South African Reserve Bank

2022 Monetary Policy Committee Schools' Challenge

Key economic outlook

SOUTH AFRICAN RESERVE BANK

Outline

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  - *Tools*

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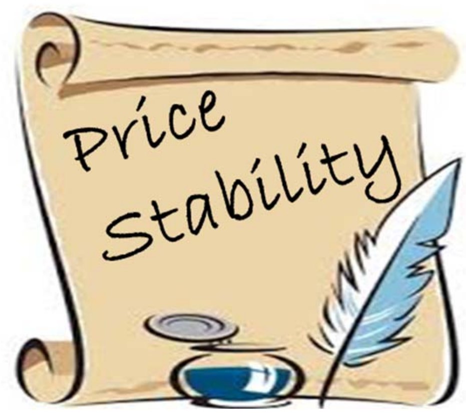
  - *Interest rate decision*

- **Data**



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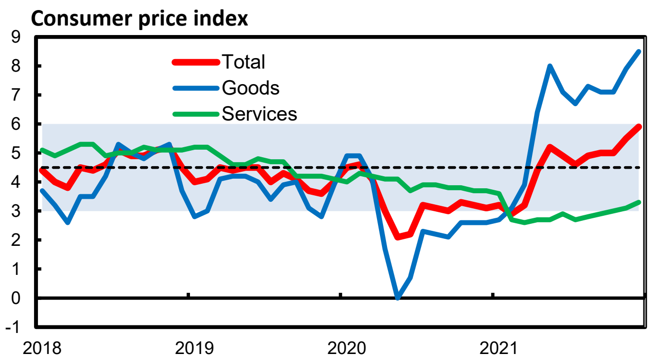
The constitutional mandate of the SARB

The primary mandate of the SARB is ***price stability***.

The SARB has ***instrument independence*** in monetary policy implementation but ***not goal independence*** in the selection of a monetary policy goal.

THE SARB's
PRIMARY MANDATE

"To protect the value of the currency in the interest of balanced and sustainable economic growth."



--- Midpoint of the inflation target range (4.5%)

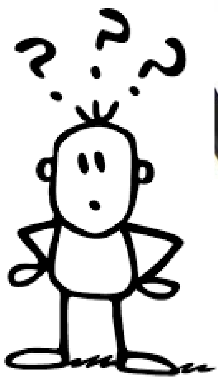
Source: Stats SA

Role of a Central Bank Economist

Price stability is achieved when:

- Changes in price levels do not materially affect the economic decision-making processes.
- South Africa: when the inflation rate is between the 3% and 6% target range.

Tools: How to achieve price stability



When would you increase or decrease the repo rate?

Why are central bankers so ‘obsessed’ with inflation?

Price stability:
- Reduces uncertainty in the economy.
- Provides a favourable environment for growth and employment creation.
- Protects the purchasing power of all South Africans.

South African Reserve Bank

And now the statement….

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The MPC statement

1 The MPC statement provides the public with a summary of the economic information that guided the MPC to get to its interest rate decision.

2 It is important to provide this statement and the announcement for transparency purposes as well as to contain inflation expectations.

Statement template

Key economic information

Inflation outlook

Interest rate decision

Key economic outlook

- Present your view of **current economic** activity and **expectations** of its future developments.

- Is the economy over-heating, i.e. is demand growing much faster than supply?
  - Demand side: look at expenditure, incomes, retail sales and demand-pull inflation.
  - Supply side: look at production output, manufacturing, mining, etc.

- Also consider factors that affect a firm’s input costs: fuel prices, electricity, wages, etc.

- **Forward-looking** indicators available include the SARB’s composite leading business cycle indicator, which gives an indication of where the economy will be in about 6 months time.

Key economic outlook

- Other forward-looking information (such as business and consumer confidence) come from opinion surveys.
- Because of limited space be sure to focus your argument on providing an overview of the most relevant indicators.
- Gauge whether any of the economy's sectors are growing particularly strong or weak. How will this impact on the other sectors in the economy?
- It takes time for monetary policy to have an effect on the economy, so your analysis should focus on where you believe the economy will be in 12 to 24 months.
- Remember that although some of these indicators may be increasing, it does not necessarily mean that demand is much more than supply.
- You may supplement data provided with other indicators.

Data provided for the analysis

- *Unit labour cost*
- *GDP for OECD* countries*
- *Manufacturing production*
- *Exchange rate*
- *Purchasing Managers' Index*
- *Composite business cycle indicators*

Economic outlook?
Inflation outlook?

- *Unemployment rate*
- *Consumer Confidence Index*
- *Petrol prices*
- *Employment*
- *Real retail sales*

*Organisation for Economic Co-operation and Development

Data provided for the analysis

GDP = C + I +G +(X-M)

- GDP (gross domestic product) measures the amount of goods and services produced in the economy.

- The **expenditure** in the economy is measured by:
  - Final household consumption expenditure (C)
  - Gross capital formation (I)
  - Final government consumption expenditure (G)
  - The difference between exports and imports (X-M)

Data provided for the analysis

Short-term indicators:

- **Manufacturing production** and **PMI** (Purchasing Managers' index). PMI provides expectations of manufacturing production in the future and leads to actual manufacturing output.
- Real **retail sales** and **CCI** (Consumer Confidence Index). CCI provides expectations of demand for goods in the future and leads to actual retail sales.
- **Unit labour cost** is a measure of the cost of producing a unit of output. Unit labour cost measures cost pressures in an economy that are related to wage cost for businesses.
- A rising **unemployment rate** could indicate weak demand or structural problems in an economy.

Data provided for the analysis

International indicators

- GDP for OECD* countries
- CPI for OECD countries
- Consider global developments and how it will impact on the demand and supply of goods and services as well as prices in South Africa.

Exchange rate

- How will the volume of imports and exports change as the value of the rand changes?
- What will the effect be on domestic prices, especially prices of imported goods?

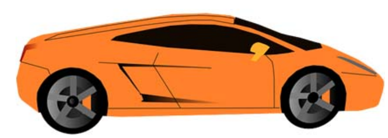
*Organisation for Economic Co-operation and Development

Data provided for the analysis

Consumer prices (inflation)

- Total consumer price index (CPI)
- Food and non-alcoholic beverages – demand and imported food

- Electricity and other fuels (cost-push)
- Petrol (cost-push)



- Core CPI (Total - Food - Electricity - Petrol) – demand-pull

You need to distinguish between cost-push and demand-pull inflation and the variables that monetary policy can have an impact on

Data provided for the analysis

Interest rates:

- The **prime** interest rate is the rate at which commercial banks lend money to the public.

- The **repurchase** (repo) rate is the rate at which commercial banks borrow money from the SARB. Through setting the repo rate, the MPC influences the price of money in the economy.

Interest rate example

- If you have a mortgage bond, and the repo rate increases, you will need to pay more money for your house which will make less money available for you to spend on other things (reducing aggregate demand in the economy).

- If the repo rate decreases, you will need to pay less money for your house, which will make more money available for you to spend on other things (stimulating aggregate demand in the economy).

Statement template

Key economic outlook → Inflation outlook → Interest rate decision

Inflation outlook

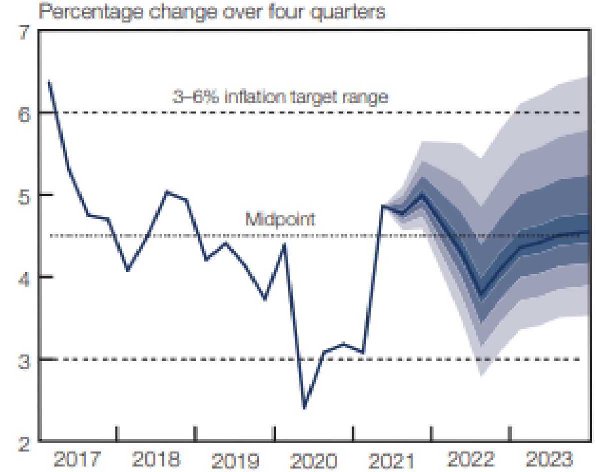
All things being equal:

- The MPC should **increase the repo** rate if there are substantial **upward risks** to inflation.

- The MPC should **decrease the repo** rate if there are substantial **downward risks** to inflation.

Targeted inflation forecast*

Percentage change over four quarters



* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.

Sources: Stats SA and SARB

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Inflation outlook

- The aim of monetary policy in South Africa is to keep the inflation rate within the 3–6% target range.
- You should sum up your statement by linking your view of the economy back to how you expect inflation to change over the next 12 to 24 months.
- Explain how this makes your monetary policy decision on the repo rate appropriate.

Interest rates decision

Key economic outlook → Inflation outlook → Interest rate decision

Interest rate decision

- Present your **decision** on the repo rate at the **end** of your statement as a conclusion to the arguments presented in the body of your statement.

Interest rate decision

- While the Committee expects inflation to stay close to the mid-point over the forecast period, inflation risks have increased and the level of policy accommodation remains high.
- Against this backdrop, the MPC decided to increase the repurchase rate by 25 basis points to 3.75% per year, with effect from the 19th of November 2021. Three members of the Committee preferred an increase and two members preferred an unchanged stance.

Extract from November 2021 MPC statement

Interest rate decision

- In the near term, headline inflation has increased well above the mid-point of the inflation target band and returns close to the mid-point in the fourth quarter of 2022. Some risks to the inflation outlook, like food and fuel, have been realised, and other risks, such as currency volatility and capital flow reversals, have become more pronounced.
- Against this backdrop, the MPC decided to increase the repurchase rate by 25 basis points to 4% per year, with effect from the 28th of January 2022. Four members of the Committee preferred an increase and one member preferred an unchanged stance.

Extract from January 2022 MPC statement

THANK YOU

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