



Steady repo rate at 8.25% but exercising caution

Highlights

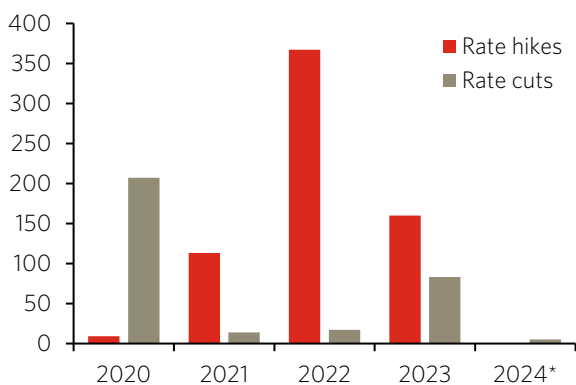
- The number of global central bank interest rate hikes in 2023 almost halved from 367 in 2022 to 160 in 2023 and we saw a rise in the number of interest rate cuts. More interest rate cuts are expected in 2024 globally in response to cooling inflationary pressures.
- The United States (US) Federal Reserve Bank (Fed) and the European Central Bank (ECB) kept their key interest rates constant at the December 2023 meetings. The Fed has started to discuss interest rate cuts while the ECB is still maintaining a hawkish tone in response to persistent price pressures.
- South Africa's (SA) economic activity contracted in the third quarter of 2023 and exposed fragility in the economy. Domestic growth is expected to improve but remain weak in the fourth quarter of 2023. The SA Reserve Bank (SARB) has subsequently revised its growth forecast for 2023 down to 0.6% (previously 0.8%). The SARB expects economic growth to tick up to 1.2% in 2024, 1.3% in 2025 and 1.6% in 2026.
- The SARB assessed risks to the medium-term domestic growth outlook as balanced but flagged the logistics and energy crises as factors limiting growth. The return and planned return of large power plants (Kusile and Medupi) increases the grid's electricity generation capacity which provides a potential upside to economic growth.
- The annual average headline inflation rate of 6% in 2023 was significantly better than 6.9% in 2022 but remained elevated at the upper limit of the inflation target range (3% to 6%). Risks to the domestic inflation outlook were assessed to the upside. The identified risks included a weak rand, geopolitical tensions, climate change, food prices, higher average salaries, elevated inflation expectations as well as energy and logistics constraints.
- The SARB kept its forecast for headline inflation (CPI) in 2024 constant at 5%. The assumption of inflation stabilising at the midpoint of the inflation target range (4.5%) was shifted from 2025 to 2026.
- The SARB expects core inflation to remain anchored around the midpoint of the inflation target range. Core inflation is expected to be 4.6% in 2024 (unchanged) and 2025 (previously 4.5%) before moderating to 4.5% in 2026.
- The rand was the fourth worst performing emerging market currency against the US dollar (\$) in 2023. In our view, the rand will likely remain under pressure in the near term due to loadshedding, logistics constraints, fiscal concerns and the upcoming SA general elections.
- International oil prices are expected to remain stable in 2024 but geopolitical tension presents upward oil price pressures.
- The SARB revealed that the decision to keep the repo rate constant at 8.25% for the fourth consecutive time was unanimous. The January meeting was concluded with five Monetary Policy Committee (MPC) members, with the introduction of David Fowkes following his appointment as an advisor to the governors earlier in the year.

- The governor emphasised that the committee would need to see a discernible trend that inflation is moderating toward the midpoint of the target range and inflation would need to remain sustainably low before they consider cutting rates.
- We maintain our view that the SARB is nearing the end of the hiking cycle and we forecast the first interest rate cut to be implemented in the second quarter of 2024, at the earliest. We forecast a total of three interest rate cuts for 2024, ending the year at 7.5%.

Interest rate cuts expected globally in 2024

Global headline inflation has come off its peak gradually and core inflation is following suit, albeit at a slower pace. Consequently, the number of central bank interest rate hikes in 2023 almost halved from the unprecedented interest rate hikes experienced in 2022 (see chart 1). Moreover, the number of central banks cutting rates was higher in 2023 and this upward trend is expected to continue in 2024. With a fair amount of certainty that more central banks will cut interest rates this year, the uncertainty now lingers over the timing and magnitude of the interest rate cuts.

Chart 1: Number of interest rate hikes almost halved in 2023 relative to 2022



Source: cbrates.com, Momentum Investments
* Year-to-date (1 January to 25 January 2024)

In its last meeting of 2023 in December, the Fed kept the federal funds target range constant at a range of between 5.25% and 5.5% for the third consecutive meeting. The meeting minutes indicated that committee members are open to rate cuts in 2024 and the Fed is signalling a cumulative 100 basis points rate cuts during this year. The Bloomberg median consensus maintains the expectation that the first US interest rate cut will be implemented in the second quarter of 2024.

The ECB also kept the interest rate constant at 4.5% during December but unlike the Fed, the ECB is not signalling consideration of rate cuts yet. Nevertheless, the Bloomberg consensus expects ECB rate cuts from the second quarter of 2024.

We believe central banks will likely remain cautious in the lead up to their respective rate cutting cycles. As the Financial Times describes, "... officials hate U-turns. They would prefer to wait, act slowly and risk being late rather than reverse course".

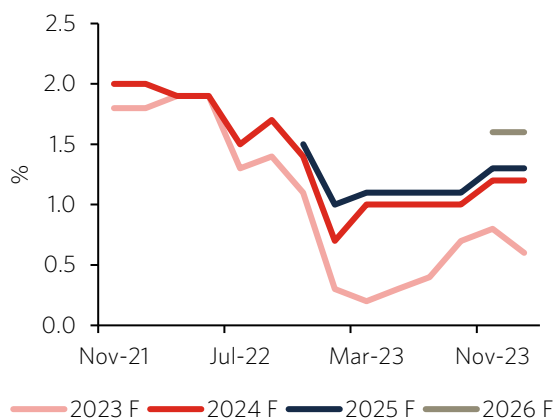
Energy and logistics constraints continue to hamper domestic growth prospects

Domestic growth disappointed in the third quarter of 2023 with a slightly larger-than-anticipated contraction of 0.2% quarter-on-quarter (q/q). Furthermore, consumers experienced a technical recession (two consecutive quarters of negative growth) in the third quarter for the first time since the second quarter of 2009 (global financial crisis). Moreover, growth in fixed investment contracted after seven consecutive quarters

of trending in positive territory. The decrease in the fourth quarter business and consumer confidence indices published by the Bureau for Economic Research (BER) points to weak growth in the fourth quarter of 2023. Against this backdrop, it is not surprising that the SARB revised its growth estimate for 2023 down to 0.6% (previously 0.8%) as illustrated in chart 2. The

new 2023 forecast is slightly below our forecast of 0.7%.

Chart 2: SARB's real growth revisions



Source: SARB, Momentum Investments
Data until January 2024

Growth is expected to improve marginally between 2024 and 2026 (see chart 2). The SARB forecasts an economic expansion of 1.2% in 2024, 1.3% in 2025 and 1.6% in 2026. Medium-term projections were kept unchanged from the November estimates. The SARB's 2024 projection is in line with the January 2024 Reuters median consensus (1.2%) but slightly higher than our projection (1%). The SARB's 2025 projection is more conservative compared to our and the Reuters projection. We see the economy expanding by 1.7% in 2025 while the January Reuters median consensus has pencilled in 1.5%.

The January Reuters median consensus forecasts economic growth of 0.3% q/q for the fourth quarter of 2023 and for the first quarter of 2024.

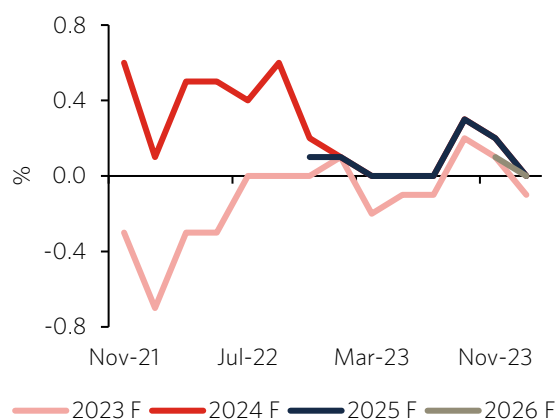
The SARB assesses risks to the medium-term growth outlook as balanced but notes that inefficiencies in the logistics industry and energy constraints are expected to continue to limit economic growth.

Loadshedding is expected to continue in 2024 but with a lower intensity, which could reduce the downward pressure on economic activity. The assumption of moderate loadshedding is based on increased electricity generation capacity. Kusile Units 1 to 3 were brought back online in the last quarter of 2023 and these units

are contributing approximately 2 400 MW to the grid (equivalent to two stages of loadshedding). Furthermore, Eskom announced the successful synchronisation of Kusile Unit 5 to the grid for the first time at the end of December 2023. This unit is expected to provide an additional c.800 MW to the grid. However, power supply from this unit will be irregular during the first six months of 2024 (testing stage) and the unit will be fully transferred into commercial operation thereafter. The return of Medupi Unit 4 is being fast-tracked and is expected to come online in April 2024 instead of August 2024. This unit would add an additional 800 MW to the grid. Private sector investment in renewable energy is expected to help ease the energy crisis. While generation capacity is gearing up in the right direction, unexpected breakdowns at the power plants remain a risk to the growth outlook.

Logistical challenges, particularly ports and rail, are an impediment to economic growth. The successful implementation of the Freight Logistics Roadmap (a plan aimed at addressing challenges in the industry) is essential to prevent further deterioration in the logistics network.

Chart 3: SARB's output gap revisions



Source: SARB, Momentum Investments
Data until January 2024

The output gap is expected to be marginally negative in 2023 and close in 2024 (see chart 3). This imputation of the output gap implies that there are no upward or downward demand pressures.

The SARB's recommended measures to improve economic growth include "achieving a prudent public debt level, increasing the supply of energy, keeping

administered price inflation low and real wage growth in line with productivity gains".

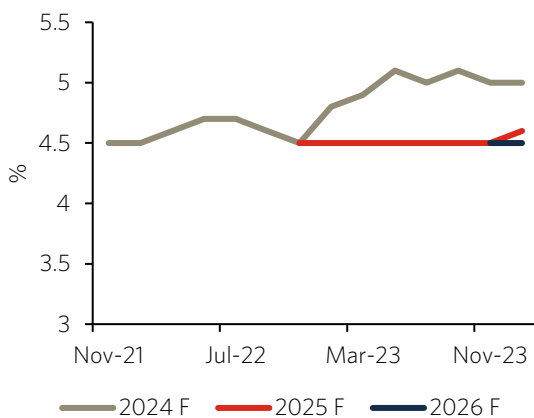
Minimal changes to the inflation projections but risks remain

The deceleration in domestic headline inflation over 2023 was not linear but good progress was achieved. CPI fell from the 2023 peak of 7.1% year-on-year (y/y) in March 2023 toward the midpoint of the inflation target range (4.7% in July) and the year ended at 5.1% y/y in December.

Furthermore, the annual average headline inflation rate of 6% in 2023 was significantly better than 6.9% in 2022. However, inflation remains a concern because it registered at the upper limit of the inflation target range.

Moving forward, the SARB expects headline inflation to average 5% in 2024 (unchanged), 4.6% in 2025 (previously 4.5%) and reach 4.5% in 2026 (unchanged) as illustrated in chart 4. The SARB's 2024 forecast is in line with the January Reuters consensus and lower than our projection of 5.4%.

Chart 4: SARB's annual headline inflation revisions

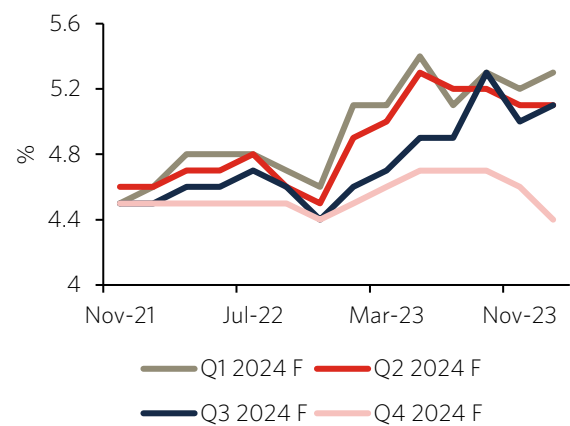


Source: SARB, Momentum Investments
Data until January 2024

On a quarterly basis, the SARB estimates a gradual decrease in the headline inflation rate during the first three quarters of 2024 followed by a larger drop in the fourth quarter (see chart 5). CPI is forecasted to average 5.3% in the first quarter of 2024 (previously

5.2%), moderate to 5.1% in the second quarter and third quarter and drop below the mid-point of the target range to 4.4% in the fourth quarter (previously 4.6%).

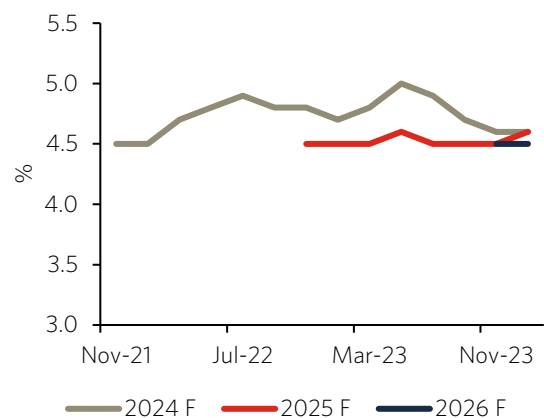
Chart 5: SARB's quarterly headline inflation revisions



Source: SARB, Momentum Investments
Data until January 2024

Core inflation in 2023 was more stable than headline inflation dropping from the 2023 high of 5.3% in April 2023 to 4.5% in December. Core inflation averaged 4.9% (slightly higher than the SARB's November forecast of 4.8%) and higher than the 4.3% recorded in 2022.

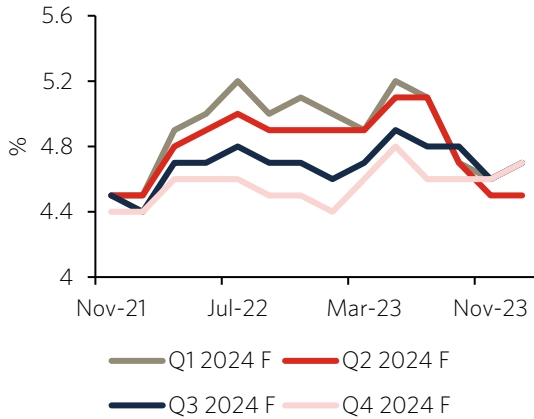
Chart 6: SARB's annual core inflation revisions



Source: SARB, Momentum Investments
Data until January 2024

The SARB expects core inflation to remain anchored around the midpoint of the inflation target range. Core inflation is expected to be 4.6% in 2024 (unchanged) and 2025 (previously 4.5%) and moderate to 4.5% in 2026 (unchanged).

Chart 7: SARB's quarterly core inflation revisions



Source: SARB, Momentum Investments
Data until January 2024

Core inflation is forecasted to average 4.7% in the first quarter of 2024 (previously 4.6%), soften to 4.5% in the second quarter (unchanged) and remain constant at 4.7% in the third and fourth quarter (previously 4.6%).

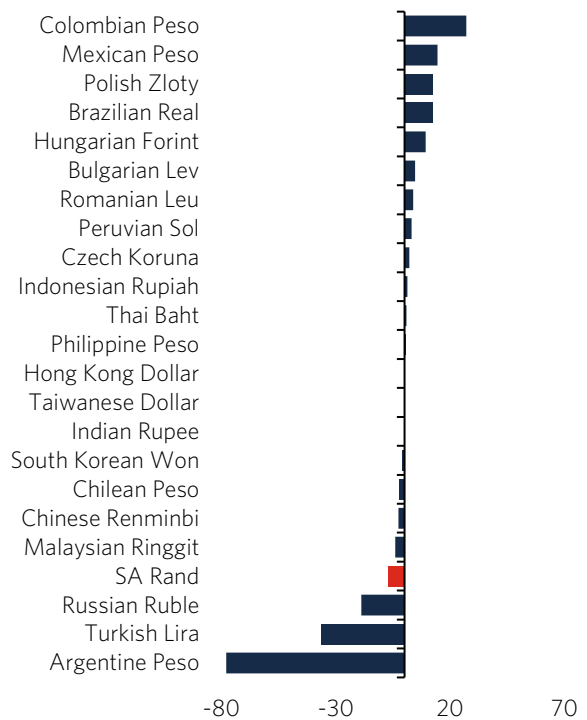
Risks to the domestic inflation outlook were assessed to the upside. The identified risks include a weak rand, geopolitical tensions, climate change, food prices, higher average salaries, elevated inflation expectations as well as energy and logistics constraints.

According to Bloomberg, the rand was the fourth worst performing emerging market currency against the US dollar in 2023 (see chart 8). The SARB noted an 11% depreciation against the dollar over the past year. Factors at play included loadshedding, an elevated country risk premium, domestic foreign policy concerns, logistics constraints and tighter global monetary policy among other factors. A weak currency is a concern for the MPC primarily because of the exchange rate pass-through (more expensive imported goods and services).

Since the start of 2024, the rand traded 1.69% weaker to the US dollar and ranked as the sixth worst performing emerging market currency. In our view, the

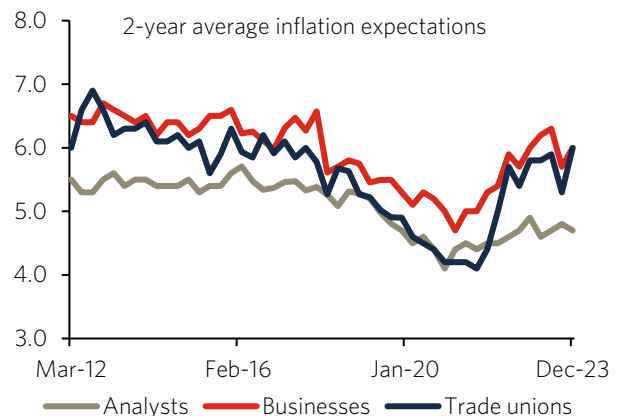
rand will likely continue to remain under pressure especially in the first half of 2024 because some of the factors that weighed on the currency in 2023 are still a concern (e.g. loadshedding, logistics constraints and fiscal concerns). Moreover, the upcoming SA general elections could potentially weaken the rand as political uncertainty builds up.

Chart 8: Rand was the fourth worst performing emerging market currency against the US\$ in 2023*



Source: Bloomberg, Momentum Investments
*3 January 2023 to 29 December 2023

Chart 9: Price setters expect higher inflation



Source: BER, Momentum Investments

Elevated inflation expectations, particularly among price setters (business and trade unions) do not bode well for the inflation outlook (see chart 9).

According to the US Energy Information Administration (EIA), international oil prices are expected to be relatively stable and average US\$82/bbl in 2024 (same forecast as the SARB). The SARB forecasts oil prices to decrease to US\$ 81/bbl in 2025 (previously US\$82/bbl) and reach US\$80/bbl in 2026

(unchanged). The probability of one of the big oil producers (catalyst for oil price changes) is considered to be low but cannot be ruled out. As such, geopolitical tensions continue to present upside risks to oil prices.

The SARB revised its forecast for food inflation up to 5.7% in 2024 (5.5% previously) and highlights the unpredictability of food inflation.

Unanimous decision to keep the repo rate on hold

The decision to keep the repo rate constant at 8.25% at the January 2024 meeting was taken unanimously and this marks the fourth consecutive meeting of keeping the repo rate unchanged (see table 1). This decision was widely anticipated. All 20 surveyed analysts in the January 2024 Reuters Econometer poll (including ourselves) expected the repo rate to be kept on hold.

Against market concerns of a four-member MPC meeting following the official departure of former Deputy Governor Kuben Naidoo in December, the January meeting took place with a five-member committee. The newest voting member of the committee (David Fowkes) was appointed on 11 January 2024 as an advisor to the governors.

In answering questions about the future composition of the MPC, the governor noted the following points:

- President Cyril Ramaphosa is yet to appoint a replacement for former Deputy Governor Naidoo. This appointment will increase the members of the MPC to six.
- There is an intention to appoint a seventh member to the committee. This would be favourable because an odd number prevents a scenario where the governor needs to exercise two votes in the event of a split vote.
- The terms of reference of the MPC indicate that the SARB can include up to four SARB staff members to the MPC.

Table 1: Shift in MPC member preferences at the scheduled January 2024 meeting

| Number of committee members | Favoured no move | Favoured a 25-basis point hike | Favoured a 50-basis point hike | Favoured a 75-basis point hike | Favoured a 100-basis point hike |
|-----------------------------|------------------|--------------------------------|--------------------------------|--------------------------------|---------------------------------|
| 27 January 2022 | 1 | 4 | - | - | - |
| 24 March 2022 | - | 3 | 2 | - | - |
| 19 May 2022 | - | 1 | 4 | - | - |
| 21 July 2022 | - | - | 1 | 3 | 1 |
| 22 September 2022 | - | - | - | 3 | 2 |
| 24 November 2022 | - | - | 2 | 3 | - |
| 26 January 2023 | - | 3 | 2 | - | - |
| 30 March 2023 | - | 2 | 3 | - | - |
| 25 May 2023 | - | - | 5 | - | - |
| 20 July 2023 | 3 | 2 | - | - | - |
| 21 September 2023 | 3 | 2 | - | - | - |
| 23 November 2023 | 5 | - | - | - | - |
| 25 January 2024 | 5 | - | - | - | - |

Source: SARB, Momentum Investments

Sustainable decrease in inflation required before rate cuts

The slow pace of inflation moderation as well as the volatility of inflation outcomes over the past year was noted as a concern to the SARB. To this end, the governor emphasised that the committee would need to see a discernible trend that inflation is moderating toward the midpoint of the target range and inflation would need to remain sustainably low before they consider cutting rates.

Furthermore, the governor flagged that “SA’s public is intolerant of inflation and the high cost of living”.

Therefore, the SARB remains committed to ensuring that inflation continues to moderate.

Nevertheless, we maintain our view that the SARB is nearing the end of the hiking cycle and we forecast the first interest rate cut to be implemented in the second quarter of 2024, at the earliest. We forecast a total of three interest rate cuts for 2024, ending the year at 7.5%.

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