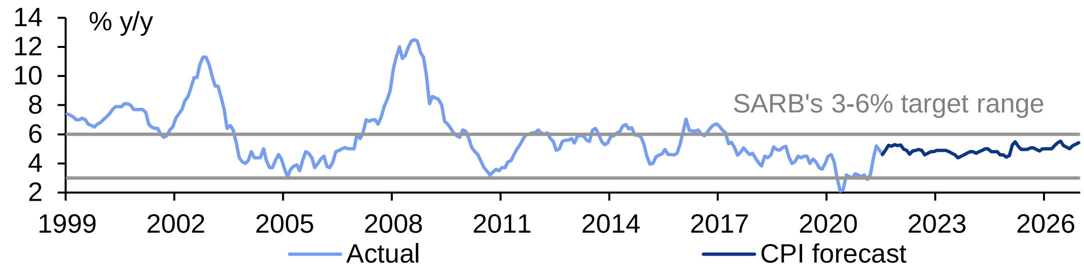
Investec

MPC update: SARB keeps rates unchanged at 3.50%, however overall risks to the short-term inflation outlook remain to the upside

Thursday 23 September 2021

Figure 1: CPI inflation: history and Investec forecasts



Sources: SARB, Stats SA, Investec

- The SARB's monetary policy committee (MPC) unanimously decided to keep the repo rate unchanged at 3.50% for now, however the implied policy rate path of the SARB's Quarterly Projection Model (QPM) which is highly dependent on new data and risks "indicates an increase of 25 basis points in the fourth quarter of 2021 and further increases in each quarter of 2022 and 2023".
- The SARB's inflation expectations for this year have increased slightly to 4.4% (from 4.3% previously), while its 2022 and 2023 projections remain unchanged at 4.2% and 4.5% respectively. This is largely in line with market-based expectations.
- Overall risks to the short-term inflation trajectory remain to the upside. Indeed, "global producer price and food price inflation have surprised to the upside in recent months and could do so again", according to the SARB, although Agbiz does still expect food price inflation to moderate on the "possible softening in grain-related products, dairy and vegetables." However, it has stressed that the outlook for meat prices "remains uncertain for now".
- Another risk to the short-term inflation outcome is the oil price which has picked up notably after dipping in August and remains volatile. Additionally, the persistent risk of electricity and other administered prices remains. Indeed, Eskom's electricity price increases have exceeded CPI for over a decade, and this is likely to persist as cash strapped Eskom, continues to face marked financial challenges.
- Longer-term risks to the inflation trajectory include "higher domestic import tariffs" rising wage demands and a softer rand. Specifically, while the domestic currency has appreciated by 1.5% year to date, on a trade-weighted basis, it has depreciated by 1% since the July MPC meeting. Accordingly, the implied starting point for the rand forecast has been revised to R14.47 against the greenback, from R14.40 previously. Furthermore, should headway towards the Fed's inflation and employment goals continue largely in line with expectations, then tapering could commence sooner than originally anticipated weighing on risk assets and the rand.

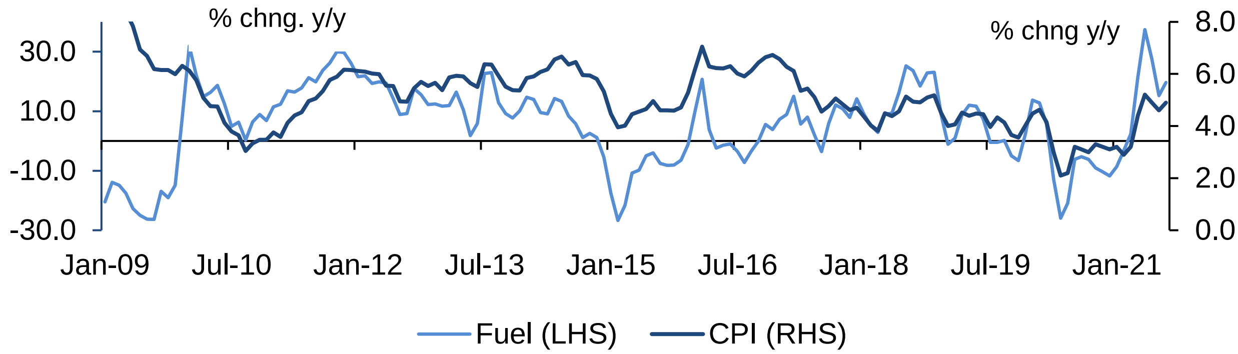
Figure 2: SARB CPI inflation forecasts (% y/y)

	2021	2022	2023
SARB 23rd September 2021	4.4	4.2	4.5
SARB 22nd July 2021	4.3	4.2	4.5
SARB 20th May 2021	4.2	4.4	4.5
SARB 25th March 2021	4.3	4.4	4.5
SARB 21st January 2021	4.0	4.5	4.6

Source: SA Reserve Bank

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za•

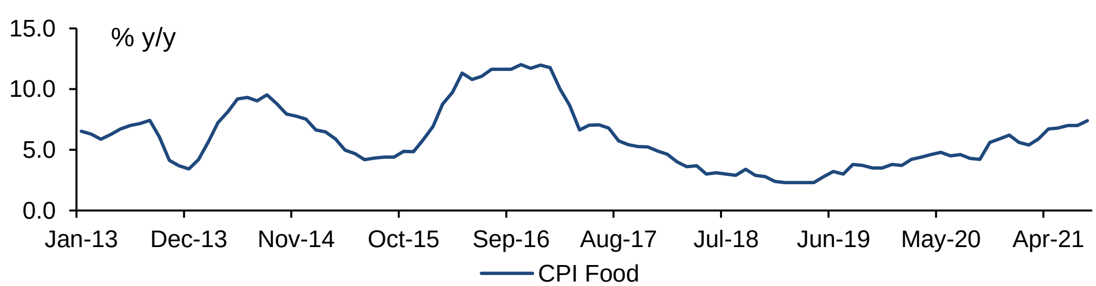
Figure 3: Fuel price inflation vs headline CPI



Source: Stats SA

- The IMF's global growth forecast of 6.0% will be revised in October. Rising infection rates in a number of countries could weigh on the outcome. Global growth continues to remain uneven with emerging markets lagging developed economies, prejudiced by slower vaccination rollouts and limited fiscal stimulus.
- South Africa's economy has been buoyed by favourable commodity prices, however it remains fragile. The looting and social unrest that occurred in July along with the tighter lockdown restrictions will l weigh on Q3.21's GDP outcome. While the SARB's GDP forecast for 2021 has been revised upwards to 5.3% y/y from 4.2% y/y previously, growth expectations for 2022 and 2023 have been lowered to 1.7% y/y (from 2.3% y/y) and to 1.8% y/y (from 2.4% y/y) respectively. Indeed, the events that took place in July, coupled with the devastating effects of the pandemic generally, "are likely to have lasting effects on investor confidence and job creation, impeding recovery in labour-intensive sectors hardest hit by the lockdowns".
- The SARB continues to evaluate the risks to the medium-term domestic growth outlook to be balanced, "as most of the bounceback from the recovery is now in the past". Elevated export prices are expected to wane, while SA's elevated unemployment rate and low labour absorption rate will continue to constrain household expenditure (which accounts for 60% of GDP). Additionally, electricity supply constraints and the potential for further waves and lockdowns remains a risk to economic recovery.
- These repo rate levels signify "a highly accommodative policy stance through the end of the forecast, keeping financial conditions supportive of credit demand as the economy continues to recover."

Figure 4: Food price inflation



Source: Stats SA

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za•

MPC update: SARB keeps rates unchanged at 3.50%, however overall risks to the short-term inflation outlook remain to the upside

Thursday 23 September 2021

Figure 5: Foreign sector assumptions						
Percentage changes (unless otherwise indicated)	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Real GDP growth in South Africa's major trading partner countries	3.3% (3.3%)	2.2% (2.2%)	-2.9% (-2.8%)	6.2% (6.1%)	4.4% (4.4%)	3.4% (3.4%)
2. Output gap in South Africa's major trading partner countries	0.8% (0.8%)	0.6% (0.6%)	-3.1% (-3.3%)	-1.4% (-1.6%)	-0.4% (-0.4%)	1.5% (1.5%)
3. International commodity prices in US$ (excluding oil)	11.5% (11.5%)	-1.2% (-1.2%)	25.5% (25.5%)	48.3% (48.1%)	-20.1% (-20.8%)	-2.7% (-1.8%)
4. Brent crude (US$/Barrel)	$71.0 ($71.0)	$64.4 ($64.4)	$41.8 ($41.8)	$69 ($66.7)	$67.0 ($65.0)	$65.0 ($63.0)
5. World food prices (US$)	-2.2% (-2.2%)	-0.8% (-0.8%)	3.1% (3.1%)	13.4% (12.8%)	-3.1% (-2.8%)	1.5% (1.5%)
6. International consumer prices	2.0% (2.0%)	1.4% (1.4%)	0.7% (0.7%)	2.4% (2.2%)	2.0% (2.0%)	1.8% (1.8%)
7. International policy interest rate	0.9% (0.9%)	1.1% (1.1%)	0.2% (0.2%)	0.0% (0.0%)	0.0% (0.0%)	0.1% (0.1%)

Figures in blue represents the previous MPC assumption

Foreign Sector Assumptions

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.
6. **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.
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.

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za•

Figure 6: Domestic sector assumptions						
Percentage changes (unless otherwise indicated)	2018	Actual 2019	2020	2021	Forecast 2022	2023
1. Electricity price	5.2% (5.2%)	9.6% (9.6%)	9.1% (9.1%)	10.1% (10.6%)	11.8% (12.1%)	10.0% (10.0%)
2. Fuel taxes and levies	9.9% (9.9%)	5.8% (5.8%)	5.7% (5.7%)	5.8% (5.3%)	5.7% (4.9%)	4.7% (4.7%)
3. Potential growth	1.2% (0.7%)	0.3% (0.3%)	-3.1% (-2.5%)	3.4% (1.6%)	0.8% (0.9%)	0.8% (0.9%)
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	1.9% (1.9%)	2.1% (2.1%)	2.0% (2.0%)	2.1% (2.1%)	2.3% (2.3%)	2.3% (2.3%)

Source: SA Reserve Bank

Figures below the assumption in parentheses represents the previous MPC assumption

Domestic Sector Assumptions

1. **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.
2. **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.
3. **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).
4. **Inflation target midpoint:** is the middle of the official target range of 3 to 6 percent.
5. **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.

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za•

Important Disclaimer – please read

For the purposes of this disclaimer, Investec shall include Investec Bank Limited, its ultimate holding company, a subsidiary (or a subsidiary of a subsidiary) of that entity, a holding company of that entity or any other subsidiary of that holding company, and any affiliated entity of any such entities. "Investec Affiliates" shall mean any directors, officers, representatives, employees, advisers or agents of any part of Investec.

The information and materials presented in this report are provided to you solely for general information and should not be considered as an offer or solicitation of an offer to sell, buy or subscribe to any securities or any derivative instrument or any other rights pertaining thereto.

The information in this report has been compiled from sources believed to be reliable, but neither Investec nor any Investec Affiliates accept liability for any loss arising from the use hereof or makes any representations as to its accuracy and completeness. Any opinions, forecasts or estimates herein constitute a judgement as at the date of this report. There can be no assurance that future results or events will be consistent with any such opinions, forecasts or estimates. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied is made regarding future performance. The information in this report and the report itself is subject to change without notice. This report as well as any other related documents or information may be incomplete, condensed and/or may not contain all material information concerning the subject of the report; its accuracy cannot be guaranteed. There is no obligation of any kind on Investec or any Investec Affiliates to update this report or any of the information, opinions, forecasts or estimates contained herein.

Investec (or its directors, officers or employees) may, to the extent permitted by law, own or have a position or interest in the financial instruments or services referred to herein, and may add to or dispose of any such position or may make a market or act as a principal in any transaction in such financial instruments. Investec (or its directors, officers or employees) may, to the extent permitted by law, act upon or use the information or opinions presented herein, or research or analysis on which they are based prior to the material being published. Investec may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them. The value of any securities or financial instruments mentioned in this report can fall as well as rise. Foreign currency denominated securities and financial instruments are subject to fluctuations in exchange rates that may have a positive or adverse effect on the value, price or income of such securities or financial instruments. Certain transactions, including those involving futures, options and other derivative instruments, can give rise to substantial risk and are not suitable for all investors.

This report does not contain advice, except as defined by the Corporations Act 2001 (Australia). Specifically, it does not take into account the objectives, financial situation or needs of any particular person. Investors should not do anything or forebear to do anything on the basis of this report. Before entering into any arrangement or transaction, investors must consider whether it is appropriate to do so based on their personal objectives, financial situation and needs and seek financial advice where needed.

No representation or warranty, express or implied, is or will be made in relation to, and no responsibility or liability is or will be accepted by Investec or any Investec Affiliates as to, or in relation to, the accuracy, reliability, or completeness of the contents of this report and each entity within Investec (for itself and on behalf of all Investec Affiliates) hereby expressly disclaims any and all responsibility or liability for the accuracy, reliability and completeness of such information or this research report generally.

The securities or financial instruments described herein may not have been registered under the US Securities Act of 1933, and may not be offered or sold in the United States of America or to US persons unless they have been registered under such Act, or except in compliance with an exemption from the registration requirements of such Act. US entities that are interested in trading securities listed in this report should contact a US registered broker dealer.

For readers of this report in South Africa: this report is produced by Investec Bank Limited, an authorised financial services provider and a member of the JSE Limited.

For readers of this report in United Kingdom and Europe: this report is produced by Investec Bank Plc ("IBP") and was prepared by the analyst named in this report. IBP is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange. This report is not intended for retail clients and may only be issued to professional clients and eligible counterparties, and investment professionals as described in S19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005.

For readers of this report in Ireland: this report is produced by Investec Bank plc (Irish Branch) and was prepared by the analyst named in this report. Investec Bank plc (Irish Branch) is authorised by the Prudential Regulation Authority in the United Kingdom and is regulated by the Central Bank of Ireland for conduct of business rules.

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za•

For readers of this report in Australia: this report is issued by Investec Australia Limited, holder of Australian Financial Services License No. 342737 only to 'Wholesale Clients' as defined by S761G of the Corporations Act 2001.

For readers of this report in Hong Kong: this report is distributed in Hong Kong by Investec Capital Asia Limited, a Securities and Futures Commission licensed corporation (Central Entity Number AFT069) and is intended for distribution to professional investors (as defined in the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)) only. This report is personal to the recipient and any unauthorised use, redistribution, retransmission or reprinting of this report (whether by digital, mechanical or other means) is strictly prohibited.

For readers of this report in India: this report is issued by Investec Capital Services (India) Private Limited which is registered with the Securities and Exchange Board of India.

For readers of this report in Singapore: this report is produced by IBP and issued and distributed in Singapore through Investec Singapore Pte. Ltd. ("ISPL"), an exempt financial adviser which is regulated by the Monetary Authority of Singapore as a capital markets services licence holder. This material is intended only for, and may be issued and distributed in Singapore only to, accredited investors and institutional investors, as defined in Section 4A of the Securities and Futures Act, Cap. 289 ("SFA"). This material is not intended to be issued or distributed to any retail or other investors. ISPL may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Singapore recipients of this document should contact ISPL at the above address in respect of any matters arising from, or in connection with, this report.

For readers of this report in Canada: this report is issued by IBP, and may only be issued to persons in Canada who are able to be categorised as a "permitted client" under National Instrument 31-103 Registration Requirements and Exemptions or to any other person to whom this report may be lawfully directed. This report may not be relied upon by any person other than the intended recipient.

The distribution of this document in other jurisdictions may be prohibited by rules, regulations and/or laws of such jurisdiction. Any failure to comply with such restrictions may constitute a violation of United States securities laws or the laws of any such other jurisdiction.

This report may have been issued to you by one entity within Investec in the fulfilment of another Investec entity's agreement to do so. In doing so, the entity providing the research is in no way acting as agent of the entity with whom you have any such agreement and in no way is standing as principal or a party to that arrangement.

This publication is confidential for the information of the addressee only and may not be reproduced in whole or in part, copies circulated, or disclosed to another party, without the prior written consent of an entity within Investec. Securities referred to in this report may not be eligible for sale in those jurisdictions where an entity within Investec is not authorised or permitted by local law to do so. In the event that you contact any representative of Investec in connection with receipt of this report, including any analyst, you should be advised that this disclaimer applies to any conversation or correspondence that occurs as a result, which is also engaged in by Investec and any relevant Investec Affiliate solely for the purposes of providing general information only. Any subsequent business you choose to transact shall be subject to the relevant terms thereof. We may monitor e-mail traffic data and the content of email. Calls may be monitored and recorded. Investec does not allow the redistribution of this report to non-professional investors or persons outside the jurisdictions referred to above and Investec cannot be held responsible in any way for third parties who effect such redistribution or recipients thereof.

Lara Hodes • Investec Bank Limited • Tel (2711) 286 7257 • email: lara.hodes@investec.co.za•