South African Reserve Bank Preview: January 2023

Details:

Decision due Thursday, January 26th, alongside a press conference with SARB Governor Kganyago.

MNI Point of View: Close Call Between 25bp & 50bp Hike

The South African Reserve Bank will likely slow the pace of monetary tightening this week amid downside surprises surrounding domestic inflation and easing peer pressure. That being said, headwinds to growth intensify, with no near-term solution to South Africa's deepening energy crisis in sight. Given the SARB's inflation-fighting bias, it seems more likely that the central bank will opt for a half-point hike to the repo rate, but it remains a very close call between 50bp versus 25bp move in rates.

Headline CPI inflation remained on a downtrend in December, slowing slightly more than forecast to +7.2% Y/Y. Core inflation unexpectedly eased to +4.9% Y/Y, raising hopes that the worst might be over. A weak auction for South African inflation-linked bonds held days after the release of the latest CPI figures pointed to the perception that we should see disinflationary processes take hold in the coming months. When this is being typed, South Africa's 10-year breakeven inflation rate sits within touching distance from its 11-month lows printed last week.

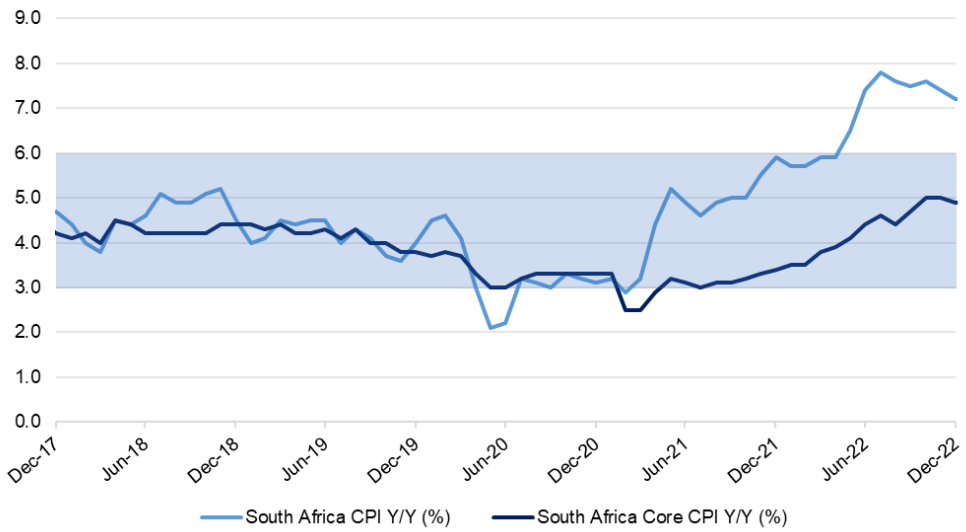

Figure 1. South Africa CPI vs. Core CPI Y/Y (%). The shaded region represents the SARB's target range.

Enthusiasm about evidence of cooling price pressures has been somewhat countered by remaining red flags. A BER survey showed that inflation expectations for this year rose to +6.1% Y/Y from +5.9% in the previous quarter, with all social groups revising their forecasts upwards. The poll was taken before South Africa's energy regulator NERSA approved an 18.65% electricity-tariff hike, the largest in over a decade, which risks pushing inflation expectations even higher. This means that the MPC are under pressure to continue tightening monetary conditions until there is convincing evidence that inflation expectations have been anchored near the mid-point of the target band.

A sense of concern about the increase in anticipated inflation was evident in recent comments from Governor Kganyago, who was interviewed by CNBC Africa on the sidelines of the World Economic Forum. The official explicitly cited the BER survey, noting that the central bank has a duty to take action and arrest inflation expectations. He emphasised the need to "remain vigilant" and "recalibrate policy" to make sure that inflation declines towards the mid-point of the +3%-6% Y/Y target range, adding that inflation has probably peaked, but is easing at a considerably slower pace than that with which it took off.

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The SARB's task is somewhat complicated by a debate on potential tweaks to its mandate inspired by the comments made by ruling party officials after the African National Congress's elective conference. Calls for expanding the central bank's remit to include job creation and economic growth applied some pressure to the rand before the electricity crisis stole the limelight again. While the debate has been shelved for now, Governor Kganyago's insistence that the central bank lacks the tools to address the dire situation of the domestic labour market points to scepticism within SARB leadership towards the idea of playing a more proactive role in ensuring high employment.

Otherwise, communications from other members of the rate-setting panel have been virtually non-existent, obstructing attempts to predict the vote split. At its November meeting, the Committee voted 3-2 in favour of a 75bp rate hike over a 50bp move. The distribution of votes marked a continued dovish shift in the panel's composite sentiment after the September (3 votes for 75bp vs. 2 votes for 100bp) and July (1 vote for 100bp, 3 votes for 75bp, 1 vote for 50bp) meetings. The latest signals on inflation dynamics should play into this trend in the general posture of the data-dependent Committee, warranting a slowdown in the pace of monetary tightening.

Looking at the FX market, the South African rand came under pressure at the start of the new year, hit by a double whammy of the SARB mandate chatter and escalating Eskom crisis. This came on the heels of turbulence caused by political jitters surrounding the Phala Phala scandal last month. Domestic headwinds created a drag on the rand, which has been the worst performer in EMEA space this year, losing around 2.8% versus the U.S. dollar. Another rate hike would provide support to the rand, bolstering the exchange-rate buffer against imported inflation.

With the SARB preparing to announce its monetary policy decision on Thursday, consensus is split between a 25bp and 50bp rate hike, with 15 out of 19 economists polled by Bloomberg opting for a larger increase. Although majority of analysts cling to their calls for a 50bp hike, it should be noted that a couple have jumped to the 25bp camp in the recent weeks. The market has taken a more dovish view, with the price action of FRA 1x4 contracts indicating substantial repricing in the first few weeks of the year, as their spread with the benchmark JIBAR tightened from the peak level of 45bp to 23bp at typing.

We expect South Africa's central bank to raise the repo rate by 50bp but concede that it will be a very close call between the consensus forecast and a smaller 25bp move. The SARB's focus on getting on top of inflation and anchoring inflation expectations close to the mid-point of the +3%-6% Y/Y target range warrant another increase in interest rates, despite headwinds to growth generated by the deepening energy crisis and signs of cooling headline inflation. The policy outlook remains murkier, albeit the market is betting on the end of the rate-hike cycle being nigh.

Data Watch

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Central Bank Watch - SARB

January 23, 2023

MNI SARB Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI YoY	% y/y	7.2	7.5	↓	7.4	↓					1.02
Core CPI YoY	% y/y	4.9	4.7	↑	4.4	↑					0.81
PPI YoY	% y/y	15.0	16.6	↓	14.7	↑					-0.50
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Trade Balance Rand	ZARbn	8.0	6.2	↑	30.9	↓					-1.20
Manufacturing Prod YoY	% y/y	-1.1	2.0	↓	-1.1	→					-0.20
Absa Manufacturing PMI	Index	53.1	48.2	↑	52.0	↑					0.83
SACCI Business Confidence	Index	110.9	105.6	↑	103.2	↑					0.92
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Money Supply M3 YoY	% y/y	8.76	8.12	↑	7.24	↑					0.95
Private Sector Credit YoY	% y/y	8.30	7.86	↑	5.34	↑					0.43
Total Loans and Advances	ZAR bn	4067	3999	↑	3848	↑					1.25
Net Reserves	$bn	53.83	52.24	↑	53.81	↑					0.61
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales YoY	% y/y	0.4	2.1	↓	0.1	↑					-0.30
BER Consumer Confidence	Index	-8.0	-20.0	↑	-25.0	↑					0.89
Unemployment	%	32.9	33.9	↓	34.5	↓					-0.90
Non-farm payrolls QoQ	%q/q	0.1	-0.9	↑	0.0	↑					-0.29
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity (FTSE/Jse Top 40)	Index	74046	57390	↑	60109	↑					1.10
SA 10-Year Yield	%	10.41	11.36	↓	11.00	↓					-0.29
SA 2-Year Yield	bps	498	575	↓	602	↓					-0.84
Effective Exchange Rate	Index	99.88	103.16	↓	109.06	↓					-1.08

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Sell-Side Views

ABSA: 25bp Rate Hike Likely This Week

- ABSA expect the moderation in domestic inflation, supported by lower fuel costs, an easing of food price pressures and a stable exchange rate to encourage the SARB to slow the pace of rate hikes to 25bp.
- They consider a split vote to be highly likely, with some MPC members possibly voting for keeping the benchmark rate on hold, as the nominal repo rate currently sits marginally above neutral.
- They expect the SARB to start easing monetary conditions modestly from September as headline inflation decelerates in the course of this year.

Barclays: SARB To Slow Pace Of Tightening To 50bp

- In South Africa, since the 25 November MPC meeting, the nominal effective rand exchange rate has appreciated by 5%, while domestic fuel prices have come off by a cumulative ZAR2/l.
- Unfortunately, domestic electricity tariffs have also been raised by as much as 18.7% in 2023 and 12.7% in 2024, offsetting the potential benefits of a stronger currency and lower oil prices, and leaving the inflation profile some 20bp higher.
- With inflation nonetheless falling back toward the mid-point of the target band in H2 24, Barclays expect the SARB to step down the pace of tightening to 50bp this week.

Bank of America: Decelerating Inflation To Warrant 25bp Rate Rise

- They expect the SARB to hike by 25bp, as inflation is decelerating in line with expectations while global central banks are starting to moderate hikes too.

Citibank: Downshifting To 50bp Hikes

- They see the SARB downshifting to a 50bp rate hike in the January meeting on the back of falling inflation data, but warn that that the decision will be a close call, with a 3-2 split of votes between 50bps and 25bps.

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Goldman Sachs: SARB To Moderate Pace Of Tightening To 25bp

- Goldman expect the SARB to raise the key policy rate by 25bp after two consecutive 75bp rate hikes in September and November.
- They assess that inflation developments since the November MPC meeting have been mostly dovish. This was notably the case in December for core inflation, which Goldman think will likely decline further in Q1 2023 and stand well below the SARB's 5.4% forecast for the quarter.
- They note that activity data have been mixed while load-shedding has intensified to record levels in recent months. They expect that MPC forecast revisions to growth are likely to be relatively small.
- They do not anticipate any forward guidance from the SARB and note that the MPC is likely to articulate continued data-dependence, but stress that the expected rate hike will likely represent the end of the tightening cycle.

Investec: SARB To Slow Hikes To 50bp

- They see the potential for the SARB to drop the pace of monetary tightening from 75bp to 50bp after the Fed did so last month.
- They note that with CPI inflation still well above the target, and risks to the outlook, the SARB is likely to hike the repo rate again this month, albeit by a smaller increment than last time.
- Looking further afield, Investec say that if the FOMC slows its rate hikes to 25bp in February, this would create space for the SARB to slow its interest rate increases as well.

JP Morgan: Core Inflation Dynamics To Warrant 25bp Hike

- They observe that recent dynamics in core inflation, as contained in the December report, combined with the global disinflationary impulse in non-core inflation, now likely will suffice to bias the SARB for a smaller 25bp hike.
- JPM continue to look for a split MPC that probably debates between at 25bp and a 50bp final hike, but believe that now a swing vote may prompt the 25bp outcome as the extent of the upside inflation risk appears better contained.
- That said, the deliberation likely remains a relatively close call as the MPC may caution that current favourable conditions for EM assets could later fade and the exchange rate of the rand likely will remain volatile.

Morgan Stanley: 50bp Hike With 3-2 Vote Split

- They expect a split committee, with three in favour of a 50bp hike and two in favor of a hold.
- MS note that the risk/reward of a final, moderate insurance hike has improved.

Nedbank: Thursday To See 25bp Rate Rise

- They expect the Reserve Bank's Monetary Policy Committee (MPC) to remain hawkish, stressing the risks to the inflation outlook.
- However, they believe that interest rates are near their peak in this cycle, given the evidence of fading global inflationary pressures, the gradual easing of domestic inflation, weaker domestic growth prospects, and the US Fed's decision to take a less aggressive monetary policy stance.
- Nedbank expect the MPC to hike by 25 bps on Thursday, which will be followed by another hike of a similar margin in March, which they say will be the last hike in the current cycle.

Société Générale: 50bp Hike This Week, Another One In March

- SocGen note that at the previous MPC meeting, the SARB delivered a hawkish statement, while Governor Kganyago said that the 7% rate was still accommodative and conducive to credit growth.
- Although the latest inflation prints surprised on the downside, the governor warned of a rise in inflation expectations in his recent Davos comments.
- They believe the SARB will maintain its hawkish stance, raising the key policy rate by 50bp, signalling that tightening is not over.
- SocGen expect that the SARB will deliver another (and last) 50bp hike in March, with the repo rate peaking at 8%.

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TD Securities: SARB To End Cycle With 50bp Rate Rise

- TD think that think that the SARB's 50bps hike this week will be the final one as domestic factors and tamer inflation outlook suggest that the CB shouldn't be too worried about inflation.

UBS: This Week To Bring Another 25-50bp Hike

- They note that inflation surprised to the downside in December, printing at +7.2% Y/Y, but this was still above the SARB's target range of +3%-6% Y/Y, with the central bank increasingly focused on binding expectations to the mid-point of that band.
- UBS expect the SARB to raise the key policy rate by another 25-50bp this week from the current 7%.