The outlook for interest rates

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NEDBANK

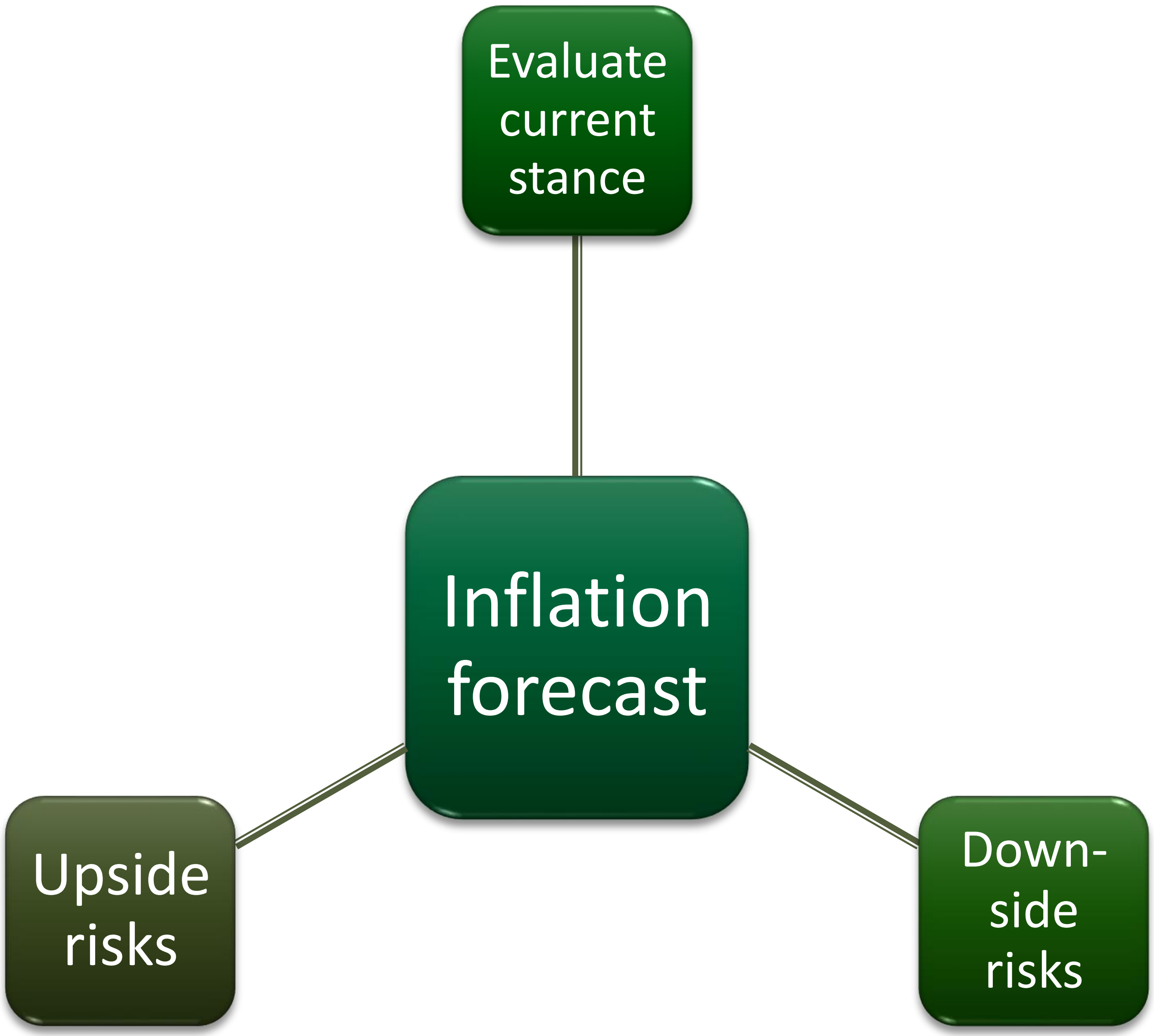
What determines the path of policy rates?

South Africa follows an inflation targeting monetary policy regime

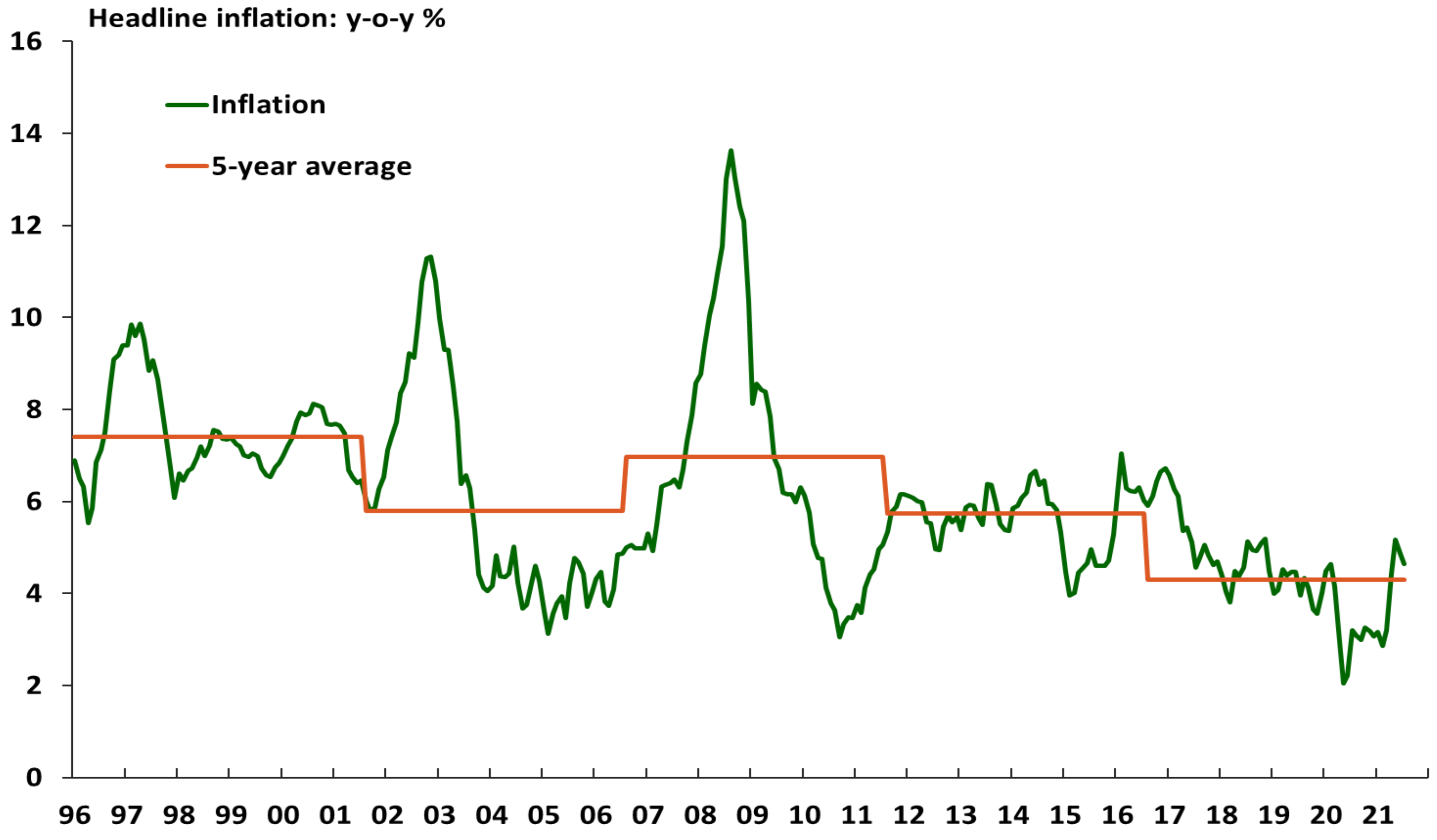
- Target = headline consumer inflation
- The range = 3% - 6%
- The SARB targets the midpoint of the range+ 4.5%

How does it work?

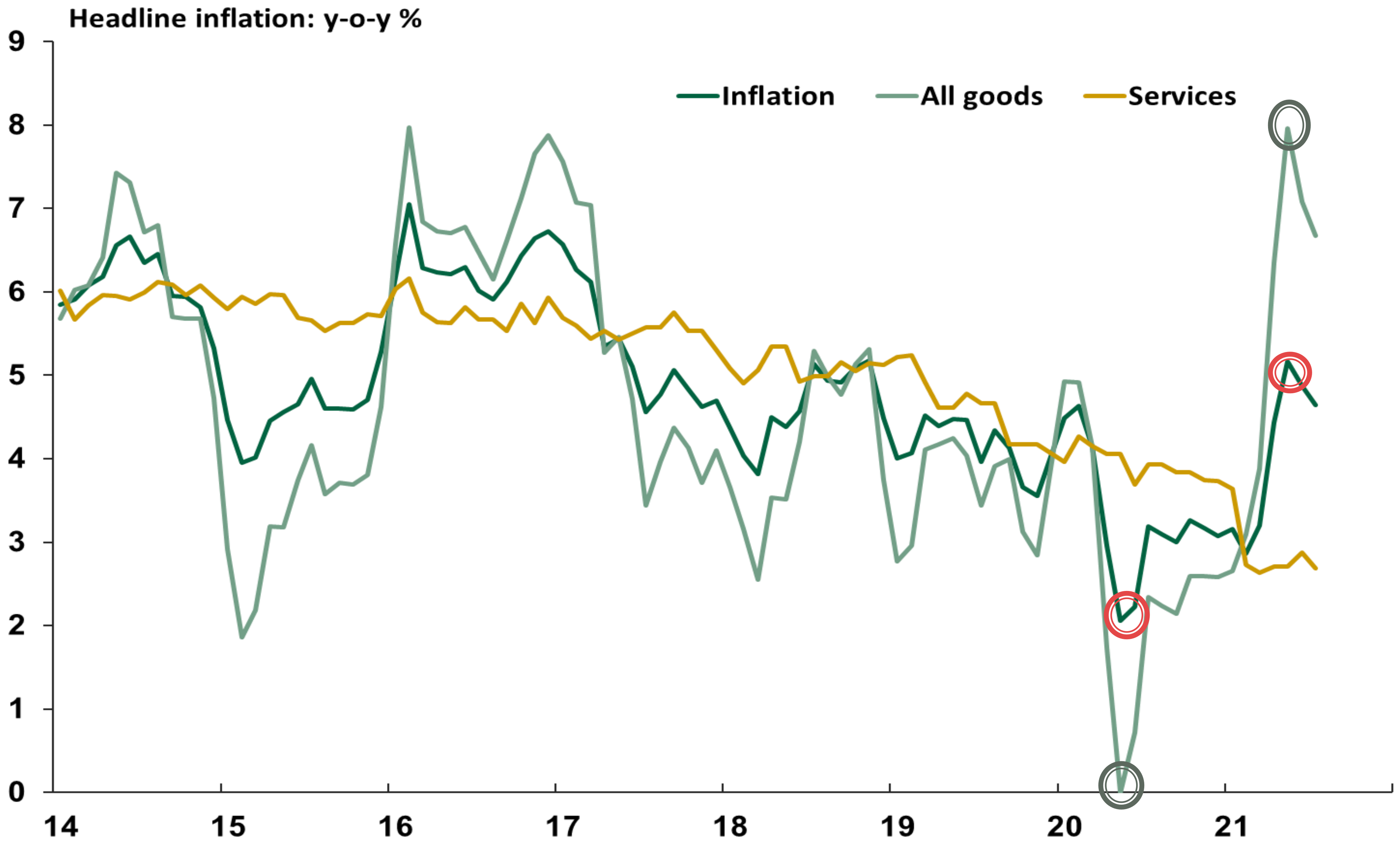
- If SARB expects inflation to rise above 4.5% over the next three years → **raise** interest rates
- If SARB expects inflation to hover around 4.5% over the next three years → **cut or leave** interest rates depending on the appropriateness of existing policies
- If SARB expects inflation to fall below 4.5% over the next three years → **cut or leave** interest rates depending on the appropriateness of existing policies
- It is always a judgement call



Inflation has moved to structurally lower levels



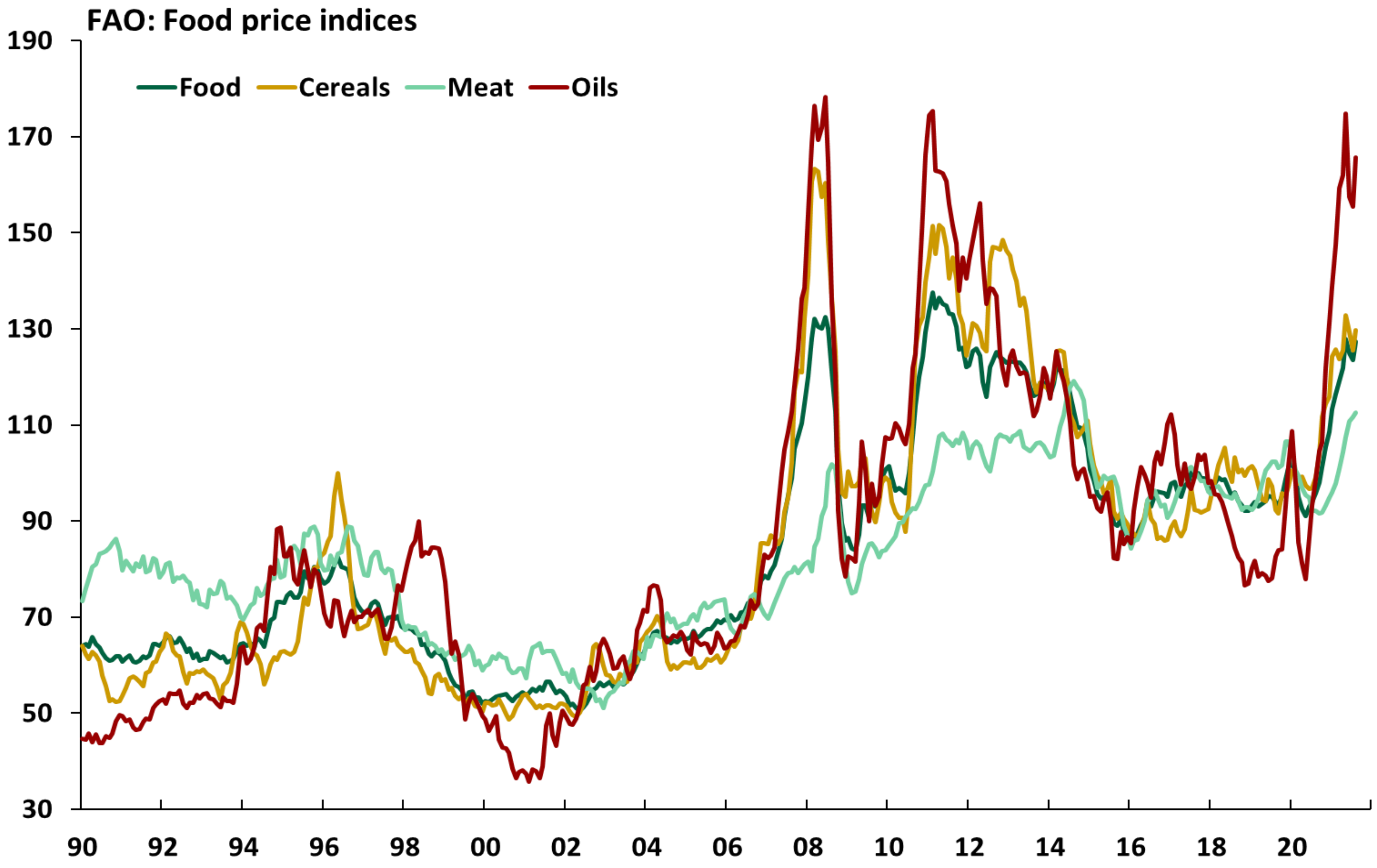
Inflation is receding again after rising to a peak of 5.2% in May



Much of the rise was driven by:

1. An artificially low base
2. Normalisation in global oil prices
3. Rising global food inflation
4. Higher imported inflation on everything from raw materials to intermediate goods
5. Higher electricity tariffs

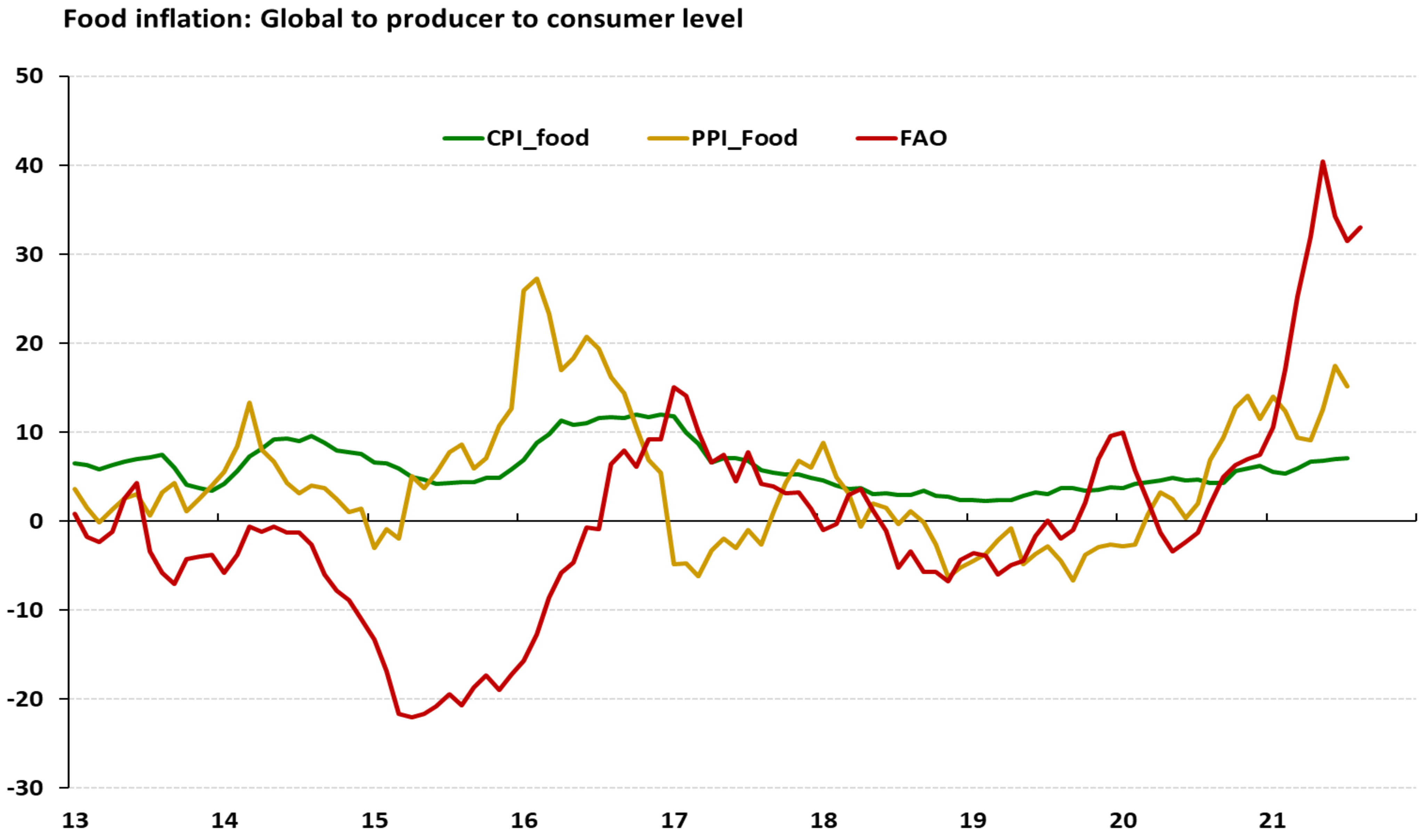
Global food prices remain elevated



Market consensus:

1. Climatic conditions have improved in key regions
2. Upbeat crop estimates for upcoming seasons
3. The worst is over. Prices should moderate
4. Palm oil prices should ease, but will remain elevated

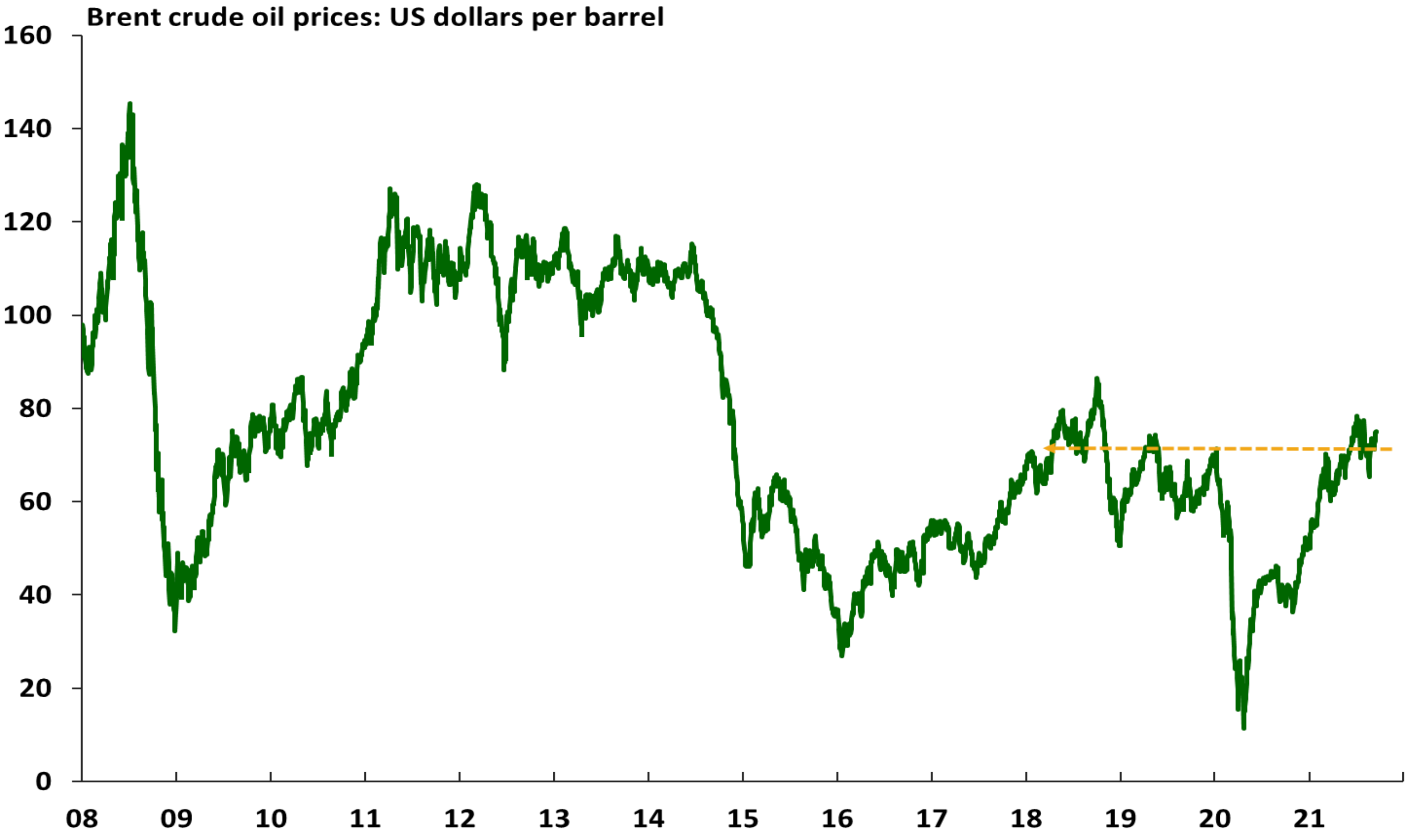
The rise in local food inflation has been modest compared to the global trend



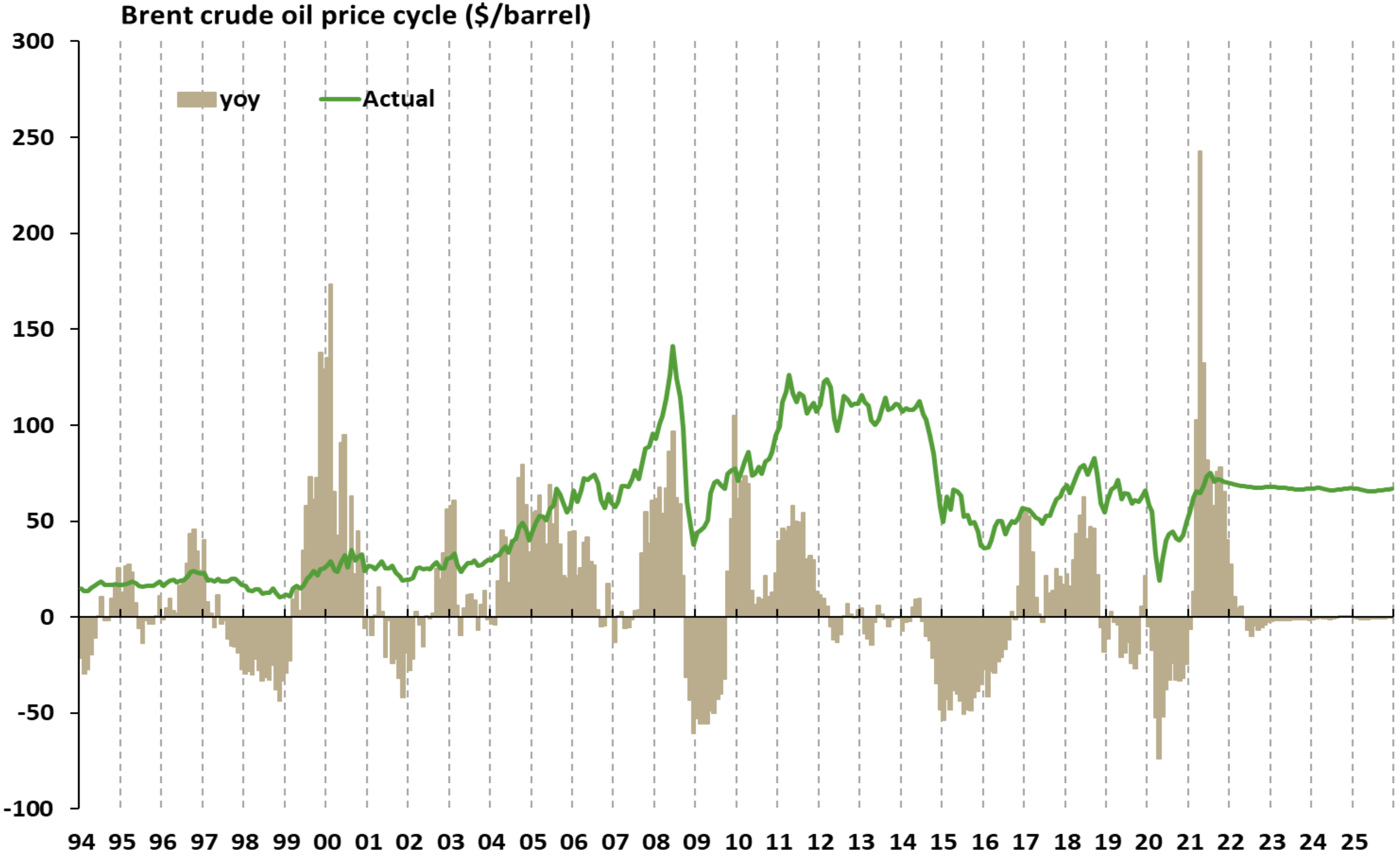
Higher domestic production & a stronger rand both reduced imports volumes & price

Food continues to pose upside risks

Global oil prices have returned to pre-pandemic levels



With the steepest part of the climb over, oil prices are expected to drift sideways



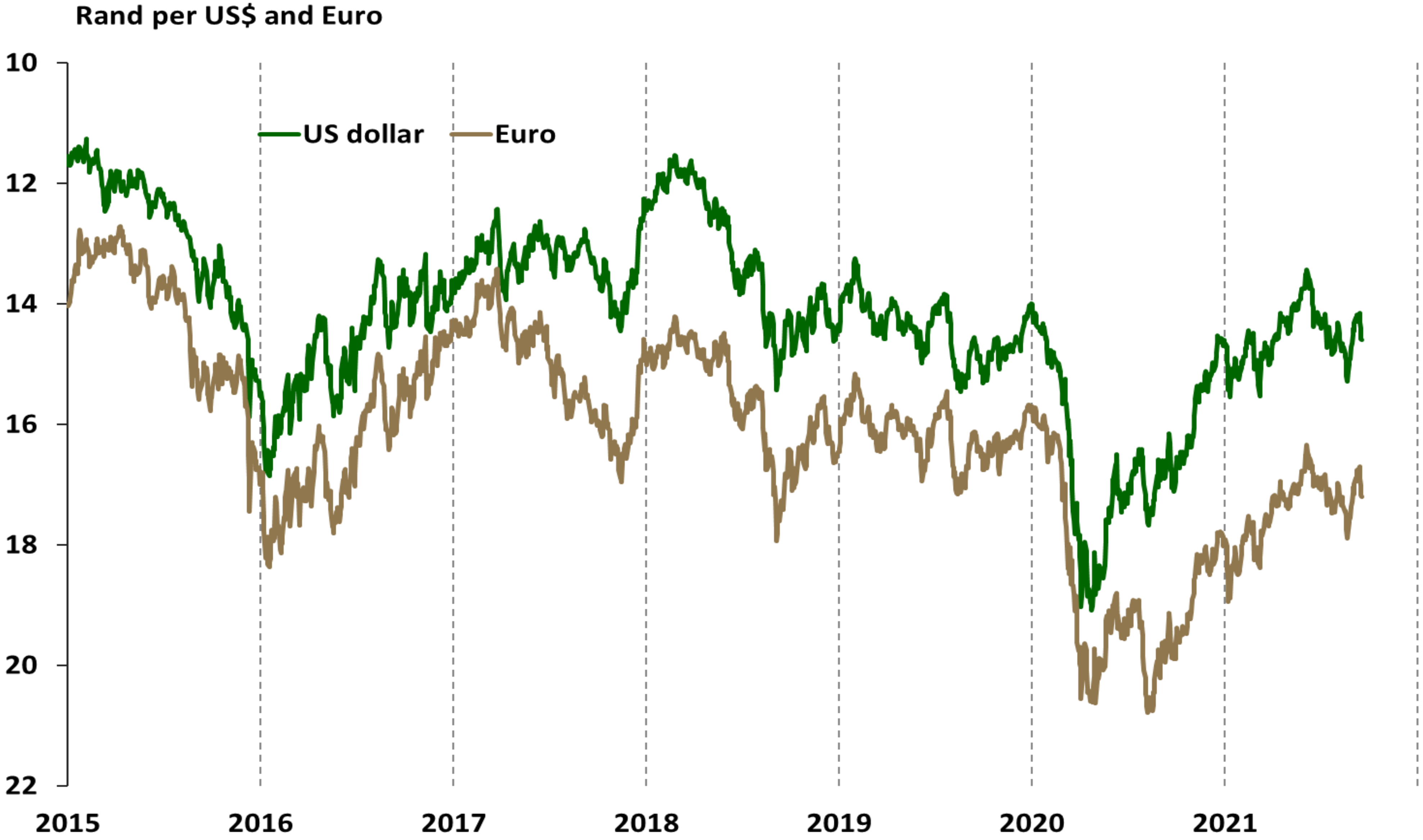
Reuters consensus forecast

31-Aug-21

Years	Brent ($ per barrel)
Q3 2021	71.99
Q4 2021	70.73
Q1 2022	69.41
Q2 2022	68.77
2021	68.02
2022	68.26
2023	66.92
2024	65.96
2025	65.17

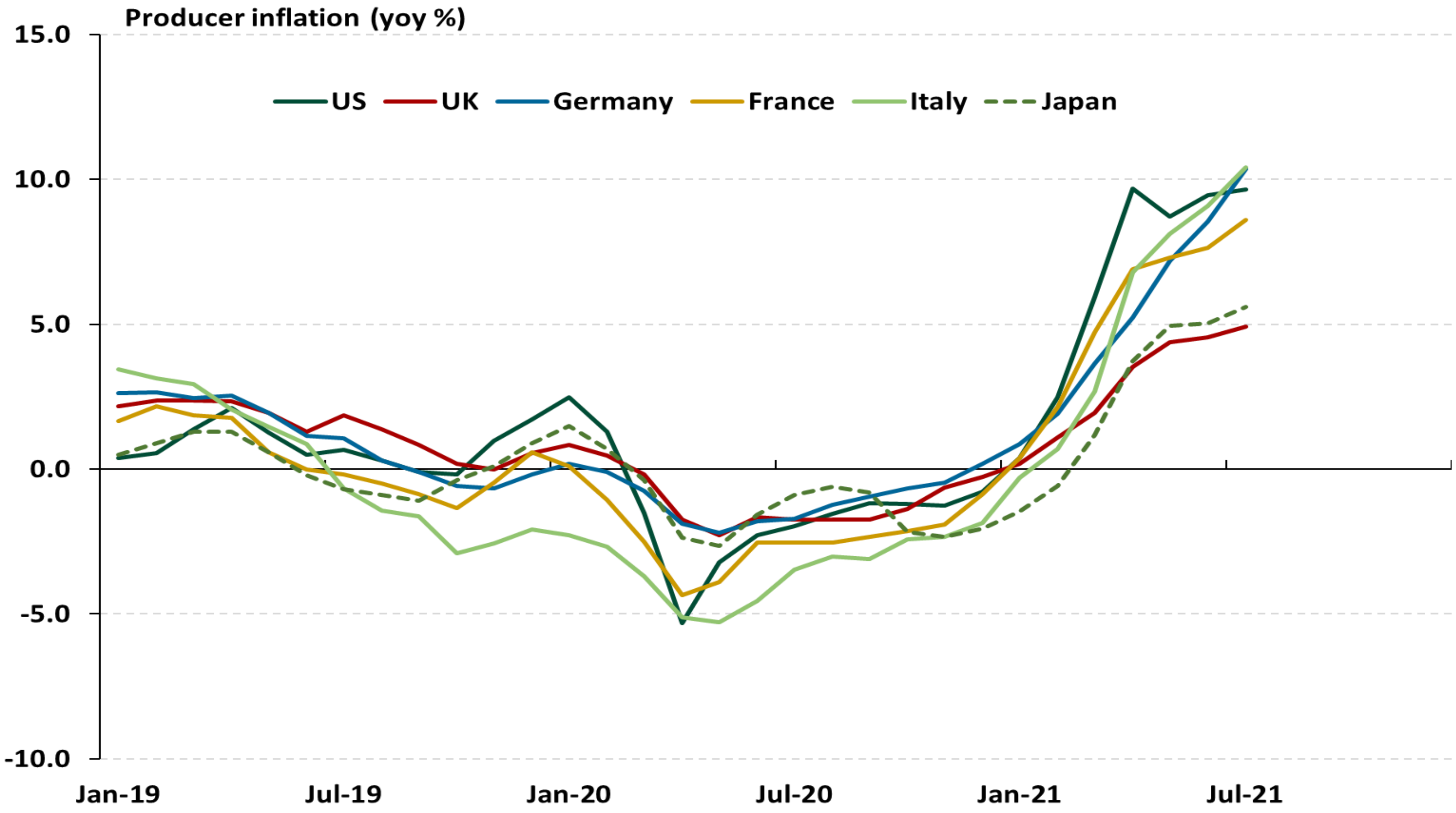
The risk posed by oil prices have eased

The rand's remarkable recovery has helped to offset higher imported inflation

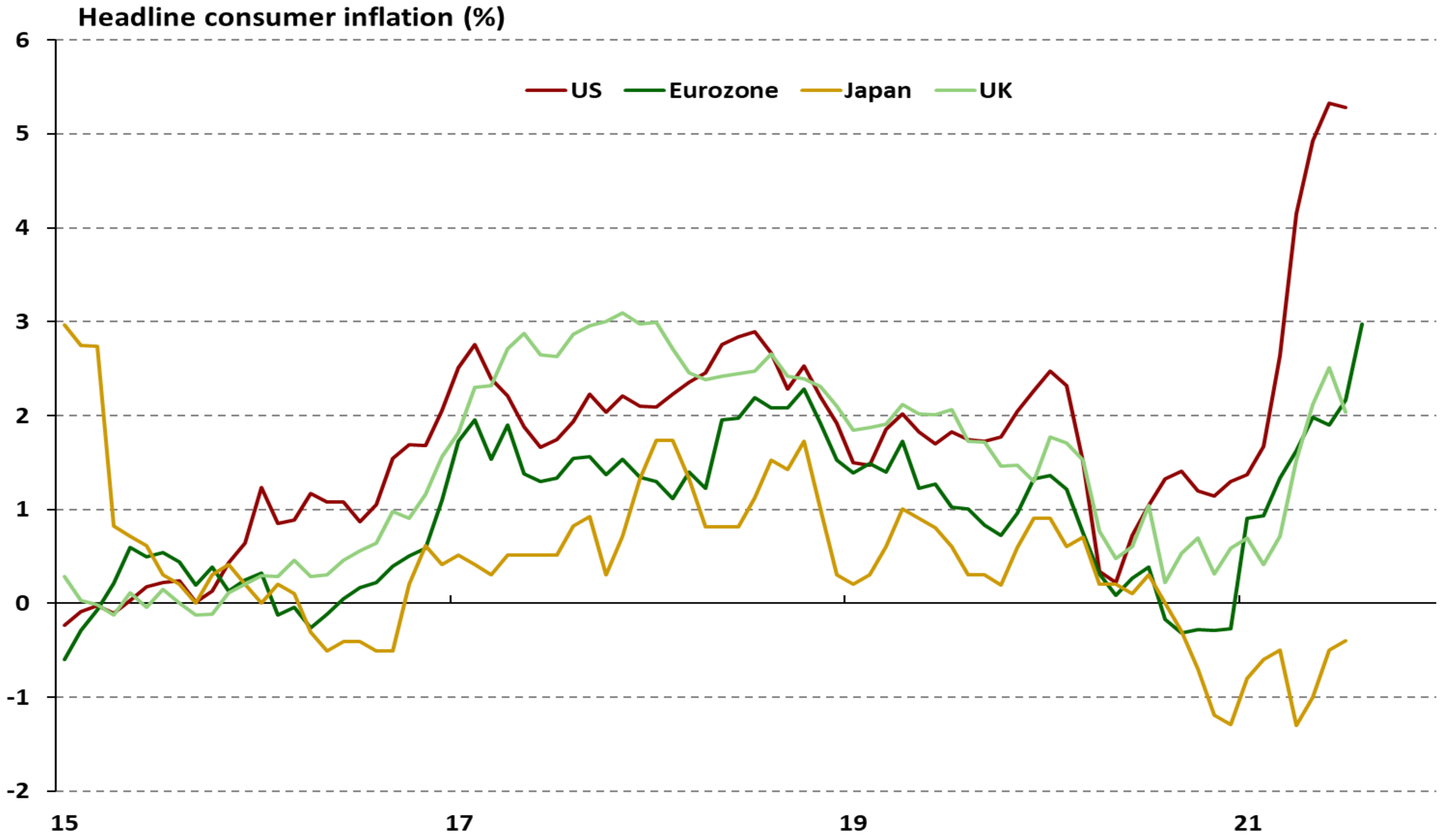


…but the fear is that the rand could come under renewed pressure

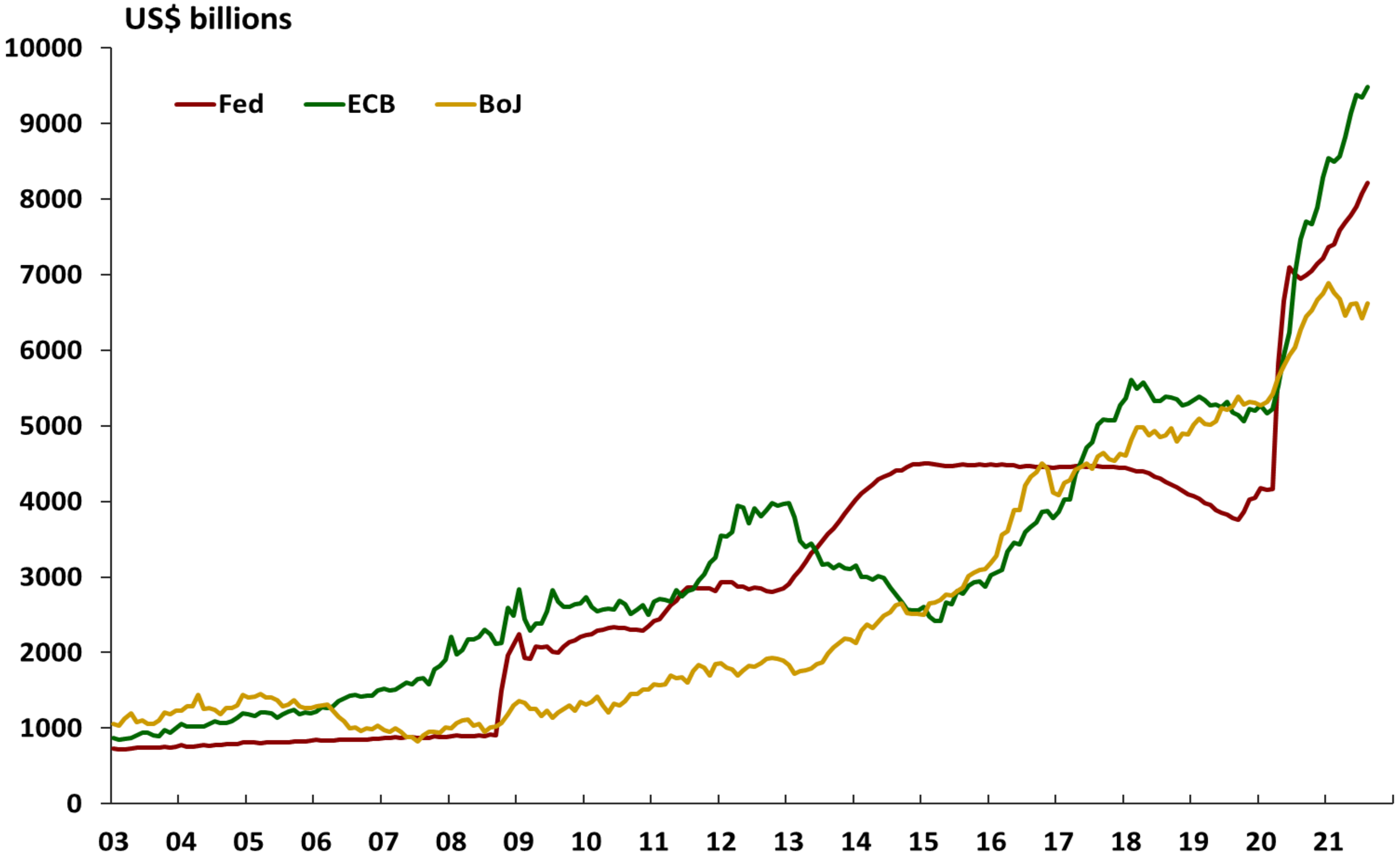
Global supply shortages continue to drive up producer inflation



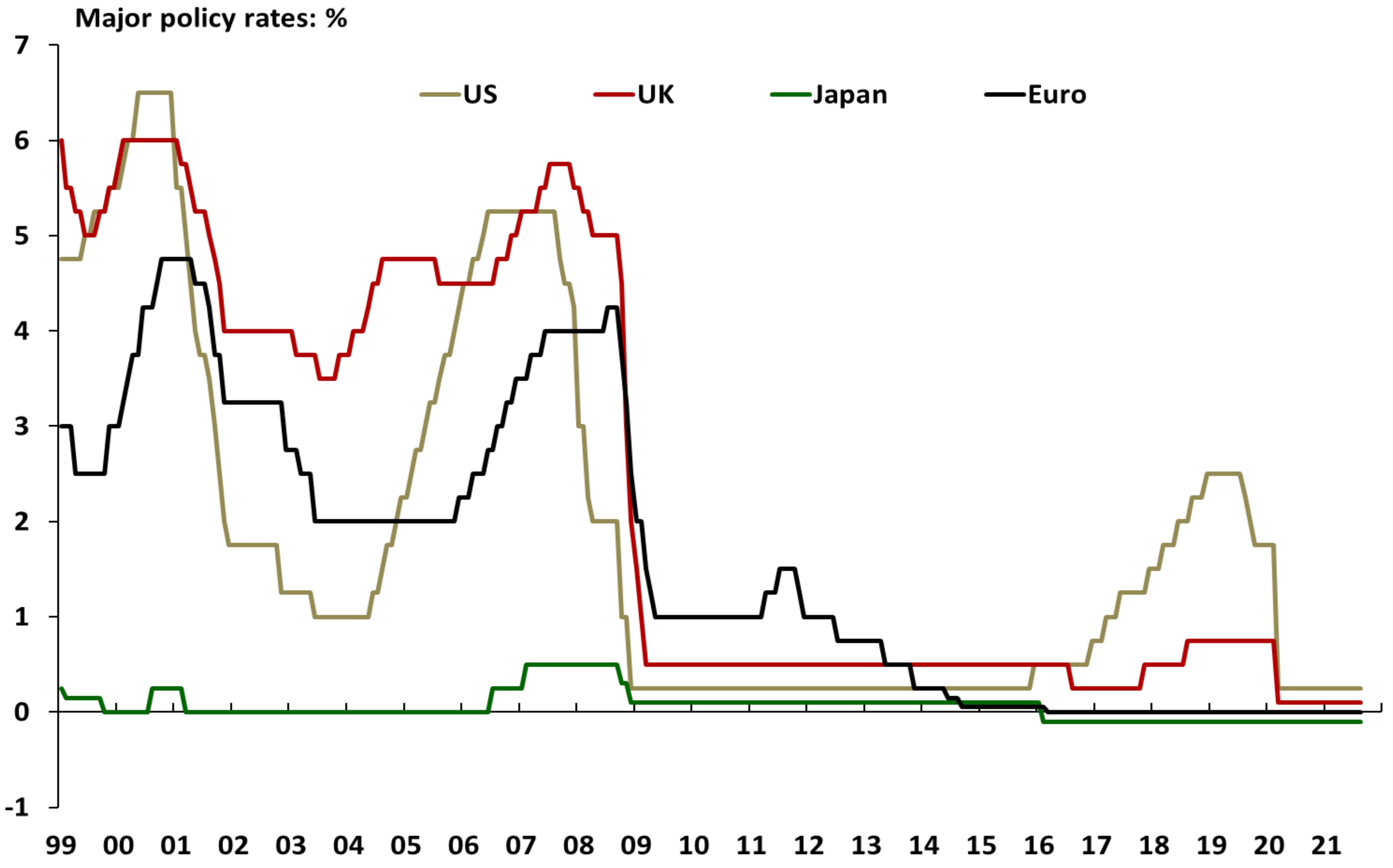
Consumer inflation has moved higher in most advanced countries



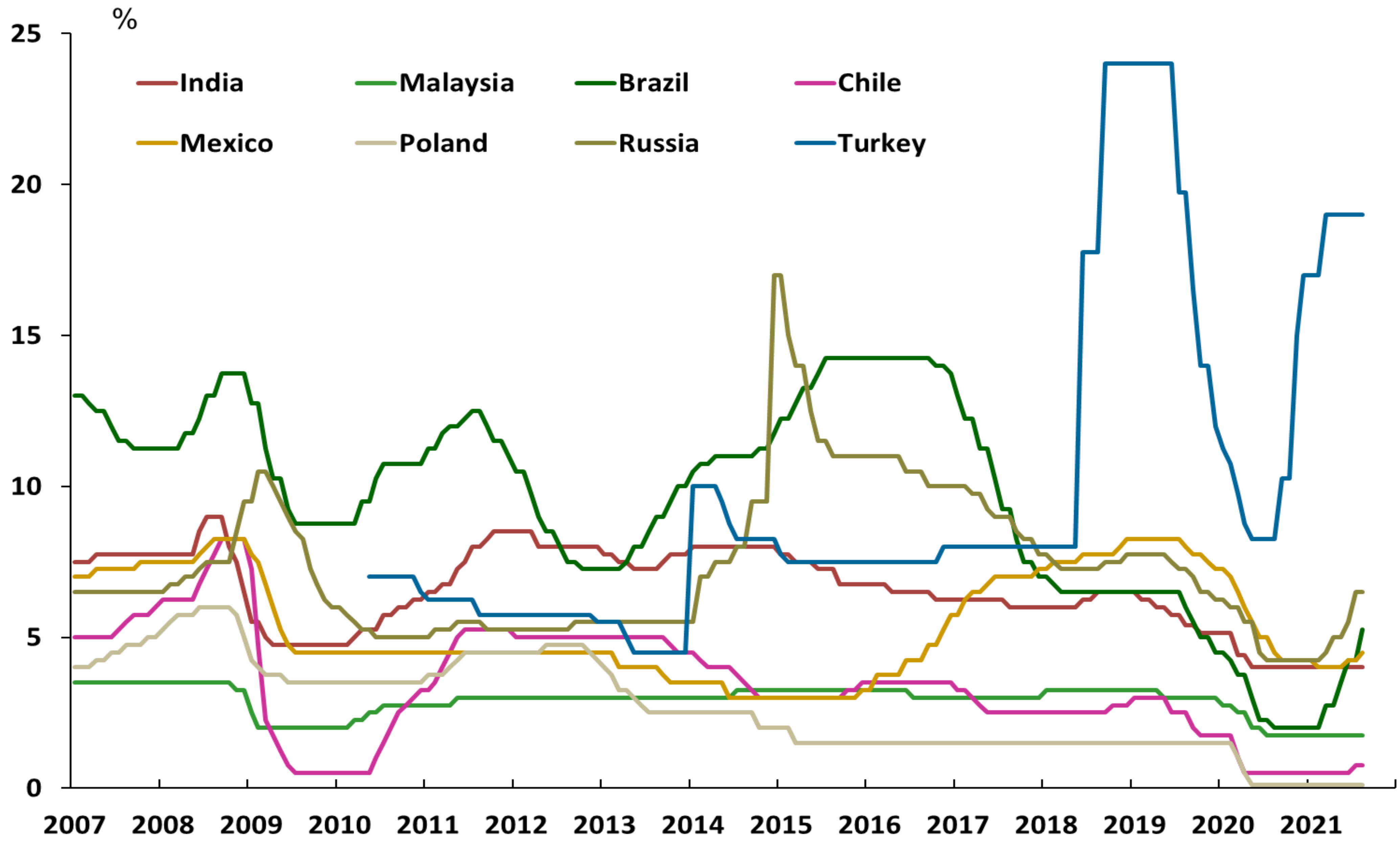
The time to start withdrawing some of pandemic-related stimulus is near



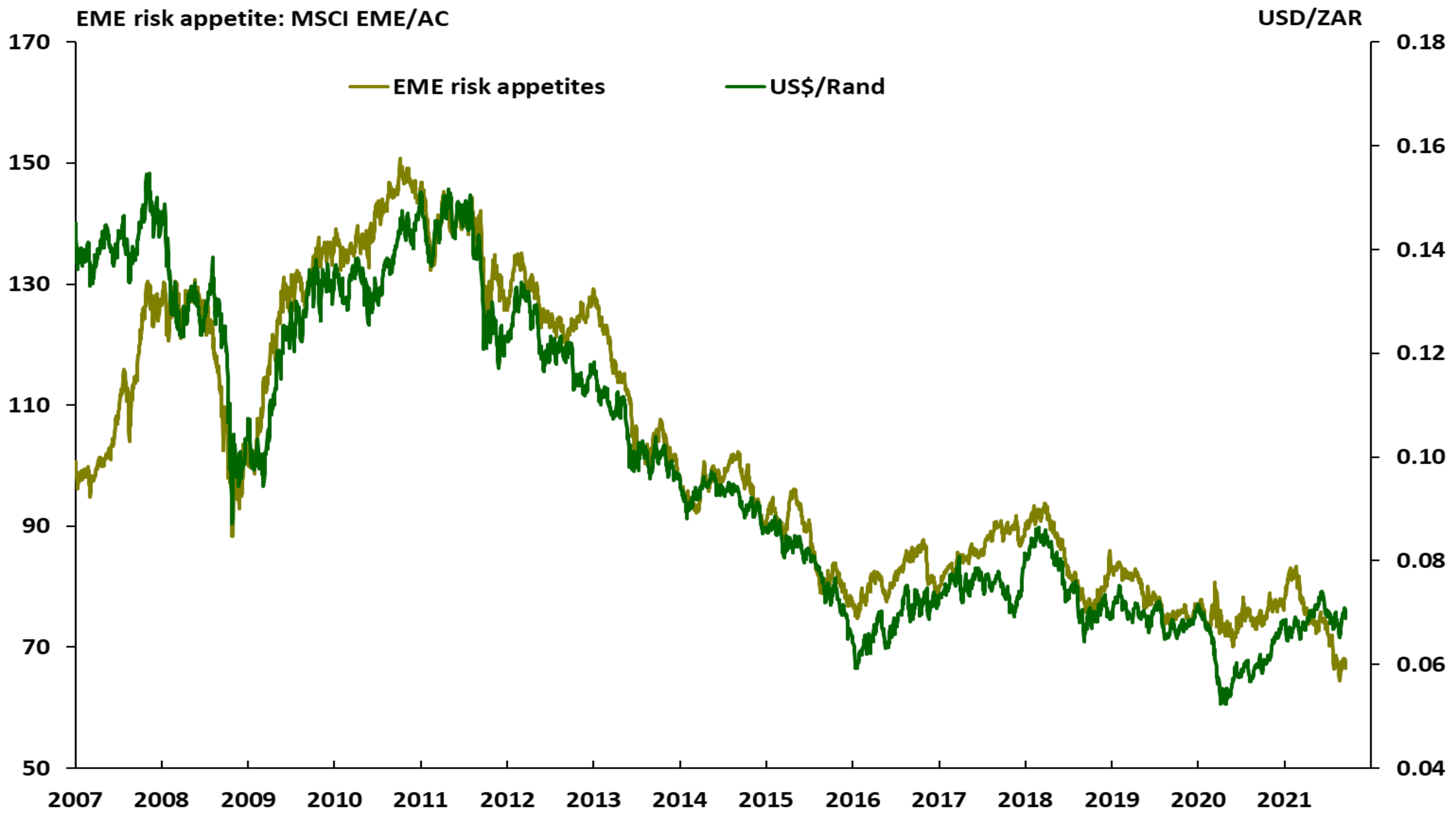
The normalisation of interest rates in low-risk advanced countries is still some way off



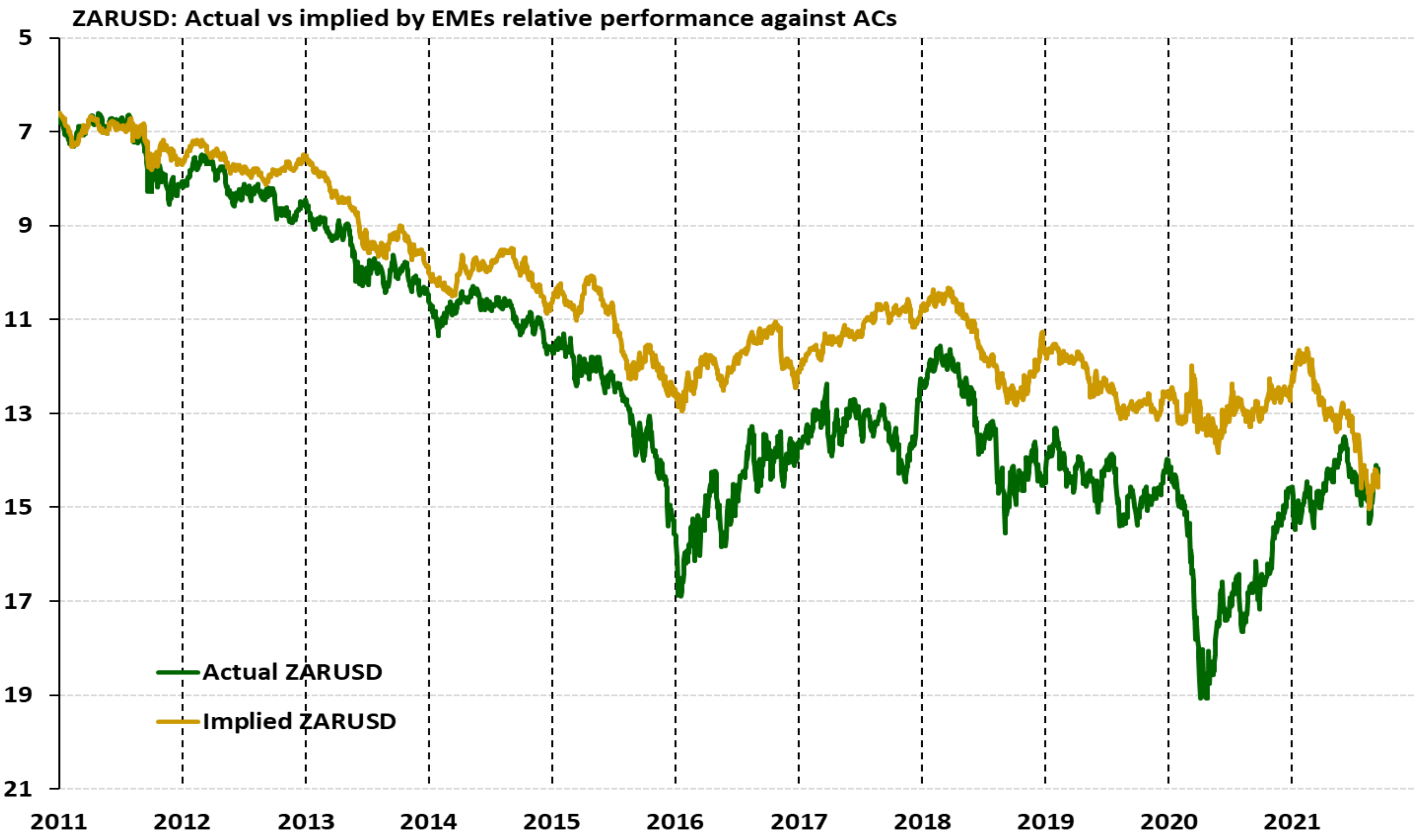
Many EMEs has started to tighten interest rates



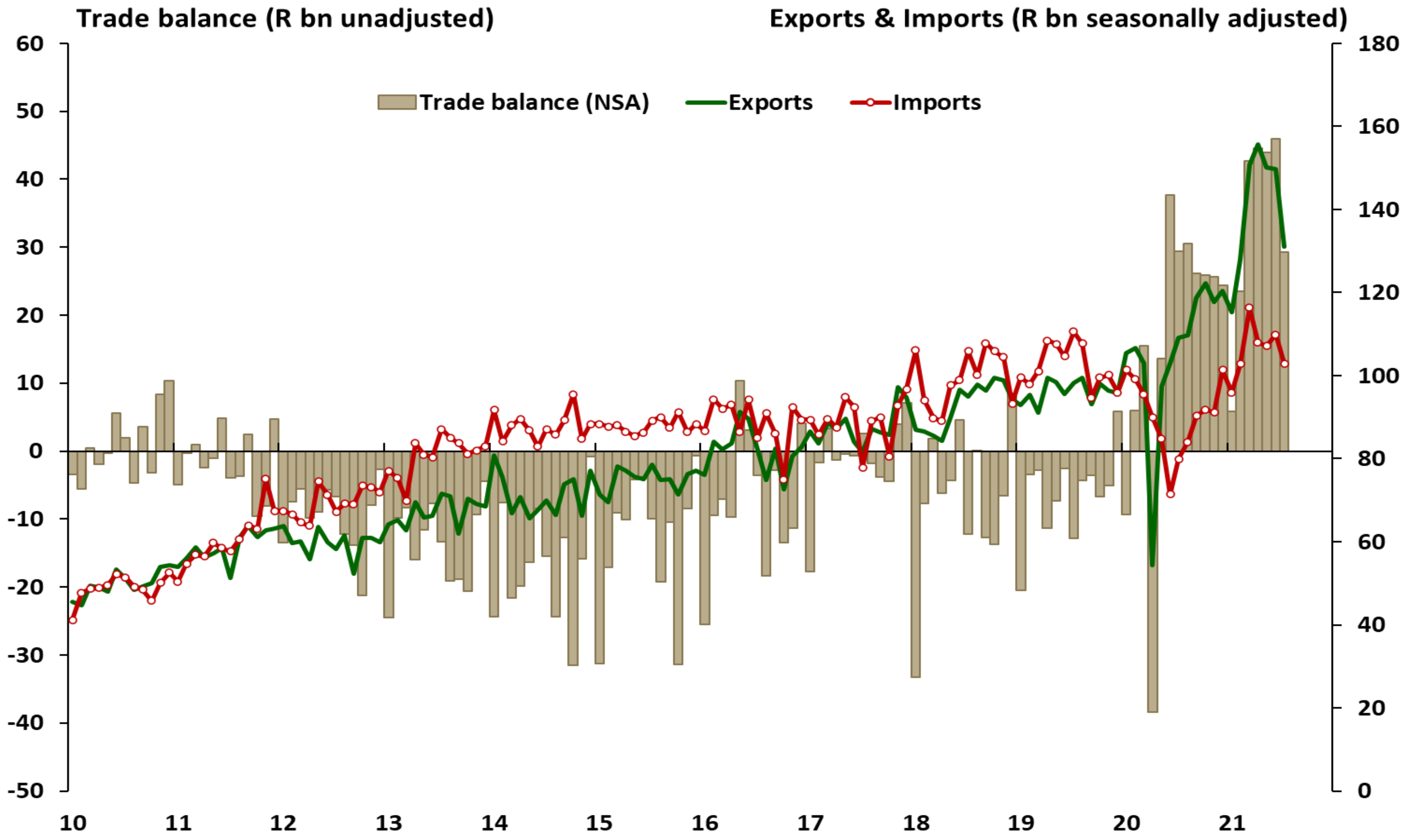
Rand is vulnerable to changes in EME risk sentiment



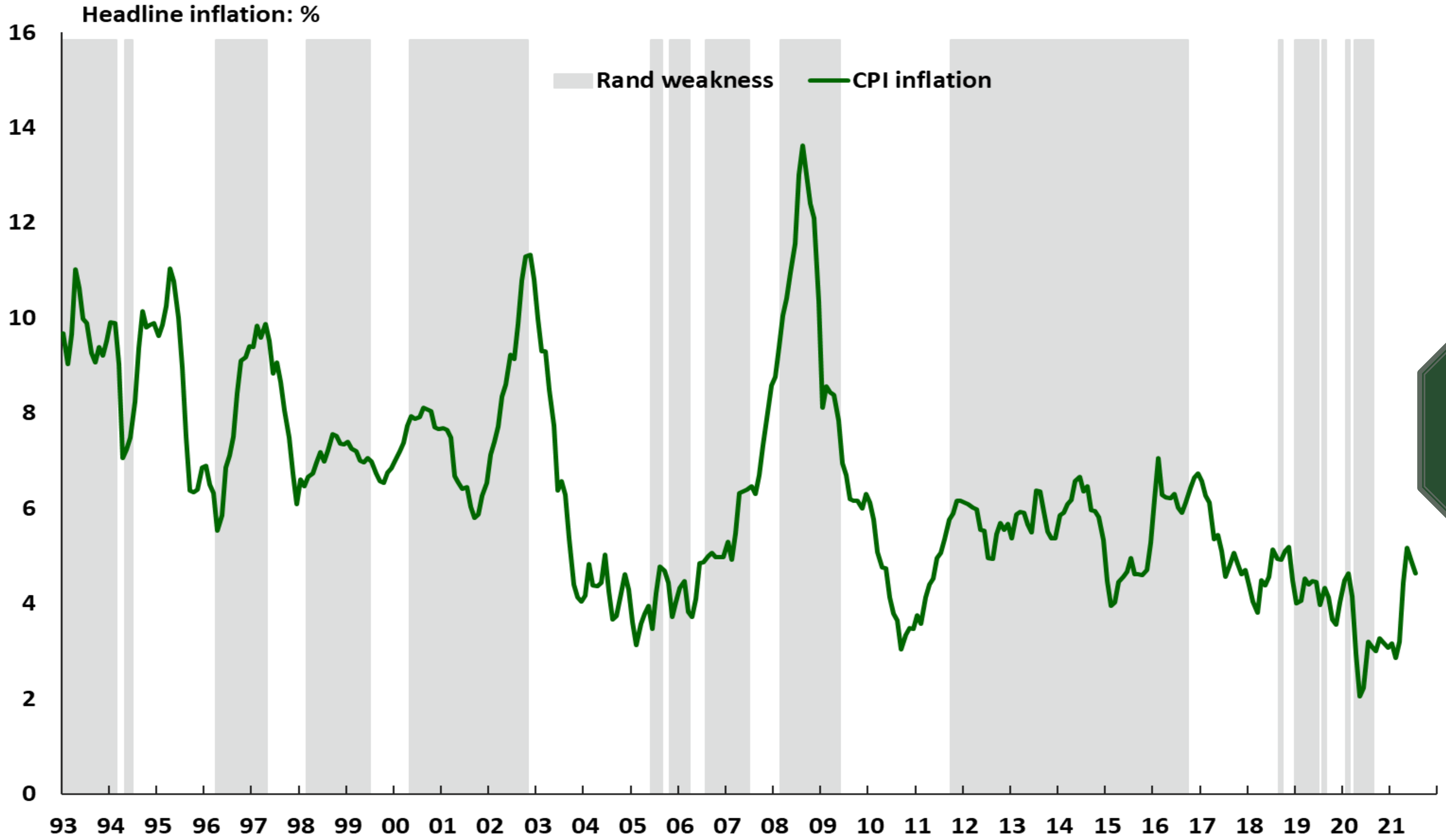
Rand is currently trading broadly in line with EME risk



A positive trade & current account balance is providing some foundation for the rand

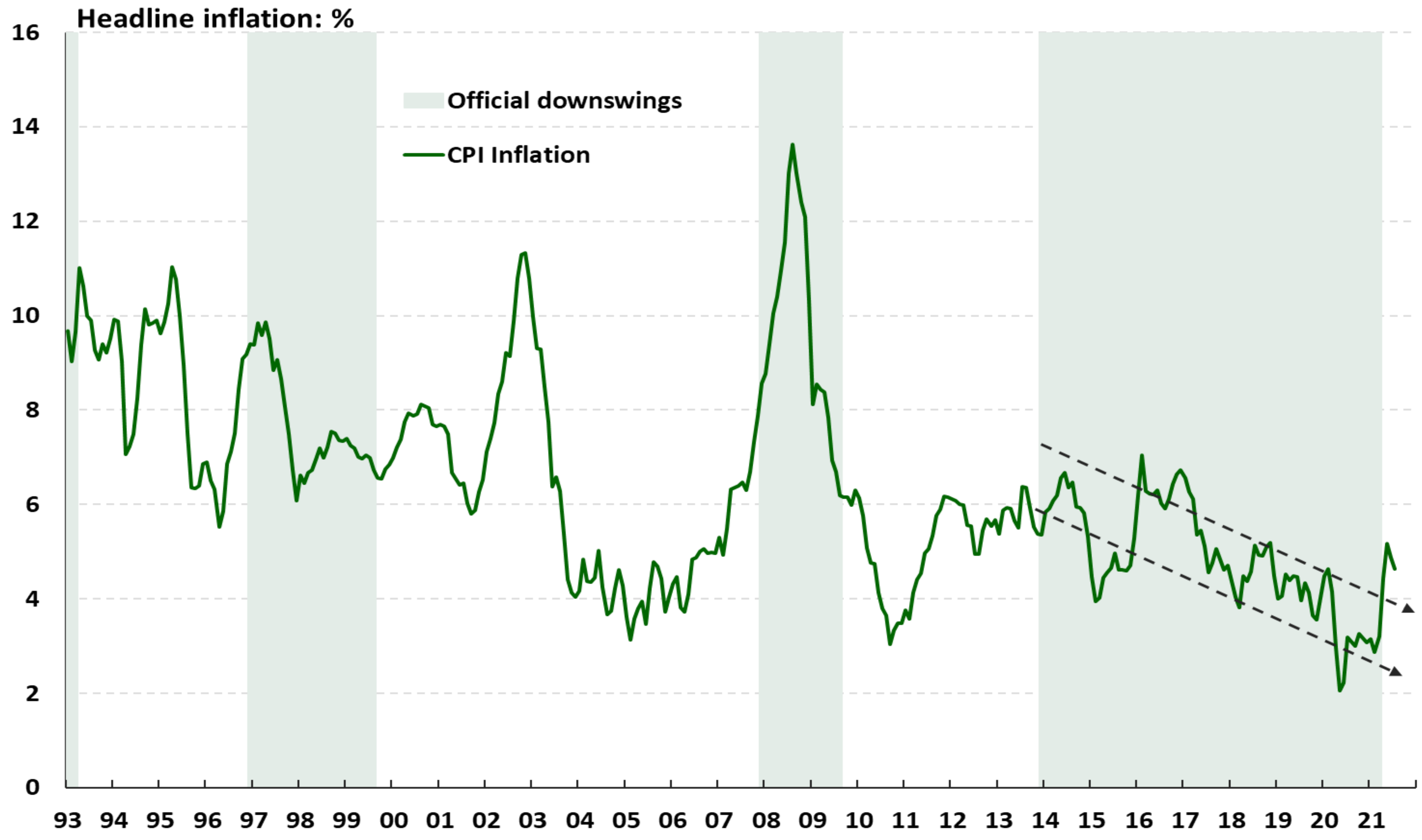


Even if the rand was to come under pressure, it would not necessarily translate into inflation

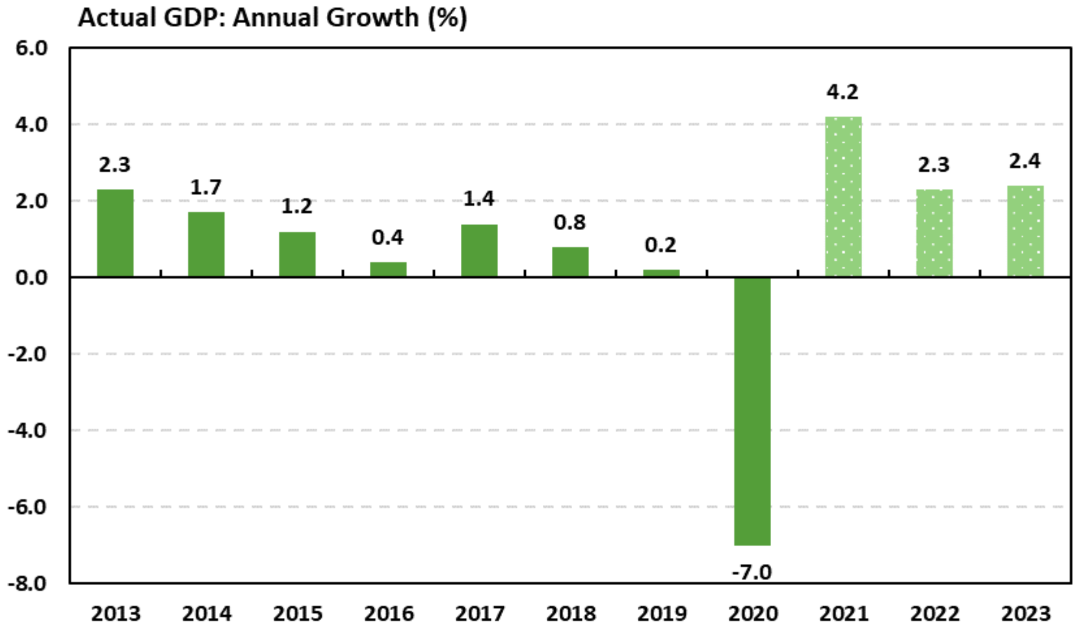


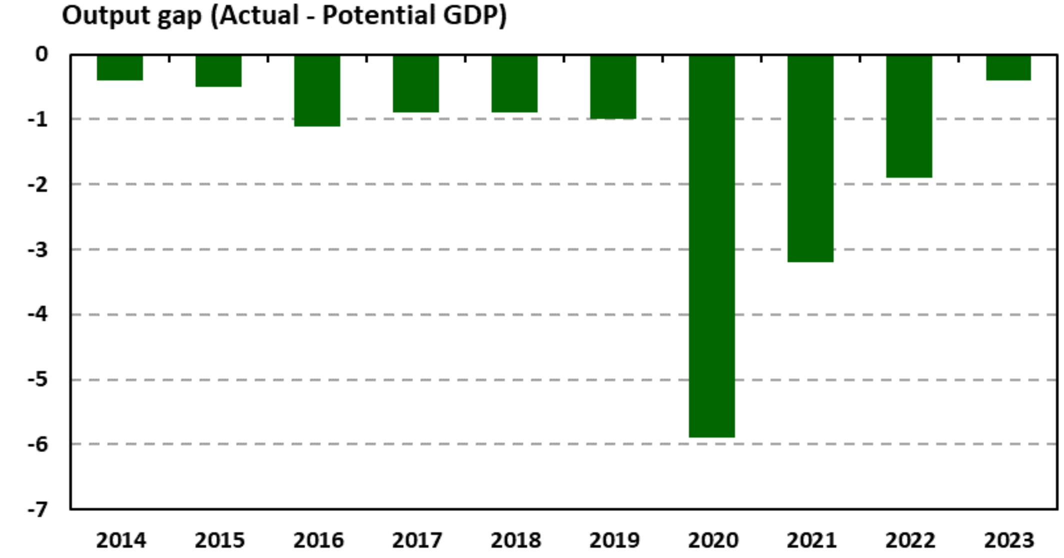
Rand not expected to add significant upward pressure

Price-sensitive demand is likely to offset any cost pressures



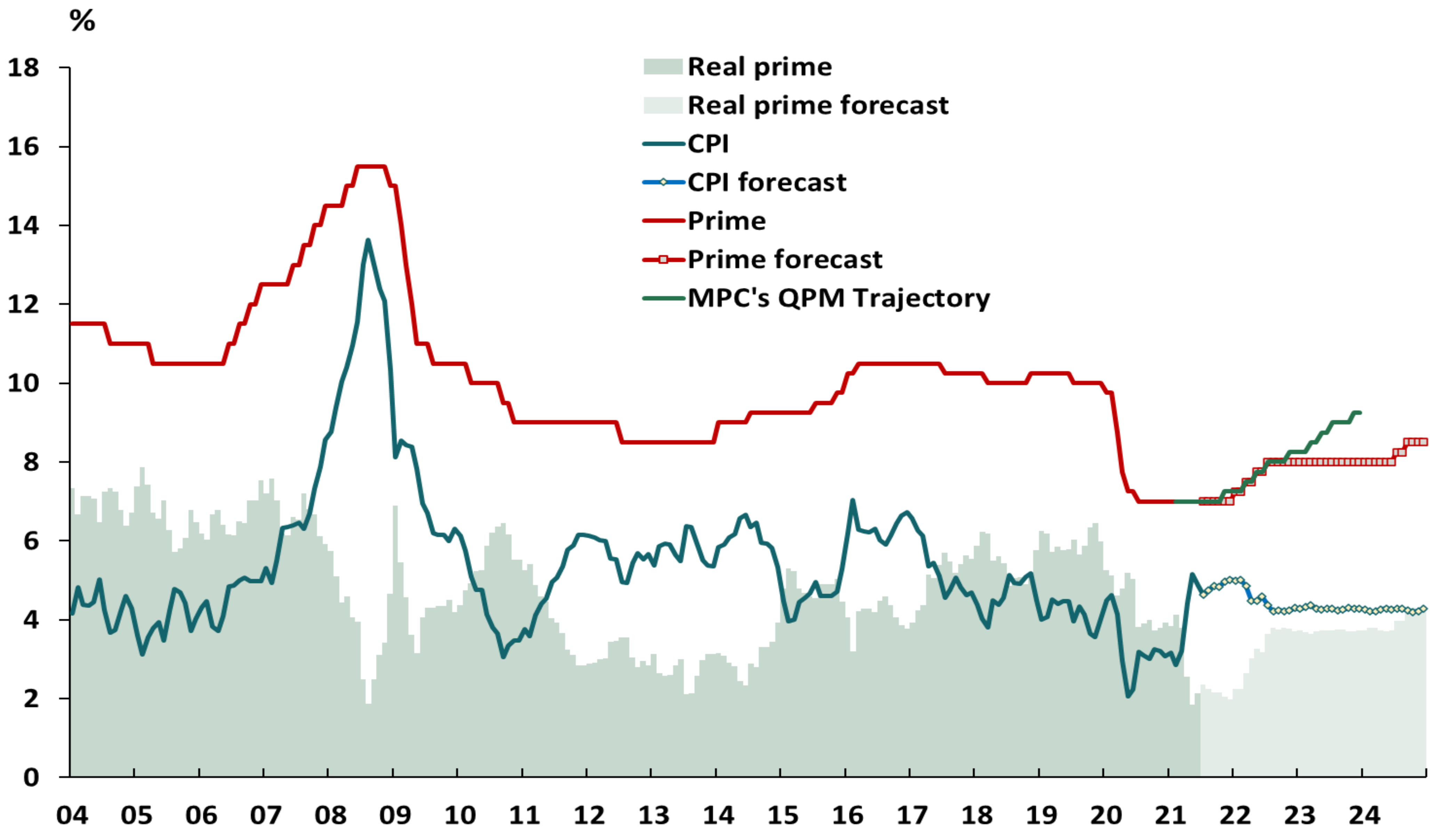
The SARB expects the economic recovery to continue & the output gap to gradually narrow





SARB inflation forecast		
Years	Headline CPI	
	20 May	22 July
Q1’21	**3.1**	**3.2**
Q2’21	**4.7**	**4.9**
Q3’21	4.3	4.6
Q4’21	4.6	4.7
2021	4.2	4.3
2022	4.4	4.2
2023	4.5	4.5

We expect moderately higher interest rates in 2022, but still well below pre-crisis levels




Thank you