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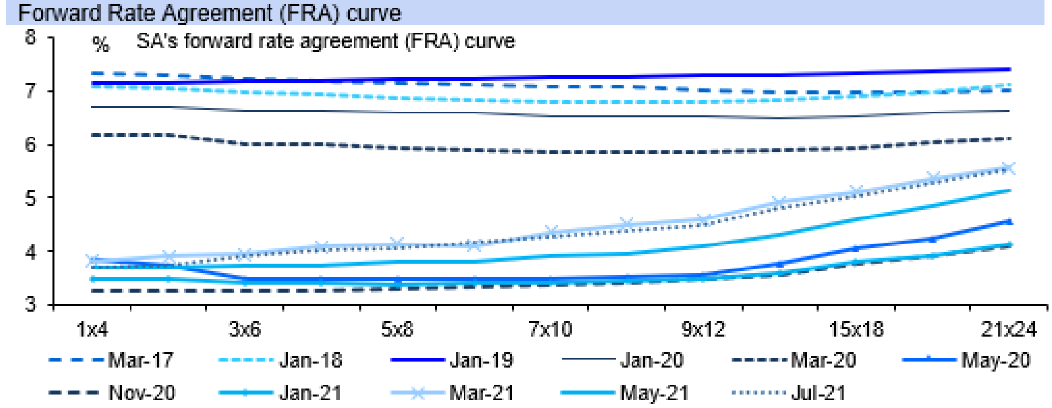
SA Economics

Thursday 22 July 2021

MPC Review: South Africa leaves its repo rate unchanged at the July MPC meeting, indicating a likely hike in Q4.21, although we currently don't think this will transpire, with inflation forecast for 2022 revised lower

Forward Rate Agreement (FRA) curve



Source: Bloomberg

Forecasts								
Period end rate %	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Repo Rate	3.50	3.50	3.50	3.50	3.75	3.75	4.00	4.00
Prime Overdraft Rate	7.00	7.00	7.00	7.00	7.25	7.25	7.50	7.50

Source: Iress, Investec

Reuters July 2021 forecasts: Repo rate end period %								
Forecast period	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	2021	2022	2023
SARB repo rate	3.50	3.50	3.75	3.75	4.00	3.50	4.00	4.50
Previous survey	3.50	3.50	3.75	3.75	4.00	3.50	4.00	4.75

Source: Reuters

- The Monetary Policy Committee's (MPC) unchanged stance on interest rates saw the rand weaken, to R14.66/USD, with many EM Central Banks having hiked rates. However, there was pressure coming though from the MPC for longer-term normalisation of monetary policy.
- The SARB highlighted that financial market and economic conditions are expected to remain volatile for South Africa in the foreseeable future. Global growth is a concern on

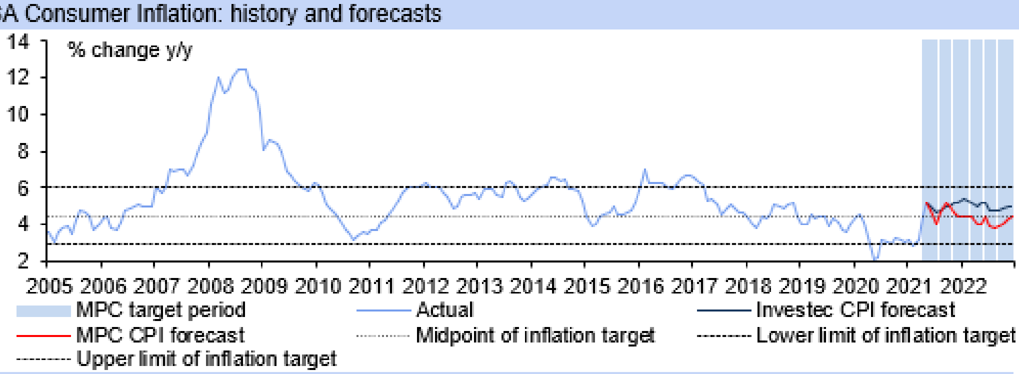
the spread of the delta variant, while recent unrest in the country has clouded the economic outlook.

- Worries over tighter lockdown restrictions, and the negative impact on global growth in key economies is a particular concern, with commodity prices having weakened, particularly metal prices, which has negatively affected the rand this week.
- The SARB lifted its inflation forecast for this year somewhat, to 4.3% y/y from 4.2% y/y, but it is the expected inflation outcome six to twenty-four months out, and particularly twelve to eighteen months out, which influences the SARB repo rate decisions.
- While the SARB lowered its 2022 inflation outlook to 4.2% y/y from 4.4% y/y, and left its 2023 inflation outlook unchanged at 4.5% y/y, the midpoint of the inflation target range, it projects hikes in the repo rate this year and next (25bp in Q4.21 and over 100bp in 2022).
- It forecasts yet further interest rate hikes over 2023, totalling around 100bp, but adds this is still highly accommodative monetary policy as the differential between inflation and the repo rate only rises to 0.5% by the end of 2023, with a neutral level instead seen at 2.0%.
- The economy is unlikely to be particularly robust over 2022 or 2023, and such a 2.25% hike in the repo rate is currently unlikely. The SARB forecasts weak economic growth of 2.3% y/y in 2022 and 2.4% y/y in 2023. For 2021 it forecasts 4.2% y/y, although this is at risk.
- The SARB's interest rate forecasts from its quarterly projection model change frequently, and the SARB also ignores the projections depending on the conditions in the economy. However, faster economic growth will not be achieved by lower interest rates but by structural reform.
- Impasses in policy proposals need to be overcome so that economic growth enhancing reforms are promoted, and SA urgently needs to sees efforts to boost business confidence through cutting red tape and the regulatory burden, and adopting free market policies.

Forecasts	2020	2021	2022	2023	2024	2025	2026
Repo Rate	3.50	3.50	4.00	4.25	4.50	4.75	5.00
Prime Overdraft Rate	7.00	7.00	7.50	7.75	8.00	8.25	8.50
SA rand bond	10.08	10.10	10.10	10.00	10.10	10.10	10.20
US Fed funds rate	0.25	0.25	0.25	0.50	1.00	1.50	2.00
UK Bank rate	0.10	0.10	0.10	0.50	1.00	1.50	2.00

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

SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

Economic Scenarios: note probability updates

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Extreme	USD/Rand (average)	14.96	14.13	13.50	13.20	13.00	12.90	12.80	12.70
Up case	Repo rate (end rate)	3.50	3.50	3.25	3.25	3.25	3.25	3.25	3.25

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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Up case 3%	USD/Rand (average)	14.96	14.13	13.70	13.50	13.30	13.40	13.20	13.00
	Repo rate (end rate)	3.50	3.50	3.50	3.50	3.50	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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Base	USD/Rand (average)	14.96	14.13	14.35	14.25	14.35	14.75	15.05	14.65
case	Repo rate (end rate)	3.50	3.50	3.50	3.50	3.75	3.75	4.00	4.00

49% Recovery from the sharp global economic slowdown by 2024 in real terms– sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises then improves. Expropriation of private sector property is limited and does not have a negative impact on the economy or on market sentiment. SA remains in the BB category rating bracket for Moody's – fiscal consolidation (debt to GDP stabilisation) occurs.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Lite	USD/Rand (average)	14.96	14.13	15.15	15.50	16.00	16.65	16.90	17.00
(domestic)	Repo rate (end rate)	3.50	3.50	3.75	4.00	4.00	4.25	4.25	4.50

Down case **41%** The international environment (including risk sentiment) is that of the base case. South Africa fails to see its debt projections stabilise and falls into single B credit ratings from all three agencies for local and foreign currency. Recession occurs. Expropriation of some private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed, rand weakness, significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Severe	USD/Rand (average)	14.96	14.13	15.65	16.40	17.00	17.50	18.00	18.50
down	Repo rate (end rate)	3.50	3.50	4.00	4.25	4.50	4.50	4.75	5.00

case **6%** Lengthy global recession, 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 CCC grade and lower to D (default) 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 Q3.21. Source: Investec

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https://www.investec.com/en_za/focus/economy.html