

Interest rate comment

SARB lifts near-term inflation forecast, policy rate on hold

The headline-grabbing information that emerged from the SA Reserve Bank's (SARB) first interest rate meeting of 2017 was not that the repo policy interest rate was unanimously kept unchanged at 7% (prime rate at 10.5%). This was widely expected. The surprise, at least from our perspective, was the extent to which the SARB raised their short-term inflation forecast.

At 6.2%, **headline CPI** is now expected to average 0.4 percentage points (% pts) higher in 2017 than was envisaged at the previous (November 2016) MPC meeting. Whereas CPI was previously forecast to moderate to below 6% from 2017Q2, this is now only expected to occur two quarters later in 2017Q4. The SARB's outlook is more downbeat than the January consensus of analysts compiled by Reuters. The consensus remains for CPI to dip below 6% from 2017Q2 onwards. This is also our current forecast.

The MPC statement provided some explanation for the SARB's "significant" revision. Primarily, it is a function of a much higher **petrol price** assumption in 2017 and persistent elevated **food prices**. The fuel price is expected to increase by 12.8% this year, more than double the rise of 5.7% forecast in November. The puzzling bit is that the SARB's Brent crude oil price assumption was only lifted marginally to \$56/bbl from \$53.5/bbl in November. At the same time, the SARB now expects an almost 9% strengthening in the real effective rand exchange rate versus a 5.7% gain projected in November. The SARB's petrol price assumption seems to be at odds with their oil and rand forecasts. One can only assume that the SARB is expecting a significant rise in the **fuel levy** when Finance Minister Gordhan delivers the Budget on 22 February. In light of the need to raise significant additional revenue, outlined in the October 2016 Medium-Term Budget Policy Statement (MTBPS), this is not unrealistic. The MPC mentions later on in the statement that expected tax increases are likely to dampen consumer spending in 2017.

Regarding **food prices**, the SARB expects an increase of 7% in 2017 compared to 6.5% forecast in November. While the headline CPI forecast for 2017 was increased, the view for 2018 remained unchanged at 5.5%. Of more importance from an interest rate perspective is that the SARB kept the outlook for **core CPI** inflation unchanged at 5.5 and 5.2% for 2017 and 2018 respectively. The core measure strips out food and energy costs from headline CPI. The statement emphasised that exogenous factors (oil, food and most probably tax hikes) are responsible for the deterioration in the near-term inflation forecast and for that reason the MPC was not going to respond by hiking the repo rate at this stage. Indeed, the MPC retained the view that "we may be near the end of the hiking cycle".

On **GDP growth**, the statement mentioned that recent soft high-frequency data raised downside risks to growth in 2016Q4. However, the growth outlook for 2017 and 2018 remained largely unchanged at 1.1 and 1.6%.

24 January 2017

Please refer to the [glossary on the BER's website](#) for explanations of technical terms.

Interest rate outlook

Domestic developments aside, the MPC was relatively sanguine on US Fed rate hikes. Because of a highly uncertain US policy environment under a Trump administration, the SARB still expects a moderate pace of Fed hikes. This is also our assumption and an important factor behind our out of consensus call that the rand exchange rate is likely to remain relatively resilient against the US dollar in the foreseeable future.

Combined with a constrained SA growth outlook and steady core inflation, our view is still that the repo rate will remain unchanged at 7% through at least 2017. Clearly, the upward revision to the SARB's headline CPI forecast rules out the possibility of an interest rate reduction in the foreseeable future. Indeed, in response to a journalist question in the Q&A session, SARB Governor Kganyago argued that the MPC's interest rate stance remained accommodative.



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