

Statement of the Monetary Policy Committee

30 April 2009

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee (MPC) in Pretoria

Introduction

The global economy continues to be in the midst of a severe synchronised downturn with a number of countries already experiencing recession. The G-20 countries, including South Africa, have committed themselves to a programme of action in order to contribute towards the earliest possible global economic recovery. Despite a generally positive response to the G-20 summit in April, it has become increasingly accepted that the slowdown is likely to be severe and protracted, and that the global recovery is likely to be gradual.

Domestic output and expenditure growth are declining or negative, and the growth outlook is dependent to a significant extent on a broader global recovery. Despite the widening domestic output gap, inflation remains sticky, but is expected to continue on its downward path.

Recent developments in inflation

The year-on-year inflation rate as measured by the consumer price index (CPI) for all urban areas increased to 8,6 per cent in February 2009 and then moderated to 8,5 per cent in March. Food price inflation continued its downward trend, increasing at a year-on-year rate of 14,7 per cent in March, compared with 15,8 per cent in the previous month. Food prices remained the largest contributor to the inflation outcome, contributing 2,3 percentage points. The largest price increase was recorded by electricity and other fuels, which increased by 30,1 per cent. Significant increases were also recorded in the prices of tobacco, housing maintenance and repairs, health, recreation and culture, and education. Countervailing pressure came from petrol prices, which declined by 14,9 per cent, despite the petrol price increase of 45 cents per litre in March.

Producer price inflation, which reached 19,1 per cent in August 2008, continued its downward trend, measuring 7,3 per cent and 5,3 per cent in February and March 2009 respectively. Prices of agricultural food products declined at a year-on-year rate of 2,1 per cent in March, while manufactured food price inflation moderated to 9,4 per cent.

The outlook for inflation

The most recent central forecast of the Bank shows a near-term deterioration in the inflation outlook, but inflation is expected to follow a downward trend and to average 5,4 per cent at the end of the forecast period in the final quarter of 2010. The slightly higher expected trend is a result of revised assumptions about administered prices and the higher-than-anticipated inflation outcome for February.

Inflation expectations show a mixed picture. The inflation expectations survey, which is conducted on behalf of the Bank by the Bureau for Economic Research (BER) at Stellenbosch University, reflects somewhat divergent inflation expectations between the different groups of respondents. In the survey conducted in the first quarter of 2009, average CPI inflation expectations for 2009 declined from 8,6 per cent to 8,3 per cent. Expectations ranged from 6,1 per cent for analysts, to 9,7 per cent for trade unionists. Inflation is expected to average 8,0 per cent in 2010, up from the 7,5 per cent measured in the previous survey. While analysts expect inflation to average 5,4 per

cent in 2010, business executives and trade union officials expect inflation to average 8,6 per cent and 10,1 per cent respectively. Inflation is expected to moderate to 7,8 per cent in 2011.

Wage settlements, which generally follow inflation trends with a lag, have also edged up slightly. According to Andrew Levy Employment Publications, the level of wage settlements increased by 10,2 per cent in the first quarter of 2009, compared to the 2008 average of 9,8 per cent. Nominal unit labour cost increased over four quarters by 12,8 per cent in the final quarter of 2008. Nominal wage settlements are expected to moderate somewhat as the inflation rate declines. According to the Quarterly Employment Statistics Survey conducted by Statistics South Africa, in the fourth quarter of 2008 employment levels showed their first decline in four years.

The risks to the inflation outlook as assessed by the MPC have remained relatively unchanged since the previous meeting of the committee, although the recent appreciation of the rand exchange rate, if sustained, may have reduced the degree of the upside risk to the inflation outlook. The rand exchange rate remains affected by changes in global risk aversion, but there has been a decline in the degree of volatility. Since the positive market reaction to the G-20 summit in early April, sentiment towards emerging-market economies in general has improved and most emerging-market currencies have appreciated against the US dollar.

As noted earlier, the global economy remains under pressure despite fiscal and monetary stimuli in many countries. In January 2009 the International Monetary Fund (IMF) forecasted global growth of 0,5 per cent and 3,0 per cent for 2009 and 2010 respectively. The IMF now expects global output to contract by 1,3 per cent in 2009, before recovering gradually to 1,9 per cent in 2010. The advanced economies are expected to contract by 3,8 per cent, while the emerging and developing economies are expected to experience positive growth of 1,6 per cent, with China and India expected to grow by 6,5 per cent and 4,5 per cent respectively. The growth forecast for Africa has been reduced from 3,4 per cent to 2,0 per cent. The risks to these forecasts are seen to be on the downside, given the current heightened levels of uncertainty. World trade has also declined and is expected to contract by a further 9,5 per cent in 2009.

World inflation is expected to remain subdued as a result of these growth trends and lower commodity prices. World inflation is expected to average 2,5 per cent in 2009 and 2,4 per cent in 2010. Although a number of commodity prices have recovered somewhat from their lows in the fourth quarter of 2008, they are expected to be restrained by the weak global demand. The price of North Sea Brent crude oil declined to around US\$35 per barrel in late December 2008, but has been trading at around the US\$50 per barrel level for most of April 2009. During this month, the higher international oil product prices have been more or less offset by the appreciation of the rand against the US dollar, and the domestic price of petrol is expected to remain relatively unchanged in May.

The outlook for domestic economic growth remains subdued, with no indications of a quick recovery. The high-frequency data continue to suggest that the negative conditions recorded in the final quarter of 2008 persisted in the first quarter of 2009. The physical volume of manufacturing production declined at a year-on-year rate of 15,0 per cent in February, following an 11,1 per cent contraction in the previous month. The outlook for manufacturing remains negative, with the Investec/BER Purchasing Managers Index declining further in March. Total mining production declined at a year-on-year rate of 12,8 per cent in February, while the real value of building plans approved declined by 42,7 per cent over the same period.

The sluggish domestic demand conditions also appear to have persisted. Wholesale trade sales declined at a year-on-year rate of 8,9 per cent in February, while retail sales declined by 4,5 per cent following a modest increase in January. Total new vehicle sales declined by 30,3 per cent in March, reflecting the continued weak demand for durable goods. However, the FNB/BER Consumer Confidence Index, while still at low levels, showed an increase in the first quarter of 2009. Falling house prices and weak asset markets are also expected to restrain consumption expenditure.

Domestic credit extension continues to reflect the declining trend in domestic expenditure, as well as more stringent credit criteria being applied by banks with respect to loans to both households and companies. Year-on-year growth in total loans and advances to the private sector declined to 10,2 per cent in February and 7,3 per cent in March 2009. The quarterly growth declined from 6,2 per cent in the fourth quarter of 2008 to 0,1 per cent in the first quarter of 2009. Instalment sale credit and leasing finance reflected the weak demand for durable goods, with increases of 3,1 per cent in February and 1,6 per cent in March.

In line with the previous MPC statement, the committee assesses the main risks to the inflation outlook to emanate from cost-push pressures, particularly administered prices, which include the risk of higher-than-expected electricity tariff increases. Food price inflation at the consumer price level, which has remained relatively unresponsive to lower inflation at the producer price level, appears to show signs of moderation. Should this downward trend accelerate, it could have a significant downward impact on the inflation trajectory.

Monetary policy stance

The MPC considered the severe synchronised downturn in international and domestic economic conditions and noted their potential future downward impact on inflation, notwithstanding the higher-than-expected recent domestic inflation outcomes. The committee is of the view that the adverse economic conditions continue to tilt the balance of risks to the inflation outlook to the downside over the medium term and has therefore decided to reduce the repurchase rate by 100 basis points to 8,5 per cent per annum with effect from 4 May 2009.