

FUNDAMENTALS

SOUTH AFRICA MPC UPDATE: TWO SIDES TO UPSIDE BALANCE OF RISK

The bottom half of the cover features a large, semi-circular orange shape on the left and three smaller orange circles of varying sizes on the right, all set against a background of blue, wavy, geometric patterns.

26 JULY 2024



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IN BRIEF

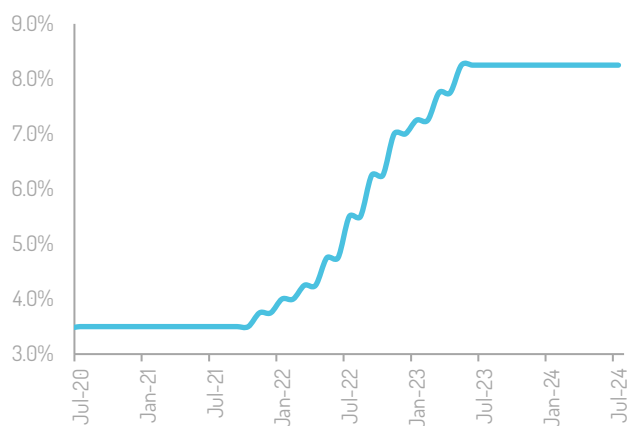
- As widely expected, the South African Reserve Bank (SARB) maintained the repo rate at 8.25% in its July 2024 Monetary Policy Committee (MPC) meeting. Four of the 6-member Committee preferred a hold, whereas the other two pivoted to the dovish side.
- With the SARB's next MPC meeting a day after the expected FOMC's first cut in September 2024, we expect it to start its easing cycle then, given the conventional market wisdom of most central banks' preference not to front run the US Federal Reserve.
- Two schools of thought emerged regarding the assessment of balance of risk tilting to the upside. One, is that the MPC assessment is that the risk factors, both global and domestic, have increased since the last MPC meeting. Secondly, the balance of risk remains the same, only that inflation outlook has improved since the May 2024 meeting.
- Data revisions to legacy GDP prints, partly offset with a more positive load shedding, resulted in a 10bps downgrade in 2024 growth forecast to 1.1% y/y. The negative blunt of load shedding on growth has reduced, supporting the better-than-expected potential growth forecast in the 2024 - 2026 period.
- Notably, ZAR has remained steady despite concern of the downside risk from elevated liquidity as the SARB meets its Gold Foreign Exchange and Contingency Reserve Account (GFECRA) ZAR 100.0bn transfer to the National Treasury in this fiscal year. The SARB put up an advance notice in mid-June, adjusting the liquidity quota limits for the participating banks to reduce the distortive effect of higher liquidity on ZAR and rates.
- Although the SARB has leaned towards a lower inflation target, that is a downward revision of the midpoint target from the current 4.5%, the impression is that the ongoing discussions with the National Treasury are not time-bound. This lower inflation target, and a possible introduction of fiscal anchor, will help anchor inflation firmly in the long-term, but the near-term outlook means that South Africa can muddle-through with the current configurations

First split vote since September 2023 MPC meeting

As widely expected, the South African Reserve Bank (SARB) maintained the repo rate at 8.25% in its July 2024 Monetary Policy Committee (MPC) meeting. Four of the 6-member Committee preferred a hold, whereas the other two pivoted to the dovish side. The Committee members reiterated their broad-based consensus approach in discussions and have averted a 3-3 vote scenario that would require Governor Lesetja to cast the tie-breaker vote, a set-up that is unnerving to investors.

The lack of unanimity in the preferred monetary policy stance, the first time since the September 2023 MPC meeting is hardly surprising. Futures markets are now penciling in rate cuts of 25bps magnitude in each of the three Federal Open Market Committee (FOMC) meetings to be held in the final third this year, compared with two rate cuts at the start of this month. With the SARB's next MPC meeting a day after the expected FOMC's first cut in September 2024, we expect it to start its easing cycle then, given the conventional market wisdom of most central banks' preference not to front run the US Federal Reserve.

REPO RATE



SOURCE: SOUTH AFRICA RESERVE BANK

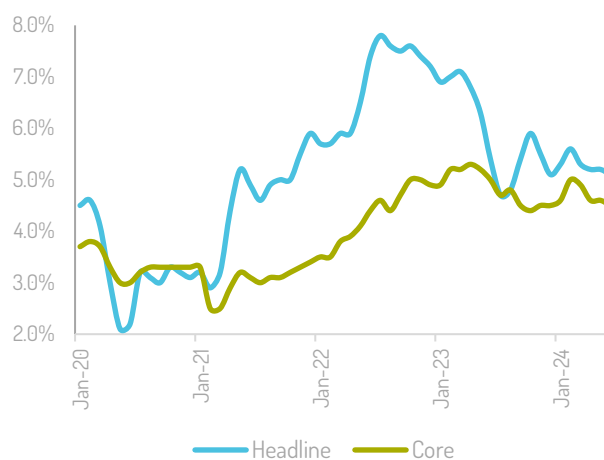
At the current policy stance, the repo rate has been restrictive given the somewhat disinflation trend since March 2024. The June 2024 inflation data, released this week, cemented this point by printing at 5.1% compared to 5.2% in the prior month. From the SARB's perspective, inflation outlook appears more promising. Inflation is expected to average 4.9% in 2024, 20bps lower than the forecast in the May 2024 MPC meeting. Given that 1H2024 inflation has averaged 5.3%, the SARB projects an average 4.5% inflation in this second half.

Balance of risks tilts to the upside

Although we are broadly in agreement with inflation's direction of travel, the upside risk to inflation reinforces our conviction that end-2024 inflation will be at 5.0% and above the SARB's

preferred 4.5% mid-point target. The assessment of the balance of risk being tilted to the upside caught our attention in the MPC statement, amidst the improved inflation outlook. Two schools of thought emerged regarding this point. Firstly, the MPC's assessment is that the risk factors, both global and domestic, have increased since the last MPC meeting. Secondly, the balance of risk remains the same, only that inflation outlook has improved since the May 2024 meeting. With our expectation that the SARB's easing cycle will start in the September 2024 meeting, we are inclined to the latter view. Although the policymakers pledged their data-dependency, and not committing to any forward guidance, the implicit recency bias to the ongoing disinflation trend anchors the favourable near-term outlook.

INFLATION RATE



SOURCE: STATISTICS SOUTH AFRICA, BLOOMBERG

Selected forecasts show a mixed bag in economic outlook

The sense we had from the post-MPC briefing is that the policymakers have faded geopolitical risks, through their price transmission and investor confidence channels. Forecast for brent crude have been retained at USD 84.0 and USD 81.0 per barrel for 2024 and 2025, respectively, despite the protracted spat in the Middle East. The ZAR is expected to appreciate 0.4% against the US dollar this year, from a stronger starting point of USDZAR of 18.35. This is against the expected depreciation of 0.4% and from a slightly weaker starting point of 18.60 at the May 2024 meeting. The formation of the Government of National Unity following the general election held in May has had a cooling effect on the ZAR, even as focus shifts to the upcoming US presidential elections in November 2024.

Data revisions to legacy GDP prints, partly offset with a more positive load shedding, resulted in a 10bps downgrade in 2024 growth forecast to 1.1% y/y. The negative blunt of load shedding on growth has reduced, supporting the better-than-expected potential growth forecast in the 2024 - 2026 period. Although

South Africa is on the cusp of crossing the 120-day mark with no load shedding, President Cyril Ramaphosa cautioned on the existing pain points in the national grid system. As a result of the higher potential growth this year, the negative output gap widened to -0.3% from the prior -0.1% but the policymakers downplayed the impact.

Broadly, we like the downward trajectory in the Services inflation, as seen in the June 2024 print, supported by the housing and utilities segment. In early July, a High Court ruling stopped municipalities with no cost-of-studies from applying the FY2024/25 electricity tariff as initially guided by the National Energy Regulator of South Africa (NERSA). That said, the SARB cited the fact that the bulk of electricity survey for purposes of CPI compilation was carried out this month, hence a higher-than-prior forecast in electricity CPI outturn in the second half this year.

Higher bank limit quota to absorb excess GFECRA liquidity and wade off ZAR weakness

Notably, the ZAR has remained steady despite concerns of the downside risk from elevated liquidity as the SARB meets its Gold Foreign Exchange and Contingency Reserve Account (GFECRA) ZAR 100.0bn transfer to the National Treasury in this fiscal year. In the 8-week period from 01 July to 19 August 2024, the gradual transfer is expected to result in a net increase in liquidity surplus in the order of ZAR 80.0bn during the period or roughly ZAR 10.0bn per week. The SARB put up an advance notice in mid-June, adjusting the liquidity quota limits for the participating banks to reduce the distortive effect of higher liquidity on ZAR and rates.

Lower inflation targeting debate remains unresolved

Although the SARB has leaned towards a lower inflation target, that is a downward revision of the midpoint target from the current 4.5%, the impression is that the ongoing discussions with the National Treasury are not time-bound. Critically, the Macro Standing Committee, comprising of members from both the SARB and the National Treasury, will need to consider the long-term benefits of a lower inflation target to the short-term costs in its assessments. We are still not aware of whether there's a preferred inclination by the DA Party, that is in the GNU, in this long-standing debate. Furthermore, the SARB pushed back the expectation that a lower inflation target will be finalized unilaterally by the central bank. This lower inflation target, and a possible introduction of fiscal anchor, will help anchor inflation firmly in the long-term, but the near-term outlook means that South Africa can muddle-through with the current configurations.

USDZAR RATE



SOURCE: BLOOMBERG



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