## South Africa monetary policy

# Unanimous hold as oil prices slashed

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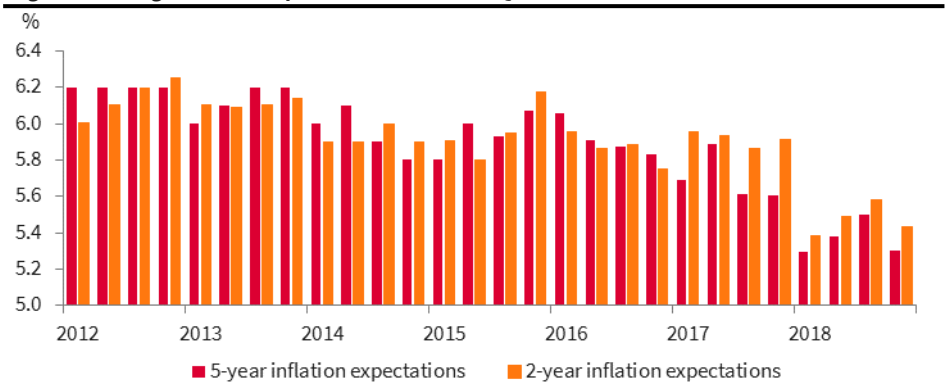
- **As we had expected, the SARB MPC voted (unanimously) to leave the repo rate on hold at 6.75%, after making surprisingly big downward adjustments to its key oil price assumption.**
- **The endogenously generated path for interest rates is much more relaxed in this QPM forecast run, with only one 25bp hike embedded out to 2021.**
- **We are maintaining our forecast that the next rate move will be a hike in September.**
- **Questions about the SARB's mandate and independence will likely continue to niggle in the run-up to the elections and after, given the factional tug of war within the ANC.**

**The SARB MPC voted unanimously to keep the repo rate unchanged, as we and every other economist polled by Thomson Reuters or Bloomberg had expected.** In November, we had argued that the case for a rate hike was slim, with scant evidence of any second-round inflationary momentum. In the end, however, the MPC seemed to adopt a somewhat novel risk mitigation justification for its narrow 3:3 vote to hike in November. With this latest sitting of the MPC, however, the SARB seems to have reverted to its traditional reaction function.

**Figure 1: Average inflation expectations declined in Q4 2018**




*Source: BER, Absa Research*



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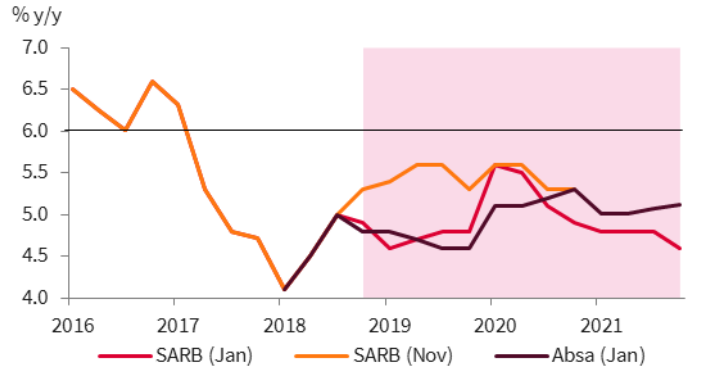
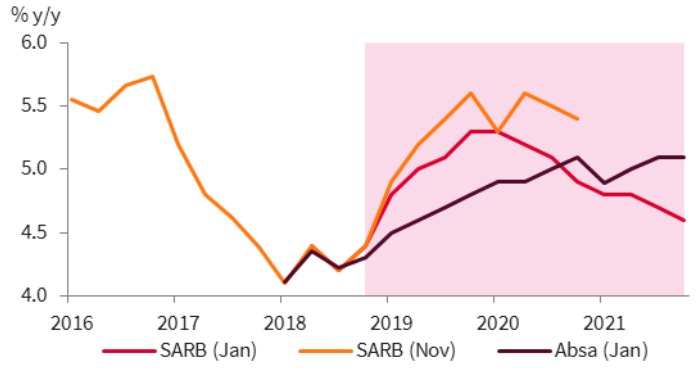
**The SARB revised its inflation forecasts sharply downwards, leaving them much closer aligned with our forecasts.** The SARB's forecast for headline CPI in 2019 have been slashed 70bp to 4.8%. Meanwhile, its CPI forecast for 2020 is 10bp lower at 5.3% (Figure 2). Big downward revisions were also delivered for the core CPI forecasts by 30bp to 5.0% in 2019 and by 40bp to 5.1% in 2020 (Figure 3). Absa Research forecasts headline CPI to average 4.6% in 2019 and 5.4% in 2020. Absa Research forecasts core CPI to average 4.7% in 2019 – still quite a bit lower than even the SARB's latest downwardly revised forecast – and 5.0% in 2020.

**Figure 2: The SARB's headline CPI inflation forecasts are now closer to ours**




*Source: SARB, Absa Research*

**Figure 3: We are still more optimistic on the near-term path of core CPI**




*Source: SARB, Absa Research*

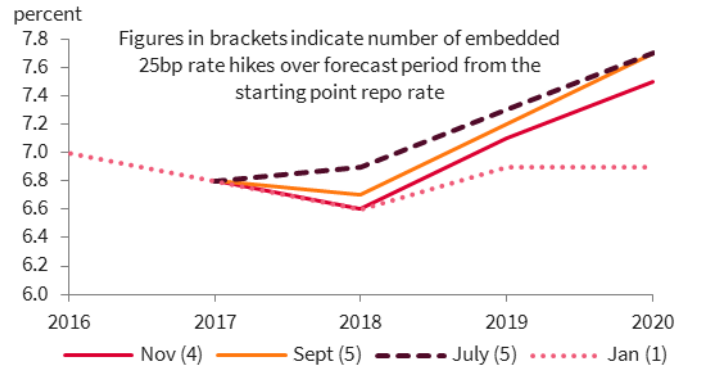
**The SARB also moderated its assessment of the balance of risks around its central inflation projections.** In November, the SARB said that 'the MPC continues to assess the risks to the longer-term inflation outlook to be on the upside'. Now, in the current statement, it says that 'the overall risks to the inflation outlook are assessed to be *moderately* on the upside' (our italics). We also discern in the current statement less focus on the long term than in the previous November statement.

**The SARB will have taken comfort from the easing in inflation expectations in Q4 18.** After a couple of quarters of increasing inflation expectations, the latest survey by the Bureau for Economic Research would have comforted the SARB, with a 20bp decline in average inflation expectations for 2019 and 2020 to 5.4%, while five-year inflation expectations also eased afresh by 20bp to 5.3% (Figure 1 on cover page).

**The biggest driver of the SARB's lower CPI forecasts is the fact that it slashed its oil price assumption.** The SARB lowered its forecast for Brent from USD73/bbl to USD62/bbl for 2019 and from USD73/bbl to USD65/bbl for 2020. These are exceptionally material adjustments, with the change in 2019 worth directly about 0.3pp on the CPI. But, of course, the starting point for its forecast run is also lower. In November, the SARB expected headline CPI to average 5.3% in Q4 18, but now the recent data suggest it will be 4.9%, which we agree with. The SARB noted that a somewhat improved food price outlook for 2019 and a less depreciated exchange rate were also factors.

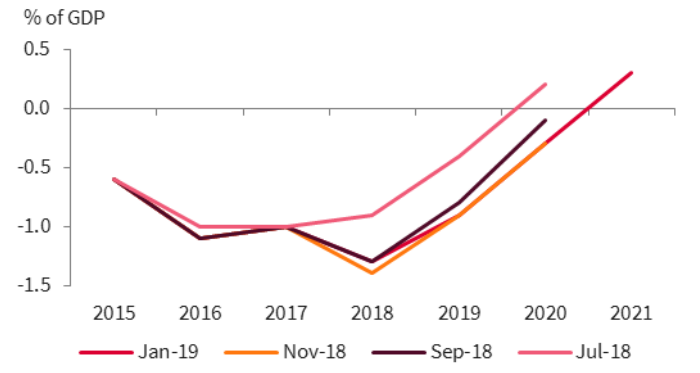
**The Quarterly Projection Model (QPM) now has a much more relaxed interest rate outlook.** The corollary or consequence of the much improved inflation outlook (within the context of the QPM) is a much less aggressive endogenous tightening path. The November MPC run projected a cumulative 100bp of rate hikes before the end of 2020. However, the latest run of the QPM embeds only a single 25bp rate hike before the end of 2021. Governor Kganyago in his Q&A section reminded that the QPM's path of interest rates is only a guide for the committee and is not prescriptive. While expectations about rate hikes in South Africa have eased sharply in recent weeks (with the FRA market this morning pricing in less than 10bp of tightening over the next 15 months) and dovish sentiment may have received further support from today's MPC, we are cognizant that upside inflation and downside economic risks still lurk. We are maintaining for now our forecast that the SARB next moves with a 25bp hike at the September MPC.

**Figure 4: QPM now only projects one 25bp hike through to 2021**




*Source: SARB, Absa Research*

**Figure 5: Output gap now expected to close in Q1 2021**




*Source: SARB, Absa Research*

**Debate about the SARB's mandate and independence is going to persist.** A number of questions in the Q&A section after the MPC's prepared statement related to the ANC's success in further muddying the already disturbed waters around the SARB's mandate, ownership and independence. In its election manifesto last weekend, the ANC said that it 'believes that the SARB must pursue a flexible monetary policy regime, aligned with the objectives of the second phase of the transition. Without sacrificing price stability, monetary policy must also take into account other objectives such as employment creation and growth'. When President Ramaphosa subsequently moved to reassure markets about the SARB's independence, ANC Secretary General Ace Magashule raised further concerns by promising in an interview with eNCA that the SARB would be nationalised within five years. Nothing the SARB can say at this stage will make the debate go away, given that it is one of the issues of factional contestation within the ANC. In fact, Governor Kganyago said that the SARB had concluded that it would not be prudent for it to continue to engage in this debate publicly until such time, as there were concrete proposals on the table, but that at that point it would engage vigorously to defend the SARB's independence. He pointed out one of the foundational principles of the South African Constitution is central bank independence.

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