South Africa monetary policy

SARB likely to leave rates on hold

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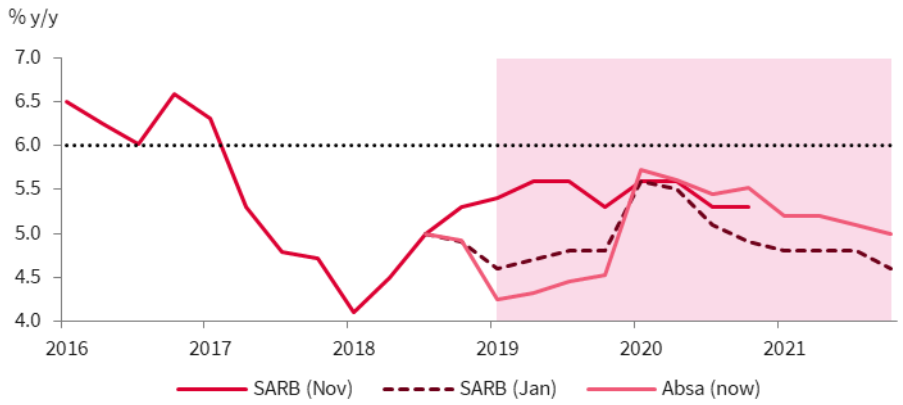
- **We and all other 23 economists surveyed by Thomson Reuters expect the SARB to leave the repo rate on hold at 6.75% on Thursday. Further out, interest rate expectations diverge but the market has become markedly more dovish since the SARB hiked rates in November, especially in the wake of last week's dovish FOMC. Growing global growth concerns will likely keep international monetary tenor firmly tilted to dovishness. The FRA curve is now pricing in 5bp of rate cuts over the next nine months.**
- **As the last CPI inflation print reiterates, inflationary pressures in South Africa are limited, barring some upside cost-push impetus from rising fuel prices and Eskom tariff hikes. Core CPI inflation remains tracking just below the midpoint of the 3-6% target. Inflation expectations eased in the last quarterly survey. A new one is due out on Thursday.**
- **Further deceleration in private sector wage settlements should help to stay the MPC's hand. The Quarterly Employment Statistics (QES) released today showed the growth in average monthly earnings in Q4 18 falling to 4.9% y/y. Furthermore, the SARB MPC is likely to be highly sensitive to the weakness in the economy. Still, we think the bar to cuts is high.**
- **The SARB MPC composition has shifted with the resignation of Deputy Governor Groepe. With just five committee members left (and a string of split decisions in recent years), whether Groepe tended more to dovishness or hawkishness could have some bearing on the committee's decisions in the future.**

Figure 1: SARB likely to adjust inflation forecasts



Source: SARB, StatsSA, Absa Research.

PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE **5**

We and every other economist polled by Thomson Reuters expect the SARB MPC to leave the repo rate on hold at 6.75% on Thursday

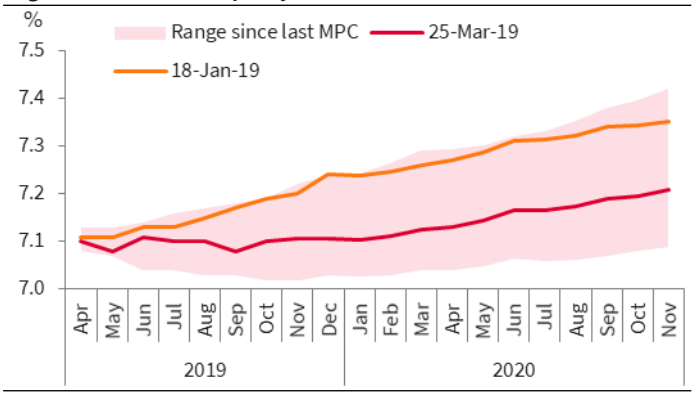
On Thursday, at 15:00 local time, the SARB Monetary Policy Committee (MPC) will unveil its interest rate decision. We and a unanimity of other economists surveyed by Thomson Reuters expect the MPC to vote to keep the repo rate on hold at 6.75%. Further ahead, however, economists' expectations are more divergent, with the latest Thomson Reuters' monthly Econometer survey (for March) showing a range of expectations. For example, of 23 economists surveyed, eight (including ourselves) currently forecast a year-end repo rate of 7.0%, while one forecasts a 25bp cut. Though we see inflationary pressures as subdued, we have left our forecast of a 25bp September rate hike in place up until now in the expectation that Moody's is more likely than not to either assign a Negative Outlook to South Africa's Baa3 credit rating on Friday or put the rating under review for a downgrade. While this might already be significantly priced in, we could equally still see some pressure on the ZAR, which could ultimately elicit a reaction from the SARB. Into 2020, economists' expectations tilt marginally towards tightening. For example, in the Econometer survey of the 17 responses for end-2020, many more economists expect hikes (from the current level) than cuts (Figure 2). The FRA curve, however, is considerably more dovish than the average economist view (admittedly as of mid-March), pricing in 5bp of rate cuts over the next nine months and 15bp of hikes by mid-2020 (Figure 3).

Figure 2: More economists expect hikes than cuts

F'cast	Q2 19	Q3 19	Q4 19	Q2 20	Q4 20
6.50	0	0	1	1	1
6.75	21*	18	13	8	6
7.00	1	4*	8*	10*	7
7.25	0	0	0	1	3*
Total	22	22	22	20	17

Source: Thomson Reuters, Absa Research

Figure 3: FRA curve sits pretty flat over 12 months

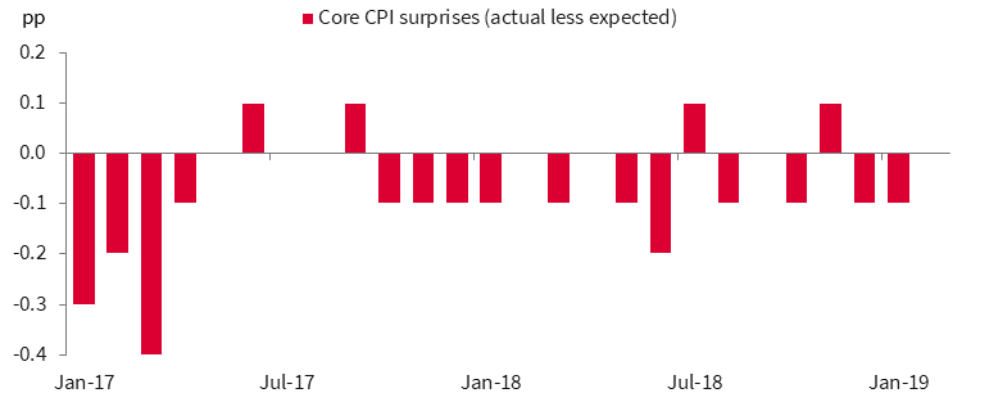


Source: Thomson Reuters, Absa Research

There are a few domestic inflationary pressures, and dovish sentiment

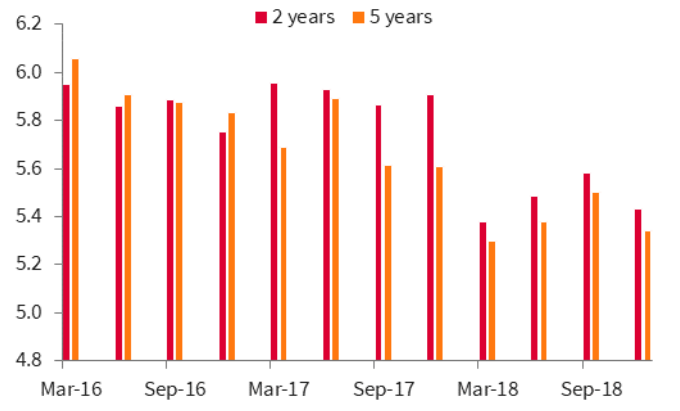
Domestic inflation is currently quiescent, as shown by last week's 4.1% y/y headline CPI print and 4.4% y/y core CPI print. Headline CPI inflation is likely to jump in the next release due to base effects, before easing anew. Core CPI inflation will grind only slowly higher, in our view. We are cognizant that over the past two years, core CPI has posted far more downside than upside surprises (Figure 4). Overall, given the embattled state of the consumer at the moment, there is little reason to expect demand-pull inflationary pressure to emerge. The SARB MPC should also likely draw some comfort from the Quarterly Employment Statistics today, which showed average monthly earnings growth decelerating to 4.9% y/y in Q4 18, down from 6.0% in Q3 18 and an average of 9.0% in 2017, although this is not a metric that the committee tends to focus on much in its statement. The MPC will also have the benefit of another inflation expectations survey, which will be published contemporaneously with the MPC statement. We think it is unlikely to reverse the improvement noted in the last survey (Figure 5).

Figure 4: More downside than upside inflation surprises



Source: Bloomberg, Absa Research

Figure 5: Inflation expectations are a key input to SARB MPC decision



Source: Bureau for Economic Research, Absa Research

Figure 6: Brent is up and the NEER has weakened since the last MPC

MPC month	FX change, %*	Brent change, %	Decision
Mar-19	-5.1	14.1	??
Jan-19	0.5	-1.3	Unanimous hold
Nov-18	5.2	-24.9	3:3 hike
Sep-18	-7.1	10.3	4:3 hold
Jul-18	-3.5	-4.4	Unanimous hold
May-18	-4.2	19.3	Unanimous hold
Mar-18	3.5	-7.7	4:3 cut

Source: Thomson Reuters, Absa Research

For the purposes of the SARB's inflation forecasts, the recent rise in USDZAR is also not much of a concern, relative to the last meeting (when the SARB voted unanimously to keep rates on hold). The current USDZAR of 14.32 is not much different from the exchange rate starting point for the last MPC forecast of 14.30, although the nominal effective exchange rate is some 5% weaker than the level prevailing at the time of the last MPC (Figure 6). With the weaker NEER and Brent, which is up some 14% from the last MPC, and the upward lift to electricity prices, the SARB might adjust its inflation forecasts slightly higher from those in the last MPC (see Figure 1, cover page). This would leave them more in line with our current forecasts, and could reverse some of the dovishness in the FRA curve.

MPC is likely to worry about the Moody's credit rating review the next day and its impact on the rand

Still, given benign core inflation currently, and considerably more dovish sentiment globally (with rapidly global growth concerns and last week's considerably more dovish FOMC), there would seem to be little need for South Africa to tighten monetary policy right at this juncture. However, it is important to remember that current inflation prints are already 'booked', and that the SARB MPC is forward looking, while MPC officials continue to warn about upside cost-push pressures from higher fuel prices, the recent Eskom tariff announcement and recent rand weakness. No doubt, the MPC members will be particularly concerned about the Moody's credit rating review the following day (after close of business hours). We believe the agency is more likely than not to assign a Negative Outlook to South Africa's Baa3 rating or to formally put the rating under review for a downgrade, although we do not think that Moody's will actually implement a downgrade at this stage, preferring instead to wait a little to assess whether the government can stabilise Eskom and to assess the lay of the land after the elections on 8 May. Still, even a negative outlook could spark some weakness in the rand, which might elicit some response from the SARB if it proved persistent and extended. (We share their concern and have left intact, for now, our forecast that the next move from the SARB will be a hike in September 2019 on the expectation that the rating review will drive the rand weaker.) If Moody's stays its hand or if the market alternatively digests its decision with equanimity, then we would be inclined to push out our rate hike call into 2020. Either way, there could be some market reaction since a Bloomberg survey of 16 economists found them evenly divided on whether Moody's would assign a Negative Outlook or not.

The MPC will also be highly cognizant of the weak growth momentum

The MPC is also likely to be mindful of weak incoming economic activity data, which suggest the negative output gap may persist even longer than it projected in January. At its January MPC meeting, where it projected GDP growth of 1.7% for 2019, the SARB said that it expected the negative output gap to close only in Q1 2021. However, the available high frequency data for Q1 19 have been mixed, but clearly point to continued weakness in growth. On the production side, January manufacturing output came in weaker than expected, while the slight increase in mining output for the same month was narrowly based. The February PMIs and the BER's quarterly surveys of major sectors of the economy, including manufacturing, retail and building, showed that activity levels remained downbeat. Also concerning is that the overall BER business confidence index fell further in Q1 19. On the demand side, retail sales normalised in January after the post Black Friday slump in December but January and February vehicle sales continued to fall sharply. The SARB's own business cycle leading indicator, which the MPC regularly references in its MPC statements,

fell sharply by 1.8% m/m in January and by 3.4% on a y/y basis. Ongoing electricity supply challenges will also likely act as a supply-side constraint on economic growth. Some downward revision of the SARB's GDP growth forecasts seems likely.

Comments from SARB Governor Kganyago and Deputy Governor Mminele suggest the bar to cuts is much higher than the bar to hikes

Despite the weak economic growth, we think the bar for interest rate cuts is probably even higher than the bar for hikes at this stage. In this regard, the two speeches by Deputy Governor Mminele (on 12 February) and Governor Kganyago (on 6 March) may be instructive reference points. Deputy Governor Mminele said in his speech that attempting to lift growth through more monetary policy would likely only have a short-lived effect, while implications for the current account and inflation expectations would be negative with the consequence of later pushing rates higher. Meanwhile, Governor Kganyago said *"the catch here is that when lower short-term rates today push up inflation in the long run, then borrowing for investment is skewed away from the long term to the short term. We shouldn't be surprised if this also skews job creation away from the types of jobs that are sustained over the long run. That is not a trade-off that we believe is consistent with the public good mandate set out in the Constitution".*

Looking ahead, the resignation of Deputy Governor Groepe has altered the balance on the MPC, but it is just not possible to assess in which direction

With the FRA curve lying flat over the next 12 months, the tenor of the MPC statement as well as the voting split on the five-person committee could prove more key than usual. While some members of the MPC might tend towards a degree of residual hawkishness, we think that they would certainly want to wait for the outcome of the Moody's rating review the next day – and the market's reaction to it – before pushing for a rate hike, and so, on balance, we expect the vote to be unanimous. Predicting the decisions of the MPC, going forward, has been made just that little bit harder by the resignation of Deputy Governor Groepe. With just five committee members left (and a string of split decisions in recent years), whether Groepe tended more to dovishness or hawkishness in recent years – something which can only be speculated about, given the MPC's policy of not disclosing the voting record of individual members – could have some bearing on the committee's decisions in the future.

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