

As expected, repo rate hiked by 50 bps to 10%

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The South African Reserve Bank's Monetary Policy Committee (MPC) raised the repo rate for the second consecutive meeting. The inflation outlook remains unfavourable, causing the MPC to **hike the repo rate by 50 basis points to 10%** - its highest level since September 2003. Major commercial banks are expected to adjust the prime overdraft rate to 13,5% from 13% previously.

The MPC remains concerned about food prices, while above-inflation wage settlements are also inflationary. According to Andrew Levy Employment Publications, the average level of wage settlements measured 6,5% in 2006. In the first half of 2007, wage settlements have averaged 6,8%, but 'a growing number of recent settlements have been closer to 8 per cent'. Furthermore, the SARB continues to see little evidence of household demand slowing although there is some moderation in the broader economy. The MPC says that oil prices, despite its recent weakening, are still considered an upside risk. Growth in credit extension also remains high and it was premature to assess the impact of the National Credit Act on credit extension.

However, there are some uncertainties in the global environment with the global economy facing some downside risk. It states that the international environment has become increasingly volatile and uncertain. Nevertheless, there appear to be no evidence that the recent turmoil in the international financial markets will have marked effects on the domestic economic outlook, although, according to the statement, this will depend on the extent of the impact of these developments on the US growth performance.

The SARB's most recent central forecast showed a slight deterioration in the inflationary outlook from the previous estimate, with CPIX inflation now expected to remain above the upper limit of the target inflation range. CPIX is expected to average above the upper limit of the target band until the second quarter of 2008. Thereafter it is anticipated to decline to around 5,1% at the end of 2009. One of the reasons for the deterioration in the outlook is 'a revised assumption on international oil prices'.

Comment

The deterioration in the inflation outlook from the SARB is not unexpected as it is more in line with ABSA GER's forecast. Nonetheless, in the statement, the MPC makes it clear that the focus of the SARB remains to ensure a return of the inflation target rate to within the target range. We expect food price pressures to continue over the next few months and into 2008, while oil has substantial upside risk, as was highlighted by the MPC. The recent weaker rand may recover somewhat unless uncertainty towards emerging markets continue, in which case the rand will come under further pressure. The weaker rand will threaten inflation and put upside to risk interest rates. **While we do not expect another rate hike during the rest of 2007**, there is a possibility that if global conditions deteriorate and the rand fall further, that interest rates could be hiked again.