Economic Insights | 24 May 2024

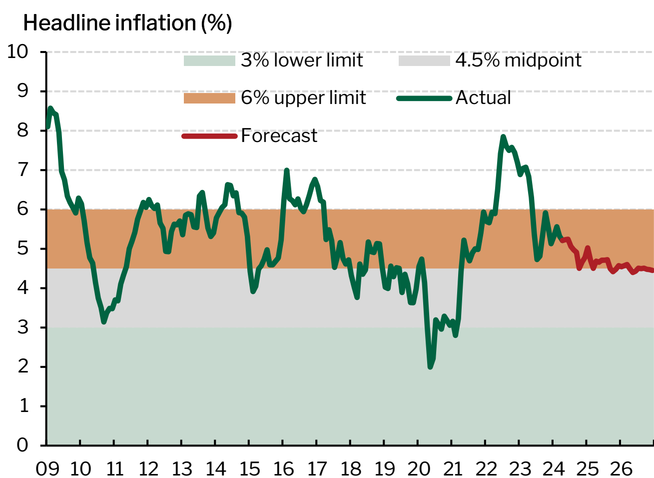
MPC Preview

ECONOMICS | SOUTH AFRICA | MONETARY POLICY

Interest rates will likely remain on hold.

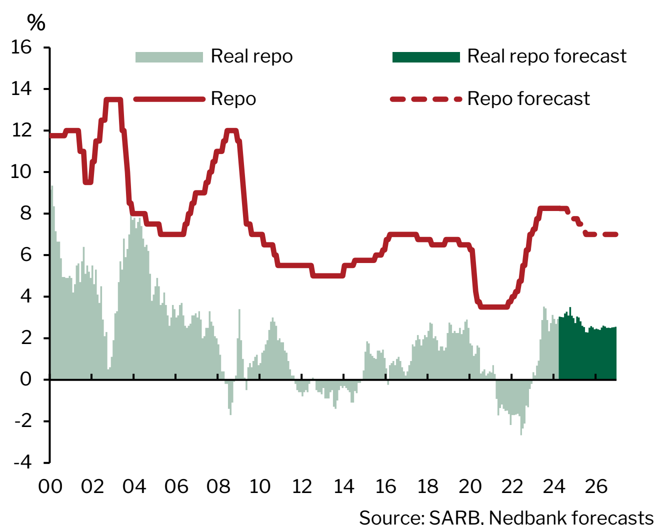
- We expect the MPC to leave the repo rate unchanged at next week's meeting as inflation's progress towards the SARB's 4.5% target remains slow.
- The news flow since the March policy meeting has been mostly positive. Inflation came out slightly better than expected in April, easing to 5.2% after sliding to 5.3% in March from 5.6% in February. The breakdown was also encouraging. Apart from fuel prices, which ticked up, food and services inflation moderated significantly. Excluding food and fuel, core inflation slowed to 4.6% after easing to 4.9% in March from 5% in February.
- Some upside risks to the inflation outlook also faded over the past month. Global disinflation broadly continued. International oil prices declined as the risk of a wider regional conflict in the Middle East receded. Global food prices were mixed, but the outlook improved as meteorologists called the end of El Niño, expecting weather patterns to normalise. US inflation resumed its downward path in April, but the hawkish tone in the minutes of the US Fed's last policy meeting spooked the markets recently, fuelling fears that US monetary policy could remain tight for longer, casting doubt over the prospects of a September rate cut. As a result, global risk sentiment faded after staging a solid recovery over the previous four weeks. Although the rand lost some ground over the past day, it nonetheless held up surprisingly well. It was buoyed by the earlier rebound in global risk sentiment, encouraging domestic economic news and market expectations of a relatively benign election outcome. The domestic operating environment improved noticeably over the past three months. Reduced load-shedding and functioning logistics helped to reduce production and operating costs, enabling companies to offer more attractive prices to boost ailing domestic demand.
- Although the stars are slowly aligning, the bar for a rate cut has not been cleared yet. Two months of inflation relief do not constitute a trend. The MPC would likely prefer more compelling evidence of consistent disinflation before shifting its stance. On this score, we still expect headline inflation's descent to be frustratingly slow, stalling over the next two months before dipping below 5% in September and ending the year at 4.8%. On top of this, the risks to the inflation outlook are highly fluid in nature. Despite the rand's firmer trend, next week's general election remains a wildcard. The future course for US interest rates is also far from set, as inflation could still prove persistent given a resilient economy and healthy labour market. With conflicts raging in Ukraine and the Middle East and tensions simmering between the US and China, the risk of new setbacks remains high.
- Consequently, we expect the SARB to keep the repo rate at 8.25% at the next two meetings. We expect conditions will gradually become more supportive of monetary policy easing over the next 4-5 months. Consequently, we expect the first 25-bps cut in September, followed by another of the same margin in November. The repo rate is forecast to end the year at 7.75%, taking the prime lending rate to 11.25%. Real interest rates will increase further, stabilising above 2% as inflation dips below 5% later this year and throughout next year.

Chart 1: Inflation likely to ease to 4.5% around Q4 2025.



Source: Stats SA, Nedbank forecast

Chart 2: Nedbank's nominal and real repo forecast.



Source: SARB, Nedbank forecasts

Recent inflation outcomes

Since the March MPC meeting, inflation outcomes have been encouraging. Headline consumer inflation eased to 5.2% in April after falling to 5.3% in March from 5.6% in February. The drag came mainly from a deceleration in food prices, which the MPC had been flagging for some time as a significant upside risk to the outlook. In April, food inflation fell to 4.4%, dropping below the SARB's 4.5% target for the first time since September 2020. The rapid decline in food inflation has been amplified by the high base established in the first four months of last year when food inflation surged and peaked at 14.4% in March. Apart from favourable base effects, less load-shedding and modest improvements in logistics also contributed to reducing operating costs and lifting efficiencies throughout the supply chain. Finally, lower global food prices helped to offset the impact of continued rand weakness on import prices, enabling a significant deceleration in domestic food prices. Moreover, the moderation was broad-based, driven by much slower price increases in milk, eggs, and cheese, bread and cereals, meat products, and vegetables, which together account for 80.9% of the food basket. Prices of oils and fats also declined further, although the rate of contraction slowed significantly to 4.9% from 13.6% in August last year as the impact of the powerful base effects waned.

Insurance costs, which surged in February and March, also moderated somewhat in April, contributing to a significant dip in services inflation. The latter slowed to 4.6% after four consecutive months of acceleration to 5% in March. Even so, it remained well above the 3.8% recorded at the end of last year. In the April Monetary Policy Review (MPR), the SARB expressed concern that services inflation could replace goods as a key driver of price pressures, as has been the case in most advanced countries. However, the relapse in April to close to the 4.5% target point to subdued dynamics, probably reflecting the effects of lower operating costs and the drag emanating from weak domestic demand.

In April, the upward pressure came mainly from rising transport costs driven by higher fuel prices, which rose 9% yoy from just 3.3% in January. The spike in global oil prices was mainly to blame, caused by an escalation in the conflict in the Middle East. The Brent crude oil price increased by 4.6% yoy in April, while the rand depreciated by 4.1%yoy. The steady climb in fuel prices pushed non-durables up again to 6.8%, which is still too high and outside the upper 6% limit of the target range. Elsewhere, prices were mixed. Semi-durables accelerated to 3% from 2.5%, while durables lost significant traction, falling to 3.3% from 4.2%. Altogether, goods inflation was stagnant at 5.7%, within the target, but still some way off from the SARB's midpoint.

Chart 3: Inflation moderated slightly in April.

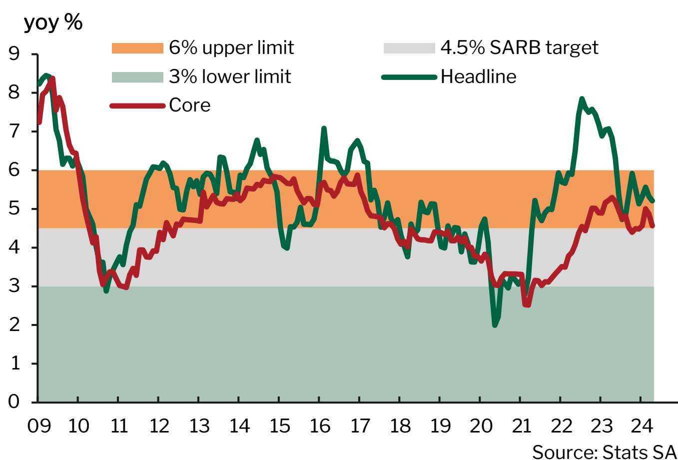
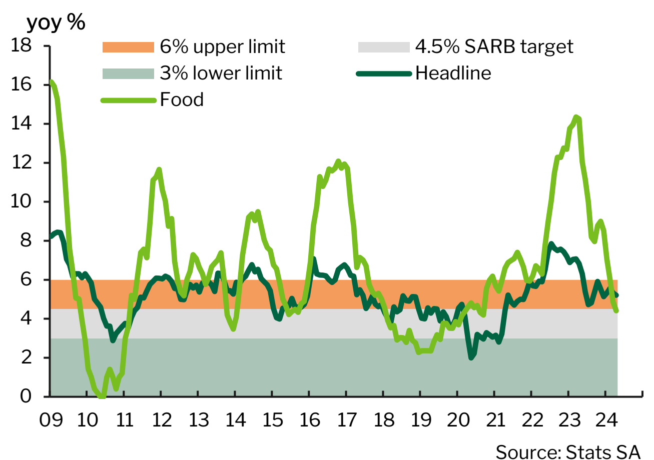


Chart 4: The drag came from lower food inflation.



Core inflation, which excludes food and fuel prices, also receded to 4.6% from 4.9%, just above the SARB's 4.5% target. The noticeable slowdown in core inflation, which probably best captures underlying price pressures, suggests that the economy is responding to weaker demand caused by restrictive monetary policy.

Although April's inflation report was encouraging, it still shows that the pace of disinflation remains painfully slow.

Chart 5: Services inflation also moderated.

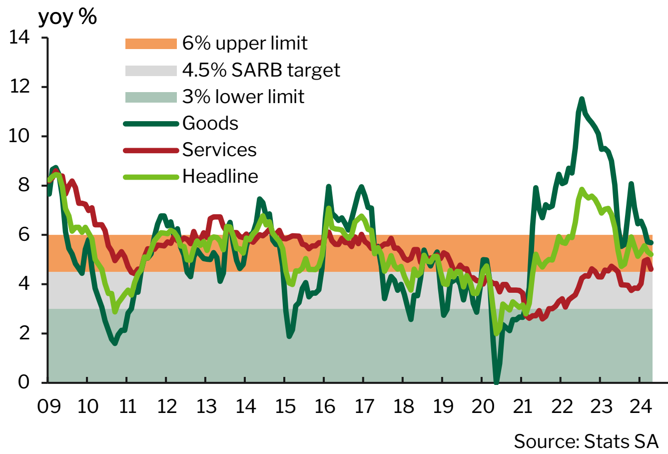
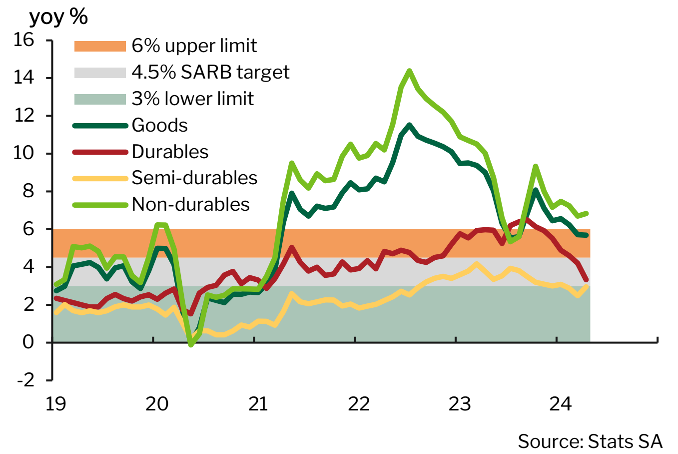


Chart 6: Breakdown of goods inflation.



Revisiting potential upside risks

Sticky US inflation and high-for-longer policy rates

After a year of rapid disinflation, concerns over sticky underlying price pressures have resurfaced. The dismay has been most acute in the US, where the progress towards the 2% target stalled and reversed slightly over Q1. However, US consumer inflation continued its slow descent in April. The headline figure eased to 3.4% yoy, after creeping up to 3.5% in March from 3.1% in January. Core inflation dipped to 3.6% in April after holding steady at 3.8% over the previous 2 months and 3.9% over the preceding 2 months. The markets took April's numbers as a step in the right direction after 6 months of price inertia, but the breakdown of the data still reflects lingering pressures.

Chart 7: US consumer inflation ebbed.

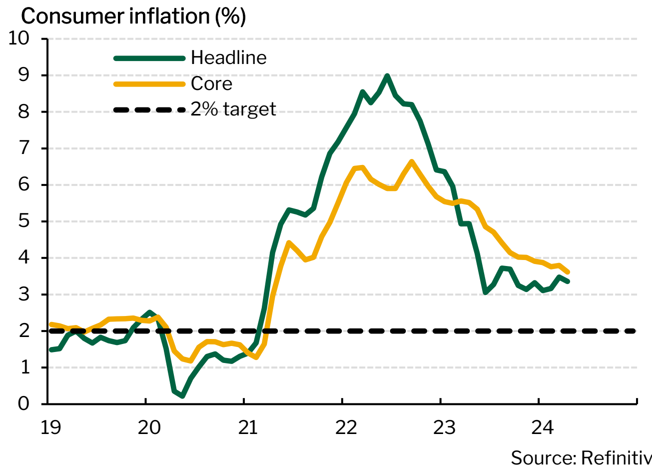
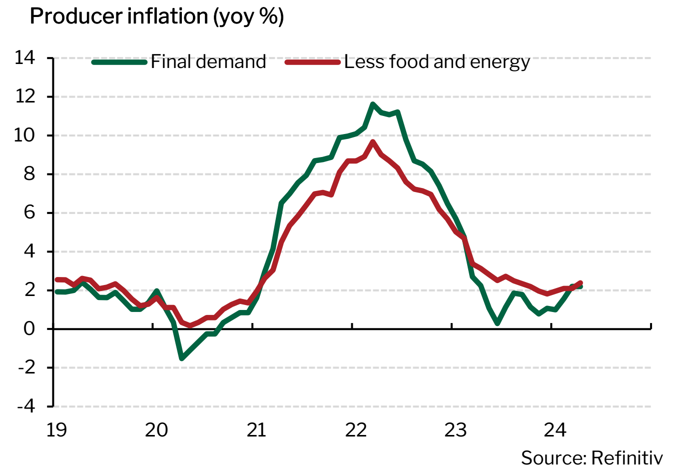


Chart 8: US producer prices edging up.



At a consumer level, most of the resistance came from services. Core services are still running relatively hot and remain far from the 2% target, but at least softened to 5.3% yoy in April from 5.7% in March. Within services, the heavy-weight shelter eased, but medical care and transport services accelerated. Encouragingly, deflation in core goods deepened, down 1.3% yoy, after falling by 0.7% in March. While food inflation remained subdued, sliding further to 1.1% from 1.2%, energy costs increased off the lower base established last year, rising to 2.6% from 2.1%. The latest producer inflation numbers - which track price changes before they reach consumers – tell a less benign tale of goods inflation. It reflected rebounds in a wide range of goods prices. This, combined with elevated services, pushed producer inflation up to 2.2% in April from 1.8% in March and the core measure to 2.4% from 2.1% over the same period.

The focus will now shift to the Fed's preferred gauge of inflation – the core PCE price index. Disinflation in core PCE also slowed noticeably over the past four months, stalling at 2.8% in March and February. Most forecasters expect the impasse to continue in April, with core PCE pinned at 2.8%.

Chart 9: Core services vs core goods inflation.

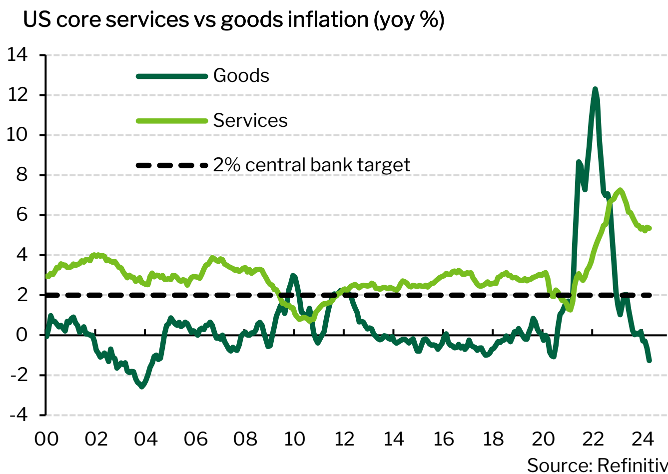
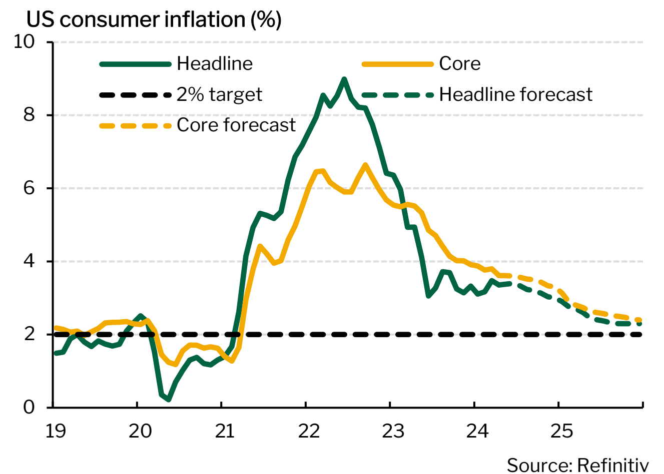


Chart 10: Most expect a slow return to target.



Viewed together, the latest inflation indicators provide little comfort, with no clear evidence of sustained disinflation. If anything, the data remains noisy and continues to point towards stickiness in underlying prices. This suggests the economy needs to cool further to change wage and pricing behaviour and ensure inflation's return to target. On this score, the US economy remains remarkably strong, but early signs of a softer trend emerged in recent months. The April PMI readings reflect a loss of momentum. S&P Global's manufacturing PMI deteriorated to 49.9 in April, just below the critical 50 threshold that separates contraction from expansion. In the same month, industrial production declined by 0.4% yoy, after expanding by a meagre 0.1% in March and February. S&P Global's services PMI slipped to 50.9 in April, still in expansionary territory but down from its peak of 55.1 in May last year.

Chart 11: The US unemployment rate.

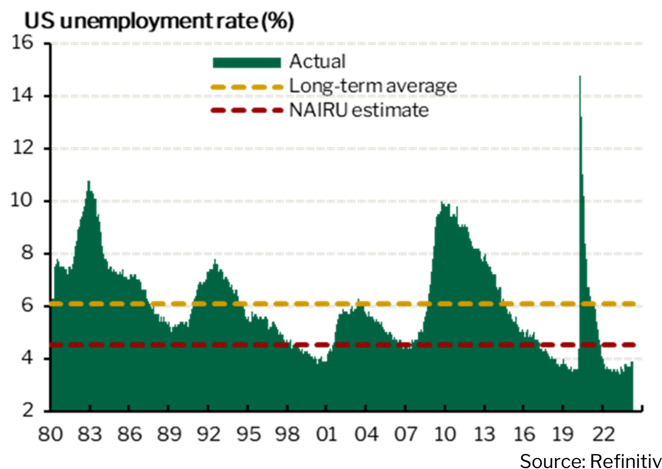
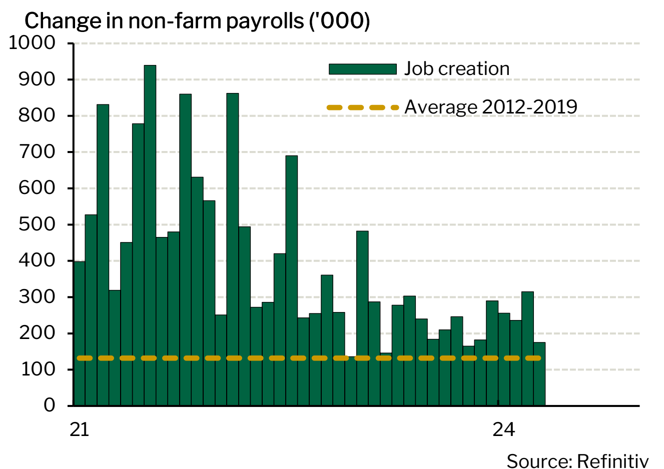


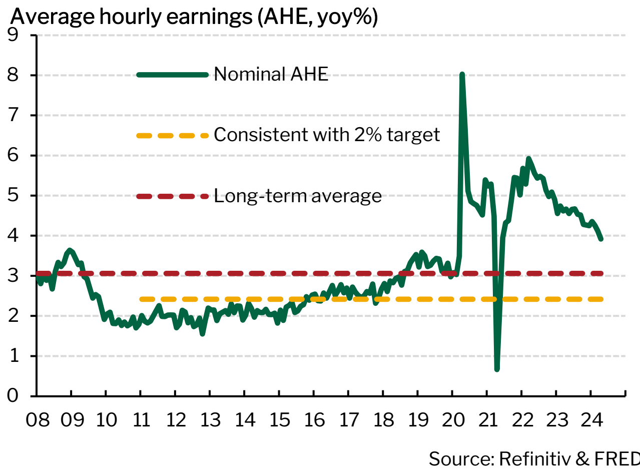
Chart 12: Job creation remains brisk.



Even consumers, who have been the key source of resilience in the US economy, appear slightly more hesitant. Consumer confidence weakened for the 3rd consecutive month in April, reflecting concerns over persistent inflation. Nominal retail sales growth moderated to 3% yoy in April, significantly down from 3.8% in March, pointing to a contraction in real or inflation-adjusted terms. A slight softening in households' financial position may be behind the more cautious approach towards spending. Employment trends remain broadly supportive. Although the unemployment rate ticked up to 3.9% in April, it is still near record lows and below the level (around 4%-5%) usually associated with steady inflation (NAIRU). The pace of job creation also remains brisk, even though it moderated over April. The caution probably emanates from wages. Nominal wage growth moderated further over April, staying on the gradual downward trend established from May 2022 onwards. With nominal wage growth moderating and inflation elevated, real wage growth has slowed consistently since the year started. The slowdown is also visible in real personal disposable income (PDI), which has drifted down without interruption since January.

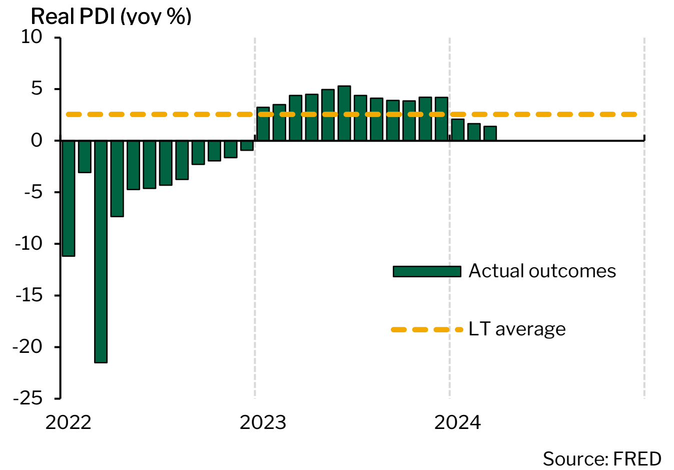
In our view, it is still too early to say whether the softer trend in some indicators will be sustained. It could be a brief pause before a fresh takeoff or the beginning of a slowdown. Viewed from a long-term perspective, US fundamentals are strong. Consumers are still in a healthy financial position. Unemployment is low, real incomes are rising, personal savings are positive, net wealth levels are much higher, and debt service costs remain manageable.

Chart 13: Nominal wage growth in slow descent.



Source: Refinitiv & FRED

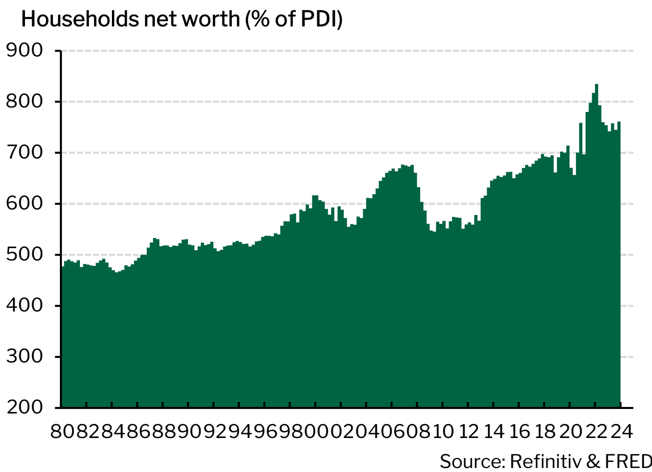
Chart 14: Real PDI growth moderated over Q1-24.



Source: FRED

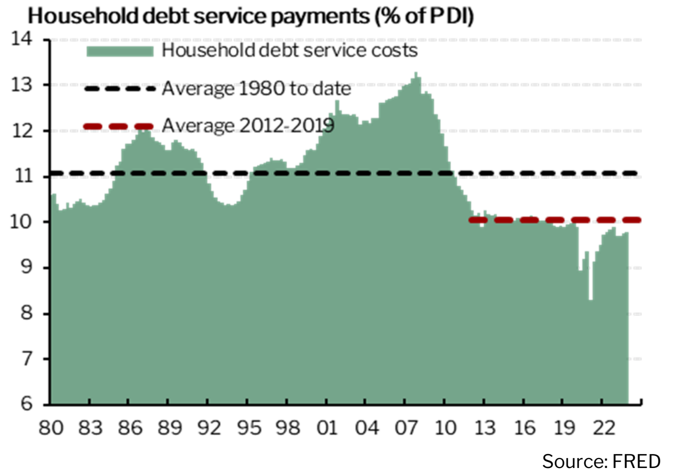
Despite the most aggressive monetary policy tightening in 25 years, the ratio of total debt service costs to PDI remains below the prepandemic average. Mortgage repayments only recently returned to their 2019 levels, which households managed without strain back then. Structural changes in the mortgage market have helped to reduce households' exposure to interest rate changes. Most households renegotiated fixed-rate mortgage agreements as interest rates imploded during the pandemic. Consequently, households managed to lock in lower rates for longer, significantly weakening the monetary policy transmission mechanism (IMF WEO, April 2024). The impact of the sharp rise in interest rates is more visible in the burden emanating from short-term borrowing. The repayments on consumer credit have increased sharply, rising above the prepandemic average (2012-2019) and slightly above the long-term average. The breakdown suggests that consumers with high exposure to short-term credit could be feeling the pinch, perhaps sufficiently to pare back spending. Nonetheless, the total debt service burden on households remains low by historical standards.

Chart 15: Households' net worth skyrocketed.



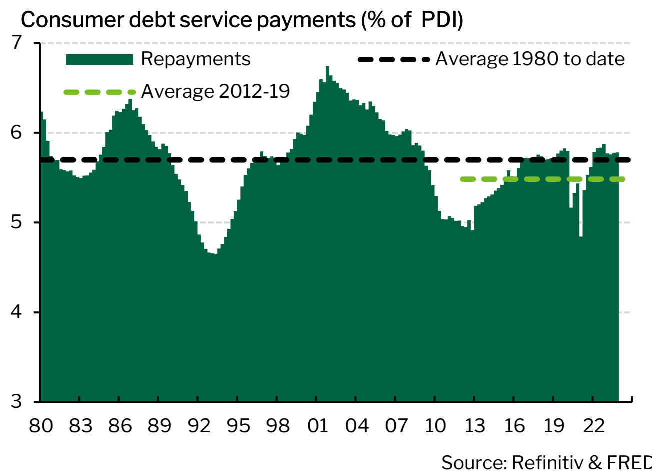
Source: Refinitiv & FRED

Chart 16: Total household debt service costs remain low.



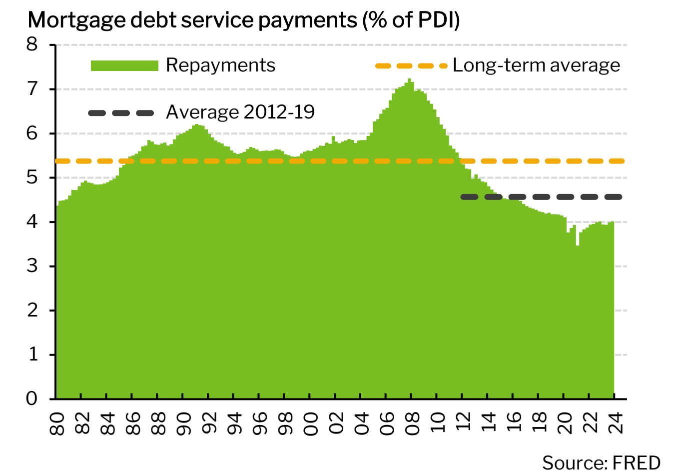
Source: FRED

Chart 17: Consumer credit repayments rose significantly.



Source: Refinitiv & FRED

Chart 18: But mortgage repayments remain comfortable.



Source: FRED

Apart from households, the US government is also feeding the inflationary impulse. The country is running enormous budget deficits with little evidence of consolidation. As a result, the public debt burden continues to climb. The soft spots have been industry and exports, dragged down by the slowdown in the rest of the world. However, recent indicators suggest that the world economy is turning the corner, with firmer activity recorded in China, the Eurozone, the UK, and many other large emerging markets. This could facilitate a rebound in US manufacturing and exports, lessening the drag from the negative net export position. In short, the underlying pulse of the US economy still looks too strong to start monetary policy easing at the next round of policy meetings.

Since the final quarter of last year, we have seen wild swings in the market's interest rate expectations. Towards the end of last year and early this year, the markets were joyfully discounting 3-4 cuts starting as early as March. Expectations shifted in February to 3 cuts starting in July before the nasty inflation prints of February and March unsettled investors, triggering fears of no cuts in 2023. Since then, the gloom has lifted somewhat, with the markets considering between 1 to 2 cuts, kicking off either in September or December.

While market rate expectations have been highly volatile, the US Fed has been cautious. Speaking at the Foreign Bankers' Association in Amsterdam on 14 May, Fed Chair Jerome Powell noted that the Fed did not expect a '*smooth*' journey. He acknowledged that inflation outcomes were, on average, higher than anyone expected, while the US economy was performing relatively well and proved more resilient than anticipated. The Chair stressed that the policy rate is currently restrictive by many measures and that the Fed needs to be *'patient and let restrictive policy do its work'*. Powell indicated a preference for keeping interest rates on hold for longer. Still, he did not expect the Fed to raise rates further in this cycle. Global investors appear to home in on the latter, taking comfort in the reassurance that US rates have peaked and assuming the easing cycle would eventually arrive, albeit much later than they hoped. As such, some investors took the opportunity to buy on the dip and pick up bargains in EMs. Much of this enthusiasm unravelled after the Fed minutes suggested that some policymakers thought further rate hikes might be needed.

What does all this mean for 'SA's monetary policy? The SARB has long cited sticky global inflation and high-for-longer US interest rates as upside risks to the domestic inflation outlook. Persistent global inflation feeds through higher import costs into domestic inflation. Given that the US policy rate acts as the global financial markets' risk-free rate, high-for-longer US policy rates hold implications for international investors' risk appetites, capital inflows to high-risk emerging markets (EMs), and therefore their currencies. In its April Monetary Policy Review, the SARB explains that elevated US policy rates compressed real interest rate differentials between emerging markets and the US, exerting a depreciation bias on emerging market currencies. Significant and sustained currency weakness, in turn, drives up import costs, lifting overall operating expenses and fuelling broader inflationary pressures within EM economies, including SA.

These upside risks will probably remain in place until the global disinflationary process gathers renewed traction and the US Fed begins to ease its monetary policy. A key implication is that EM currencies could be vulnerable if their central banks opt to cut interest rates before the US. Real interest rate differentials are not the only driver of global portfolio flows. An EM's current economic performance, future growth prospects, and specific social, political, and economic policy risks are more important. However, in the absence of economic growth, positive real interest rate differentials often become pivotal. Given SA's poor growth prospects and elevated sovereign risk premium, the rand is probably more vulnerable than most other EMs to narrowing real policy rate differentials.

Beyond the US, disinflation is gathering pace.

In the rest of the world, the disinflation process largely continued as the impact of tighter monetary policies took effect. Inflation has been slightly sticky in some economies but remained within target in other countries. Food inflation has been contained, although the intensely hot and dry weather conditions that prevailed across the globe over January and February raised concerns about the potential upside risk to prices later in the year. Like SA, the upward pressure came mainly from higher oil prices due to uncertainties created by the ongoing conflict in the Middle East.

In emerging-market economies (EMs), inflation dynamics have generally trended lower. However, there have been some differences. China grappled with deflation over the past year as weak confidence and tepid domestic demand fuelled significant discounting. Inflation increased slightly to 0.3% yoy in April, after relapsing in March following the temporary consumption boost from the Lunar New Year festivities in February. In Brazil, inflation moderated to its lowest level in 10 months in April, remaining within the central bank's target of 1.5%–4.5% (3% with a ±1.5% tolerance band) for a 4th straight month. India's inflation rate has also been within the target range of 2%–6% since September 2023 but recently displayed some stickiness caused mainly by elevated food prices. In Mexico and Chile, prices have increased slightly in recent months due to an uptick in food and transport prices.

In other advanced economies (ACs), the decline towards the 2% target has been much more convincing than in the US. The general path of prices is now trending notably closer to central bank targets. In most ACs, including the eurozone, the UK and Japan, energy and fuel prices either rose again or the rate of decline slowed, reflecting the impact of the developments in the global oil markets mentioned above. Apart from this, other consumer prices remained subdued. Eurozone inflation was steady at 2.4% in April, hovering around a 3-year low. Most components of inflation declined further, although food prices edged up to 2.8% from 2.6%. UK inflation fell by 0.9 percentage points (ppts) to 2.3% in April from 3.2% in March. The downward pressure stemmed from a steeper decline in energy tariffs after the 'country's regulator reduced the price cap in April. Lower food and recreation costs also contributed. In Japan, inflation eased slightly to 2.7% in March, led by moderations in most components.

Chart 19: Price pressures have eased further in some EMs

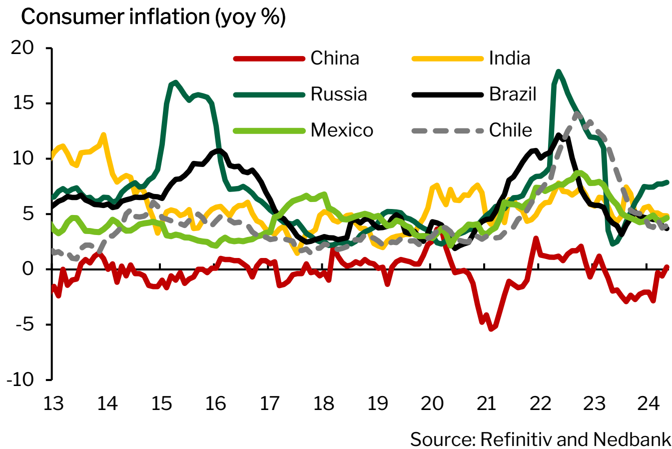
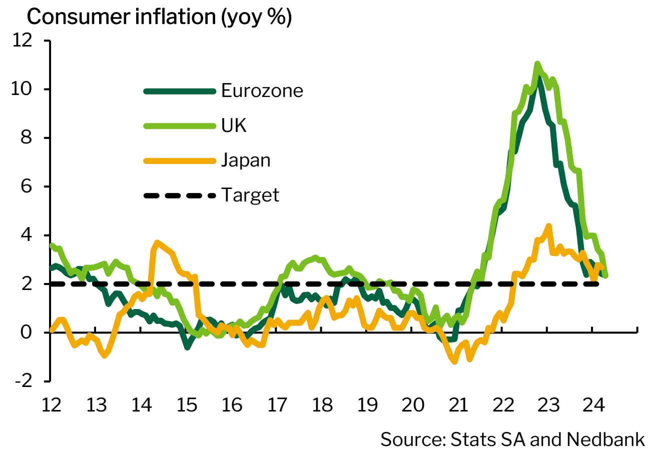


Chart 20: Inflation is quite close to the target in other ACs.



The decline in headline inflation in the eurozone and the UK has been encouraging, fuelling expectations that their central banks could cut interest rates before the Fed. However, core inflation has been more elevated, easing only slowly due to stronger demand for services. Ultimately, sticky core inflation suggests that underlying pressures have not entirely dissipated, thus raising uncertainty about the true path of inflation. This uncertainty will likely push central banks to err on the side of caution and hold rates steady for slightly longer until inflation dynamics provide a more certain downward path. UK core inflation is trending the furthest from the target, justifying the need for tighter-for-longer monetary policy. The Bank of England has echoed this sentiment as it has maintained a hawkish stance, stating in its May meeting that *"monetary policy needs to be restrictive for an extended period of time until the risk of inflation becoming embedded above the 2% target dissipates"*. In the eurozone, core inflation is moving more convincingly towards the target, creating room for the European Central Bank to cut as early as June.

Chart 21: Underlying price pressures continue to ease

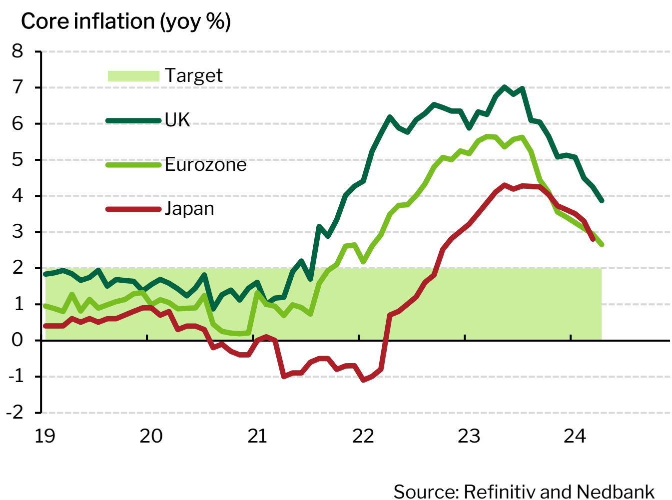
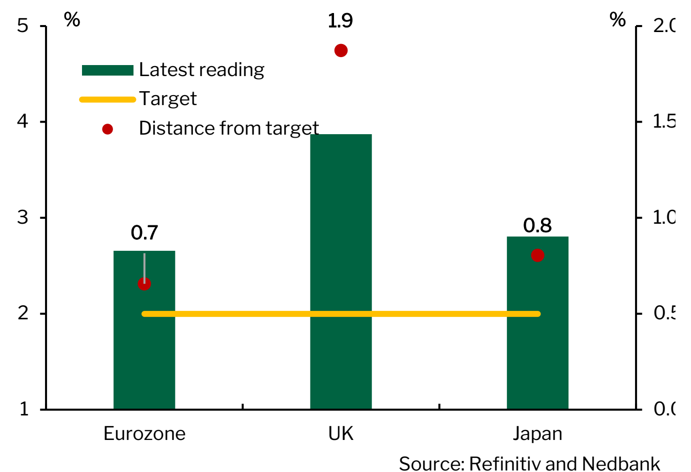


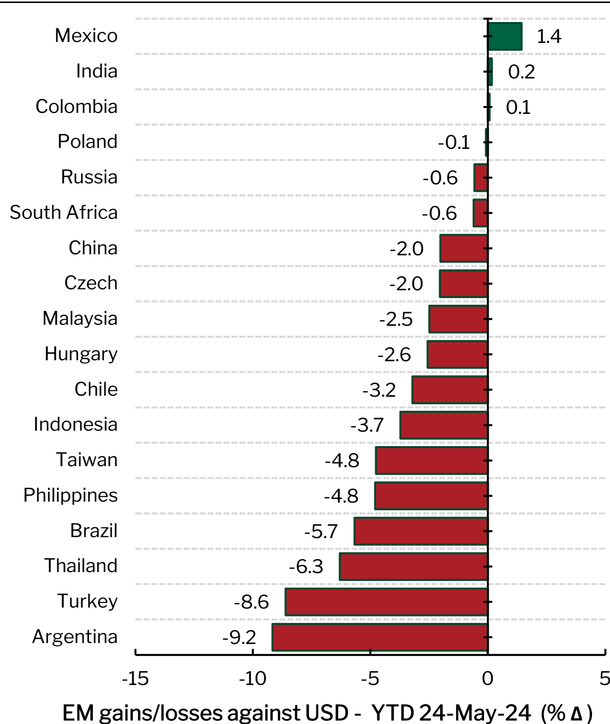
Chart 22: But core inflation is still a distance from the target.



How vulnerable is the rand?

Oddly enough, the rand has enjoyed a relatively good spell of late. It regained lost ground against most major currencies from around mid-April, strengthening further over May. On a trade-weighted basis, the rand appreciated by 6.2% since the end of February, taking its gains over the year to date to 4.2%. So far this year, the rand has been one of the better-performing EM currencies against the USD.

Chart 23: EM currencies performance against the USD



Source: Refinitiv

The rand's appreciation appears counterintuitive ahead of the highly uncertain outcome of the country's general election on 29 May and last week's signing of the controversial National Health Insurance (NHI) scheme into law. The global risk-on rally following the better-than-expected US inflation print for April resulted in a softer US dollar over April and May, supporting most EM currencies. However, global risk appetites evaporated after the release of the Fed's minutes, which showed that some committee members considered the possibility of further rate hikes to ensure inflation's return to target. The resurgence in risk-off sentiment capped the rand's gains over the past day.

Investors are also less spooked by SA's election. They were encouraged by the latest polls, which showed fading support for the radical left Economic Freedom Fighters (EFF) and growing support for the ANC as the country enjoyed more than 50 consecutive days without rolling blackouts. The markets also shrugged off the passing of the NHI, which could have severe implications for the country's already compromised fiscal position and casts a long shadow over the future of the private healthcare system. The assumption appears to be that the NHI is unlikely to see the light of day within the foreseeable future as its implementation will be delayed by prolonged court challenges and a lack of public funding and administrative capacity. There was also some good news on the fiscal front, with National Treasury reporting that the country achieved a primary budget surplus (revenue exceeded non-interest expenditure) of 0.4% of GDP for the fiscal year ending March 2024. This is the first primary surplus in 15 years, facilitated by higher-than-expected tax revenues over the final quarter of the fiscal year. On top of this encouraging development, S&P Global Ratings confirmed the country's foreign currency rating at BB- with a stable outlook on 18 May. After four years of relentless volatility and continuous depreciation, the undervalued rand appears to be benefitting from many small victories in tackling SA's most pressing challenges and favourable assumptions around some big unknowns.

We expect the rand to come under renewed pressure over the next few months. Investors' nerves are bound to be tested around election time. The polls still point to the ruling ANC losing its outright majority for the 1st time since the dawn of democracy in 1994. If this happens, a coalition government will be on the cards, introducing a range of new uncertainties to an already murky policy landscape. In addition, SA still has a long road to travel towards fiscal sustainability, which depends on continued expenditure restraint. This task is difficult under a stable political setup and could prove even more challenging for a new and fragile coalition.

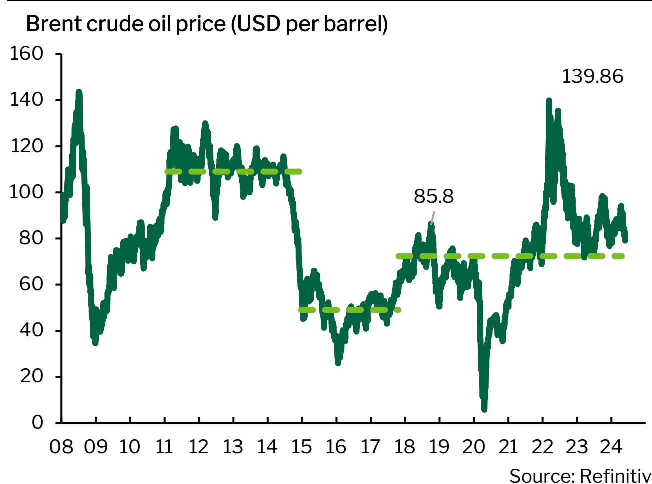
Most downside risks to the country's growth outlook have been priced into the rand throughout 2023. In recent weeks, the rand has benefitted from small steps in the right direction, which led to some unwinding of the sizeable risk premium built into the currency's valuation. However, the risk of fresh setbacks in dealing with the country's structural challenges remains high. Only time will tell whether Eskom and Transnet can embed recent improvements in their operational efficiency. At the same time, government has made little progress in tackling high levels of crime and corruption, rapidly failing municipal services, and generally poor-quality public services. On the growth front, our estimates suggest that the Q1 GDP numbers will still reflect a weak picture and are more likely to surprise on the downside than the upside. Finally, the global landscape is still unsettled. Global risk appetites remain highly sensitive to US inflation news, which could still surprise on the upside over the short term, dampening US interest rate expectations and prolonging the US dollar's yield advantage. Finally, the geopolitical environment is another wildcard, with Israel's offensive in Gaza testing its relations with the US and the tariff war between the US and China escalating.

The rand's outlook beyond the election fog appears more promising. Global risk sentiment should strengthen towards year-end as global disinflation gathers pace, the US and other major central banks start their rate-cutting cycles, and the world economy gains mild upward traction. With the rand undervalued, a revival in global risk appetites, a weaker US dollar and modestly firmer domestic growth prospects should provide grounds for a more sustained pullback.

The outlook for global oil prices remains uncertain.

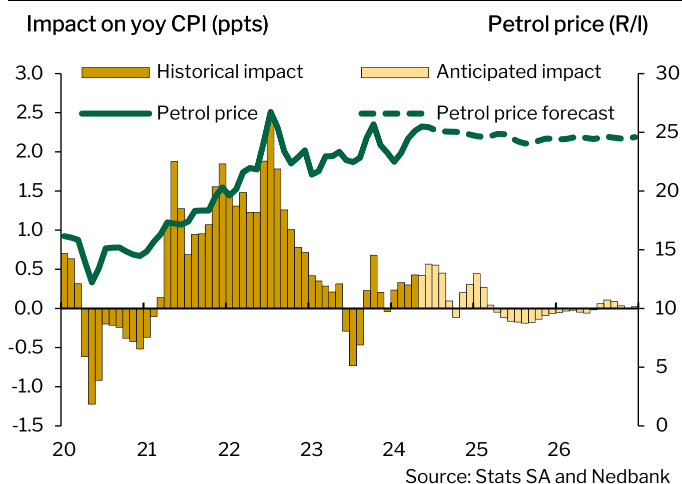
Global oil prices weakened over May. The Brent crude oil price dipped to $79 per barrel, down a sizeable 11.5% over May, after climbing to around $90 per barrel in April. Some of the geopolitical risks priced into oil unwound as Iran's missile attack on Israel only triggered limited retaliation. Consequently, supply and demand dynamics reasserted itself, resulting in lower prices. According to the US Energy Information Agency (EIA), the global oil market will remain finely balanced, with demand outpacing supply over the next three quarters, resulting in a moderate drawdown of inventories. The EIA forecasts Brent at an average of $87.79 in 2024, up 6.5% over the year, before easing by 2.5% to $85.88 in 2025. Market participants also expect global oil prices to remain elevated but relatively rangebound, rising to around $86 over the middle of the year before ending the year between $80-$82. If these estimates materialise, global oil prices are unlikely to add substantial upward pressure to the inflation outlook. While relatively subdued global demand will likely keep oil prices in check over the short term, the Middle East conflict still poses upside risks to the forecast.

Chart 24: Oil prices remain above 2019 levels.



Source: Refinitiv

Chart 25: Petrol price forecast and impact of CPI



Source: Stats SA and Nedbank

The upside risks to food prices have subsided somewhat.

We believe that the upside risks of food prices have moderated. According to Agbiz's reports, the worst of the El Niño phenomenon has ended. While farmers are still assessing the damage from the sweltering summer, some preliminary reports indicate that the impact on South African crops has been less severe and affected selected food types. The most significant impact will likely be on seeds and grain production. According to data from the Crop Estimates Committee (CEC), South Africa's maise harvest is forecast to fall by 19% in 2024, with most of the damage inflicted by the dry conditions in February and March. Even so, the shortfall will be mitigated by imports. Fortunately, some regions of the country have already started to receive rain, which should support the winter crop. Moreover, the earlier dry weather conditions have not impacted the country's dam levels, which are still healthy from the rains towards the end of last year and early this year. The high dam levels will support irrigation in the coming months. The International Research Institute for Climate and Society forecasts a return of a La Niña weather phenomenon (associated with favourable rain conditions) during the second half of the year, which means that the damage caused by El Niño could be reversed quickly.

While the threat posed by adverse weather appears to be fading, last year's high base, which greatly amplified the deceleration in food prices, will also fall away in the coming months. Consequently, we expect prices of grain products, such as maise, bread, and cereals, to edge higher in the coming months. Prices of milk, eggs, and cheese are still normalising from the spikes caused by supply shortages resulting from the avian flu outbreak towards the end of last year. This normalisation will likely continue throughout 2024, helping to limit the impact of firmer grain prices on food inflation. The threats posed by animal diseases will continue to loom in the background. Some farms in the Eastern Cape reported an outbreak of foot-and-mouth disease. Fortunately, the authorities and producers responded quickly, implementing measures such as quarantine and vaccination to limit the spread of the disease.

Lastly, load-shedding has receded in recent months, and Eskom is adamant that the improvement in the power supply is sustainable, barring any significant unexpected breakdowns and disruptions to the system. Steadier power supply and logistics improvements should reduce operating and production costs, which will reduce food prices in general. Additionally, global prices are still easing, and domestic demand remains weak. Consequently, we expect food prices to remain relatively subdued for most of the year. However, the deceleration rate will ease during the year's second half as the base effect wanes. The rand is also a significant risk factor in our food price forecast. If the local currency comes under renewed pressure, it will contain the

improvement in food inflation. We expect food prices to end 2024 at around 5%, down from 7% recorded at the beginning of the year.

Chart 26: Bread and cereals comprise 3.16% of CPI.

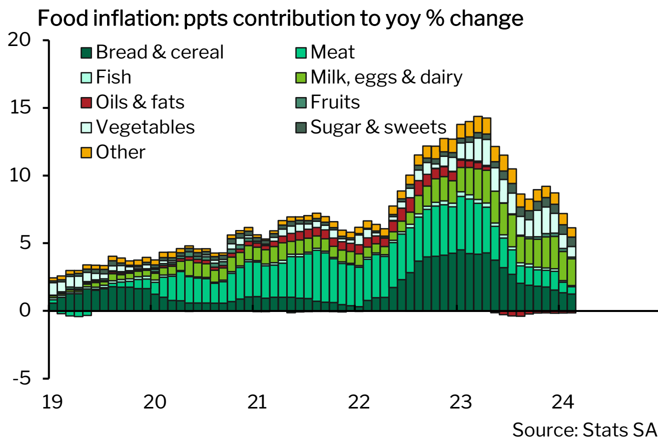
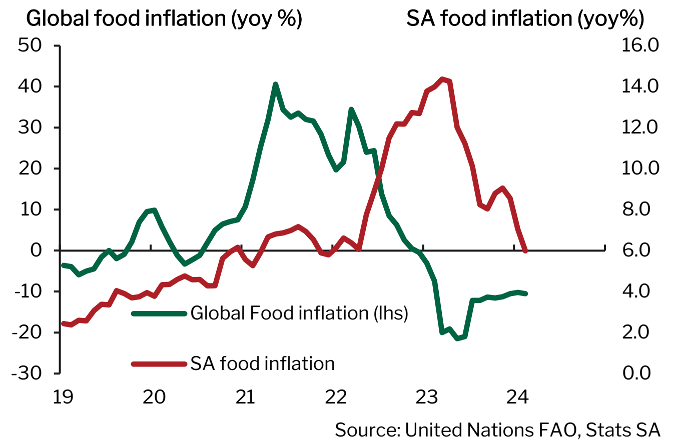


Chart 27: Disinflation in global food prices.



Domestic supply conditions appear to be improving, while demand remains weak.

The SARB has long stressed that the country's protracted structural challenges limit the potential growth rate, thereby severely constraining the supply side of the economy. With supply inhibited, demand need not grow much to place upward pressure on prices. This situation played out throughout last year. While demand weakened in response to tighter monetary policy, supply contracted even more severely amid unprecedented power outages, collapsing rail services, and severe cargo processing backlogs at the ports. Since the start of this year, operating conditions have improved noticeably. Electricity supply stabilised, with the economy entering its longest spell without load-shedding since mid-2022. At the same time, logistics improved as more cargo shifted to rail, and the delays at the ports declined. The SARB expects further progress towards resolving the country's structural challenges over the next three years. As such, the country's potential growth is forecast to accelerate from a meagre 0.1% in 2023 to 1% in 2024, 1.2% in 2025 and 1.6% in 2026.

However, the SARB still expects actual output to match potential this year and exceed it next year, creating a positive output gap and, therefore, mild underlying pressure on prices. We believe actual growth will fall short of potential this year. High-frequency data suggest that output remained weak in Q1 2024. Over the quarter, mining, manufacturing, and electricity production all contracted, shrinking by 1.7%, 0.9% and 1%, respectively. Output by the tertiary sector also weakened, but not as sharply as the primary and secondary sectors. Over the quarter, wholesale sale trade grew by 0.4%, real income from food and beverage services expanded by 0.7%, and real accommodation income rose by 3.1%. Only retail sales and motor trade contracted, down 0.9% and 2.9%, respectively. At this stage, we forecast no growth in GDP in Q1, with considerable downside risks emanating from agriculture. Another sharp decline in value added by agriculture could tip GDP into a contraction.

Chart 28: Household loan growth vs the rate cycle.

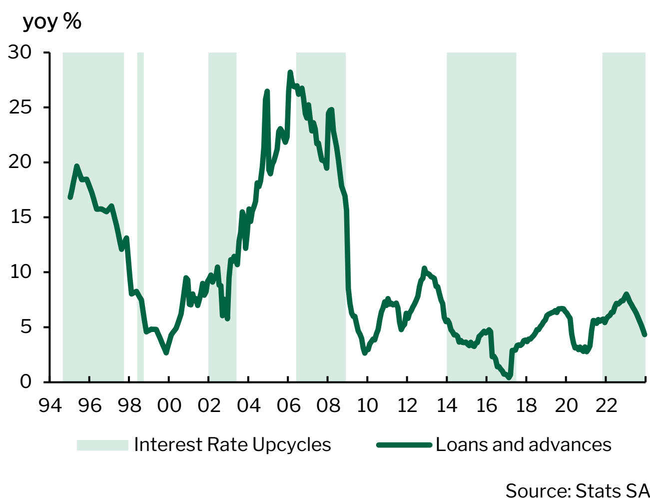
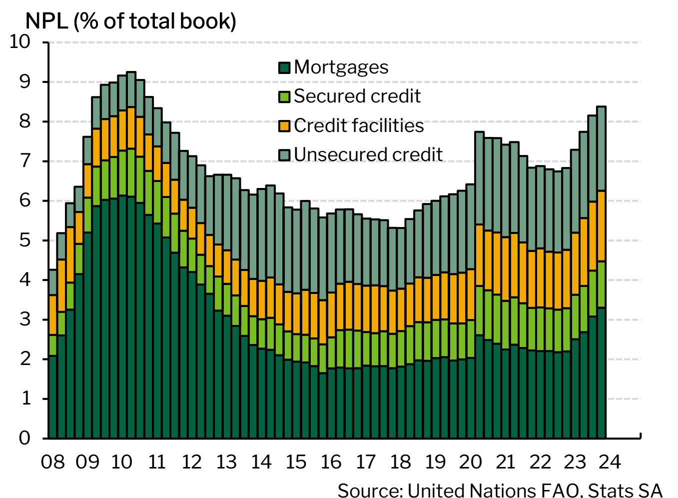


Chart 29: Non-performing loans



There are other signs of strain, too. Consumer confidence remained fragile in Q1, hurt by shrinking real incomes, slowing job creation, higher unemployment, high borrowing costs and depleted savings. Weakening credit demand and higher debt

defaults suggest the pressure on households has intensified. Growth in household loans slowed to only 3.7% yoy in March from 4.3% at the end of 2023 and 7.7% at the end of 2022. At the same time, the National Credit Regulator's data show that arrears of 90 days and over (non-performing loans) on mortgages and unsecured credit rose further towards the end of the year. As a percentage of the gross loan book, non-performing mortgages crept up to 6.2% in Q4 2023 from 4.1% at the end of 2023, and those on unsecured credit remained at a high 22.2%. Consequently, consumer spending will likely remain weak and patchy in Q2, eroding companies' pricing power and facilitating inflation's gradual return to target.

Our inflation forecasts.

We still expect inflation to trend lower during the remainder of this year. However, the disinflation process will remain slow. Inflation will likely be sticky at around 5.2% over the next two months before slowly drifting lower, dipping below 5% in September, and ending the year at 4.8%. The stickiness will stem from the lower statistical base, elevated global oil prices, and some moderation in food disinflation later this year. The downward pressure will come from continued global disinflation and weak domestic demand. Altogether, we forecast inflation to average around 5% in 2024, easing to 4.6% in 2025 and 4.5% in 2026.

We still see upside risks to our forecast, although less so than in March. The rand is a crucial concern. The markets' favourable assumptions on the outcome of SA's election will be tested next week. Apart from this uncertainty, the currency remains highly sensitive to shifts in global risk appetites, which will likely remain volatile until US disinflation gathers downward traction and the Fed starts its rate-cutting cycle. Any relapse in global growth or signs of a hard landing in the US could also trigger another bout of risk-off sentiment. In addition, the geopolitical landscape remains fraught with conflicts and tensions, which could again disrupt oil production and global supply chains. Finally, SA's complex structural challenges against the backdrop of the changing political landscape also continue to pose upside risks to the inflation outlook.

The implications for monetary policy

In our view, the SARB will likely wait for the elections to pass and for more evidence to emerge that inflation is trending towards 4.5% before easing monetary policy. We believe that the data will support modest easing later this year. We expect the first 25-bps cut in September, followed by another in November, taking the repo rate to 7.75% and the prime lending rate at 11.25% by the end of this year.

GROUP ECONOMIC UNIT

Nicky Weimar	+27 10 234 8357	nickywe@nedbank.co.za
Johannes Khosa	+27 10 234 8359	johanneskh@nedbank.co.za
Liandra da Silva	+27 10 228 3527	iandrad@nedbank.co.za

DISCLAIMER

The information furnished in this report (the "report"). which information may include opinions. estimates. indicative rates. terms. price quotations and projections. reflects the existing judgment of the author(s) and the prevailing market conditions as at the date of this report. which judgment and conditions are subject to change without notice. modification or amendment. This report does not necessarily reflect the opinion of Nedbank Limited ("Nedbank"). The information herein has been obtained from various sources. the accuracy and/or completeness of which Nedbank does not guarantee and for which Nedbank accepts no liability.

Any prices or levels contained herein are preliminary and indicative only and do not represent bids or offers. These indications are provided solely for your information and consideration. The information contained in this publication may include results of analyses from a quantitative model which represent potential future events that may or may not be realised. and is not a complete analysis of every material fact representing any product. Any estimates included herein constitute Nedbank's judgment as of the date hereof and are subject to change without any notice. Nedbank and/or its affiliates may make a market in these instruments for our customers and for our own account. Accordingly. Nedbank's may have a position in any such instrument at any time.

Nedbank recommends that independent tax. accounting. legal and financial advice be sought should any party seek to place any reliance on the information contained herein. This report is intended for use by professional and business investors only. It may not be considered as advice. recommendation or an offer to enter into or conclude any transactions. This report has been prepared for general dissemination and information purposes only and may not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction. Any additional information relative to any financial instruments and/or financial products reviewed in this report is available upon request.

All rights reserved. Any unauthorised use or disclosure of this report is prohibited. This report may not be reproduced without the prior written consent of Nedbank. The information contained in this note is intended solely for the recipient and may not be distributed by the recipient.

All trademarks. service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of Nedbank or its affiliates.