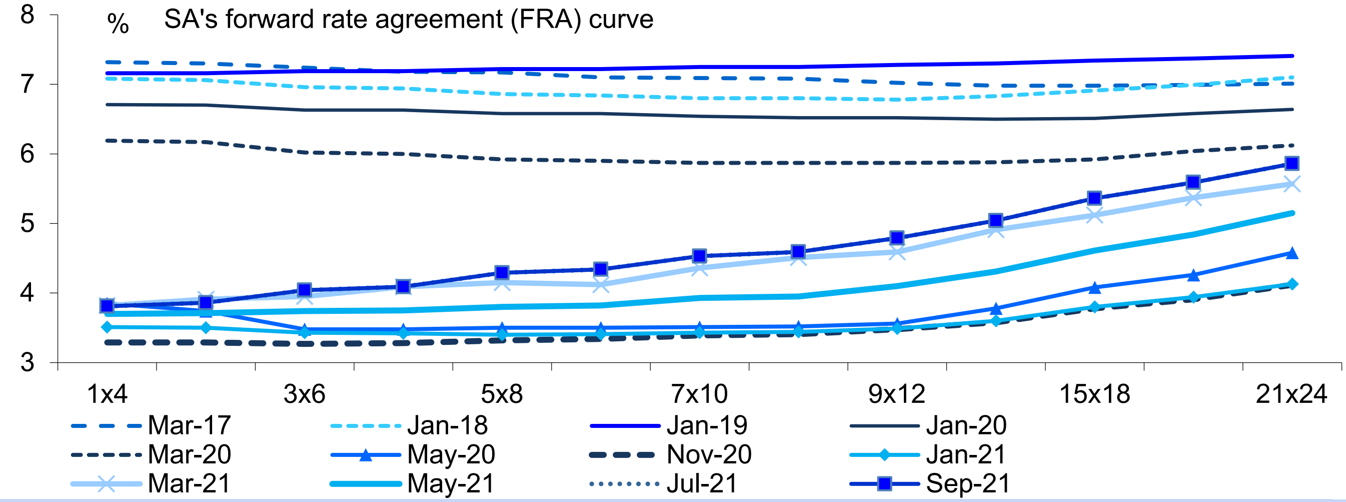
Investec

MPC preview: South Africa is currently likely to leave its repo rate unchanged at both the September MPC meeting and the rest of this year

Wednesday 15 September 2021

Figure 1: Forward Rate Agreement (FRA) curve



Source: Bloomberg

The Monetary Policy Committee (MPC) meets next week to decide on its interest rate, with Thursday 23rd September likely seeing an unchanged stance. The Governor recently presented to Parliament and identified that inflation was likely to remain contained within the inflation target, around the 4.5% midpoint over the inflation targeting period, and a change in interest rates was not expected this year. However, this does not mean that monetary policy normalisation in SA is not on the cards, and higher interest rates are still likely next year for South Africa (we have revised up our view). South Africa's Reserve Bank (SARB) has also put forward its plans to seek a lower inflation target, a figure below the current 4.5% midpoint of the target range, potentially closer to 3.0%. However, National Treasury is responsible for setting the inflation target/s and or range in South Africa, while the SARB is responsible for achieving it. Should the SARB not meet the target it needs to explain to Treasury the reason for missing it and its mechanisms for returning inflation to the target. With SA having seen CPI inflation average 4.1% y/y in 2019 and 3.3% y/y last year, after 2018's 4.7% and 2017's 5.3% y/y (2016 6.3% y/y), the SARB's thoughts have turned to a lower inflation target. This year inflation is likely to average 4.5% y/y, and next year a bit higher, while the net outcome of the recent civil servants' wage negotiations is an overall increase of 5.5% y/y, adding in all the areas of renumeration which saw increases. Furthermore, state administered prices are also running well above the 4.5% y/y inflation target mid-point and are unlikely to collapse down to 3.0% y/y annual increases, or lower, given the huge, unresolved debt burden and financial pressure on Eskom. Proposals for Eskom to see some debt forgiveness in exchange for borrowing for green investing are likely to fall flat with investors if taken to markets as current holders of Eskom debt do want the money they have invested returned (repaid), and by not doing so would substantially elevate country risk (SA guarantees a large part of Eskom's debt) and so would increase bond yields generally, and therefore SA long-term interest rates.

Figure 2: 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	3.50	3.75	3.75	4.00
Prime Overdraft Rate	7.00	7.00	7.00	7.00	7.00	7.25	7.25	7.50

Source: Iress, Investec

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Figure 3:Economic Scenarios: note interest rate hikes pushed out in expected case

		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 **2%**	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	14.55	14.35	14.45	14.85	15.15	14.75
case	Repo rate (end rate)	3.50	3.50	3.50	3.50	3.50	3.75	3.75	4.00

48% 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	3.75	4.00	4.00	4.25	4.25

Down case **43%** 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	4.00	4.50	4.50	5.00	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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Figure 4: Reuters August 2021 forecasts: Repo rate end period %									
Forecast period	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4,22	2021	2022	2023
SARB repo rate	3.50	3.50	3.75	3.75	4.00	4.25	3.50	4,25	4.50
Previous survey	3.50	3.50	3.75	3.75	4.00	na	3.50	4.00	4.50
									Source: Reuters

Indeed, SA's bond yields could rise substantially higher, depending on the quantum of debt forgiveness eventually proposed, if this goes ahead, in what would essentially be a voluntary debt default on behalf of the SOE, and so indirectly likely seen as a government voluntary default, would not be taken kindly by financial markets, creating risk aversion and so risk-off towards SA's assets generally. Government in general, has elevated debt levels and while the ratios have moderated as a % of GDP due to the 11% upwards revision to the size off the economy, this does not mean the fiscal position itself has actually improved on a level basis. There has been some reduction in the quantum of Eskom's debt, to about R400bn as it repaid matured loans, a 17% drop from R484bn. Substantial cost saving, eradication of corruption and upskilling have not yet returned the SOE to a sufficient level of cash generation to cover its costs (both interest payments and operating expenses) and electricity tariff hikes well above 4.5% are likely for the next several years if the current model continues. However, R401bn is still a very sizeable amount of debt, while reportedly government continues to drag its heels on the best way to deal with Eskom's debt (but repayment and reduction is the best solution) as many areas of government weigh in, slowing the process along with COVID-19 reportedly according to Minister Gordhan.

Lowering SA's inflation target will mean putting pressure on consumer demand, as supply pressures will remain elevated on the state administered side, while relying on lower oil (and commodities) prices and rand strength to moderate inflation as occurred last year, is unlikely to be of any sustained assistance. While food price pressures (the largest component in the CPI) are expected to be aided by the bumper summer crops expected for 2021/22, input costs for agricultural production have seen high inflation which will moderate this. SA is not entering a naturally lower inflation cycle, or even reading for next year than this year at the moment, and unless factors change, lowering the average inflation rate to below 4.5% y/y will require higher interest rates to quell consumer demand in an already fragile economic recovery, with COVID-19 still an uncertainty and no guarantee restrictions will not be tightened again. The MTBPS may give some insight on when, or if, a lowering of the inflation target is being considered, but SA is already likely to see a hike next year in the repo rate. This could be brought forward, and even repeated next year more than once if other EM markets increase their hikes, and if the US sees a less hawkish taper of its QE than has recently been recalibrated into market expectations from the latest Fed communications.

The EU now has an inflation target of 2.0%, previously close to, but below, 2.0%, and when inflation targeting was introduced in the area it was an upper bound of 2.0% y/y but no lower bound for the target range. The EU target has essentially crept up but critics are still concerned it stifles growth. The UK in

Figure 5: Reuters August 2021 forecasts: CPI % y/y									
Forecast period	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	2021	2022	2023
CPI % y/y	4.7	4.8	4.7	4.3	4.2	4.2	4.4	4.4	4.4
Previous survey	4.6	4.6	4.6	4.3	4.2	na	4.3	4.4	4.4
									Source: Reuters

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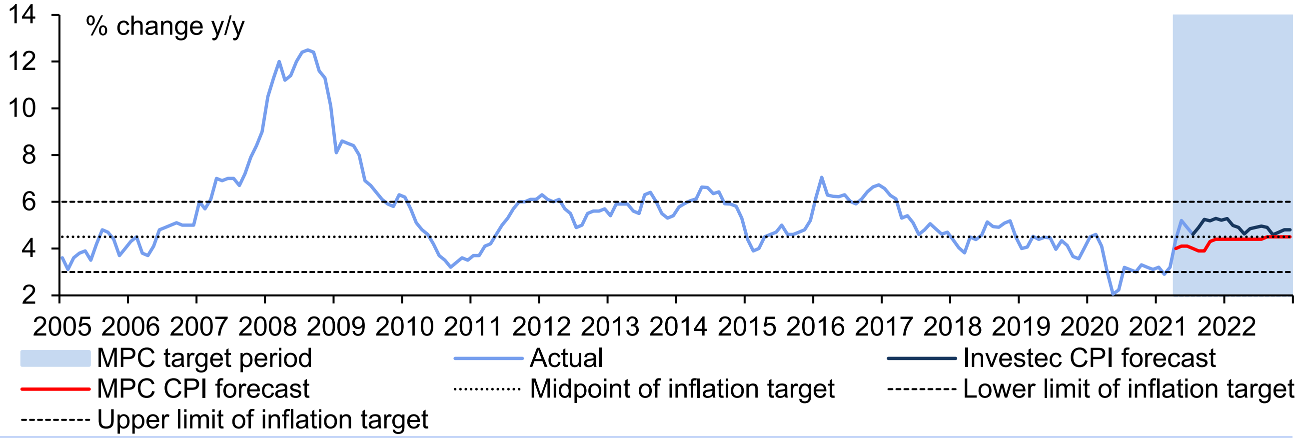
Figure 6: SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

Figure 7: Reuters August 2021 Foreign exchange rates poll: USDZAR

	1M	3M	6M	1Y
Release/Effective Date	30 Sep 2021	30 Nov 2021	28 Feb 2021	31 Aug 2022
Median	14.5000	14.5750	14.8550	15.2800
High	15.2500	15.7500	16.0000	16.5000
Low	13.3000	13.1000	13.0000	12.8000
No. of forecasts	21	22	22	19

Source: Reuters

Figure 8: SA Monetary Policy Committee (MPC) meeting dates for 2021

Month	Date	Forecast
September	21st – 23rd	3.50
November	16th – 18th	3.50

Source: SA Reserve Bank, Investec

Figure 9: Reuters August 2021 forecasts: GDP

Forecast period	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	2021	2022	2023
GDP q/q %	-2.3	3.0	3.2	3.2	2.3	2.1	4.3	2.4	2.1
Previous survey	1.0	2.7	2.2	2.4	2.5	na	4.3	2.2	1.9

Source: Reuters

Figure 10: Inflation forecasts	2020	2021	2022	2023	2024	2025	2026
Consumer Inflation (Av: %)	3.3	4.5	4.9	4.7	4.8	5.0	5.2
Producer Inflation (Av: %)	2.5	6.3	5.4	4.7	4.6	4.8	5.0
Salary & wage increases (%)	0.9	4.9	5.0	5.4	6.0	6.4	6.5

Source: Investec

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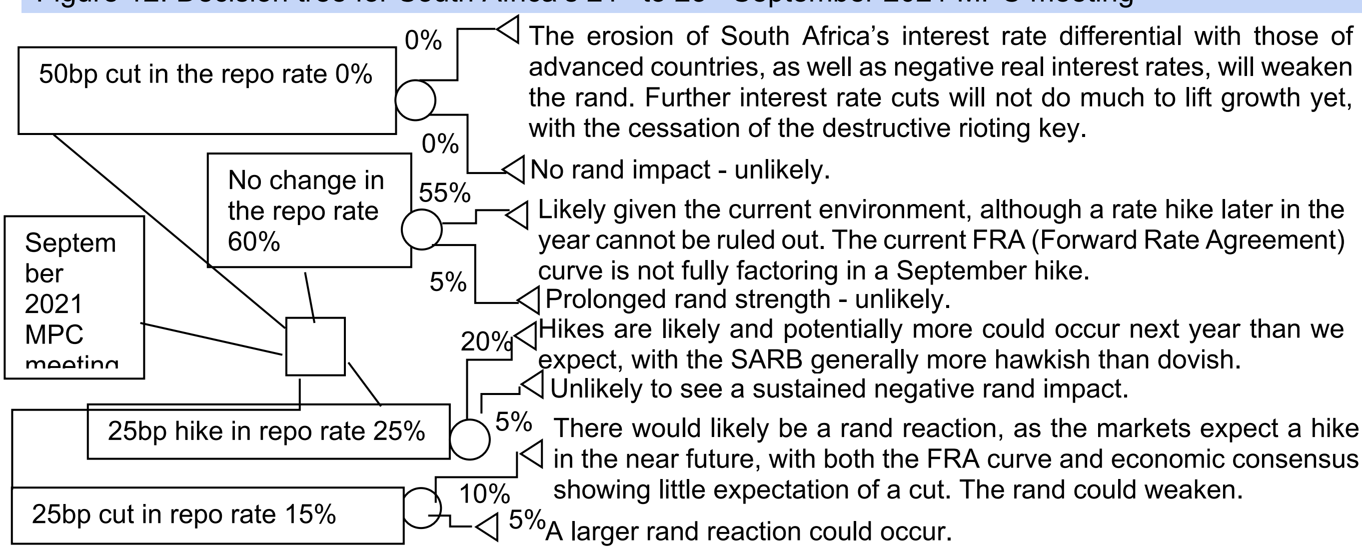
Figure 11: forecasts	2020	2021	2022	2023	2024	2025	2026
Repo Rate	3.50	3.50	4.00	5.00	6.00	6.50	6.50
Prime Overdraft Rate	7.00	7.00	7.50	8.50	9.50	10.00	10.00
SA rand bond	10.08	10.10	10.10	10.00	10.10	10.10	10.20
US Fed funds rate	0.25	0.25	0.25	0.75	1.25	1.75	2.25
UK Bank rate	0.10	0.10	0.50	1.00	1.50	2.00	2.00

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

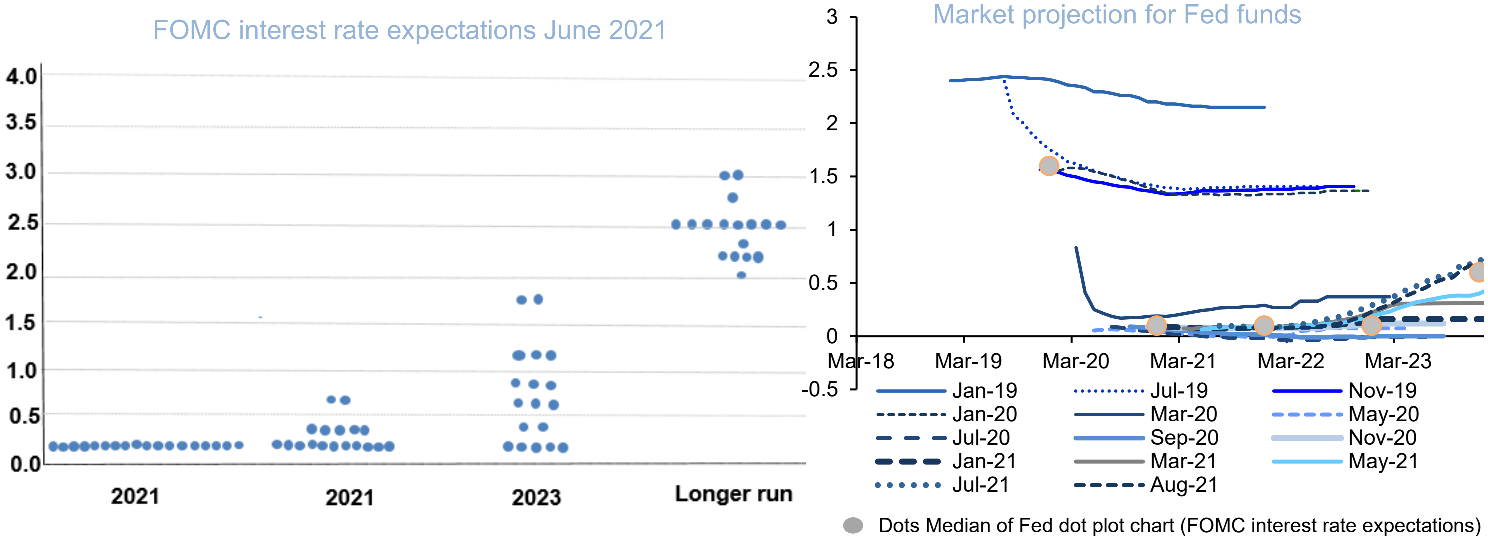
contrast has an inflation target of 2% but with a 1% band around this (a 1% to 3% range), allowing more flexibility. The EU also has less flexibility in its monetary targeting given the treaties it is bound by in its formation. The EU does now note that when its policy rate is close to zero (zero bound), it will use 'especially forceful or persistent monetary policy measures to avoid negative deviations from the inflation target becoming entrenched. This may also imply a transitory period in which inflation is moderately above target'. South Africa is unlikely to have this problem, but the UK, US and EU are South Africa's chief trading partners, along with China, and the SARB is looking to reduce SA's midpoint of 4.5% to close to that of its key trading partners. The US has a looser approach to monetary policy considering both inflation (with a particularly informal target of 2.0% y/y), and a strong, if not stronger, focus on unemployment (or full employment). China currently looks to see inflation at 3.0% y/y. If SA faces strong inflationary pressures from drought, high oil prices, rand collapse (all of which have occurred many times in the past) its inflation rate tends to rise towards 6.0% y/y, and climate change is a key risk. Keeping it at 4.5% y/y – or potentially 3.5% y/y or 3.0% y/y implies hawkish monetary policy and higher interest rates. SA's repo rate is currently at 3.5% y/y with the SARB having said a neutral rate would be 2% above inflation, or a repo rate of 6.5% y/y this year with inflation at 4.5% y/y. Already a 3.0% y/y hike in interest rates would be envisioned for monetary policy normalisation if the CPI inflation rate averages 4.5% y/y for the period. If inflation averages 3.0% y/y a neutral repo rate of 5.0% y/y would be seen, or 4.0% y/y for a SA inflation rate of 2.0% y/y.

Figure 12: Decision tree for South Africa's 21st to 23rd September 2021 MPC meeting



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

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 2021 Meeting Schedule

September 21st – 22nd
November 2nd – 3rd
December 14th – 15th*

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
Q1.21	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
Q1.22	0.00-0.25	0.00	-0.50	0.10
Q2.22	0.00-0.25	0.00	-0.50	0.25
Q3.22	0.00-0.25	0.00	-0.50	0.25
Q4.22	0.00-0.25	0.00	-0.50	0.50

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	3.9	3.50	0.4
Sep 2020	7.00	4.0	3.50	0.5
Oct 2020	7.00	3.7	3.50	0.2
Nov 2020	7.00	3.8	3.50	0.3
Dec 2020	7.00	3.9	3.50	0.4
Jan 2021	7.00	3.8	3.50	0.3
Feb 2021	7.00	4.1	3.50	0.6
Mar 2021	7.00	3.8	3.50	0.3
Apr 2021	7.00	2.6	3.50	-0.9
May 2021	7.00	1.8	3.50	-1.7
Jun 2021	7.00	2.1	3.50	-1.4
Jul 2021	7.00	2.4	3.50	-1.1
Aug 2021	7.00	2.1	3.50	-1.4
Sep 2021	7.00	1.8	3.50	-1.7
Oct 2021	7.00	1.8	3.50	-1.7
Nov 2021	7.00	1.7	3.50	-1.8
Dec 2021	7.00	1.8	3.50	-1.7
Jan 2022	7.00	1.7	3.50	-1.8
Feb 2022	7.00	2.0	3.50	-1.5
Mar 2022	7.00	2.1	3.50	-1.4
Apr 2022	7.00	2.4	3.50	-1.1
May 2022	7.25	2.4	3.75	-1.1
Jun 2022	7.25	2.3	3.75	-1.2
Jul 2022	7.25	2.3	3.75	-1.2
Aug 2022	7.25	2.3	3.75	-1.2
Sep 2022	7.25	2.7	3.75	-0.8
Oct 2022	7.25	2.6	3.75	-0.9
Nov 2022	7.50	2.7	4.00	-0.8
Dec 2022	7.50	2.7	4.00	-0.8

Source: IRESS, Investec

South Africa is not a high-income economy (with resultant low unemployment), nor is it an extremely large economy like China, which is the second largest in the world (and also has reported low unemployment). SA is a small open, and particularly fragile, economy, with exceptionally high unemployment, little will from government to make the structural reforms needed to triple the size of the private sector and so bring down

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Figure 16: Interest rate forecast end rates (continued)

Date	Prime forecast	Prime less Inflation	Repo	Repo less Inflation
Jan 2023	7.50	2.6	4.00	-0.9
Feb 2023	7.50	2.6	4.00	-0.9
Mar 2023	7.75	2.8	4.25	-0.7
Apr 2023	7.75	2.8	4.25	-0.7
May 2023	7.75	3.0	4.25	-0.5
Jun 2023	7.75	3.1	4.25	-0.4
Jul 2023	8.00	3.4	4.50	-0.1
Aug 2023	8.00	3.6	4.50	0.1
Sep 2023	8.00	3.5	4.50	0.0
Oct 2023	8.00	3.4	4.50	-0.1
Nov 2023	8.50	3.8	5.00	0.3
Dec 2023	8.50	3.7	5.00	0.2
Jan 2024	8.50	3.7	5.00	0.2
Feb 2024	8.50	3.8	5.00	0.3
Mar 2024	8.75	4.0	5.25	0.5
Apr 2024	8.75	3.8	5.25	0.3
May 2024	8.75	3.7	5.25	0.2
Jun 2024	8.75	3.7	5.25	0.2
Jul 2024	9.00	4.2	5.50	0.7
Aug 2024	9.00	4.2	5.50	0.7
Sep 2024	9.00	4.2	5.50	0.7
Oct 2024	9.00	4.4	5.50	0.9
Nov 2024	9.50	4.9	6.00	1.4
Dec 2024	9.50	5.1	6.00	1.6
Jan 2025	9.50	5.0	6.00	1.5
Feb 2025	9.50	4.2	6.00	0.7
Mar 2025	9.75	4.3	6.25	0.8
Apr 2025	9.75	4.6	6.25	1.1
May 2025	9.75	4.8	6.25	1.3
Jun 2025	9.75	4.8	6.25	1.3
Jul 2025	9.75	4.8	6.25	1.3
Aug 2025	9.75	4.7	6.25	1.2
Sep 2025	10.00	4.9	6.50	1.4
Oct 2025	10.00	5.0	6.50	1.5
Nov 2025	10.00	5.1	6.50	1.6
Dec 2025	10.00	5.0	6.50	1.5

Source: IRESS, Investec

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		
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		
Jul 2020	116.4	3.2	1.3			
Aug 2020	116.6	3.1	0.2			
Sep 2020	116.8	3.0	0.2	3.1		
Oct 2020	117.1	3.3	0.3			
Nov 2020	117.1	3.2	0.0			
Dec 2020	117.3	3.1	0.2	3.2	2020	3.3
Jan 2021	117.7	3.2	0.3			
Feb 2021	118.5	2.9	0.7			
Mar 2021	119.3	3.2	0.7	3.1		
Apr 2021	120.1	4.4	0.7			
May 2021	120.2	5.2	0.2			
Jun 2021	120.5	4.9	0.3	4.8		
Jul 2021	121.8	4.6	1.1			
Aug 2021	122.3	4.9	0.5			
Sep 2021	122.9	5.2	0.5	4.9		
Oct 2021	123.2	5.2	0.2			
Nov 2021	123.3	5.3	0.1			
Dec 2021	123.4	5.2	0.1	5.2	2021	4.5
Jan 2022	123.9	5.3	0.4			
Feb 2022	124.4	5.0	0.4			
Mar 2022	125.2	4.9	0.6	5.1		
Apr 2022	125.7	4.6	0.4			
May 2022	126.0	4.9	0.3			
Jun 2022	126.4	4.9	0.3	4.8		
Jul 2022	127.8	5.0	1.1			
Aug 2022	128.3	4.9	0.4			
Sep 2022	128.6	4.6	0.2	4.8		
Oct 2022	129.0	4.7	0.3			
Nov 2022	129.2	4.8	0.2			
Dec 2022	129.3	4.8	0.1	4.8	2022	4.9

Source: Stats SA, Investec

the unemployment rate towards, but not even reaching, single digits. By lowering its inflation target towards those of higher income economies SA will doubtless initially see pressure on interest rates, at least initially. The crisis of unemployment in SA is growing and should be the core focus of government.

Figure 17: CPI forecast averages (continued)

Date	Index Base 2016	Annual y/y	Monthly m/m	Quarterly y/y	Calendar year y/y	
Jan 2023	130.0	4.9	0.5			
Feb 2023	130.5	4.9	0.4			
Mar 2023	131.3	4.9	0.6	4.9		
Apr 2023	131.8	4.9	0.4			
May 2023	132.1	4.8	0.2			
Jun 2023	132.3	4.7	0.2	4.8		
Jul 2023	133.7	4.6	1.0			
Aug 2023	133.9	4.4	0.2			
Sep 2023	134.3	4.5	0.3	4.5		
Oct 2023	134.9	4.6	0.4			
Nov 2023	135.3	4.7	0.3			
Dec 2023	135.5	4.8	0.2	4.7	2023	4.7
Jan 2024	136.2	4.8	0.5			
Feb 2024	136.6	4.7	0.3			
Mar 2024	137.6	4.8	0.7	4.8		
Apr 2024	138.3	4.9	0.5			
May 2024	138.7	5.0	0.3			
Jun 2024	139.0	5.0	0.2	5.0		
Jul 2024	140.1	4.8	0.8			
Aug 2024	140.4	4.8	0.2			
Sep 2024	140.8	4.8	0.3	4.8		
Oct 2024	141.1	4.6	0.2			
Nov 2024	141.5	4.6	0.3			
Dec 2024	141.6	4.4	0.1	4.5	2024	4.8
Jan 2025	142.4	4.5	0.6			
Feb 2025	143.8	5.3	1.0			
Mar 2025	145.1	5.5	0.9	5.1		
Apr 2025	145.4	5.2	0.2			
May 2025	145.6	5.0	0.1			
Jun 2025	145.9	5.0	0.2	5.0		
Jul 2025	147.0	5.0	0.8			
Aug 2025	147.5	5.1	0.3			
Sep 2025	147.9	5.1	0.3	5.0		
Oct 2025	148.1	5.0	0.1			
Nov 2025	148.4	4.9	0.2			
Dec 2025	148.7	5.0	0.2	4.9	2025	5.0
Jan 2026	149.5	5.0	0.6			
Feb 2026	151.0	5.0	1.0			
Mar 2026	152.4	5.0	0.9	5.0		
Apr 2026	153.0	5.2	0.4			
May 2026	153.5	5.4	0.3			

Source: Stats SA, Investec

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