BIZCOMMUNITY

Sarb has no choice but to raise rates - experts

By Carin Smith

21 Jan 2016

Nedbank's economic unit has said that in an environment with a rapidly deteriorating inflation outlook, the South African Reserve Bank (Sarb) would have no choice but to raise rates to contain inflationary expectations and restore financial stability.

©macgyverhh via 123RF

This was in reaction to the announcement by Statistics SA that South Africa's annual consumer price inflation rose to 5.2% in December 2015. This was in line with expectations and 4 percentage points higher than November's 4.8% rise. It was the highest rate for the year as consumers battle with increased food and fuel prices and interest rate hikes.

Rising inflation

Nedbank expects inflation to lift markedly in 2016 as food prices increase in response to the drought and as the weak rand puts upward pressure on the prices of all imported goods, including grains. In the bank's view, inflation will be above Sarb's 6% upper target range for most of 2016. "We believe the Sarb will increase the repo rate by 50 basis points at its meeting later this month and then hike by the usual 25 basis points in the following three consecutive meetings," said Nedbank.

Investec is of the opinion that a petrol price hike of 10 cents per litre is currently building up for February as rand weakness cancels out the effect of low oil prices. "Globally, as the oil price falls on the back of oversupply and weak demand, metals prices have moderated too and commodity currencies (which include the rand) weakened substantially," said Investec in reaction to the CPI data. "The rand has also weakened on portfolio outflows, along with other emerging market currencies and expected higher interest rates in SA."

It pointed out that mild price pressure on the month came from food and non-alcoholic beverages, particularly fruit, vegetables and meat, as the drought has a devastating effect and farmers have not had relief. "Food prices are low globally, but rand weakness and expected domestic supply shortages have elevated domestic maize prices. However, the pass through from the rand's weakness to retailers (and CPI inflation) has been moderate due to domestic demand essentially stalling last year," said Investec.

CPI inflation averaged 4.6% y/y in 2015 and will likely average 5.8% y/y in 2016 in Investec's view and it warned that SA continues to risk recession this year, as do other commodity exporting countries who in the main have cut interest rates, unlike SA which is hiking.

Expert opinion

"The Sarb looks set to embark on an aggressive rate hike cycle by moving in January by 25 to 50bp after having hiked in November 2015. Such consecutive meeting (steep) rate hikes would belie previous assurances that the rate hike cycle would be gradual, and would ignore the collapse in the economic growth outlook and suppressing impact that simultaneous fiscal tightening and higher interest rates have," said Investec.

Brett Birkenstock of Overberg Asset Management said with the recent fall of the rand, inflation will rise even with the drop in the oil price. "We should expect further interest rate increases to curb inflation and to try and protect the rand. We have seen this is expected in the drop in Reits (Real-estate Investment Trusts) and bonds in the market already, said Birkenstock.

Kirk Swart, also of Overberg Asset Management, said with the exchange rate weakening our exports will be more expensive which will push inflation higher. In his view Sarb has done well to guide the market regarding inflation expectations.

Sanisha Packirisamy, economist of MMI, said inflation risks are firmly tilted to the upside. In her view ongoing currency weakness (and volatility), prolonged drought conditions leading to higher food inflation and an anticipated steep rise in electricity tariffs are likely to drive a further acceleration in inflation from the 4.6% y/y average print in 2015 to an estimated average rate of 6.4% this year, potentially peaking above 7% in the fourth quarter of 2016.

"We expect inflationary pressures to persist in 2017, estimating a 6.3% y/y rise on average," she said. "Moreover the inflation expectations of the price-makers in the economy, namely businesses and trade unions, have deteriorated sharply over the past year."

According to the inflation survey results from the Bureau of Economic Research, SA firms are expecting headline inflation to average 6.5% y/y over the next five-year period, while trade unions see inflation averaging 6.2% y/y over the same time period. These expectations have increased from 6.1% and 6.0% y/y, respectively, a year ago.

Fin24 via News24 Wire