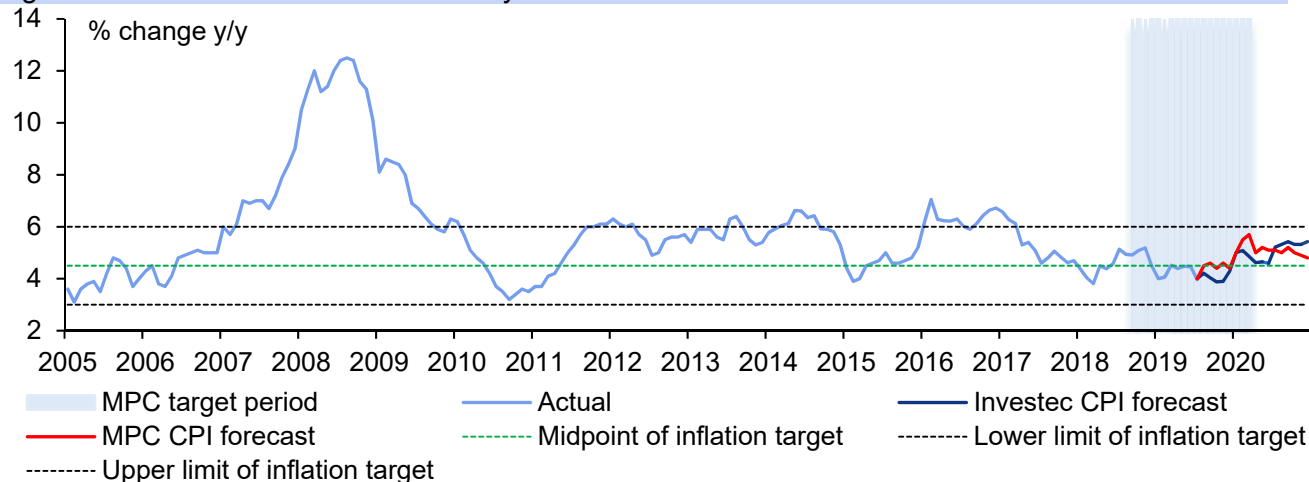




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Figure 1: SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

With Central Banks globally tending towards easing monetary policy in order to support growth in the face of slowing trade volumes and a slowdown in economic activity, attention has turned in SA towards its interest rate. The MPC (Monetary Policy Committee) will deliver its decision tomorrow afternoon in a near stagnant economic growth environment where demand led inflation is quelled, and administered price inflation is a key driver. The tone of this week's MPC statement is likely to be somewhat more dovish than in July, but no interest rate cut is anticipated. South Africa's FRA (Forward Rate Agreement) curve does not show any expectations of a cut in SA's interest rates this year, nor any of significance next year. With real GDP lower in H1.19 versus Q4.18 saa, and expected at only 0.6% y/y in 2019 overall, continuing the downward trend recorded since 2010, further interest rate cuts may be hoped for should CPI inflation be expected to remain contained within the SARB's inflation target band 3-6% y/y.

The South African Reserve Bank (SARB) has recently said "(i)n a constrained economic environment, it is not unexpected that some voices argue that monetary policy could do more to support economic growth. But what exactly is the SARB's margin of manoeuvre, bearing in mind that any policy move must comply with our mandate of price and financial stability?" "At the time of its latest meeting held on 18 July 2019, the MPC felt comfortable enough with the recent downward trend in inflation outcomes, as well as the ongoing decline in inflation expectations, to lower the repo rate by 25 basis points. Overall, when looking back at the last few years, it is important to acknowledge the progress that has been made in reducing

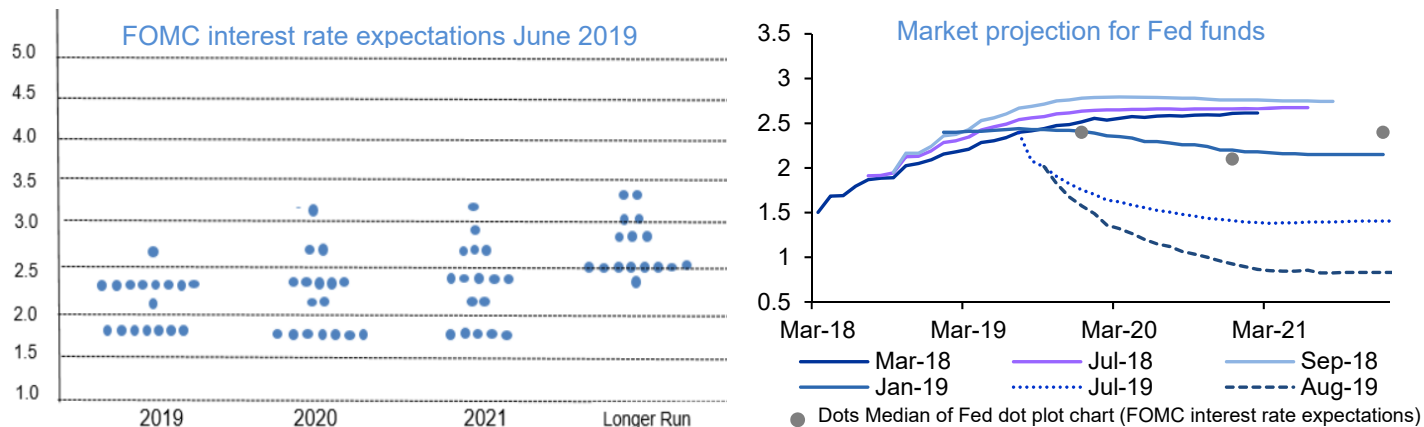
Figure 2: Forecasts

Period end rate %	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Repo Rate	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50
Prime Overdraft Rate	10.25	10.25	10.00	10.00	10.00	10.00	10.00	10.00

Source: Iress, Investec



Figure 3: 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 4: FOMC 2019 Meeting Schedule

September 17th – 18th*
 October 29th – 30th
 December 10th – 11th*

Source: Federal Reserve Bank

*Meeting associated with a Summary of Economic Projections

Figure 5: Forecast of international interest rates (% , end quarter)

	US	Euro zone	Euro zone	UK
	Fed funds	Refi rate	deposit rate	Bank Rate
Current	2.25-2.50	0.00	-0.40	1.25
Q1.19	2.25-2.50	0.00	-0.40	1.50
Q2.19	2.25-2.50	0.00	-0.40	1.25
Q3.19	2.00-2.25	0.00	-0.40	1.00
Q4.19	1.75-2.00	0.00	-0.40	0.75
Q1.20	1.50-1.75	0.00	-0.40	0.75
Q2.20	1.50-1.75	0.00	-0.40	0.75
Q3.20	1.50-1.75	0.00	-0.40	0.75
Q4.20	1.50-1.75	0.00	-0.20	0.75

Source: Macrobond, Investec



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Figure 6: Reuters September 2019 Econometer poll: Repo rate end period %

Forecast period	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	2019	2020	2021
Median	6.50	6.50	6.50	6.25	6.25	6.25	6.50	6.25	6.25
Highest forecast	6.50	6.50	6.50	6.50	6.50	6.75	6.50	6.75	7.00
Lowest forecast	6.25	6.25	6.00	6.00	6.00	6.00	6.25	6.00	6.00
No. of forecasts	22	25	24	23	23	22	26	23	20

Source: Reuters

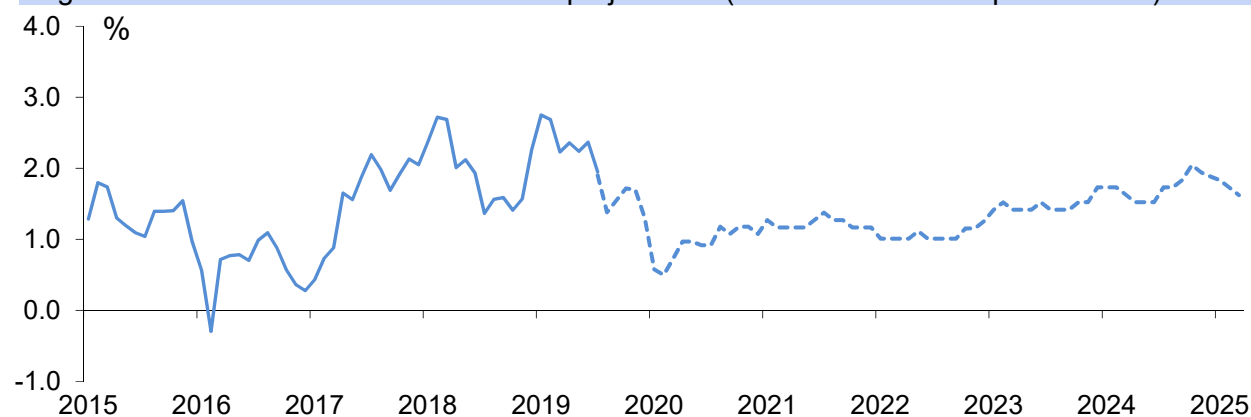
Figure 7: Reuters September 2019 Econometer poll: SARB CPI, unadjusted % ch y/y, avg for period

Forecast period	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	2019	2020	2021
Median	4.2	4.4	5.2	4.8	4.9	4.8	4.3	4.9	4.8
Highest forecast	4.9	5.1	5.6	5.3	5.5	5.4	5.3	5.4	5.5
Lowest forecast	4.0	3.9	4.1	3.8	3.8	3.7	4.0	4.0	3.5
No. of forecasts	15	15	15	15	15	15	28	28	20

Source: Econometer

inflation volatility in South Africa, including in response to exchange rate shifts, and how this has allowed for a better anchoring of inflation expectations and, in turn, how this has also limited the need for sharp monetary adjustments. Since 2016, surveyed inflation expectations have declined by 100 basis points. A more stable and predictable path of interest rates will enhance the environment for sustained economic growth, as the experience of many advanced economies and, increasingly, also the emerging economies has shown. The persistence of such gains is, however, not certain, meaning that the MPC will continue to exercise vigilance in the years ahead.” This standpoint of the SARB supports the flat market view of no change in interest rates in SA this week, but it is also key to note that the actual forecast of the MPC for 2021 is currently one of modest inflation, an average of 4.6% y/y. With the SARB targeting inflation twelve

Figure 8: South Africa's real interest rate projections: (Investec CPI and repo forecasts)



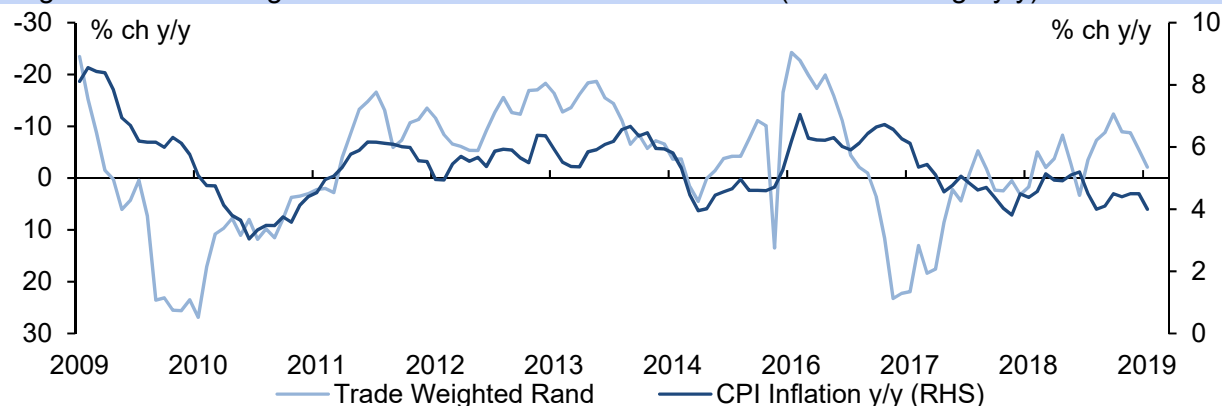
Source: Investec, Iress



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Figure 9: Trade weighted rand movements vs CPI inflation (both % change y/y)



Source: Stats SA, Iress

Figure 10: Inflation forecasts	2018	2019	2020	2021	2022	2023	2024	2025
Consumer Inflation (Av: %)	4.7	4.2	5.2	5.5	5.8	5.5	5.3	5.3
(year-end: %)	4.5	4.4	5.4	5.6	5.7	5.3	5.1	5.1
Producer Inflation (Av: %)	5.5	4.9	5.4	5.6	5.6	5.3	5.2	5.2
(year-end: %)	5.2	4.8	5.6	5.2	5.2	5.2	5.2	5.2
Salary & wage increases (%)	4.7	5.1	5.8	6.0	6.3	6.2	6.3	6.4

Source: Investec

Figure 11: Reuters September 2019: Econometer poll: SARB GDP end period

Forecast period	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	2019	2020	2021
Median	1.3	1.6	0.3	1.1	1.6	1.6	0.6	1.3	1.6
Highest forecast	2.2	2.0	1.5	3.7	2.5	4.0	0.8	2.0	2.5
Lowest forecast	0.1	0.2	-2.3	0.6	0.8	1.0	0.2	0.8	1.0
No. of forecasts	15	15	15	15	15	15	30	30	20

Source: Reuters

Figure 12: SA Monetary Policy Committee (MPC) meeting dates for 2019

Month	Date	Forecast
January	15 th – 17 th	6.75
March	26 th – 28 th	6.75
May	21 st – 23 rd	6.75
July	16 th – 18 th	6.50
September	17 th – 19 th	6.50
November	20 th – 22 nd	6.50

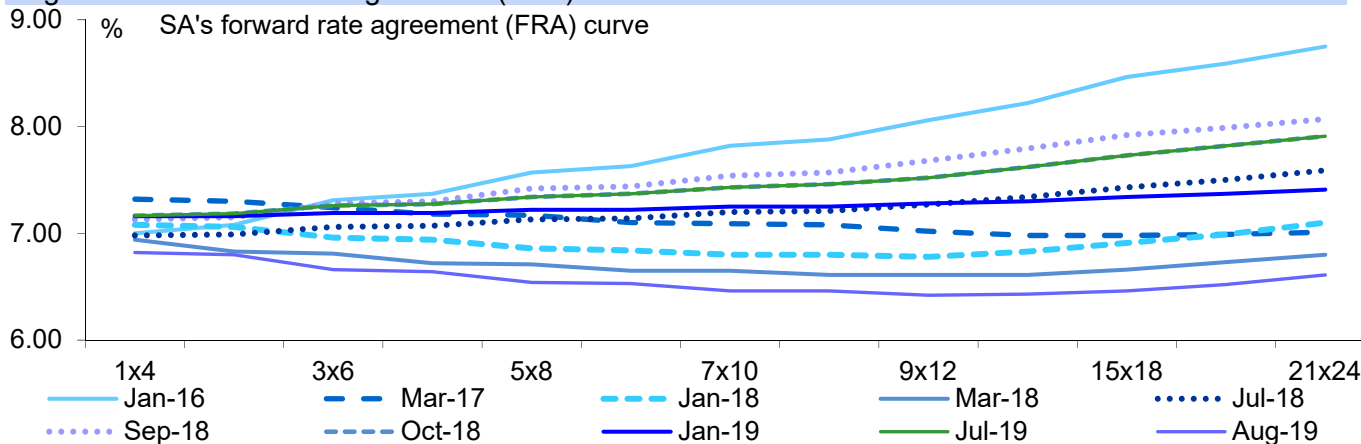
Source: SA Reserve Bank, Investec



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Figure 13: Forward Rate Agreement (FRA) curve



Source: Bloomberg

to eighteen months out (the period six to twenty-four months is also monitored), 2021 is now becoming key.

However, the SARB's most recent forecast for CPI inflation in 2021 (made at the July MPC meeting) could be revised upwards slightly, to 4.7% y/y or 4.8% y/y from 4.6% y/y, as more substantial electricity price increases, closer to those of this year than those of recent years, are factored in. The SARB's most recent forecast for CPI inflation in 2019 is 4.4% y/y but this is likely to be revised down at its meeting this week, to 4.3% y/y, while its forecast for 2020 is likely to be dropped from 5.1% y/y to 5.0% y/y. Such revisions in 2019 and 2020 will have little impact on tomorrow's MPC decision as the key area the SARB is targeting in its monetary policy decisions currently will be the last quarter of 2020 and first quarter, to first half of 2021. With the SARB forecasting CPI inflation at 4.9% y/y for Q4.20 and 4.7% for H1.21 there is little need for it to alter the repo rate from an inflation vigilance point of view – it tends to view the neutral real interest rate at around 2.0% y/y, meaning that currently monetary policy is even slightly accommodative.

At its last MPC meeting the SARB said that "(t)he implied path of policy rates generated by the Quarterly Projection Model was for one cut of 25 basis points to the repo rate by the end of fourth quarter of 2019. The endogenous interest rate path is built into the growth and inflation forecast." This cut has now

Figure 14: Reuters August 2019 Foreign exchange rates poll: USDZAR

	1M	3M	6M	1Y
Release/Effective Date	30 Aug 2019	31 Oct 2019	31 Jan 2020	31 Jul 2020
Median	14.5300	14.4700	14.3050	14.2750
High	15.3000	15.1750	15.4800	15.9000
Low	13.7600	13.6700	13.3500	13.4700
No. of forecasts	29	33	34	32

Source: Reuters



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Figure 15: Economic Scenarios: - note change in probabilities

		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Extreme	Rand/USD (average)	14.01	14.38	11.50	10.30	9.50	8.60	7.90	7.60
	Up case	6.75	6.75	6.00	6.00	5.75	5.75	5.50	5.50
1%	Fast, sustainable economic growth of 5-7% y/y . Change in political will with growth creating economic reforms that structurally lift private sector investor confidence and fixed investment. Global growth boom (including commodities), Trump protectionism removed, SA export and domestic growth boom lifts employment and incomes, poverty eventually eliminated. Property rights strengthened, individuals obtain title deeds in EWC without disruption to economy. Fiscal consolidation, credit rating upgrades to A grade .								
Up case	Rand/USD (average)	14.01	14.38	13.00	11.50	10.00	9.95	9.90	9.70
	Repo rate (end rate)	6.75	6.75	6.25	6.25	6.25	6.00	6.00	6.00
10%	Persistent growth of 3–5% , higher probability of extreme up case. Better governance , growth creating reforms (structural constraints are overcome), greater socio-economic stability, strengthening in property rights, individuals obtain title deeds in EWC without disruption to economy and can leverage and obtain credit. High business confidence and fixed investment growth, substantial FDI inflows, fiscal consolidation. Strong global growth and commodity cycle, 'trade war' subsides. Stabilisation of credit ratings , with ultimately credit rating upgrades.								
Base case	Rand/USD (average)	14.01	14.38	14.30	13.90	13.40	13.70	13.90	13.30
	Repo rate (end rate)	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50
45%	Annual growth rate of close to 2.0% y/y reached by 2020, 3.0% y/y by 2024 . Higher confidence and investment levels than past decade. Rand structurally stronger nears PPP by 2021. SA retains one investment grade (Moody's) rating on its local currency long-term sovereign debt in 2019 . Sedate global monetary policy normalisation – avoid severe global risk-off environment, neutral to global risk-on. Modestly strengthening global demand . Limited impact of EWC/expropriation without compensation (to abandoned and unused land of government and agricultural sector – individuals are new owners and receive title deeds).								
Lite	Rand/USD (average)	14.01	14.38	15.50	17.00	16.50	15.50	15.15	14.90
	Repo rate (end rate)	6.75	6.75	7.50	8.50	7.50	7.50	7.50	7.25
(domestic)									
Down case	Business confidence remains depressed, marked rand weakness, significant load shedding and weak investment growth. SA sub-investment grade Moody's rating but substantial repair avoids further marked downgrades . SA experiences a V shaped, credit rating downgrade related, recession . However, modestly strengthening global demand and elevated commodity prices help lessen the longer-term impact of domestic disturbances . Sedate global monetary policy normalisation occurs – a severe global risk-off environment is avoided, with neutral to global risk-on. Partial expropriation of (certain groups') private commercial sector property (including productive land) without compensation.								
	35%								
Severe	Rand/USD (average)	14.01	14.38	16.10	18.50	19.50	20.00	19.25	18.70
	Repo rate (end rate)	6.75	6.75	8.00	9.25	9.75	10.25	10.75	9.50
down case									
9%	Faster than expected global (US) monetary policy normalisation , general market risk-off, global sharp economic slowdown (commodity slump) followed by marked escalation of US-China trade war – short US recession, global financial crisis . SA sub-investment grade , risks further credit rating downgrades. Significantly more severe recession than in lite down case . Confidence and investment depressed, marked rand weakness, significant strike action and widespread services load shedding. Expropriation of private sector property (title deeds not transferred to individuals nationalisation) without compensation.								

Note: Event risk begins Q3.19. Source: Investec, Iress historical data



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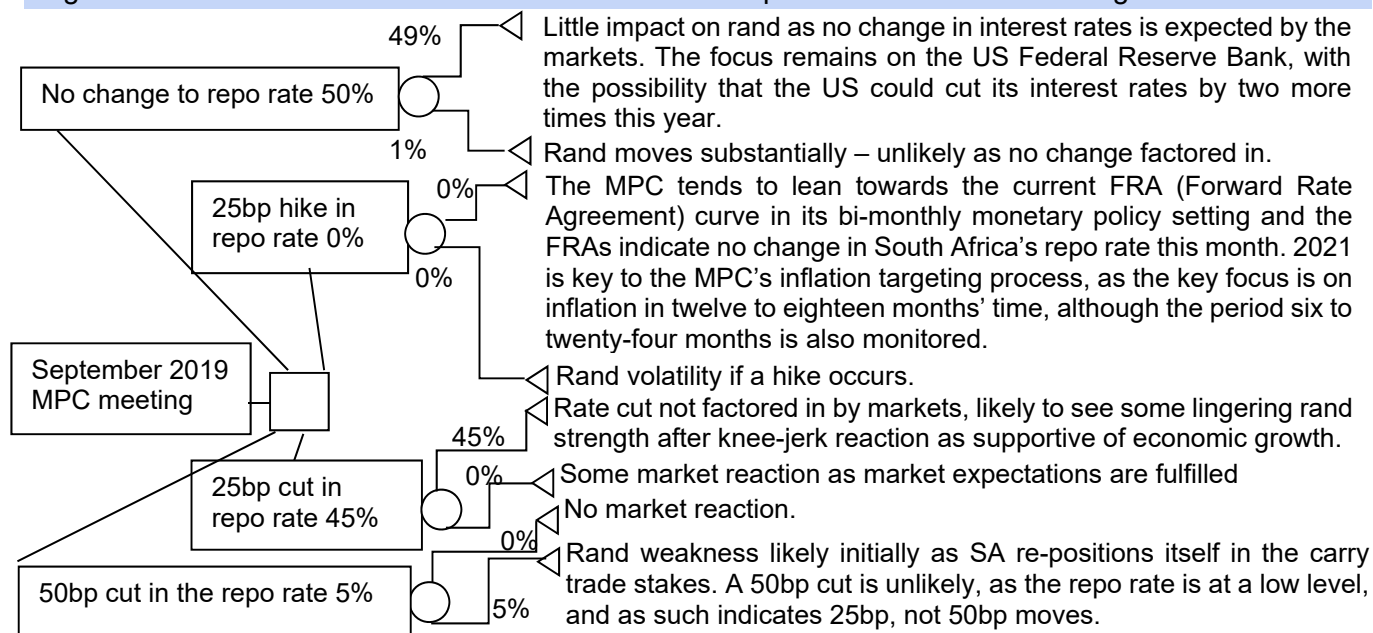
Figure 16: Forecasts	2018	2019	2020	2021	2022	2023	2024	2025
Repo Rate	6.75	6.50	6.50	6.75	7.00	7.00	7.00	7.00
Prime Overdraft Rate	10.25	10.00	10.00	10.25	10.50	10.50	10.50	10.50
SA rand bond	9.57	8.90	9.00	9.25	9.40	9.20	9.00	8.90
US Fed funds rate	2-25-2.50	1.75-2.00	1.50-1.75	1.75-2.00	1.75-2.00	1.75-2.00	1.75-2.00	1.75-2.00
UK Bank rate	0.75	0.75	0.75	1.00	1.25	1.25	1.25	1.25

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

occurred, with little apparent room for further easing if the SARB's CPI inflation forecasts do not change dramatically, as it persists with its vigilance on inflation.

A 25bp cut in US interest rates tonight would open up limited scope for a 25bp cut in South Africa's repo rate, through widening the margin between SA interest rates and those of the US. Should the margin become too narrow, i.e. if the US hikes interest rates and SA does not for example, then the rand can weaken substantially as the risk premium (margin above US rates foreign investors need to invest in SA assets) is eroded. When the US cuts interest rates, SA can follow suit if the significant number of other factors the SARB analyses are also supportive of further monetary easing. The rand's strengthening trend since August, and likely lower volatility levels in Q4.19 and Q1.20, means it is likely to be less of a concern for the SARB than at its previous MPC meeting. However, concerns over the upcoming MTBPS (now potentially 30th October 2019) and Moody's rating agency's reaction will remain in mind for the SARB.

Figure 17: Decision tree for South Africa's 17th – 19th September 2019 MPC meeting



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



Figure 18: Interest rate forecast end rates

Date	Prime forecast	Prime less Inflation	Repo	Repo less Inflation
Jan 2019	10.25	6.3	6.75	2.8
Feb 2019	10.25	6.2	6.75	2.7
Mar 2019	10.25	5.7	6.75	2.2
Apr 2019	10.25	5.9	6.75	2.4
May 2019	10.25	5.8	6.75	2.3
Jun 2019	10.25	5.8	6.75	2.3
Jul 2019	10.00	6.0	6.50	2.5
Aug 2019	10.00	5.7	6.50	2.2
Sep 2019	10.00	5.8	6.50	2.3
Oct 2019	10.00	6.0	6.50	2.5
Nov 2019	10.00	6.0	6.50	2.5
Dec 2019	10.00	5.6	6.50	2.1
Jan 2020	10.00	4.9	6.50	1.4
Feb 2020	10.00	4.8	6.50	1.3
Mar 2020	10.00	5.0	6.50	1.5
Apr 2020	10.00	5.3	6.50	1.8
May 2020	10.00	5.2	6.50	1.7
Jun 2020	10.00	5.3	6.50	1.8
Jul 2020	10.00	4.6	6.50	1.1
Aug 2020	10.00	4.7	6.50	1.2
Sep 2020	10.00	4.6	6.50	1.1
Oct 2020	10.00	4.7	6.50	1.2
Nov 2020	10.00	4.7	6.50	1.2
Dec 2020	10.00	4.6	6.50	1.1
Jan 2021	10.25	4.8	6.75	1.3
Feb 2021	10.25	4.7	6.75	1.2
Mar 2021	10.25	4.7	6.75	1.2
Apr 2021	10.25	4.7	6.75	1.2
May 2021	10.25	4.7	6.75	1.2
Jun 2021	10.25	4.8	6.75	1.3
Jul 2021	10.25	4.9	6.75	1.4
Aug 2021	10.25	4.8	6.75	1.3
Sep 2021	10.25	4.8	6.75	1.3
Oct 2021	10.25	4.7	6.75	1.2
Nov 2021	10.25	4.7	6.75	1.2
Dec 2021	10.25	4.7	6.75	1.2

Source: IRESS, Investec Annabel Bishop

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Figure 19: CPI forecast averages

Date	Index Base 2016	Annual y/y	Monthly m/m	Quarterly y/y	Calendar year y/y		
Jan 2019	109.2	4.0	-0.2				
Feb 2019	110.1	4.1	0.8				
Mar 2019	111.0	4.5	0.8	4.2		Mar 2018/19	4.6
Apr 2019	111.7	4.4	0.6				
May 2019	112.0	4.5	0.3				
Jun 2019	112.4	4.5	0.4	4.4			
Jul 2019	112.8	4.0	0.4				
Aug 2019	113.2	4.3	0.3				
Sep 2019	113.5	4.2	0.3	4.2			
Oct 2019	113.9	4.0	0.3				
Nov 2019	114.1	4.0	0.2				
Dec 2019	114.3	4.4	0.2	4.1	2019	4.2	
Jan 2020	114.9	5.1	0.5				
Feb 2020	115.9	5.2	0.9				
Mar 2020	116.6	5.0	0.6	5.1		Mar 2019/20	4.5
Apr 2020	117.1	4.7	0.4				
May 2020	117.4	4.8	0.3				
Jun 2020	117.8	4.7	0.3	4.7			
Jul 2020	119.0	5.4	1.0				
Aug 2020	119.2	5.3	0.2				
Sep 2020	119.7	5.4	0.4	5.4			
Oct 2020	119.9	5.3	0.2				
Nov 2020	120.2	5.3	0.2				
Dec 2020	120.5	5.4	0.3	5.4	2020	5.2	
Jan 2021	121.2	5.5	0.6				
Feb 2021	122.4	5.6	1.0				
Mar 2021	123.1	5.6	0.6	5.5		Mar 2020/21	4.9
Apr 2021	123.6	5.6	0.4				
May 2021	124.0	5.6	0.3				
Jun 2021	124.2	5.5	0.2	5.5			
Jul 2021	125.4	5.4	0.9				
Aug 2021	125.7	5.5	0.3				
Sep 2021	126.2	5.5	0.4	5.4			
Oct 2021	126.6	5.6	0.3				
Nov 2021	126.9	5.6	0.2				
Dec 2021	127.3	5.6	0.3	5.6	2021	5.5	

Source: Stats SA, Investec

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