



South African Reserve Bank

2023 Monetary Policy Committee Schools Challenge

Key economic outlook



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Outline

- **Primary purpose of the SARB**
 - *Mandate*
 - *Tools*
- **Statement and statement template**
 - *Key economic outlook*
 - *Inflation risks*
 - *Interest rate decision*
- **Data**



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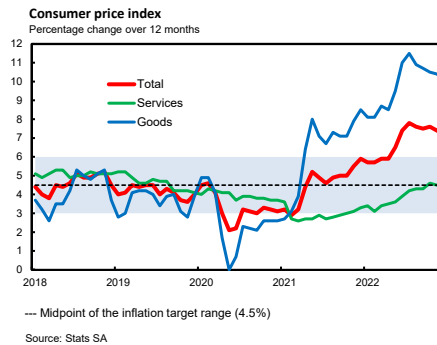
The constitutional mandate of the SARB

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



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Role of a central bank economist



Price stability

Price stability is achieved when:

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



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Tools: How to achieve price stability



- When would you increase or decrease the repo rate?
- What should drive the decision to increase or decrease rates and how do these interest rate decisions ultimately affect consumers?

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Why are central bankers so 'obsessed' with inflation?



Price stability:

- reduces uncertainty in the economy;
- provides a favourable environment for growth and employment creation; and
- protects the purchasing power of all South Africans.



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And now the statement ...



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The MPC statement



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

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



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Statement template



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 six months' time.



Key economic outlook

- Other forward-looking information (i.e. business and consumer confidence) comes 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' time.
- 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.



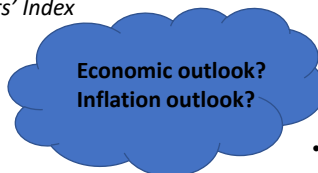
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Data provided for the analysis

- *Unit labour cost*
- *GDP for OECD* countries*
- *Manufacturing production*
- *Exchange rate*
- *Purchasing Managers' Index*
- *Composite business cycle indicators*
- *Unemployment rate*
- *Consumer confidence index*
- *Petrol prices*
- *Employment*
- *Real retail sales*



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Data provided for the analysis

$$\text{GDP} = C + I + G + (X - M)$$

- 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)



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Data provided for the analysis

Short-term indicators:

- **Manufacturing production** and **Purchasing Managers' Index (PMI)**.
PMI provides expectations of manufacturing production in the future and leads to actual manufacturing output.
- Real **retail sales** and the **consumer confidence index (CCI)**.
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.



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Data provided for the analysis



International indicators

- GDP for OECD* countries
- CPI for OECD countries
- Consider global developments and how they 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?

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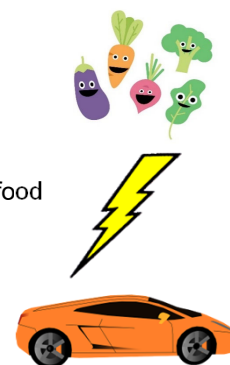
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Data provided for the analysis

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



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



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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.



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Interest rate example

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



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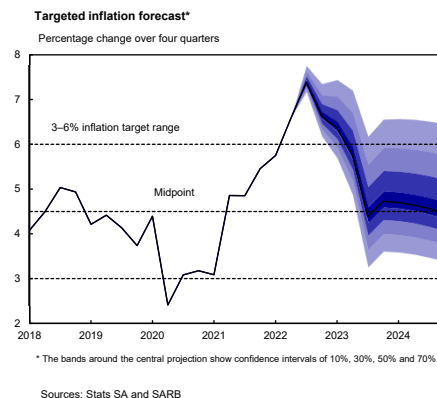
Statement template



Inflation outlook

All things being equal, the MPC should:

- **increase the repo rate** if there are substantial **upward risks** to inflation;
- **decrease the repo rate** if there are substantial **downward risks** to inflation; and
- understand the driving factors behind the inflationary environment and, in turn, the interest rate hikes/cuts.



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 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.



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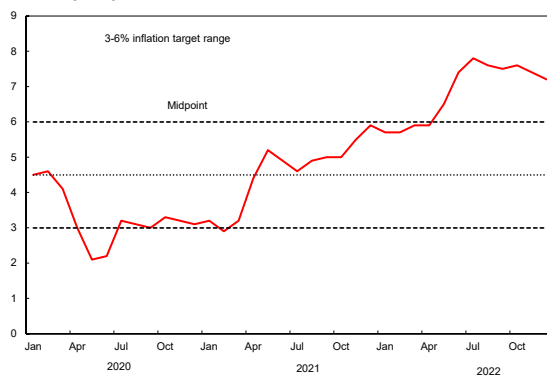
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Inflation and the repo rate

Headline inflation

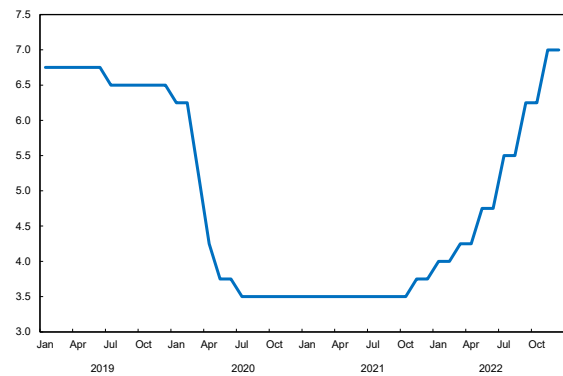
Percentage change over 12 months



Sources: Stats SA and SARB

Repo rate

Per cent



Source: SARB



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Interest rate decision



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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.

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Interest rate decision

Extract from the November 2022 MPC statement

- After revisions, the risks to the medium-term domestic growth outlook are assessed to the downside. Risks to the inflation outlook are assessed to the upside. Despite easing of global producer price and food inflation, Russia's war in the Ukraine continues, with adverse effects on global prices generally. The oil market is expected to remain tight, with upside risk to prices. Electricity and other administered prices continue to present clear medium-term risks. Given low public sector wage assumptions, and high petrol and food price inflation, considerable risk still attaches to the forecast for average salaries.
- Against this backdrop, the MPC decided to increase the repurchase rate by 75 basis points to 7% per year, with effect from the 25th of November 2022. Three members of the Committee preferred the announced increase. Two members preferred a 50 basis points increase.



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THANK YOU



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