FUNDAMENTALS

SOUTH AFRICA MPC UPDATE: LEANING AGAINST THE WIND

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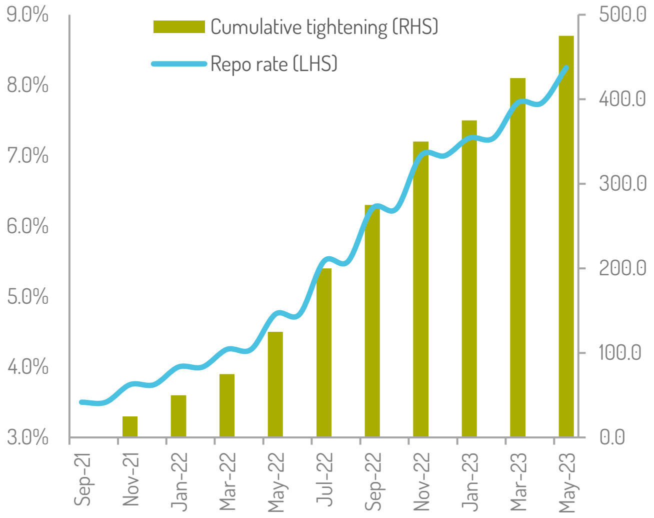
IN BRIEF

- As per market consensus, the South African Reserve Bank (SARB) hiked its policy rate by 50bps to 8.25% in its May 2023 MPC Meeting. The decision was unanimous from the 5-member Committee, the first unanimous decision since September 2021 and in its current tightening cycle.
- The April 2023 inflation of 6.8% printed at the lowest reading in 11 months, surprising policymakers 10bps to the downside. The SARB maintained its 2Q2023 inflation forecast at 6.4%, although adjusted its 2023 inflation forecast marginally higher by 20bps to 6.2% as compared to its outlook in its March MPC meeting.
- Despite an increased number of loadshedding days in the year, the central bank marginally revised upwards its 2023 real GDP growth forecast to 0.3% from the 0.2% projected in the previous MPC meeting. The Committee penciled in a reduced intensity for loadshedding (in days) despite the overall increase in loadshedding days by 30 days to 280 days.
- ZAR has weakened 13.3% YTD as at the week ending 26 May 2023, taking the currency to its record low level of 19.65. The Lady R ship armament debacle following news flow suggesting the country is warming up to host Russian President in the upcoming BRICS Summit in August 2023, has amplified the currency weakness
- We like the fact that the authorities ruled out imposing exchange rate controls to stem volatility as ZAR is one of the tradable currencies in our universe. There was concern from market participants that the implementation of Regulation 28 of the Pension Fund Act has exacerbated ZAR volatility.
- The monetary policy statement characterized the policy stance as 'restrictive' although there is some longstanding ambiguity on the real repo policy rate as the benchmark. Nevertheless, we think that the upcoming working paper that will pivot the SARB towards a new Quarterly Projection Model - from July 2023 MPC Meeting - that factors in additional variables may provide much clarity.

In tune with consensus

As per market consensus, the South African Reserve Bank (SARB) hiked its policy rate by 50bps to 8.25% in its May 2023 MPC Meeting. The decision was unanimous from the 5-member Committee, the first unanimous decision since September 2021 and in its current tightening cycle. Amidst April 2023 inflation surprising to the downside, we are of the view that the rate decision was to quell recent South African Rand (ZAR) volatility. Nonetheless, a policy hike remains a blunt instrument to tone down the risk wrought by foreign policy-induced uncertainty in our view. For a central bank that has avowed data-dependency, a policy peak may be on the horizon from our assessment of inflation trend and outlook.

POLICY RATE



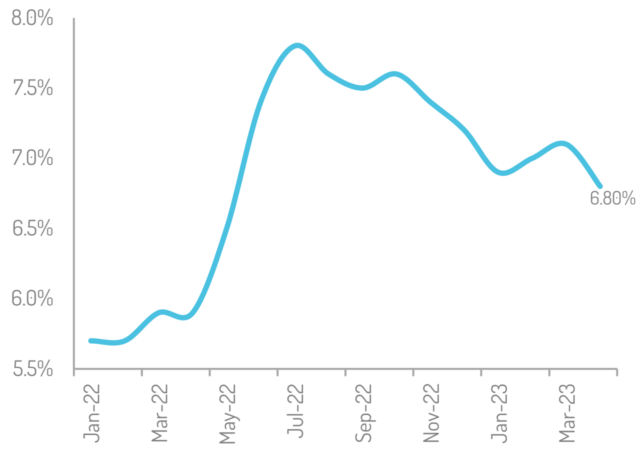
SOURCE: SOUTH AFRICAN RESERVE BANK

Inflationary expectations elevated by administered prices

The April 2023 inflation of 6.8% printed at the lowest reading in 11 months, surprising policymakers 10bps to the downside. The main contributors to the lift in the print was food and non-alcoholic beverages, housing and utilities, and miscellaneous goods and services. Administered prices, specifically electricity and fuel, contributed 5.3ppts change to the April inflation print. Core inflation printed at 5.3% in April, delivering an equal 10bps downside surprise to the policymakers.

The SARB maintained its 2Q2023 inflation forecast at 6.4%, although adjusted its 2023 inflation forecast marginally higher by 20bps to 6.2% as compared to its outlook in its March MPC meeting. Considering a 240bps further weakness in its Nominal Effective Exchange Rate (NEER) outlook from 8.6% in the previous meeting to 11.0% in the May 2023 MPC meeting, the policymakers had a bullish take on some offsetting inflationary factors. On the back of assumed lower fuel taxes and levies, and electricity prices, the MPC have penciled in the somewhat lower inflation projection. Nevertheless, the lagged effect of the inflation impact of these administered prices has elevated inflationary expectations over the medium-term.

INFLATION



SOURCE: STATISITICS SOUTH AFRICA

Load-shed concern although 2023 growth outlook lifted marginally

Despite an increased number of loadshedding days in the year, the central bank marginally revised upwards its 2023 real GDP growth forecast to 0.3% from the 0.2% projected in the previous MPC meeting. The Committee penciled in a reduced intensity for loadshedding (in days) despite the overall increase in loadshedding days by 30 days to 280 days. In effect, the SARB projection baked in stage 1 through stage 3 has been increased by cumulative 44 days to 95 days. Although the bulk of the loadshedding is in stage 4, the number of days was further lowered by 21 to 90days. The central bank struck a more bullish tone of more power generating units to be brought online to meet the pent-up demand for the upcoming winter season (June – August 2023).

Real disposable income is expected to grow by 0.9% and 0.5% in 2023 and 2024, respectively, underpinning household spending. The monetary authorities were upbeat by the better-than-expected outturn in the 4Q2022 employment numbers, lifting their expectation of disposable income throughout 2023. Upside to growth seems to emanate from an acceleration in private sector investment, largely in the energy sector, together with the rolling of 1Q2023 high frequency data that is telegraphing better-than-expected growth outturn. Overall, the monetary policy statement maintained its downbeat assessment of loadshedding impact to growth; "*We estimate loadshedding alone to deduct 2ppts from growth this year*".

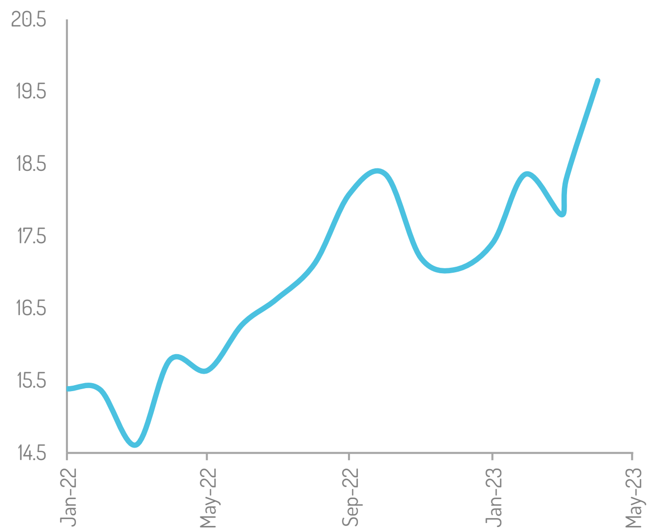
Elephant in the room; ZAR volatility

ZAR has weakened 13.3% YTD as at the week ending 26 May 2023, taking the currency to its record low level of 19.65/USD. The Lady R ship armament debacle following news flow suggesting the country is warming up to host Russian President in the upcoming BRICS Summit in August 2023, has amplified the currency weakness. Nevertheless, the Presidency has set up an investigative panel whose outcome will be published in late July 2023. Against a backdrop of low growth concern and receding inflationary risk, the SARB Governor Lesetja Kganyago sounded less convincing in his Press Conference that the "*MPC does not respond to ZAR*".

However, the authorities downplayed the ZAR volatility although the monetary policy statement had, "*further currency weakness appears likely*". Although this phrase has been consistent in the three consecutive policy statements, the current backdrop of foreign policy uncertainty has added much weight. Nevertheless, this guidance suggests that the SARB is upbeat of a ZAR appreciation from current levels, with a projected 4Q2023 forecast of 18.50/USD. With the May 2023 MPC meeting assuming lower commodity prices this year (-23.7%), we are struggling to reconcile this upbeat ZAR projection. We see continued pressure on the current account balance which switched into negative territory (-2.6% of GDP) in 4Q2022 from a zero current account balance in the preceding quarter.

We like the fact that the authorities ruled out imposing exchange rate controls to stem volatility as ZAR is one of the tradable currencies in our universe. There was concern from market participants that the implementation of Regulation 28 of the Pension Fund Act, within the context of FY23 budget, that revised upwards the offshore asset allocation limit from 30.0% to 45.0% has exacerbated ZAR volatility. Based on our preliminary assessment of Collective Investment Schemes up to 1Q2023, the asset allocations were steady. However, the lagged data for 2Q2023 will give us a clearer picture whether portfolio allocation towards increased foreign portfolio has exacerbated the ZAR slide.

SOUTH AFRICAN RAND, ZAR



SOURCE: BLOOMBERG

In defense of 'restrictive' policy

Facing a binary option of either falling behind the inflation curve or premature tightening, the SARB Governor made it clear at the press conference that its policy hike avoids the former option. The monetary policy statement characterized the policy stance as 'restrictive' although there is some longstanding ambiguity on the real repo policy rate as the benchmark. Nevertheless, we think that the upcoming working paper that will pivot the SARB towards a new Quarterly Projection Model - from July 2023 MPC Meeting - that factors in additional variables may provide much clarity.

Although the real sector will bear the cost of the cumulative 475bps rate hike in the current cycle, the pushback has been that the structural strains in South Africa's energy and transport sectors have inflicted much more pain. That said, we think increased investment in these sectors will be curtailed by the higher cost of borrowing in the economy. Barring any targeted subsidy to the sectors and/or enhanced social assistance from the budget sector, we foresee a much-impaired real sector in the current restrictive policy stance.

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