reserve Bank

Figures below the assumption in parentheses represents the previous MPC assumption

Domestic Sector Assumptions

- Fuel taxes and levies:** are the total domestic taxes and costs included in the price of fuel paid at the pump. They include the Road Accident Fund (RAF), the fuel levy, retail and wholesale margins, slate levy, and other minor levies. The two major taxes, which are set by the Minister of Finance in the annual budget, are the RAF and fuel levy. Income generated by the RAF levy is utilised to compensate third party victims of motor vehicle accidents while the fuel levy is used to provide funding for road infrastructure.
- Electricity price:** is an administered price measured at the municipal level with a weight of 3.75 per cent in the headline CPI basket. Electricity price adjustments generally take place in the months of July and August of each year, and the assumed pace of increase over the forecast period reflects the multi-year price determination (MYPD) agreement between Eskom and NERSA with a slight adjustment for measurement at the municipal level.
- Potential growth:** the pace of potential growth is derived from the SARB's semi-structural potential output model. The measurement accounts for the impact of the financial cycle on real economic activity and introduces economic structure via the relationship between potential output and capacity utilisation in the manufacturing sector (South African Reserve Bank, Working Paper Series, WP/14/08).
- Inflation target midpoint:** is the middle of the official target range of 3 to 6 percent.
- Neutral real interest rate:** The neutral real interest rate is the rate at which inflation is stable at the inflation target midpoint and output is operating at its potential. It is a key variable to determine the appropriate stance of monetary policy. The neutral real interest rate is a function of the model consistent real interest rate.

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