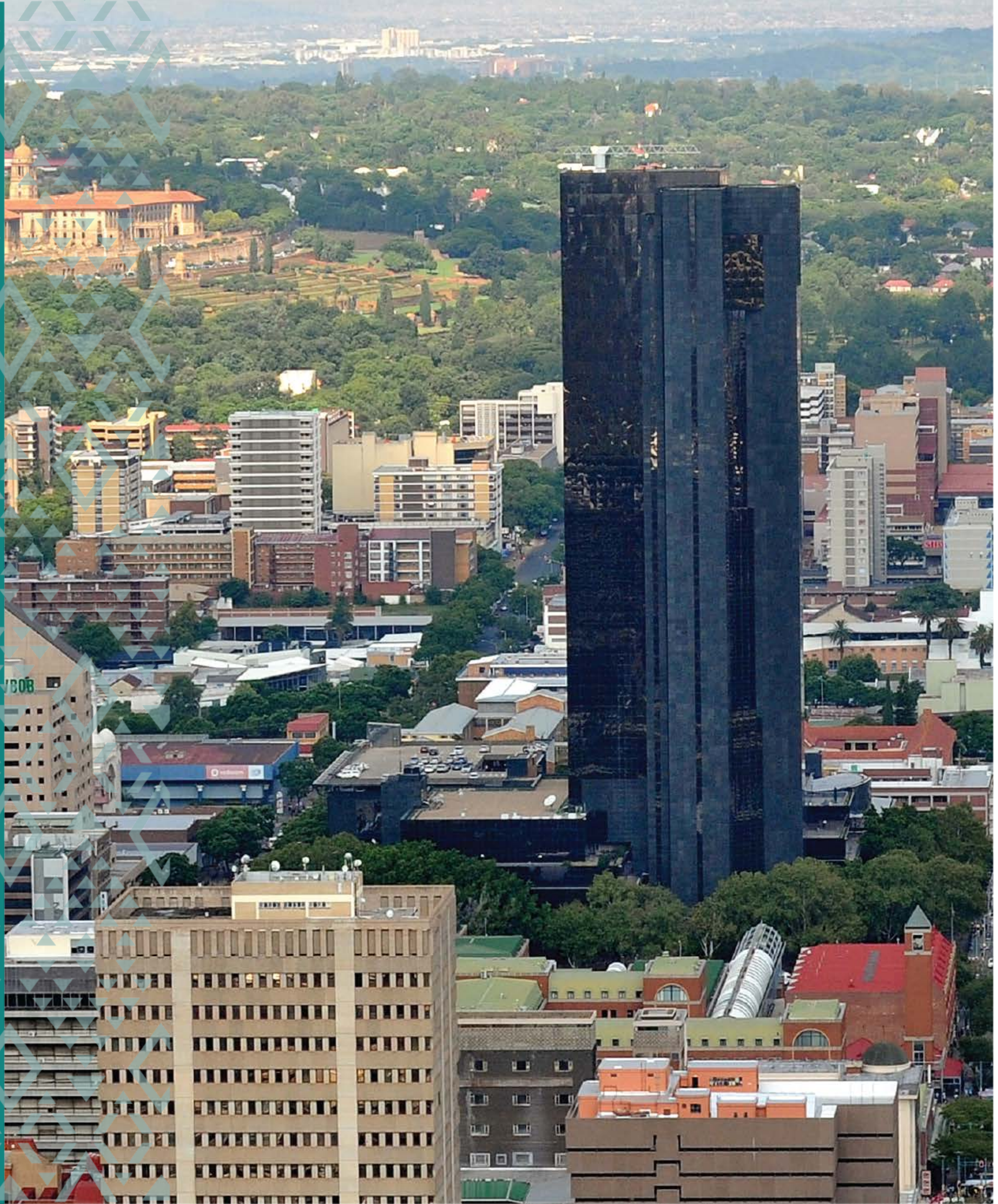


South African Reserve Bank (SARB) and Department of Basic Education (DBE)

2021 Monetary Policy Committee Schools Challenge

Key economic outlook

South African Reserve Bank

Outline

- **Primary purpose of the South African Reserve Bank**
  - *Mandate*
  - *Tools*

- **Statement and statement template**
  - *Key economic outlook*
  - *Inflation risks*
  - *Interest rate decision*

- **Data**

The primary purpose of the SARB

- To achieve and maintain **price stability** in the interest of balanced and sustainable **economic growth**.
- Together with other institutions, the SARB also plays a pivotal role in ensuring **financial stability.**

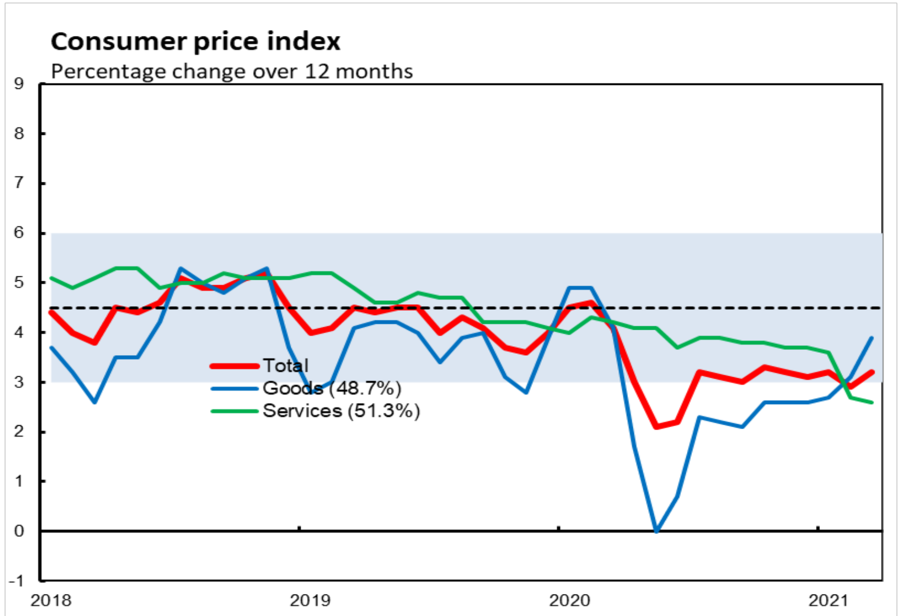
The constitutional mandate of the SARB

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%)
Numbers in brackets indicate weight in the consumer price basket.
Source: Stats SA

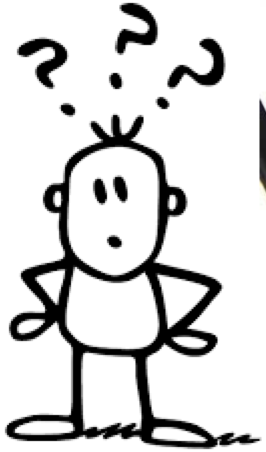
SOUTH AFRICAN RESERVE BANK

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

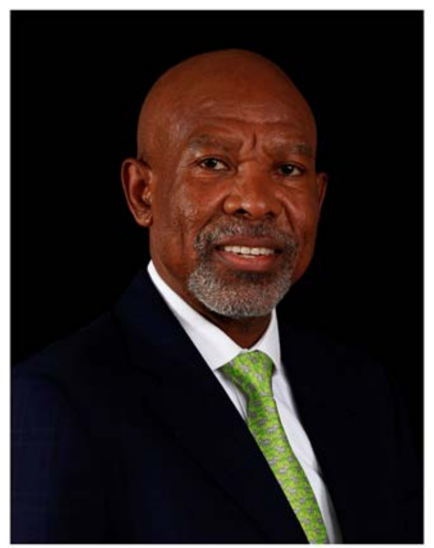


When would you increase or decrease the repo rate?

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.

And now the statement….



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)

SOUTH AFRICAN RESERVE BANK

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

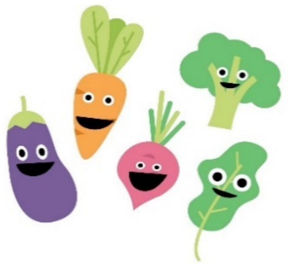
- How will the volume of imports and exports change as the value of the rand changes?
- What will the effect be on domestic prices, especially prices of imported goods?

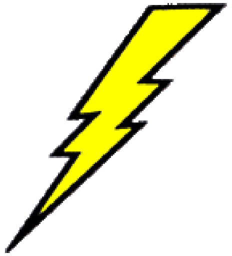
*Organisation for Economic Co-operation and Development

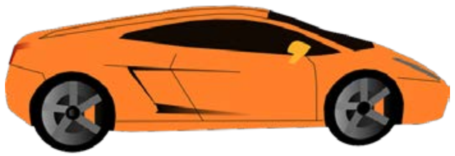
Data provided for the analysis

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

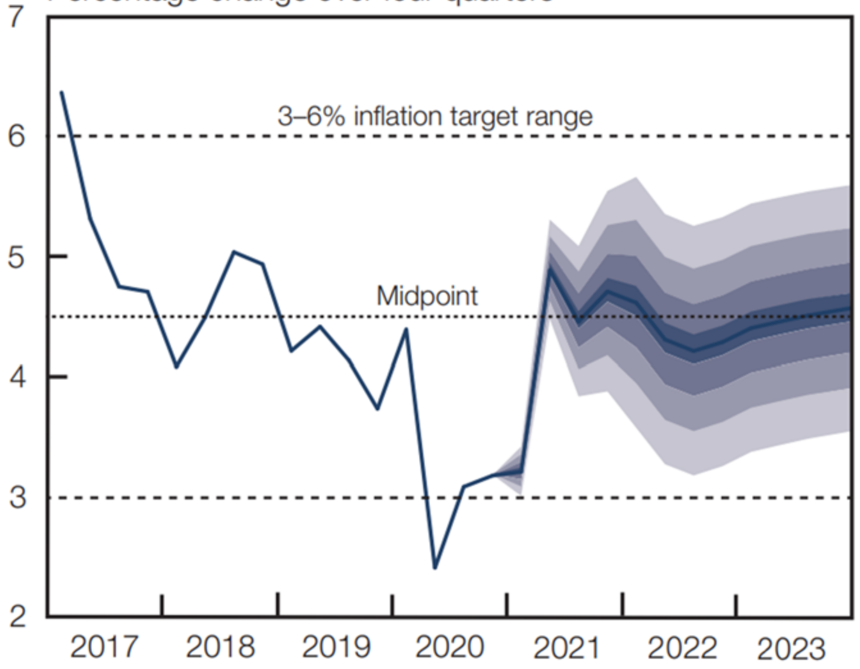
All things being equal:

- 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

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

The Committee notes that the slow recovery will keep inflation below the midpoint of the target range for this year and next. Unless risks outlined earlier materialise, inflation is expected to be well contained over the medium-term, remaining below but close to the midpoint in 2021 and 2022.

Against this backdrop, the MPC decided to keep rates unchanged at 3.5% per annum. Two members of the committee preferred a 25 basis point cut and three preferred to hold rates at the current level.

Extract from November 2020 MPC statement

Interest rate decision

The Committee notes that the slow economic recovery will help keep inflation below the midpoint of the target range for this year and next. Unless risks outlined earlier materialise, inflation is expected to be well contained in 2021, before rising to around the midpoint in 2022 and 2023.

Against this backdrop, the MPC decided to keep rates unchanged at 3.5% per annum. Two members of the Committee preferred a 25 basis point cut and three preferred to hold rates at the current level.

Extract from January 2021 MPC statement

Interest rate decision

While there are no demand side pressures evident at present, higher growth in 2021 and no change in the potential growth rate implies a narrowing of the output gap over the forecast period, compared to the January meeting.

Unless the risks outlined earlier materialise, inflation is expected to be well contained in 2021, before rising to around the midpoint of the inflation target range in 2022 and 2023.

Against this backdrop, the MPC decided to keep rates unchanged at 3.5% per annum. The decision was unanimous.

Extract from March 2021 MPC statement

THANK YOU

South African Reserve Bank