MPC Preview

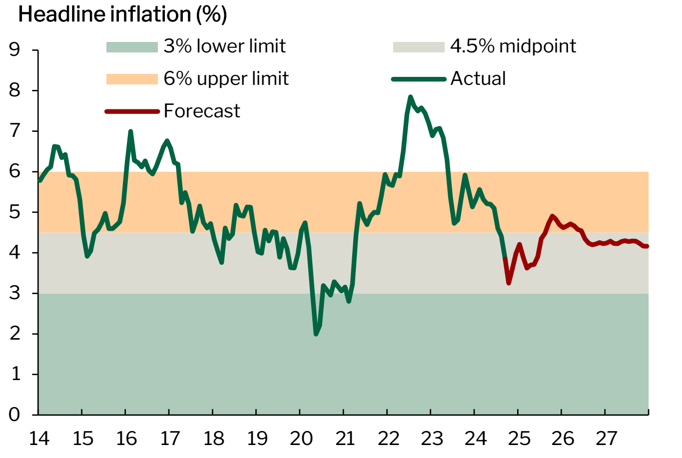
ECONOMICS | SOUTH AFRICA | MONETARY POLICY

NEDBANK

More interest rate relief expected next week

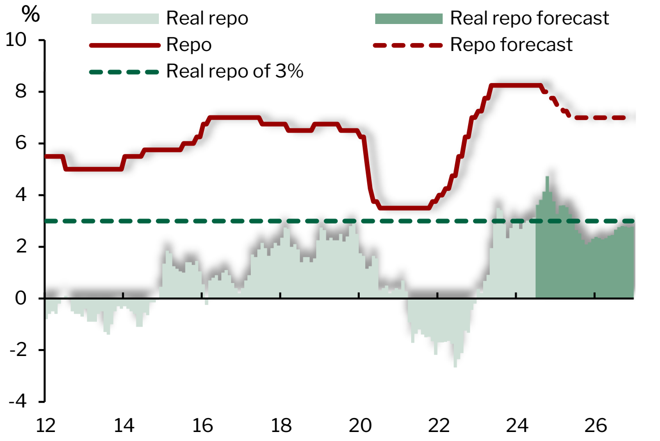
- We expect another 25 basis points (bps) reduction in the repo rate at next week's Monetary Policy Committee (MPC) meeting as inflation continues to undershoot the SARB 4.5% target and the outlook remains subdued. However, upside risks increased somewhat over the past month.
- Inflation receded further below the SARB's target in September, with the headline figure falling to 3.8% after easing to 4.4% in August. Fuel price cuts exerted the most downward pressure, but food and core inflation also held steady at a relatively low 4.1%. The downward trend is expected to intensify and broaden in October, amplified by another sharp drop in local fuel prices caused by the virtuous combination of falling global oil prices and a stronger rand. We expect headline and core inflation to fall to about 3.3% and 4%, respectively, in October. After that, our forecasts suggest that inflation will hover around and below the 4% level for an extended period before drifting higher off a low base to about 4.7% by the end of 2025. We forecast inflation to average 4.6% in 2024, 4.3% in 2025, and 4.4% in 2026. Overall, inflation is forecast to remain anchored around the SARB's target over the next three years, contained by continued global disinflation, subdued commodity prices, a steadier rand and measured domestic demand.
- That said, the upside risks to the inflation outlook increased slightly since the September MPC meeting. The most significant risk emanates from the likely change in US economic policies during the next four years following Donald Trump's emphatic victory in the US elections. The proposed policy mix of tax cuts, tariffs and mass deportation will likely be reflationary and potentially raise the floor on US interest rates over the medium term. The tariff plan also poses significant downside risks to global trade and world growth prospects, with adverse consequences for China's already struggling economy. Given that China is the world's largest consumer of commodities, the tariff plan could depress commodity prices, weighing export earnings, the terms of trade and, therefore, the currencies of many commodity-exporting developing countries. Moreover, the high uncertainty surrounding the future course of US economic policy and foreign relations in a world already beset by tensions and conflicts will tend to weigh on risk appetites towards emerging markets (EMs) and favour a stronger US dollar, amplifying the downward pressure on EM currencies. Recent global developments, therefore, threaten to reverse the rand's pullback since the May elections, which played a significant role in returning domestic inflation to the SARB's target faster than most expected.
- Other developments were more encouraging. Global disinflation continued, international oil prices declined significantly, and the US and other major central banks pressed ahead with further monetary policy easing. Although the domestic economy is slowly recovering, improved supply-side conditions more than compensated for the uptick in domestic demand, keeping price pressures in check. There was also good news on electricity prices as NERSA introduced meaningful regulatory reforms and rejected Eskom's hefty tariff proposal for the upcoming financial year.
- Altogether, we believe that conditions remain supportive of further monetary policy easing. Consequently, we expect another 25-bps cut next week, followed by a further 75-bps reduction in 2025, taking the repo rate down to 7% and the prime lending rate to 10.50% by the end of next year. If inflation and interest rates align with our forecasts, the real repo rate will remain above 2% throughout 2025.

Chart 1: Inflation is likely to remain anchored at 4.5%.



Source: Stats SA, Nedbank forecast

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

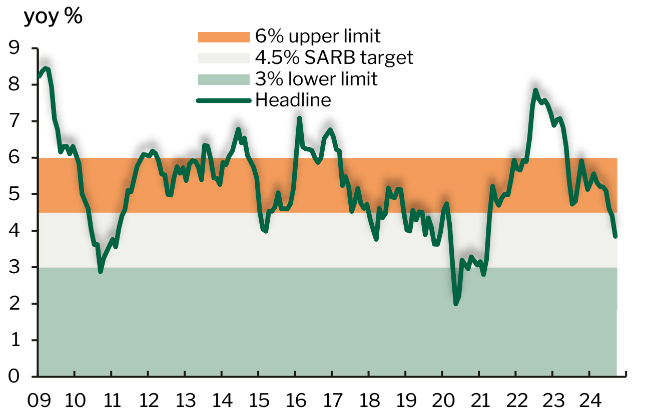


Source: SARB, Nedbank forecasts

Recent inflation outcomes

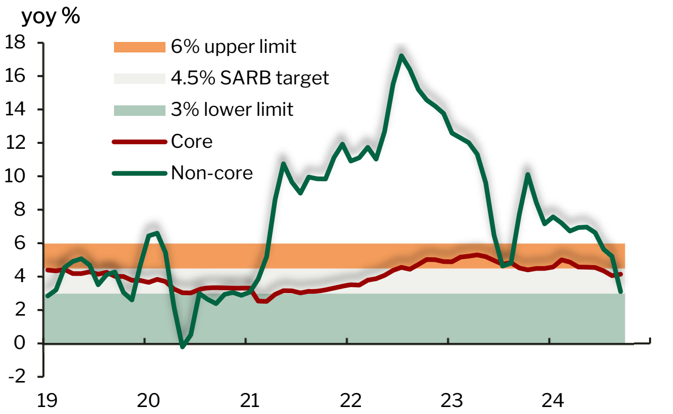
Disinflation continued in September, with consumer inflation falling further below the SARB's 4.5% target. The headline figure declined to a modest 3.8% after easing to 4.4% in August from 5.6% in February. Over the past few months, fuel prices exerted the most downward pressure, falling by 9% yoy in September on lower global oil prices and a firmer rand. As expected, food price disinflation stalled, holding steady at a relatively low 4.1%. Encouragingly, the deceleration continued in most food products, still supported by last year's high base, subdued global food prices, a stronger rand, the fading impact of various animal diseases at home, and improved domestic operating conditions throughout the supply chain brought about by the end of load-shedding, the shift to more cost-effective energy solutions, and slightly smoother logistics.

Chart 3: Inflation's rapid decline continued.



Source: Stats SA

Chart 4: Disinflation broadened.

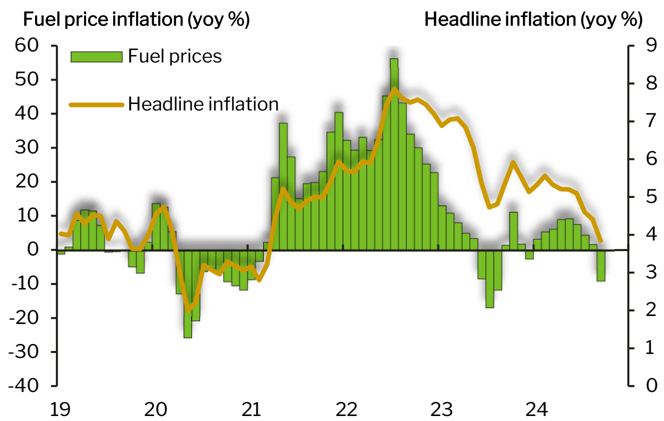


Source: SARB October 2024 MPR and Nedbank calculations

Administered prices excluding fuel remained elevated at 7% yoy, driven mainly by electricity tariffs, which rose by 11.5% yoy in September, only marginally down from 15.3% in June. The SARB notes in its October 2024 Monetary Policy Review (MPR) that electricity prices have increased by an average rate of 12.1% per year since 2009, outpacing the average increase in headline inflation of 5.3% per year by a considerable margin. Even so, lower fuel prices and slower food inflation outweighed the persistent rise in electricity prices, with non-core inflation easing to only 3.1% yoy in September from 5.2% in August and 6.6% in June.

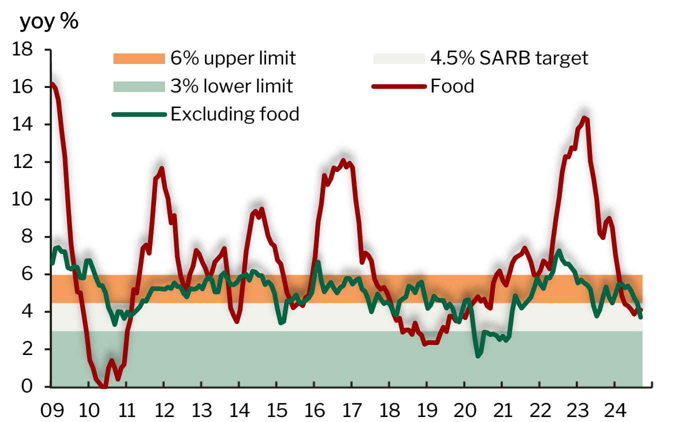
Excluding food, fuel, and energy prices, core inflation was unchanged, remaining at a tame 4.1%, kept in check by continued global disinflation, a stronger rand, benign housing inflation, and relatively weak domestic demand. Goods inflation dropped to 3.3% from 4.4%, while services inflation eased to 4.4% from 4.5%. All said, September's CPI numbers pointed to relatively widespread disinflation, supporting the MPC's pivot towards monetary policy easing.

Chart 5: Fuel price cuts pulled headline inflation down.



Source: Stats SA

Chart 6: Food inflation held steady at a low 4.1%.



Source: Stats SA

Revisiting potential upside risks

At the September MPC meeting, the SARB again revised its headline and core inflation forecasts lower, while the Committee considered the risks to the outlook as balanced. The MPC listed the following potential upside risks:

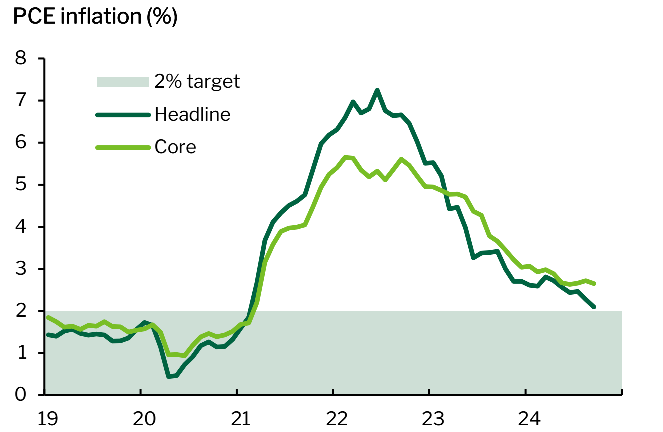
- The global outlook remains murky, fraught with prolonged geopolitical conflicts and significant political and policy uncertainties in many countries. Depending on the outcomes, these events could still trigger new economic shocks,

increase trade restrictions, and worsen already high global debt burdens, potentially fuelling a reflation cycle and a renewed pivot towards monetary policy tightening. Such outcomes could again result in difficult financial conditions for SA and other developing countries, exerting downward pressure on the rand.
- Housing costs could rise as the domestic economy recovers.
- Increases in electricity tariffs could be larger than the SARB's assumptions.
- Wage growth could still outpace inflation and productivity growth, raising operating costs and fuelling an acceleration in services inflation.
- The outlook for food inflation also remains uncertain, given increasingly unpredictable weather conditions due to climate change, the persistent risk of renewed outbreaks of animal diseases and the threat posed by increased protectionism.

The implications of a second Trump administration for global inflation

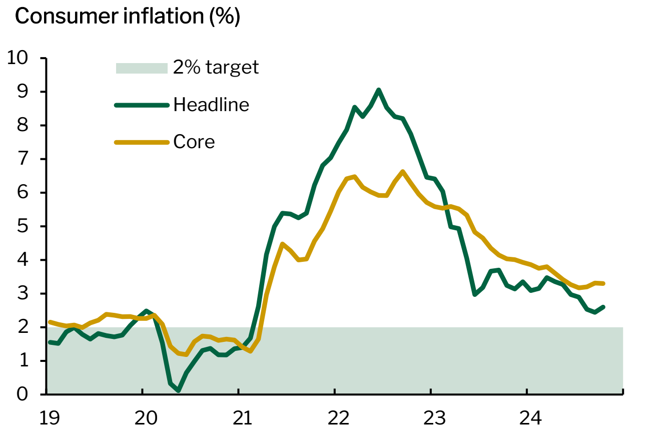
Since the last MPC meeting, disinflation generally continued. In the US, most inflation measures crept closer to the central bank's 2% target. Headline PCE inflation (based on the personal consumption expenditure price index) eased to 2.1% in September from 2.3% in August, down significantly from its peak of 7.2% in June 2022. The US Fed's preferred inflation gauge - core PCE inflation, which excludes food and energy prices, remained sticky but steady at 2.7% for the third consecutive month. The downward trend in consumer inflation reversed slightly in October, mainly due to constrained and disrupted supply conditions in the regions affected by two devastating hurricanes. The headline figure increased to 2.6% after receding to 2.4% in September from 2.5% in August, while core inflation remained at 3.3%.

Chart 7: US PCE inflation



Source: LSEG

Chart 8: US consumer inflation



Source: LSEG

While inflation moderated further, the US economy remained strong. Real GDP grew by a robust 2.8% qoq (seasonally adjusted and annualised) in Q3, slightly softer than the blistering 3% pace set in Q2. Consumer and government spending provided the momentum, but private sector fixed investment also contributed, although the growth rate eased. Net trade remained negative but relatively steady. US labour market conditions softened somewhat. The pace of job creation slowed in October, mainly due to temporary shocks in the form of a prolonged labour strike and the destruction caused by the hurricanes. Despite these events, the unemployment rate held steady at 4.1% in October, down slightly from 4.3% in July but higher than the levels recorded last year. Nominal wage growth increased slightly in October, rising to 4% yoy from 3.9%. Although still elevated and above rates usually considered consistent with 2% inflation, wage growth has nonetheless slowed noticeably throughout 2023 and 2024 to date. All said, the labour market has cooled this year, with the demand and supply of labour moving into better balance.

Against this backdrop, the US Fed eased monetary policy further in November, reducing the target range for federal funds rate (FFR) by 25 bps to 4.50-4.75%. Fed Chair Jerome Powell struck an upbeat tone. He stated that the Federal Open Market Committee (FOMC) was confident it could maintain the strength in the economy and stabilise inflation at 2% with appropriate policy adjustments. The Chair noted that the labour market was no longer a source of significant inflationary pressures and that longer-term inflation expectations appeared anchored.

The markets correctly predicted the Fed's move at this month's meeting. Analysts in the Reuters and Bloomberg polls maintain that monetary policy easing will continue, with another 25-bps reduction in December, followed by cuts totalling 100-125 bps in 2025 and another 25 bps in 2026. However, the markets have begun to price the potential implications of Donald Trump's policy agenda after his emphatic victory in the 2024 US elections. While much remains unknown, the president-elect campaigned on essentially four policy proposals, consisting of:
- extending and expanding his 2017 Tax Cuts and Jobs Act beyond its current expiry date in 2025;

- sweeping deregulation,
- a pledge to lump a universal tariff of 10-20% on imports from all countries and 60% on imports from China
- the mass deportation of undocumented foreign workers from the US.

Chart 9: US demand remained exceptionally strong.

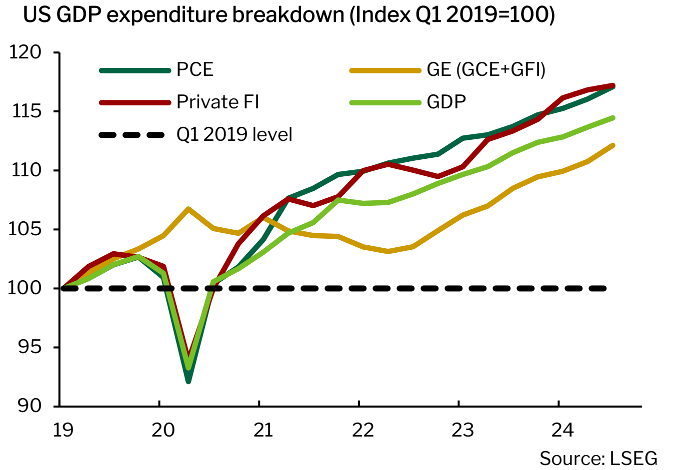
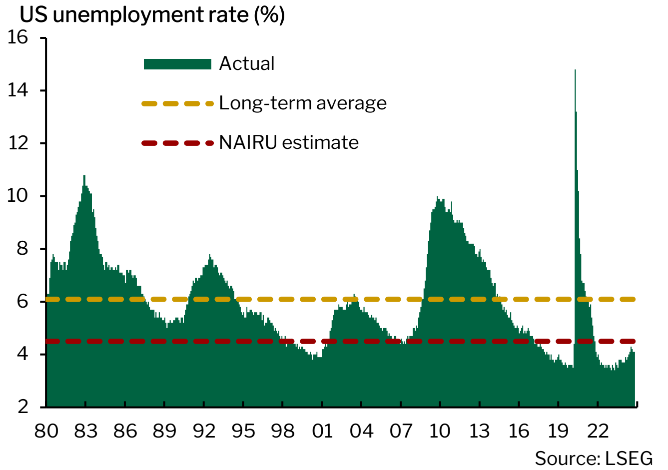


Chart 10: The US labour market cooled further.



The policy proposals could fuel another upsurge in inflationary pressures in the US and elsewhere. The policies will probably only be implemented around the second half of next year, and the impact is more likely to hit home over the medium term. The proposed tax cuts would widen the budget deficit, adding to the country's already substantial and unsustainable public debt burden. The Committee for a Responsible Federal Budget estimated that the Trump plan could add $7.8 trillion to the federal deficit and $1 trillion to debt service costs over 2026 to 2035, increasing the debt burden from its current 99% of GDP to an estimated 143% of GDP over the same period. The tax cuts would increase deficit financing and boost consumer spending, supporting economic growth but also reigniting demand pressure on prices.

Chart 11: The nominal and real federal funds rate (FFR).

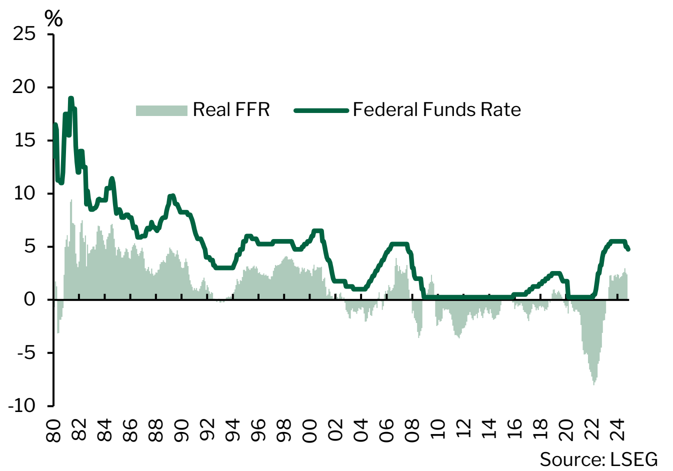
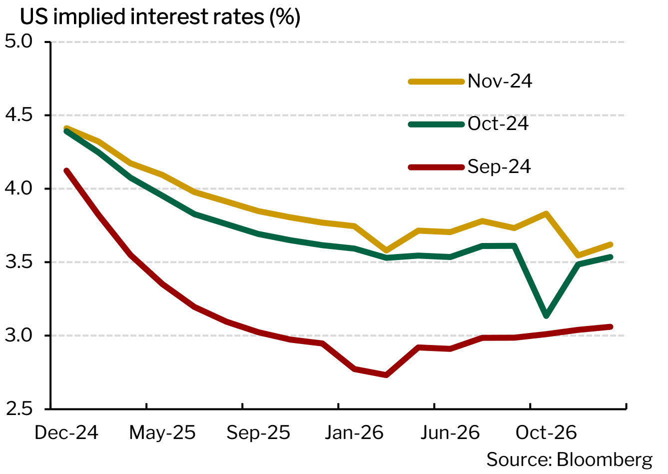


Chart 12: Markets' interest rate expectations

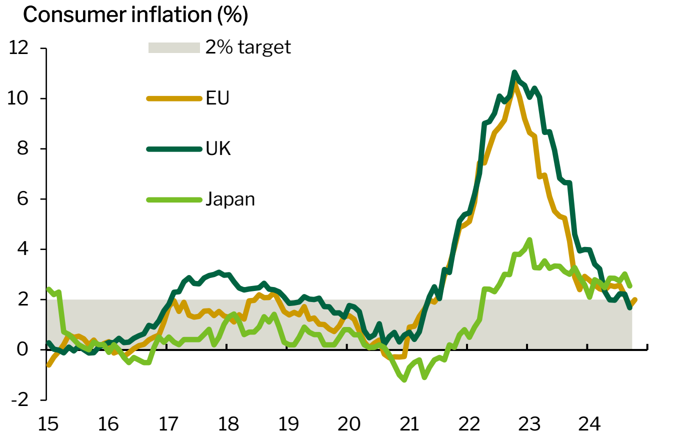


Given robust domestic demand, companies will likely recoup the total cost of the tariff hikes through higher prices. The initial impact of the tariffs may be relatively modest, amounting to a universal upward adjustment in prices across all goods and services, which would gradually fade as it becomes baked into the base. However, empirical evidence overwhelmingly shows that high tariffs increase concentration, reduce competition, undermine productivity, and increase inefficiencies, leading to higher inflation over the medium- to longer-term. In addition, other countries will likely retaliate by lifting tariffs on US goods, potentially triggering a tit-for-tat trade war, adding to inflation, reducing global trade and hurting world growth. Finally, the clamp down on migration could again lead to acute labour supply shortages in some industries, notably agriculture, construction, manufacturing, and hospitality. Under such circumstances, wage growth would again become a source of price pressure.

In response, the markets have scaled back their rate-cut expectations for 2025 and 2026, anticipating a shallower cycle. Bond investors are starting to price in the risk of structurally higher inflation and policy rates over the next five years. The shift in interest rate expectations, alongside a much greater degree of uncertainty over the outlook, drove US bond yields higher and underpinned a strong rebound in the US dollar.

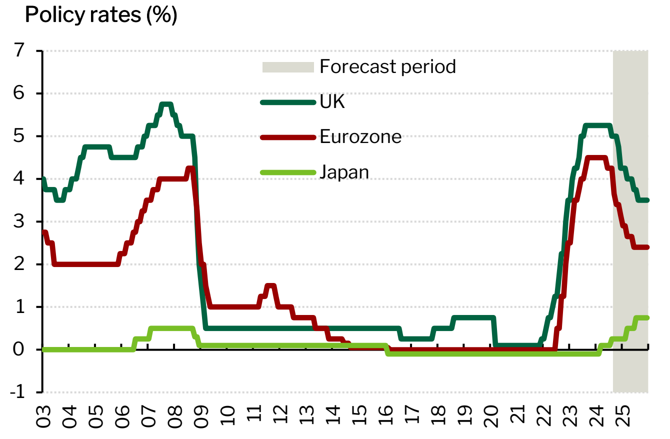
In the Eurozone and the UK, inflation hovered at or slightly below the 2% target. Eurozone headline inflation edged up slightly to 2% in October after falling to 1.7% in September from 2.2% in August, averaging 2% over the three months. Like the US, core inflation was unchanged at 2.7% in October, down from 2.8% in August. In the UK, both headline and core inflation decelerated significantly. Headline inflation dipped to 1.7% in September from 2.2% in August, while core inflation fell to 3.2% from 3.6% over the same period.

Chart 13: Inflation in the Eurozone, UK, and Japan



Source: LSEG

Chart 14: Consensus rate forecasts for other majors.



Source: Reuters Poll

Economic activity in the Eurozone and the UK improved further in Q3. Eurozone GDP increased by 0.4% qoq (seasonally adjusted and not annualised), up from 0.2% in Q2 and 0.3% in Q1. The lift came from the German economy's return to growth after contracting in Q2. The economies of most other countries either expanded at the same pace as in Q2 or fared slightly better. Although the UK economy expanded in Q3, the growth rate likely slowed to around 0.3% qoq from 0.5% in Q2 and 0.7% in Q1. The softer pace mainly reflects a weak spell over June and July, but the monthly GDP estimates show that economic activity regained some upward traction in August. Manufacturing and construction rebounded, while services remained relatively healthy.

With inflation at target, the European Central Bank (ECB) reduced its key policy rates by a further 25 bps in October, taking the deposit facility rate, the main refinancing rate, and the marginal lending facility rate down to 3.25%, 3.40% and 3.65%, respectively. The ECB expects inflation to remain relatively steady around 2% in 2025. Although the ECB still cited robust wage growth relative to productivity growth as an upside risk, it acknowledged that these pressures were easing. In November, the Bank of England (BoE) cut its bank rate by 25 bps to 4.75%. Although the decision was not unanimous, with one member preferring a hold, others were encouraged by signs of disinflation broadening as services inflation cooled more meaningfully, falling to a two-year low in September. While the BoE declined to comment, the markets are concerned that the Labour Party's expansionary budget for fiscal year 2026 could compromise the BoE's inflation goals and force tighter policy to counter fiscal largesse. According to the latest Reuters polls, the ECB and BoE are expected to cut rates by 100 bps and 125 bps, respectively by the end of 2025.

Japan remained an outlier among advanced countries. Headline and core inflation was still elevated but at least eased noticeably in September. Over the past three months, the removal of generous energy subsidies introduced considerable noise into the headline numbers. These distortions started dissipating in September, pulling headline inflation down to 2.5% from 3% in August and 2.8% in July. Core inflation also slowed to a five-month low of 2.4% from 2.8% in August. High-frequency data suggests that Japan's economic recovery continued in Q3, after activity rebounded in Q2, when GDP grew by 0.7% qoq, buoyed by stronger growth in consumer spending driven by the highest wage increases in over 30 years. The Jibun Bank composite purchasing managers index remained comfortably above the key 50 threshold associated with expansionary conditions throughout Q3, with most of the heavy lifting done by robust services. Although manufacturing remained relatively subdued, factories reported relatively steady conditions, with pockets of improvements, particularly in the automotive industry, as the impact of earlier financial scandals faded.

Despite these encouraging signs, Japan's outlook is clouded by political uncertainty after the ruling coalition under the leadership of the Liberal Democratic Party lost its majority in the 27 October elections. Although the parliament recently re-elected Shigeru Ishiba as prime minister, the way forward will require consent from opposition parties, raising the risk of political paralysis. Amid the changing political landscape, the Bank of Japan (BoE) unanimously opted to leave its key policy rate unchanged at 0.25% in October. The BoJ still expects inflation to ease to 1.9% in 2025 and 2026 from around 2.5% in 2024, while GDP growth was forecast to average 0.6% this year, 1.1% in 2025 and 1% in 2026. The policy board committed to further rate increases provided the economy and inflation align with the BoJ's forecast.

Inflation moderated further in most key emerging market economies, supporting further monetary easing by most central banks. Brazil is an exception. Price pressures resurfaced around June, with headline inflation accelerating further to 4.8% in October, rising consistently from a low of 3.7% in April and shooting above the central bank's upper tolerance limit of 4.5%. A resurgence in food and energy prices due to severe drought is mainly to blame. Still, a weaker real (exchange rate), robust economy and expansionary fiscal policy amplified the impact of these shocks. In response, the central bank reversed course, hiking interest rates by 25 bps in September and an aggressive 50 bps in November, taking its policy rate up to 11.25%.

On the opposite end of the inflation spectrum, the threat of deflation persisted in China. Headline inflation dipped to 0.3% yoy in October, averaging only 0.4% over the past ten months. Food and non-food prices slowed, with transport and housing exerting the most downward pressure. Core inflation ticked up slightly to 0.2% yoy, from only 0.1% in September. These deflationary pressures came amid sluggish economic activity, characterised by weak demand and excess housing and manufacturing capacity. Real GDP growth slowed to 4.6% yoy in Q3, down from 4.7% in Q2, falling short of the government's 5% target.

In response to these challenges, the Chinese government announced a raft of stimulus measures, including interventions to address the overhang in the property market and high debt burdens among local authorities. Local governments will receive RMB10 trillion (USD1.4 trillion) to deal with hidden debt of RMB14.3 trillion. The People's Bank of China (PBOC) also contributed, reducing all relevant interest rates in September and October, including the 7- and 14-day reverse repo rates, the 1- and 5-year loan prime rates, and the cash reserve ratio for banks, while accelerating its liquidity injections dramatically over September and October. The markets were underwhelmed, with the consensus assessing that the stimulus as too little and too late to turn the tide in the property market and revive domestic consumption materially. On top of these challenges, China is the primary target of Donald Trump's tariff proposals. While a 60% tariff will hurt China, the damage could be less than the new US administration imagines. The higher tariffs on Chinese exports will undermine its price competitiveness in the US market relative to other countries, but a weaker renminbi against the US dollar will provide some offset. These counterbalancing forces and the US's relatively small share of China's total exports (only 2.8% in 2023) explain why Trump's tariffs during his first stint as president had little impact on China's growth performance and overall global trade volumes.

In conclusion, advanced countries are still on course to return inflation to target without risking a pronounced economic downturn and significantly higher unemployment. In the current cycle, the soft-landing scenario remains the most likely outcome. Therefore, monetary policy easing will likely continue in the US and other advanced countries. However, the anticipated change in US economic policies under Donald Trump's administration raises the upside risks to the inflation and interest rate outlooks and the downside risks to global growth prospects over the medium term.

The Trump trade weighs on the rand.

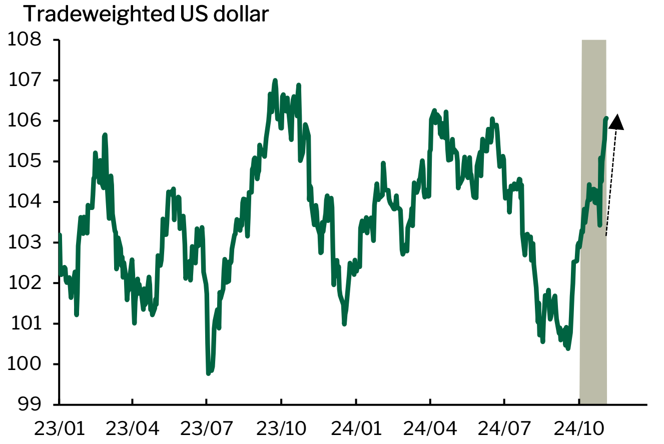
The rand came under pressure from the burgeoning Trump trade over the past two months. In anticipation of Donald Trump's policy agenda, the markets have been stocking up on US dollars, selling US Treasuries, buying US equities and cryptocurrencies, and selling the assets of those countries most likely to be hurt by Trump's tariff plans, notably the Eurozone, China, and other EMs. While the rand held up better than most other EM currencies, it also lost ground against a stronger US dollar. The rand depreciated by 1.7% against the US dollar in October and lost a further 3.8% in the first two weeks of November. The recent weakness has not yet undone the rand's gains off last year's levels. Over 2024 to date, the rand is up 6.8% against the trade-weighted basket currencies, only 0.1% against the US dollar, 4.5% against the euro, and 1% against the British pound.

Global developments will likely shape the rand's direction, with the incoming Trump administration casting a long shadow over the outlook. Global risk appetites towards emerging market assets will likely remain volatile over the next six months as global investors prepare for Trump's return to the White House by repositioning their portfolios to benefit from the potential policy mix of tax cuts, deregulation, tariffs, and deportation. This policy cocktail will support the US dollar through three channels:

- the promise of higher returns on US equities due to lower taxes, deregulation, and stronger domestic demand over the next year;
- safe-haven demand driven by fears of weaker economic growth in the rest of the world due to higher tariffs and expectations of higher returns on low-risk investments over the medium term on the possibility of US reflation and structurally higher US interest rates and
- safe-haven demand fuelled by general uncertainty over the impact of Trump's policies on the world economy and the geopolitical landscape.

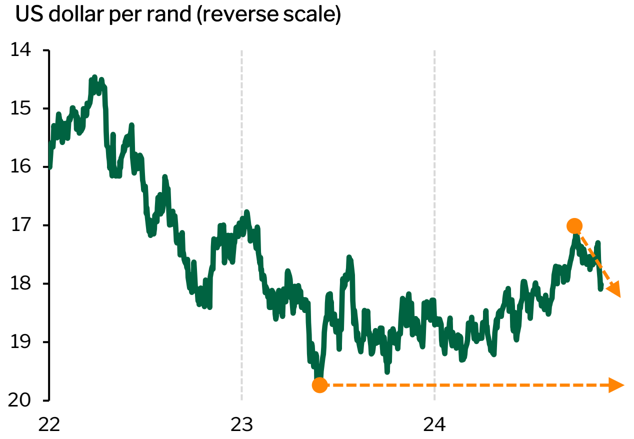
Over the next year, at least, these forces will be partly countered by continued US disinflation, easing US monetary policy and the reasonable prospect of a soft landing for the US and the world economy.

Chart 15: The US dollar shoots for the stars.



Source: LSEG

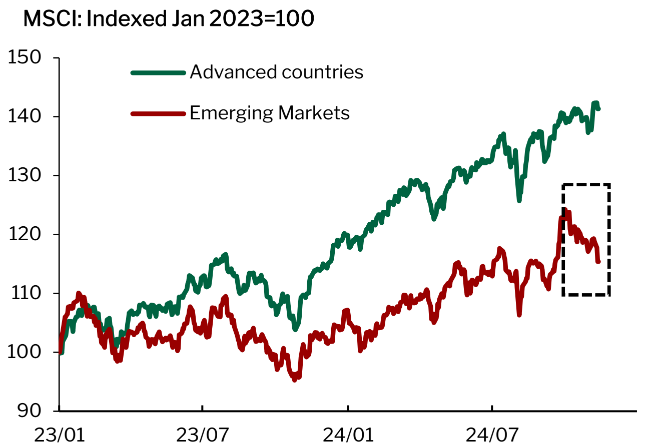
Chart 16: The rand weakened but is still up over 2023.



Source: Refinitiv

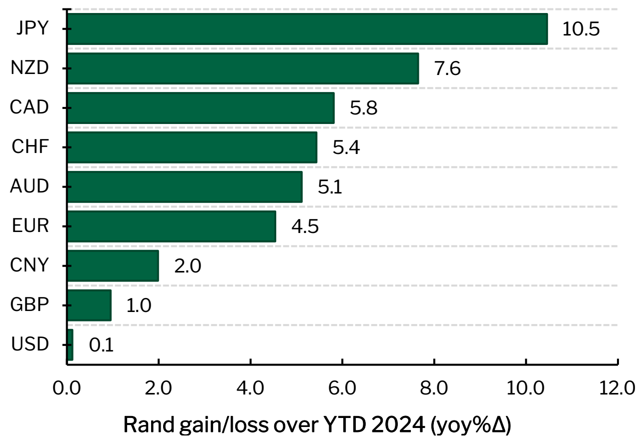
Apart from the factors impacting the demand for US dollars, sentiment towards emerging markets will also be affected by how well China copes with its current growth woes and the looming threat of US tariffs. So far, China has struggled to revive its economy, which has weighed on global commodity markets, hurting export earnings, the terms of trade, and the currencies of many commodity-based EMs. These pressures appear set to persist into 2025, but recent stimulus measures may prove more effective and the pending trade war less damaging than the markets currently anticipate. Nonetheless, most analysts expect China's economy to post even slower growth in 2025, while commodity prices are forecast to remain relatively depressed.

Chart 17: Sell-off out of EMs has been significant.



Source: LSEG

Chart 18: The rand's performance so far in 2024.



Source: LSEG

If the above combination materialises, it will hurt SA's export volumes and prices, potentially upending the country's trade surplus, which has kept the current account deficit contained over the past year. On top of these headwinds, Trump's tariff plans will end SA's preferential access to the US market through the Africa Growth and Opportunity Act (AGOA), which would hurt the trade balance, the current account, and the economy.

On the local front, all the good news, including steadier electricity supply, peaceful elections, the government of national unity, and firmer domestic growth prospects, have already been fully discounted. SA's fiscal story, as presented in October's Medium Term Budget Policy Statement (MTBPS), was not quite as uplifting as the markets expected, reflecting a significantly slower pace of deficit reduction over the next three years, with the public debt burden remaining elevated. From now on, local developments will likely be neutral for the rand. Some upside could materialise if evidence emerges of accelerated structural reforms, increased infrastructure spending, and a faster-than-expected economic recovery, which would also strengthen the country's fiscal position and gradually reduce the sovereign risk premium.

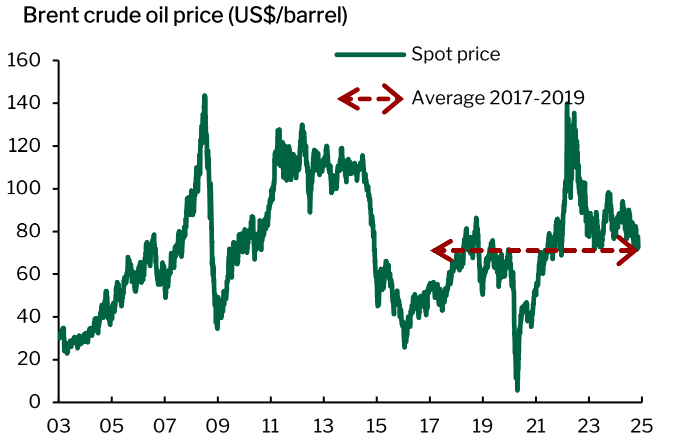
All said, the global landscape will be less supportive of the rand in the months ahead. Although recent market moves appear excessive, the uncertainty surrounding the extent and scale of the Trump administration's policy changes will likely favour the dollar and weigh on all emerging market currencies.

Global oil prices remain vulnerable to geopolitical shocks.

Global oil prices declined significantly over the past three months, dipping below $75 per barrel in September and October before sliding below $73 in early November. Over September, the Brent crude oil prices declined by 24.6% yoy, while the rand appreciated by 9.6% yoy. This translated into an average decline of 5.2% mom and 18.4% yoy in local petrol prices and 5.9% mom and 26.8% yoy in local diesel prices. Consequently, we expect fuel price deflation to exert further downward pressure on headline inflation in October. This trend is forecast to continue in the final months of this year, with lower global oil prices offsetting the impact of a weaker rand.

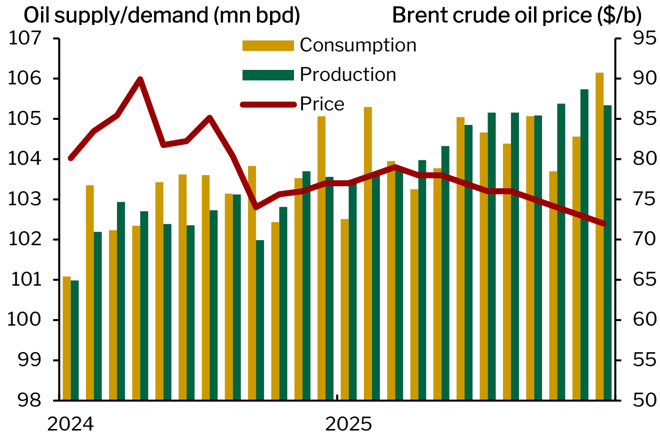
The outlook for 2025 is murky. In its November Short-Term Energy Outlook, the US Energy Information Administration (EIA) shows that supply and demand will remain finely balanced until around April next year. Consequently, the Brent crude oil price is forecast to end 2024 at a higher $77 per barrel, propped by strong demand out of India and a seasonal spike driven by the onset of the Northern Hemisphere's winter. Thereafter, production is expected to outpace consumption, placing downward pressure on oil prices, which are estimated to fall to $72 per barrel by the end of 2025. Analysts surveyed by Bloomberg tell the same tale. The Bloomberg poll shows Brent falling from an average of $79.73 in 2024 to $70.89 in 2025, $69.57 in 2026, and $68.92 in 2027. The Reuters poll reflects a more bullish outlook, with oil prices at higher levels and easing only slowly over the next three years, falling from an average of $80.55 in 2024 to $76.61 in 2025 and $76.30 in 2026.

Chart 19: Brent crude returned to pre-pandemic levels.



Source: LSEG

Chart 20: The global oil market will remain tight.



Source: EIA November 2024

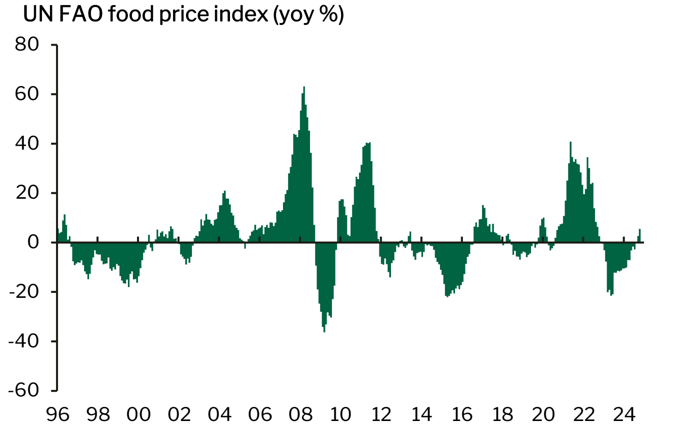
We also expect global oil prices to moderate further as US oil production will likely accelerate under the Trump administration. Meanwhile, oil demand will be undermined by China's economic slowdown and its ongoing structural shift to renewable energy and transport systems. The most significant risk for oil prices remains the conflict in the Middle East. If Donald Trump's rhetoric on the campaign trail is anything to go by, the new administration could worsen the conflict by adopting a hard pro-Israel/anti-Iran stance, potentially fuelling renewed fears of supply and transport disruptions.

Food prices are starting to rise.

The outlook for food inflation remains relatively contained, but the deflationary impact on headline inflation will dissipate in the months ahead. On the positive side, meteorologists expect reasonable rainfall over the summer months as the grip of the drought-inducing El Niño weather pattern fades. Local food production is expected to remain broadly unchanged from last year. According to the latest estimates, this year's winter crop will be slightly higher than last year's, while the latest survey shows that farmers intend to increase summer crop production by around 1% over the upcoming season. Improved domestic operating conditions due to a stable electricity supply and further efficiency gains in logistics should also help contain input costs and operating expenses throughout the food supply chain.

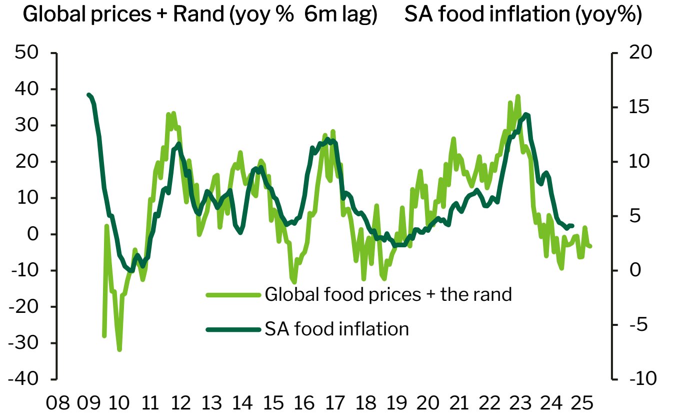
World food production is also expected to increase as planting conditions in the Southern Hemisphere improve. However, global food deflation has moderated noticeably in recent months. According to the United Nations measure, food prices started to increase in September, with only meat prices bucking the trend. On a year-on-year basis, global food prices rose by 5.5% in October after turning the corner in September, when prices rose by 2.6% following 21 months of deflation. Global food prices will likely rise further in the months ahead, but expectations of healthy food supply should help limit the upside throughout 2025. Improved domestic operating conditions due to stable electricity supply and further efficiency gains in logistics should also help contain input costs and operating expenses throughout the food supply chain. While the rand poses upside risks, it is unlikely to become a major source of cost pressures in the year's first half.

Chart 21: Global food prices are starting to edge higher.



Source: UN FAO

Chart 22: A stronger rand also subdued food prices



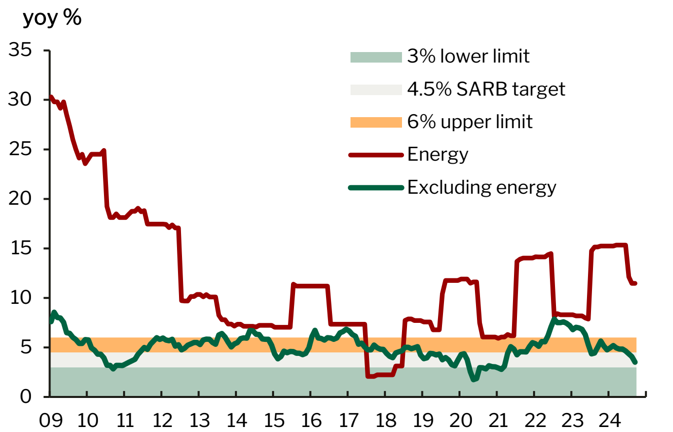
Source: UN FAO, LSEG, Stats SA and Nedbank calculatins

Altogether, we expect food prices to start drifting higher off a low base toward the end of this year and throughout next year. However, the impact on overall inflation will likely be relatively mild.

Electricity tariffs remain troublesome.

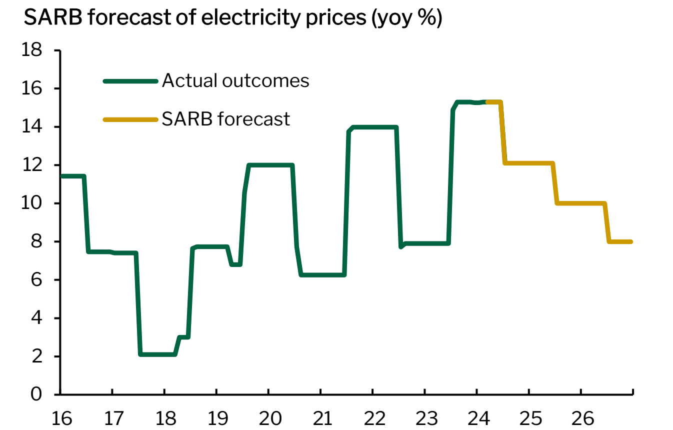
Although NERSA has rejected Eskom's 36% tariff increase proposal for the 2025/26 financial year, the final decision on Eskom's 6th multi-year price determination (MYPD6) will be taken on 20 December. We still expect Eskom to secure a double-digit tariff increase next year, which will keep input costs across the economy high, squeezing company margins and increasing the risk of pass-through to output prices. The continued surge in electricity tariffs will likely further accelerate the shift towards renewable energy sources. Even so, electricity tariffs continue to pose significant upside risks to the inflation outlook.

Chart 23: Electricity tariffs outpace headline consistently.



Source: Stats SA

Chart 24: The SARB's forecasts of electricity prices.

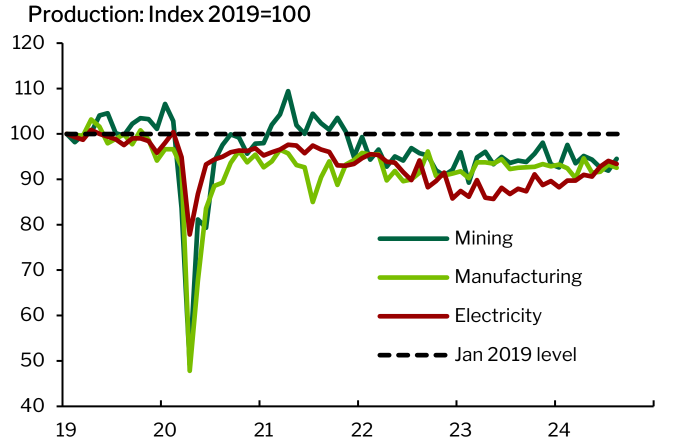


Source: SARB October 2024 MPR

The economic recovery is unlikely to lead to significant demand pressure on prices.

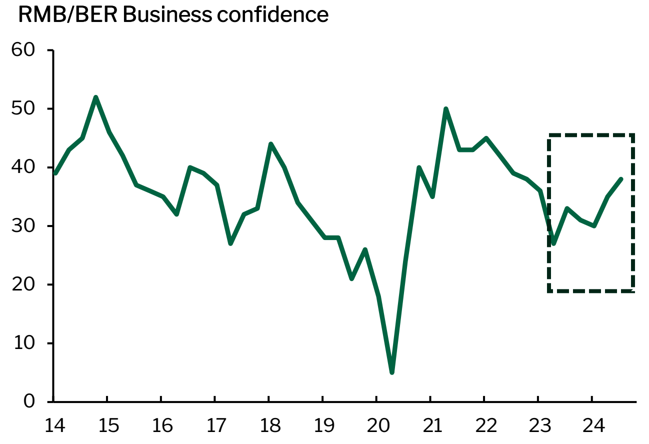
Recent indicators suggest the economic recovery continued in Q3. Operating conditions remained relatively steady, with no load-shedding and electricity supply up 2.9% over the quarter. Meanwhile, the country's largest ports fared a little better, with the most significant progress recorded in the processing of containers, while that of bulk minerals was little changed. In contrast, rail freight volumes relapsed, while water supply disruptions increased sharply in some large metros. Although progress has been slow with mixed results, the absence of load-shedding alone has been enough to lift the mood. Business confidence improved further in Q3 after turning the corner in Q2. The latest ABSA PMI reflects greater optimism among manufacturers, rising above the key 50 threshold that signifies expansionary conditions in September and October. Despite this, improved supply-side conditions have only led to marginally higher production. Mining production only returned to growth in August, expanding by a weak 0.3% yoy and off a very low base in 2023. Manufacturing output relapsed in August and September, capping the increase to a modest 0.2% over Q3.

Chart 25: Producers remain constrained.



Source: Stats SA

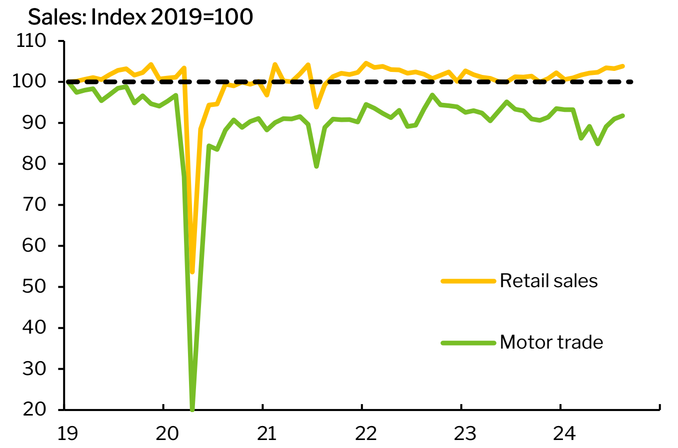
Chart 26: Business confidence has lifted noticeably.



Source: BER

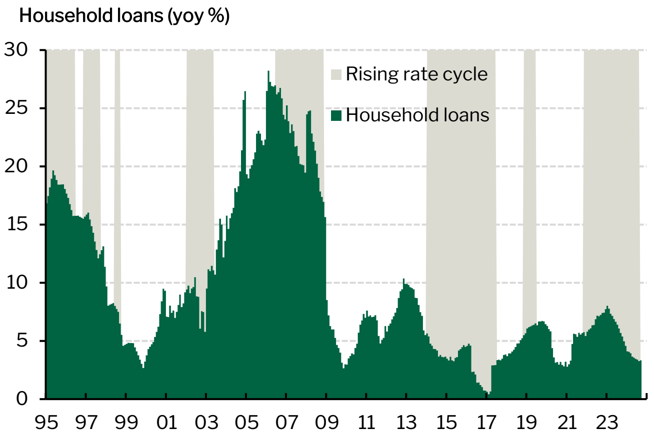
While the gains among producers have been marginal, services benefited from firmer consumer demand. Household finances likely improved further, supported by increased job creation, lower unemployment, the sharp deceleration in inflation and September's interest rate cut. Real retail sales grew by 1.7% yoy in July and a faster 3.2% in August. Used vehicle sales picked up pace over July and August, and new passenger vehicle sales rose for the 4th consecutive month in October. However, the upturn in consumer spending has not yet revived credit demand. The slowdown in household loans entered its 20th month in September, with growth unchanged at a weak 3.3% yoy. On the bright side, there were signs of life in vehicle finance and credit cards, which improved to 7.4% yoy and 9.9%, respectively.

Chart 27: Retail sales are gaining upward traction.



Source: Stas SA

Chart 28: Household credit demand remains subdued.



Source: SARB and Nedbank calculations

We still expect the recovery to gather pace in the year's final stretch, driven primarily by the cyclical upturn in consumer spending as real incomes recover, inflation falls further, and interest rates come down. Access to contractional savings through the two-pot retirement system, which came into effect in September, will provide an additional boost, with consumers likely to use these funds to repay debt, restore their financial health, and increase spending. In our view, the boost from higher consumer spending will be tempered by subdued government spending amid significant budget constraints, weak fixed investment, and a negative net export position as imports outpace exports. We still expect relatively subdued GDP growth of 1% over the whole year. After that, we look forward to a more significant acceleration, with GDP growth forecast to pick up pace to 1.6% in 2026, 1.7% in 2027 and 1.9% in 2028.

The revival in domestic demand should be partly facilitated by higher potential growth as structural constraints ease, which should help counter potential cost and price pressures. We still do not see significant demand pressure on prices over the next three years.

Our inflation and interest rate forecasts

The downward trend in inflation is expected to intensify and broaden in October, amplified by another sharp drop in local fuel prices caused by the virtuous combination of falling global oil prices and a stronger rand. We expect headline and core inflation to fall to about 3.3% and 4%, respectively. Thereafter, our forecasts suggest that inflation will hover around and below 4% level for an extended period before drifting up off a low base to about 4.7% by the end of 2025. We expect inflation to average 4.6% in 2024, 4.3% in 2025, and 4.4% in 2026. Overall, inflation is forecast to remain anchored around the SARB's target over the next three years, contained by continued global disinflation, relatively subdued commodity prices and measured domestic demand.

We assess the risks to our forecasts for the rest of this year to be relatively balanced before shifting to the upside in 2025 and 2026. The rand remains the main worry given its sensitivity to shifts in global risk appetites, which will likely remain volatile until the extent of the changes in US economic policies and foreign relations and its implications for the world economy are clear. Any resurge in US inflation, renewed setbacks in China, or signs of a hard landing for the world economy could trigger another bout of risk-off sentiment, potentially triggering a new wave of rand weakness. Another concern is that the prolonged deflationary trend in global food prices appears to be over. Still, relatively healthy world production and stockpiles should help limit the upside in the months ahead.

Other developments were more encouraging. Global disinflation continued, albeit slowly and with pockets of persistence, notably in services. International oil prices declined significantly as supply and demand dynamics reasserted themselves once fears of an escalation in the conflict between Israel and Iran subsided. The US and other major central banks pressed ahead with further monetary policy easing. Moreover, the pivot towards more accommodative policy across the globe is expected to continue, although the rate-cutting cycle will likely be shallower than initially anticipated. Finally, the domestic economy is slowly recovering. However, improving supply-side conditions are accommodating the cyclical uptick in domestic demand, keeping price pressures in check. There was also good news on electricity prices as NERSA introduced meaningful regulatory reforms and rejected Eskom's hefty tariff proposal for the upcoming financial year.

Viewed together, inflation's rapid slide to below the SARB's 4.5% target and its likely trajectory over the next year supports further monetary policy easing. As a result, we expect another 25-bps cut next week, followed by a further 75-bps reduction in 2025.

GROUP ECONOMIC UNIT

Nicky Weimar	+27 10 234 8357	nickywe@nedbank.co.za
Johannes (Matimba) Khosa	+27 10 234 8359	johanneskh@nedbank.co.za
Isaac Matshego	+27 10 234 8358	isaacmat@nedbank.co.za