South African Reserve Bank

PRESS STATEMENT
23 May 2019

STATEMENT OF THE MONETARY POLICY COMMITTEE
Issued by Lesetja Kganyago, Governor of the South African Reserve Bank

Over the past few months, global growth has rebounded somewhat, but significant downside risks remain, in particular from threats to the global trade regime. Domestically, electricity supply constraints and a protracted strike in a major gold mine contributed to a weak first quarter performance. Business and consumer confidence continue to weigh on the near-term growth forecast. Recent monthly inflation outcomes have remained around the mid-point of the inflation target range, in part due to weak demand and positive inflation data surprises. The medium-term inflation outlook has moderated slightly.

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas was 4.4% in April (down from 4.5% in March). Goods price inflation was 4.2% (up from 4.1% in March), while services price inflation was 4.6% (down from 4.9% in March). The Bank’s measure of core inflation, which excludes food, fuel and electricity, was 4.1% in April (down from 4.4% in March). Producer price inflation for final manufactured goods increased to 6.2% in March (from 4.7% in February).

The inflation forecast generated by the SARB’s Quarterly Projection Model (QPM) has improved since the previous MPC. Headline inflation is expected to average 4.5% in 2019 (down from 4.8%), increasing to 5.1% in 2020 (down from 5.3%) and moderating to 4.6% in 2021 (down from 4.7%). Headline CPI inflation is expected to peak at 5.5% in the first quarter of 2020 and settle at 4.5% in the last two quarters of 2021.

The main drivers of the forecast are a lower starting point for food and services inflation, and the revised oil price assumptions. Food price inflation is now expected to average 3.7% in 2019 (down from 4.1%). The assumptions for Brent crude oil in the QPM were revised up from US$64 to US$69.50 for 2019. The assumptions for 2020 and 2021 were also revised up from US$65 to US$68.

Moderation in rental prices, unit labour costs and inflation expectations also contribute to lower core inflation over the medium term. The forecast for core inflation is lower at 4.5% in 2019 (down from 4.8%), 4.8% in 2020 (down from 4.9%) and 4.5% in 2021.

Average inflation expectations have been declining slowly since the end of 2017. The inflation expectations of market analysts in the May 2019 Reuters Econometer survey were unchanged at 4.7% for 2019 while expectations edged down to 5.2% for 2020 (from 5.3%) and 5.0% for 2021 (from 5.1%). Market-based expectations implicit in the break-even inflation rates (i.e. the yield differential between conventional and inflation-linked government bonds) remain sensitive to exchange rate movements. Since our last meeting, five-year break-even rates increased to 5.1% and ten-year break-even rates were unchanged at 5.8%. The next BER[1] inflation expectations survey will be published in July.

Global GDP is expected to average 3.3% in 2019 and stabilise around 3.5% from 2020. While global economic activity remains moderate overall, growth momentum has slowed somewhat and there are many risks. Trade tensions have escalated

[1] Bureau for Economic Research

between the United States and China, weighing on market confidence. Further tariff increases could disrupt global value chains and further reduce global trade. The IMF April 2019 World Economic Outlook estimates that tariff increases could subtract as much as 0.8 percentage points from global growth. Much uncertainty remains around Brexit, alongside other geo-political developments. In some countries, there also remain significant financial vulnerabilities associated with elevated private and public debt.

Inflation in most advanced economies remains below targeted levels, allowing major central banks space to put monetary policy normalisation on hold. However, the risk of a renewed tightening of financial conditions should not be underestimated.

The performance of emerging market currencies was mixed, reflecting a combination of changes in investor sentiment, easier monetary conditions in major economies and country specific factors. Currencies of countries with stronger macroeconomic fundamentals remain better placed to benefit from these developments. The rand has benefited from improved sentiment towards riskier assets but will continue to be affected by idiosyncratic factors such as domestic growth prospects and policy settings.

Since the March MPC, the rand has appreciated by 1.5% against the US dollar, by 2.5% against the euro, and by 3.1% on a trade-weighted basis. The implied starting point for the rand is R14.40 against the US dollar, compared with R14.00 at the time of the previous meeting. At these levels, the QPM assesses the rand to be slightly undervalued.

Based on recent short term indicators and negative growth in mining and manufacturing, GDP is expected to contract in the first quarter of 2019. The disappointing data outcomes partly reflect supply side constraints due to load shedding and a strike at a major gold mine. Fixed capital formation and household consumption expenditure also remain weak.

The Absa Purchasing Managers' Index has recovered to 47.2 index points, remaining below the neutral level. The SARB's composite leading business cycle indicator has trended lower since March 2018 and decreased further by 0.4% in March 2019.

The SARB now expects GDP growth for 2019 to average 1.0% (down from 1.3% in March). The forecast for 2020 and 2021 is unchanged at 1.8% and 2.0% respectively. The near term growth outlook is limited by the larger than expected slowdown in the first quarter, weak business and consumer confidence as well as growing pressure on household disposable income. Real fixed investment is now forecast to contract by 0.3% in 2019, while household consumption expenditure will rise by a modest 1.0%.

The MPC assesses the risks to the growth forecast to be on the downside. Weak business confidence, possible electricity supply constraints and high debt levels in certain state-owned enterprises will continue to limit investment prospects. The escalation of trade tensions could significantly impact global trade with likely negative impacts for South Africa as a small open economy. The Committee remains of the view that current challenges facing the economy are primarily structural in nature and cannot be resolved by monetary policy alone. It is now even more urgent to have a combination of prudent macroeconomic policies and structural reforms that raise potential growth and lower the cost structure of the economy.

The MPC welcomes the continued downward trend in recent inflation outcomes and the moderation in inflation expectations. These are positive developments, as the

Committee would like to see inflation remain close to the mid-point of the inflation target range on a more sustained basis.

The overall risks to the inflation outlook are assessed to be more or less evenly balanced. While there is scope for further moderation in meat and services prices, oil prices are expected to remain elevated and global food prices appear to have bottomed out. Electricity and water prices, among other administered prices, present additional upside risks.

Against this backdrop, the MPC decided to keep the repurchase rate unchanged at 6.75% per year. Three members preferred to keep rates on hold and two members preferred a cut of 25 basis points. The Committee assesses the stance of monetary policy to be broadly accommodative over the forecast period. Any future policy adjustments will continue to be data dependent.

The implied path of policy rates generated by the Quarterly Projection Model is for one cut of 25 basis points to the repo rate by the end of first quarter of 2020. The endogenous interest rate path is built into the growth and inflation forecast. As emphasized previously, the implied path remains a broad policy guide which could change in either direction from meeting to meeting in response to new developments and changing risks.

Lesetja Kganyago
GOVERNOR

The next statement of the Monetary Policy Committee will be released on 18 July 2019.

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