

South African Reserve Bank

2023 Monetary Policy Committee Schools Challenge

Economic lecture



SOUTH AFRICAN RESERVE BANK

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3. Factors influencing economic growth and inflation
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5. Inflation
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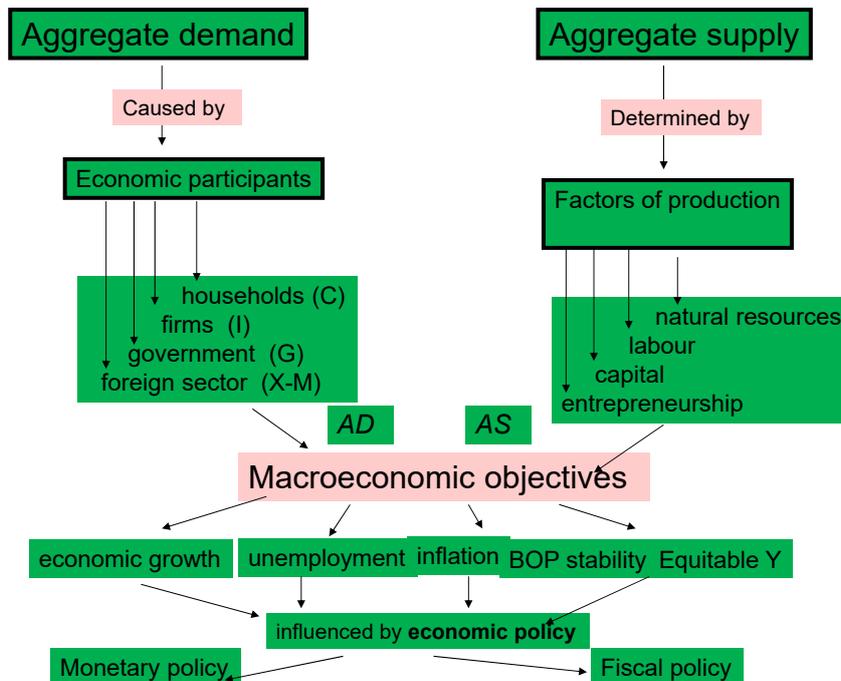
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Introduction: What the competition requires

- An understanding of **economics**
- An understanding of **monetary policy and inflation** in South Africa
- The ability to clearly **articulate thoughts and ideas** (in an essay with tables/graphs, etc.)
- The ability to present
- **READ, READ, READ!**
- **TALK, TALK, TALK!**
- **SPEAK, SPEAK, SPEAK!**

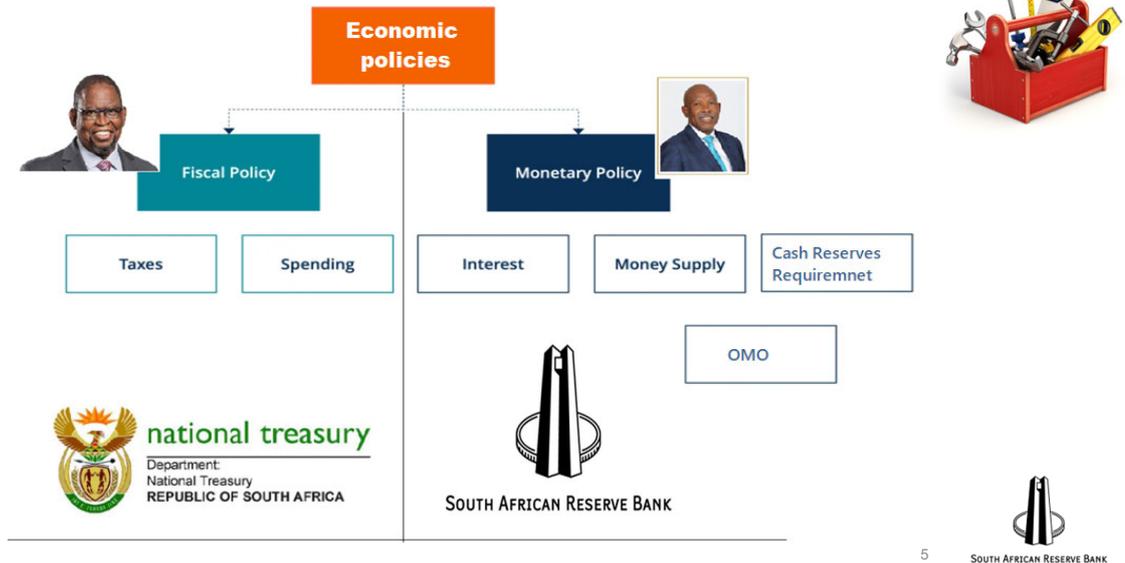


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Fiscal and monetary policy tools



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The SARB's mandate



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The SARB's mandate

The Constitution of the Republic of South Africa prescribes the objective of the Bank as the **protection of the value of the currency** in the interest of balanced and sustainable economic growth and development.



The primary mandate of the SARB is to achieve and maintain price stability in the interest of balanced and sustainable economic growth.

The SARB has a complementary mandate to oversee and **maintain financial stability**.

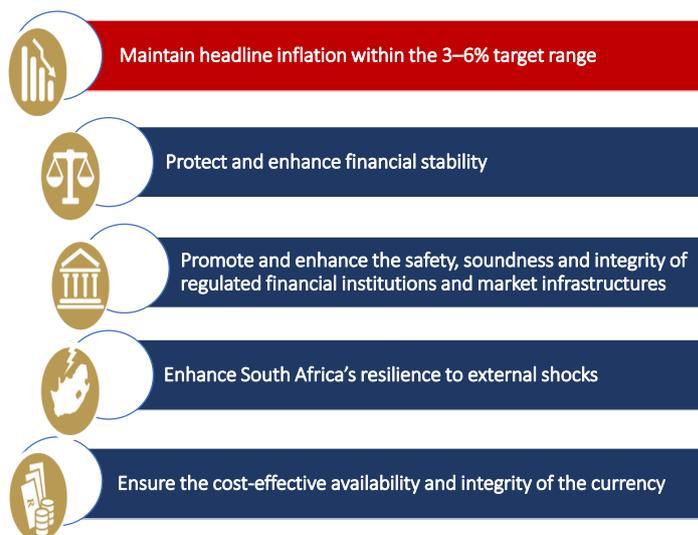


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How does the SARB aim to achieve its mandate?



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Factors influencing economic growth and inflation

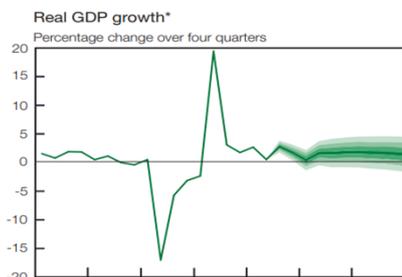


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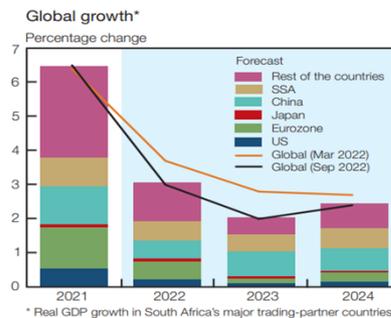
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Global and domestic economic growth: macroeconomic risks

- South Africa's GDP growth is expected to slow down in 2023, in line with slower growth in its major trading partners.
- Factors that are likely to influence economic activity in 2023:
 - Ongoing war between Russia and Ukraine; commodity prices (energy, precious metals); supply chain pressures
 - Load-shedding; the condition of rail and ports infrastructure



* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.
This chart shows seasonally adjusted data, as used in the QPM.
Sources: Stats SA and SARB



* Real GDP growth in South Africa's major trading-partner countries
Source: SARB

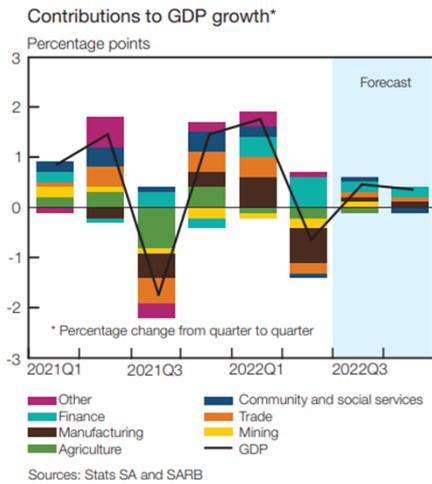


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Sectoral analysis of economic growth

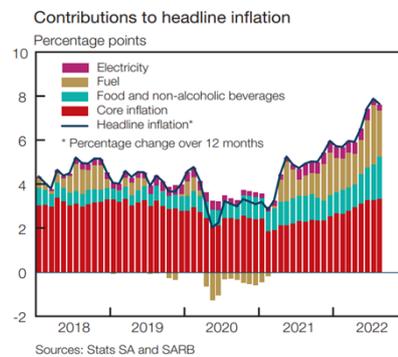
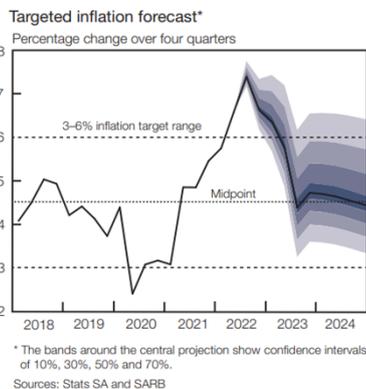


1. Which sectors have contributed the most or detracted the most from GDP growth?
2. How does this affect inflation risks?

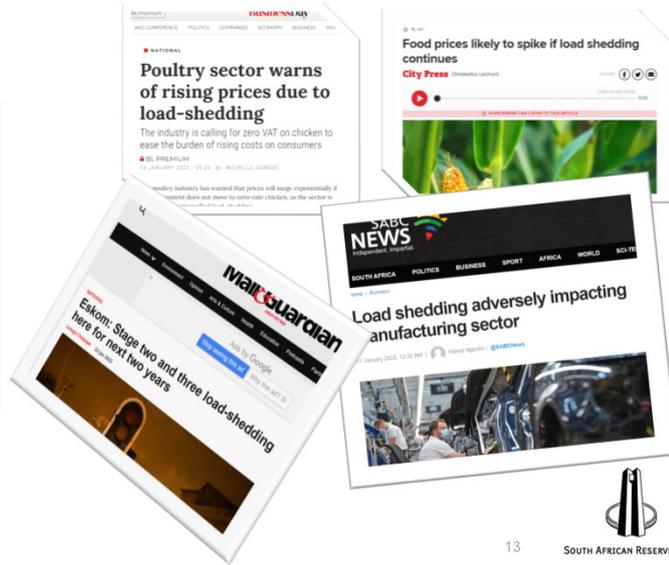
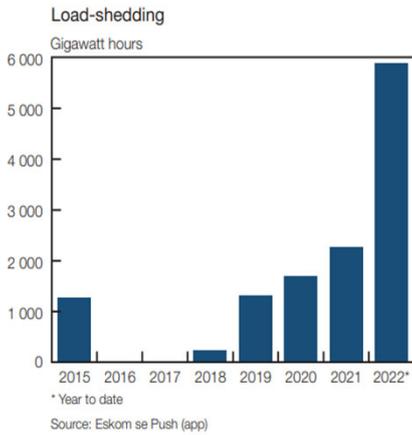


Inflation outlook

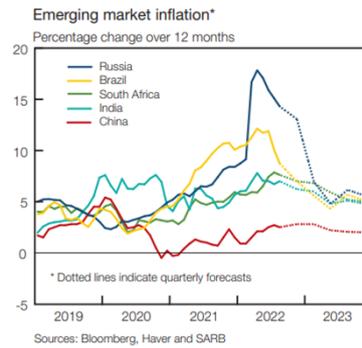
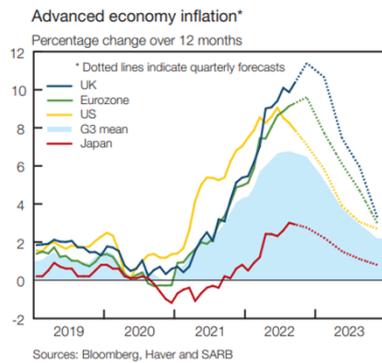
- Inflation remained above the upper limit of the inflation target range for most of 2022, mainly due to higher fuel and food prices.
- Possible drivers of inflation risks in 2023 include food prices, fuel prices, load-shedding, oil prices, commodities and global economic growth.



What is the impact of load-shedding on inflation and economic activity?



Inflation trends in advanced and emerging markets



Key economic indicators



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Contributors Demand factors

$$Y = C + I + G + (X-M)$$

Real gross domestic expenditure

Quarter-to-quarter percentage change at seasonally adjusted but not annualised rates

Component	2021					2022		
	Q1	Q2	Q3	Q4	Year ¹	Q1	Q2	Q3
Final consumption expenditure								
Households.....	0.5	1.6	-2.8	3.0	5.6	1.2	0.6	-0.3
General government.....	-0.6	0.4	0.5	0.2	0.6	1.1	-0.8	0.5
Gross fixed capital formation.....	-3.1	-0.3	-1.1	1.6	0.2	3.4	0.4	0.3
Domestic final demand².....	-0.2	1.1	-1.9	2.2	3.8	1.5	0.3	-0.1
<i>Change in inventories (R billions)³.....</i>	<i>-21.8</i>	<i>-41.6</i>	<i>6.0</i>	<i>-25.0</i>	<i>-20.6</i>	<i>4.8</i>	<i>31.4</i>	<i>62.9</i>
<i>Residual⁴.....</i>	<i>0.3</i>	<i>0.3</i>	<i>0.3</i>	<i>0.2</i>	<i>0.3</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>
Gross domestic expenditure⁵.....	2.1	0.7	-0.8	1.4	4.8	2.1	0.8	0.6

- 1 Percentage change over one year
- 2 Comprises final consumption expenditure by households and general government as well as gross fixed capital formation
- 3 At constant 2015 prices. Seasonally adjusted and annualised
- 4 The residual as a percentage of GDP
- 5 Including the residual

Sources: Stats SA and SARB



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Contributors

Supply factors

- Electricity and water inflation:
 - moderated due to delayed implementation of the annual price increases in response to the COVID-19 pandemic
- Agriculture prices increased
- Exchange rate: possible pass-through to consumer prices
 - Prices of imported products such as petrol
 - Input costs



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Inflation



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Is inflation a good or a bad thing?

What happens if inflation is too **HIGH**?



What happens if inflation is too **LOW**?

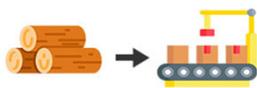


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Cost-push and demand-pull inflation



Cost-push inflation:

A sustained increase in price levels due to increased costs of production. The main sources of cost-push inflation are:

- salary and wage increases;
- higher costs of imported input goods;
- inflation expectations;
- increases in profit margins.



Demand-pull inflation:

When aggregate demand exceeds the aggregate supply of goods and services, resulting in a sustained increase in price levels. The main sources of demand-pull inflation are:

- higher household expenditure;
- increased government expenditure;
- inflation expectations;
- Increased export demand.



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What is the purpose of monetary policy?

- The main goal is *price stability*
- Responsibility rests with the central bank (SARB)
- South Africa adopted **inflation targeting** in February 2000 = where the SARB announces an **inflation target** and implements monetary policy to achieve this target directly



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SFA 1

HEADLINE INFLATION =
CORE INFLATION PLUS
prices of food and
energy which change all
the time!



Maintain **headline
inflation** within the
target range

CORE INFLATION only
includes prices that do
not change frequently
(e.g. rent, labour)



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Price stability – keep inflation between 3–6%

Figure 1: Consumer price index
Percentage change over 12 months

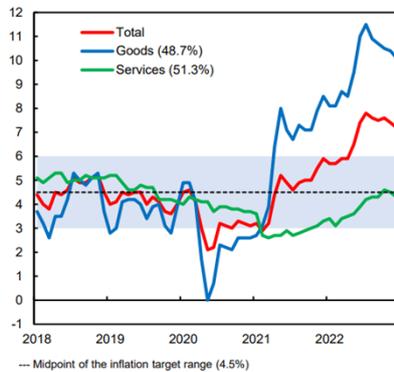
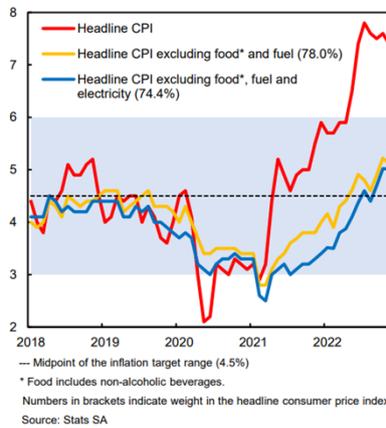


Figure 2: Underlying measures of headline CPI
Percentage change over 12 months



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Weight of the different COICOP categories (100%)

- Food and non-alcoholic beverages (17.14%)
- Alcoholic beverages and tobacco (6.26%)
- Clothing and footwear (3.65%)
- Housing and utilities (24.49%)
- Household content, equipment and maintenance (4.37%)
- Health (1.44%)
- Transport (14.35%)
- Communication (2.42%)
- Recreation and culture (5.20%)
- Education (2.62%)
- Restaurants and hotels (3.25%)
- Miscellaneous goods and services (14.81%)



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Sometimes a rise in the price of one item can cause a rise in the price of all other items

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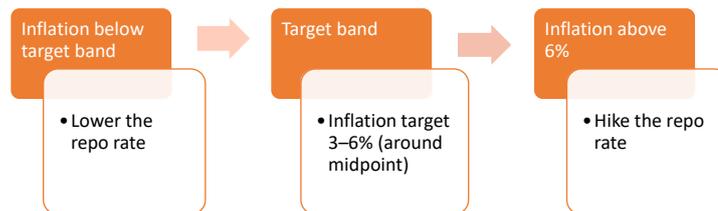
Monetary policy transmission mechanism



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1. Identify the *goal* of the model – methodology

- *1st step is to identify key drivers of inflation* (hint – see MPC statement for more info):
 - Demand-pull inflation
 - Cost-push inflation
- 2nd step is to decide how to *change the repo rate*



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2. Identify the *elements* of the model – the basic elements

Monetary policy

- The central bank's control of the financial conditions in a country in order to achieve an inflation target

Instrument

= Repo rate

- The **rate at which commercial banks borrow money from the central bank (SARB)**
- **Prime rate**
- The **rate at which a client with a normal risk can borrow money** from commercial banks

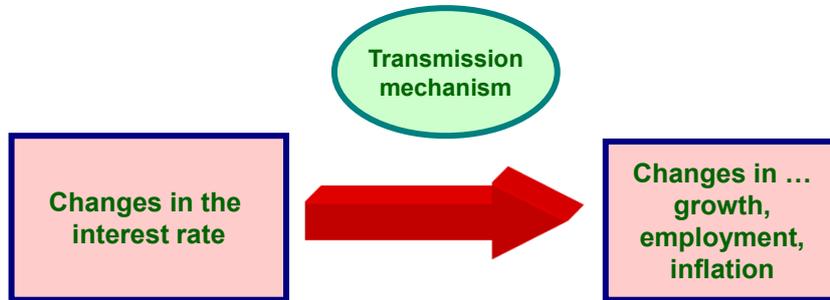


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Transmission mechanism

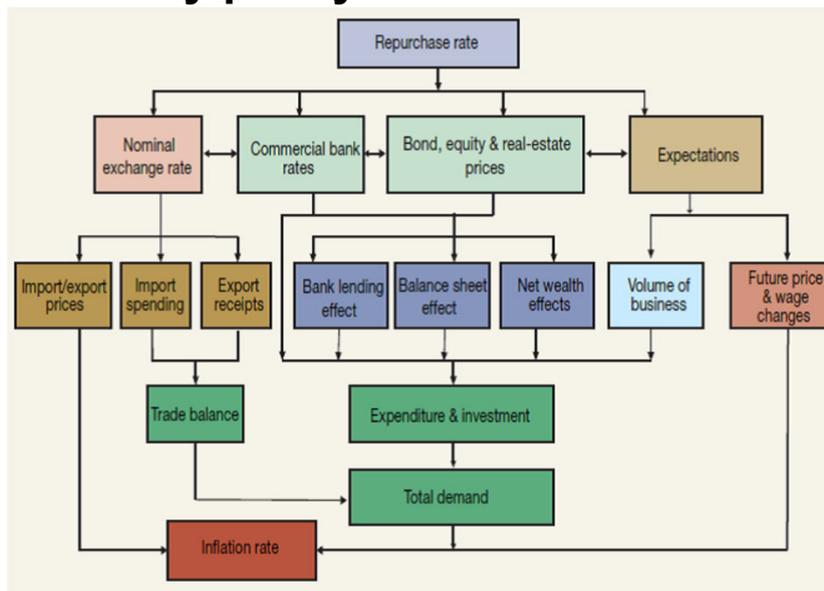


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Monetary policy transmission mechanism



Examples

1. Repo ↓
2. Repo ↑

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MPC statement



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Statement structure

Key economic
information



Inflation
outlook



Interest rate
decision



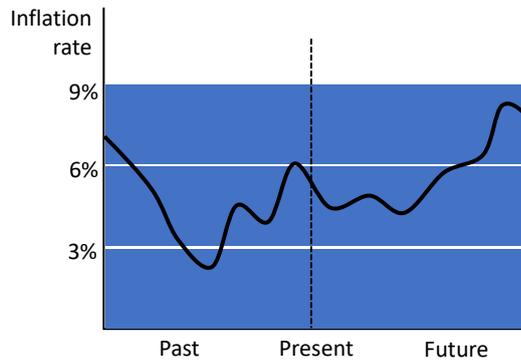
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Your task for the statement is to decide whether to...

1. **Raise** the repo rate 



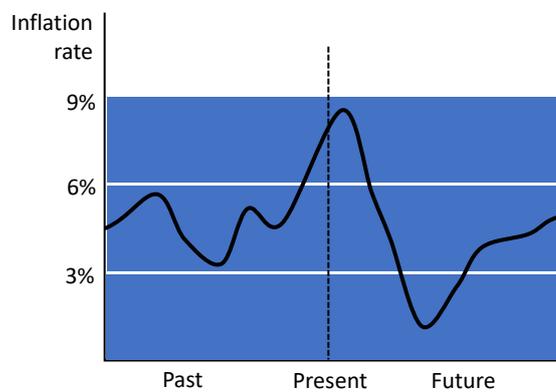
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Your task for the statement is to decide whether to...

2. Keep the repo rate **constant** 



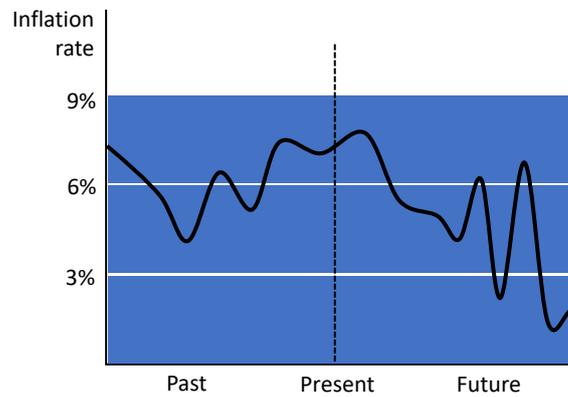
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Your task for the statement is to decide whether to...

3. **Decrease** the repo rate ↓



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What makes a winning statement?

You need to make an *argument*

What is an argument?

- Saying something
- Story line
- **Evidence and fact**

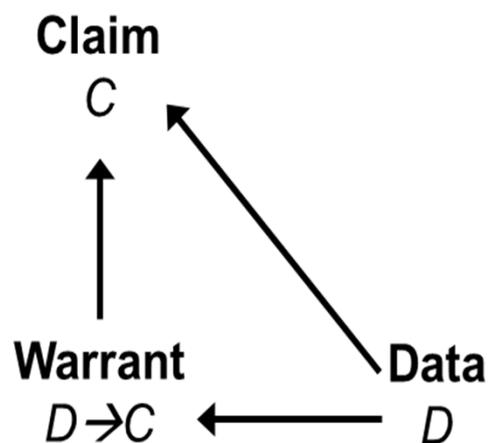


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What goes into an economic statement?



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Data sources

- Various topics
 - <http://www.resbank.co.za/Research/Statistics/Pages/Statistics-Home.aspx>
- Specific data search
 - <http://www.resbank.co.za/Research/Statistics/Pages/OnlineDownloadFacility.aspx>
- *Monetary Policy Review*
 - <http://www.resbank.co.za/Publications/Reviews/Pages/Monetary-Policy-Review.aspx>
- MPC statements
 - <http://www.resbank.co.za/Publications/Statements/Pages/MonetaryPolicyStatements.aspx>

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More data sources to consult

- South African Reserve Bank (SARB)
 - Quarterly Bulletin App [Quarterly Bulletins \(resbank.co.za\)](http://resbank.co.za)
- Statistics South Africa
- Bureau for Economic Research
- Big 4 banks - economic commentary section
- Business newspapers/websites



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Technical aspects: Table – the wrong way ❌

	Utopia repo rate	Lemuria repo rate	Atlantis repo rate
2005	8.0%	2.0%	10.0%
2006	10.0%	3.0%	2.0%
2007	13.0%	2.0%	8.5%
2008	11.0%	4.0%	3.0%
2009	10.5%	3.0%	0.5%
2010	8.5%	2.5%	8.0%
2011	7.0%	2.0%	15.0%
2012	5.5%	1.5%	14.0%
2013	5.0%	2.0%	10.0%
2014	6.0%	1.5%	7.0%

- Utopia's interest rate was 8% in 2005, and Lemuria's rate was 2% and the rate in Atlantis was 10%. In 2006, Utopia's rate went up to 10% and Lemuria's rate also went up to 3%, while Atlantis's repo rate went down to 2%. Then in 2007...



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Technical aspects: Table – the right way ✓

	Utopia repo rate	Lemuria repo rate	Atlantis repo rate
2005	8.0%	2.0%	10.0%
2006	10.0%	3.0%	2.0%
2007	13.0%	2.0%	8.5%
2008	11.0%	4.0%	3.0%
2009	10.5%	3.0%	0.5%
2010	8.5%	2.5%	8.0%
2011	7.0%	2.0%	15.0%
2012	5.5%	1.5%	14.0%
2013	5.0%	2.0%	10.0%
2014	6.0%	1.5%	7.0%

The interest rate in Atlantis was much more volatile compared to Utopia and Lemuria. This is partly due to the fact that Atlantis did not follow inflation targeting. Lemuria's effective monetary policy allowed it to keep inflation low, and it therefore experienced the lowest interest rates...

Substantiate with a graph

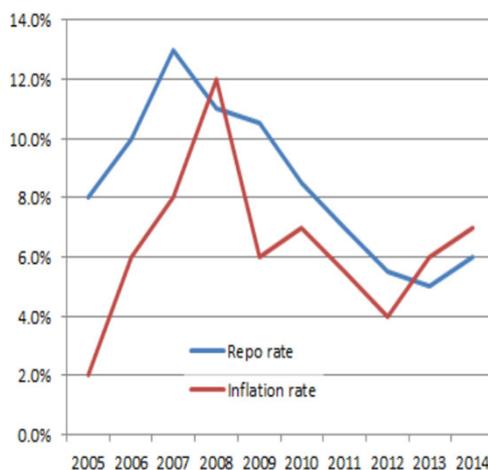


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Technical aspects: Graph – the wrong way ✗



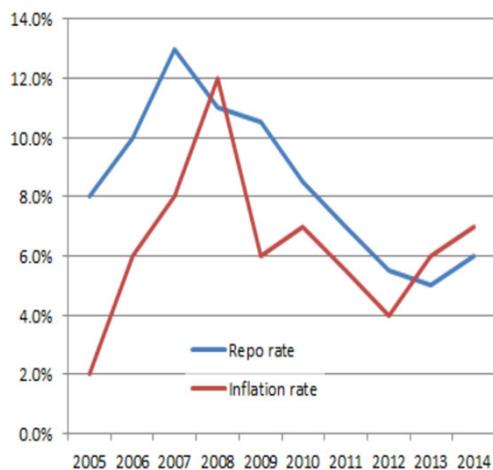
The repo rate went up to 13% in 2007, and then went down to 5% in 2013, and then it went up again. The inflation rate went up to 12% in 2008, went up and down to 4% in 2012, and then rose again to 7%...



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Technical aspects: Graph – the right way ✓



The central bank seems to respond to the inflation rate as is evident from the way the repo rate moves together with the inflation rate.



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What was the difference?

- No simple repetition!
- Rather show the *meaning*:
 - Highlight what you want the reader to notice
 - Connect to how it supports your argument



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The process



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Recommendations – **VERY IMPORTANT**

- Does your inflation forecast suggest the need for:
 - a rise in the repo rate (↑)
 - no change in the repo rate (↔)
 - a drop in the repo rate (↓)
- Justify (as explained)
 - Consider the target range over 12 to 24 months
 - Other variables?
- Forward-looking

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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.

The level of the repurchase rate is now above the level prevailing before the start of the pandemic. The revised repurchase rate remains supportive of credit demand in the near term, while raising rates to levels more consistent with the current view of inflation and risks to it. The aim of policy is to anchor inflation expectations more firmly

Extract from the November 2022 MPC Statement



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In conclusion

- Know **what you will argue** about the repo rate
- Your argument should be derived from the future direction of **inflation**
 - **Forward-looking**
- It should also be supported by **current developments**
- **Remember to provide your final repo rate decision**



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