Monetary Policy Review

November 2008

South African Reserve Bank

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Introduction

This review of monetary policy is presented against a backdrop of financial turmoil in global markets, which has increased the degree of uncertainty regarding the world economic outlook considerably. Although South African markets have been fairly resilient to the current crisis, the heightened levels of uncertainty about the global economy are contributing to a challenging monetary policy-making environment. At the same time, policy has to deal with the continuing pass-through of inflation pressures from a succession of international food and energy price shocks; developments in domestic electricity prices; and, more recently, from the foreign-exchange rate of the rand.

An important development for the inflation-targeting framework was the announcement by the Minister of Finance on 21 October 2008 that the targeted inflation measure would be changed from 25 February 2009. The year-on-year increase in the consumer price index excluding mortgage interest cost for metropolitan and other urban areas (CPIX) would be replaced as the targeted measure with the headline consumer price index (CPI for all urban areas). More information regarding this change is provided in the boxes that are included in this document.

In this *Monetary Policy Review* the latest developments in inflation and the factors that impact on inflation are analysed. Recent monetary policy developments are then reviewed, and the outlook for inflation and the inflation forecast are presented. In addition, three issues are examined in boxes. The first box discusses the changes to the inflation target measure, while the second reviews the international treatment of owner-occupied housing in measures of consumer prices and places the changes in the South African consumer price index (CPI) in context. The final box provides an analysis of the changes in the weights of various expenditure groups for the new headline CPI.

Box 1 Changes to the inflation target measure

On 21 October 2008 the Minister of Finance announced in his Medium Term Budget Policy Statement that the targeted inflation measure would be changed from 25 February 2009 when the January 2009 consumer price index (CPI) data were released. Following revisions to the methodology employed to compile the CPI, which would result, *inter alia,* in a change in the treatment of housing (Box 2), the year-on-year increase in the consumer price index excluding mortgage interest cost for metropolitan and other urban areas (CPIX) would be replaced as the targeted measure with the headline CPI (CPI for all urban areas). The continuous inflation target range for headline CPI would remain at 3 to 6 per cent.

The new CPI for all urban areas measure brings into alignment the two most commonly cited measures of inflation in South Africa, namely the CPI (for metropolitan areas) and the CPIX. The new index will serve as both the headline measure and the inflation target measure, and will realign the geographic collection and reporting areas of the measures. The new CPI for all urban areas will cover the primary and secondary urban areas detailed by Statistics South Africa (2006).

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Recent developments in inflation

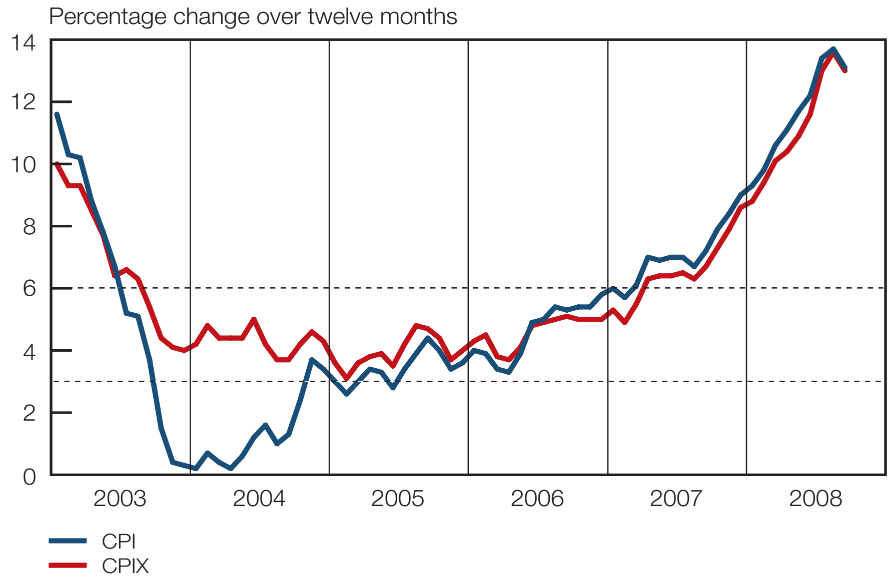
This section analyses recent trends in the main inflation indices and reviews developments in the main determinants of inflation in the South African economy.

The evolution of indicators of inflation

The measure of inflation currently targeted by the South African Reserve Bank (the Bank), namely the year-on-year increase in the CPIX, has remained above the inflation target range of 3 to 6 per cent since April 2007 (Figure 1). When the previous *Monetary Policy Review* was published in May 2008, the latest available CPIX inflation rate, for March, was 10,1 per cent. Since then, driven mainly by developments in the prices of food and energy, CPIX inflation increased to 13,6 per cent in August 2008, before declining to 13,0 per cent in September. The transitional upward bias, which is included in the year-on-year CPIX inflation rates for the period from January to December 2008 due to the treatment of non-discounted clothing and footwear, is estimated to have averaged 0,23 of a percentage point for the months from March to September 2008.

Figure 1 also shows that the inflation rate measured in terms of the headline consumer price index for metropolitan areas (CPI) moved in tandem with that of the CPIX, rising from 10,6 per cent in March 2008 to 13,7 per cent in August and then slowing to 13,1 per cent in September.

Figure 1 Consumer price inflation: CPIX and CPI



Source: Statistics South Africa

Table 1 reports the weighted contributions of the main components of the CPIX to the overall year-on-year inflation rate. The influence of food and energy prices is clearly evident. The contribution of the food component increased from 4,4 percentage points in March 2008 to 5,3 percentage points in August, and then decreased to 5,0 percentage points in September. The contribution of the transport component increased from 2,1 percentage points to 3,2 percentage points between March and July, before declining to 2,7 percentage points in September. The contribution of the fuel and power component also increased significantly, rising from 0,4 percentage points in March–June 2008 to 1,3 percentage points in August and September. This increase mainly reflects the electricity price increase in July 2008.

Table 1 Contributions to CPIX inflation

Percentage change over twelve months* and percentage points

	2008						
	Mar	Apr	May	Jun	Jul	Aug	Sep
Total*	10,1	10,4	10,9	11,6	13,0	13,6	13,0
Of which:							
Food	4,4	4,5	4,7	5,1	5,1	5,3	5,0
Housing	0,9	0,9	0,9	0,9	0,9	0,9	0,9
Medical care and health expenses	0,5	0,5	0,5	0,6	0,6	0,6	0,7
Transport	2,1	2,1	2,3	2,6	3,2	3,1	2,7
Education	0,4	0,4	0,4	0,4	0,4	0,4	0,4
Fuel and power	0,4	0,4	0,4	0,4	1,1	1,3	1,3
Other	1,4	1,6	1,7	1,6	1,7	2,0	2,0

Source: Statistics South Africa

Box 2 Owner-occupied housing and the consumer price index

The treatment of housing services, which typically account for a large proportion of a household's consumption expenditure, is a complex issue faced by compilers of consumer price indices (CPIs), not only in South Africa but around the world. Internationally, there are three main methodological approaches to measuring owner-occupied housing services in the CPI,[1] namely (1) the acquisitions, (2) user cost and (3) rental equivalence approaches (Table B2.1). Statistics South Africa will change from a user cost approach to compiling housing in the CPI to a rental equivalence approach from January 2009,[2] a change that has important implications for the inflation-targeting framework (see Box 1).

1 Classification differs from one author to the other. Poole et al. (2005), for example, classify these approaches into four categories.

2 Statistics South Africa (2008) documents the change. Haglund (2000) provides a preliminary discussion of the issues in the South African context.

Table B2.1 International comparison of housing in the CPI

Per cent

Country	Method of measuring owner-occupied housing (OOH)	Housing weights		
		OOH	Rental	Total
Australia	Acquisitions	11,21	5,22	16,43
Canada	User cost	16,48	5,36	21,84
Euro area	OOH not included	–	6,00	6,00
Japan	Rental equivalence	14,22	3,44	17,66
Mexico	Rental equivalence	11,97	2,52	14,49
New Zealand	Acquisitions	5,51	7,85	13,36
Norway	Rental equivalence	14,95	2,51	17,46
South Africa	Rental equivalence	12,21	3,49	15,70
United Kingdom	OOH not included	–	4,90	4,90

Source: Various national statistical agencies

The approaches differ conceptually according to whether the intention is to consider the cost of the use of the dwelling (the user cost approach and the rental equivalence approach) or the cost of acquiring the dwelling (the acquisitions approach). The methodologies also differ in their data requirements.

The *acquisitions approach* focuses on measuring the cost of new dwellings and renovations to current dwellings. The data requirements in this case include legal and real-estate agency fees; the cost of repairs and maintenance; property rates and taxes; and more demanding items such as the net purchases of the dwelling (by the reference population); and the cost of construction of new dwellings, and of alterations and renovations. Countries that have implemented this approach include Australia and New Zealand.

The *user cost approach* requires that the actual cost of owner-occupied housing services and other costs related to the use of the dwelling are estimated, as well as the opportunity cost of having invested in the dwelling as opposed to alternative assets and the rate of depreciation of dwellings. Canada is an example of a country that measures owner-occupied housing using a user cost approach. Given the complexity of the formulation of the user cost, in part due to the complexity of estimating or acquiring the necessary information, countries using this approach usually employ some derivative of the approach rather than the full approach outlined in the International Labour Organisation (ILO) handbook on compiling the CPI (ILO, 2004).

The use of mortgage interest rates as a measure of homeowners' cost in the user cost approach to measuring the CPI, which is currently the case in South Africa, is problematic when the CPI is used as a reference measure for monetary policy. Increases in policy rates are passed through mechanically to the measured CPI, perversely increasing CPI inflation. Since such increases do not reflect authentic inflationary pressures in the economy, countries using this methodology have sought to remove the effects of interest rate changes from their reference measure. In South Africa this was the reason why the consumer price index excluding mortgage interest cost (CPIX) was specified as the target measure for the inflation-targeting framework.

The *rental equivalence approach* to measuring the CPI, which is used by a number of countries as specified in Table B2.1, will be followed by Statistics South Africa from the January 2009 release. This approach assumes that housing services from rental property and owner-occupied property are close substitutes, and requires that the rental market is large enough to provide representative data. In South Africa, for example, the rental market comprises about one quarter of occupied dwellings. Under these circumstances, the market rental values of dwellings over time are held to approximate the corresponding values of services yielded by the use of the same type of dwelling for the same period (Statistics South Africa, 2008). A rental index can therefore be compiled and applied to the owner-occupied portion of dwellings in the country. The new South African CPI will include information from two rental surveys, the first undertaken by Rode & Associates Property Consultants and the second by Statistics South Africa.

The change in the measurement of owner-occupied housing to a measure that is not directly related to the interest rate means that the problems associated with using the CPI for monetary policy purposes will be substantially reduced. An important implication for South Africa – as has been the case in other countries that have made this transition, which include Australia, New Zealand and the United Kingdom – is that mortgage interest costs will no longer need to be removed from the CPI when evaluating the effects of monetary policy.

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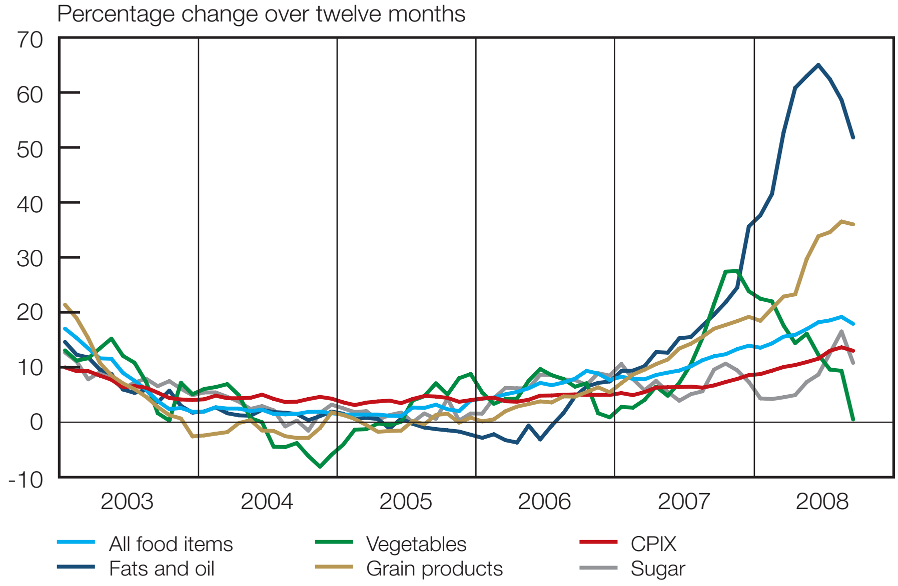
Food prices continued to increase strongly during 2008, although some signs of moderation are evident. The inflation rate for the overall food price component of the CPIX increased from 15,6 per cent in March to 19,2 per cent in August, before slowing to 17,9 per cent in September (Figure 2). The prices of grain products and of fats and oils rose particularly strongly in this period. The price of fats and oils accelerated from a rate of 52,7 per cent in March to 65,0 per cent in June, before moderating to a rate of 51,8 per cent in September. The rate of increase of grain product prices rose from 22,9 per cent in March to 36,5 per cent in August and 36,0 per cent in September. Vegetable price inflation slowed from 17,6 per cent to 0,5 per cent between March and September 2008.

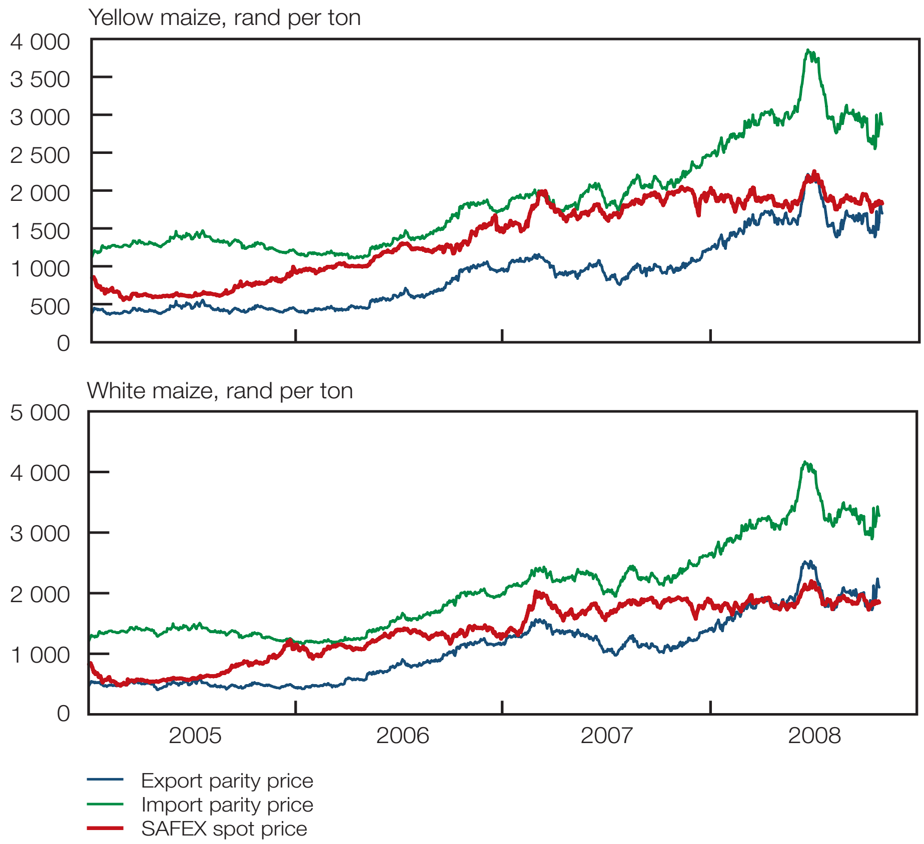
Figure 2 CPIX and food inflation



Source: Statistics South Africa

Figure 3 shows that the spot prices of maize have moved closely with export parity prices in recent months, aided by a maize harvest that was 13,6 per cent larger than initially estimated. The average price for yellow maize increased from R1 921 per ton in March 2008 to R2 073 per ton in June, before declining again to around R1 818 per ton in October. White maize prices increased from an average price of R1 787 per ton in May to R2 014 per ton in June and then declined to average around R1 828 per ton in October.

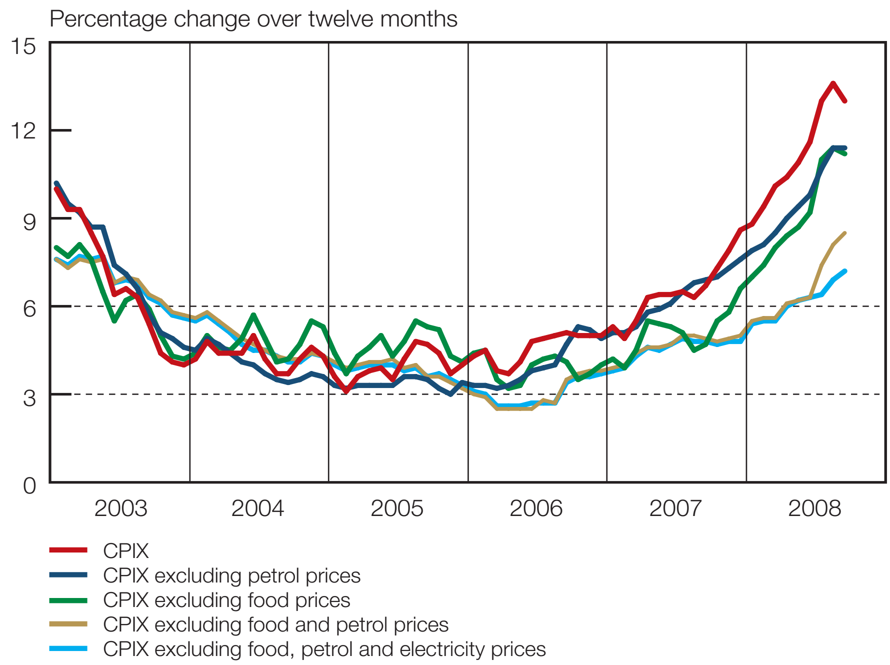
Figure 3 Maize prices



Source: Grain South Africa

The effect of excluding food, petrol and electricity prices from the CPIX inflation measure is illustrated in Figure 4. Since these prices provided upward pressure on CPIX inflation during 2008, excluding them from the CPIX results in lower inflation rates for the new measures, although they all remain above the 6 per cent upper limit of the inflation target. Excluding food prices, the inflation rate for the remaining items in the CPIX increased from 8,0 per cent in March to 11,4 per cent in August, before declining to 11,2 per cent in September. The inflation rate for CPIX excluding petrol prices increased from 8,5 per cent in March to 11,4 per cent in August and September. Excluding both food and petrol prices from the CPIX, inflation increased from 5,6 per cent in March to 8,5 per cent in September. The major contributor to this increase was electricity prices. However, if electricity prices were excluded in addition to food and petrol prices, the inflation rate for the remaining items in the CPIX would have been 7,2 per cent in September 2008.

Figure 4 The effect of food, petrol and electricity prices on CPIX inflation

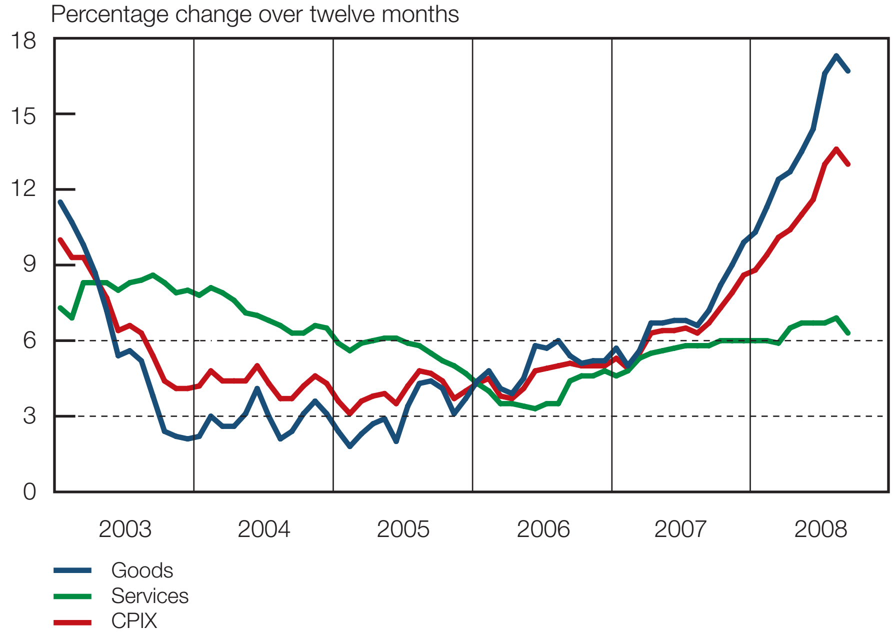


Sources: Statistics South Africa and SARB calculations

The inflation rates for the goods and services categories of the CPIX are presented in Figure 5. Goods prices continued to accelerate at a significantly faster pace than services prices in 2008, rising from a rate of 12,4 per cent in March to 17,3 per cent in August, before declining to 16,7 per cent in September. Food and transport prices were again the main contributors to this acceleration. Services prices increased at a more moderate pace, accelerating from a rate of 5,9 per cent in March to 6,9 per cent in August and then slowing to 6,3 per cent in September. The inflation rates for the housing, transport, medical, communication, and recreation and entertainment components all followed a similar path to that of the overall services index over this period.

Figure 6 presents the year-on-year inflation rate for the administered prices component of the CPIX together with the main contributors to this rate. The inflation rate for the administered price index (API) increased from 14,8 per cent in March 2008 to 22,1 per cent in August, before decelerating to 20,0 per cent in September. The major driver of these movements was the petrol component of the index. This component's contribution to the API inflation rate increased from 9,9 percentage points in March to 14,0 percentage

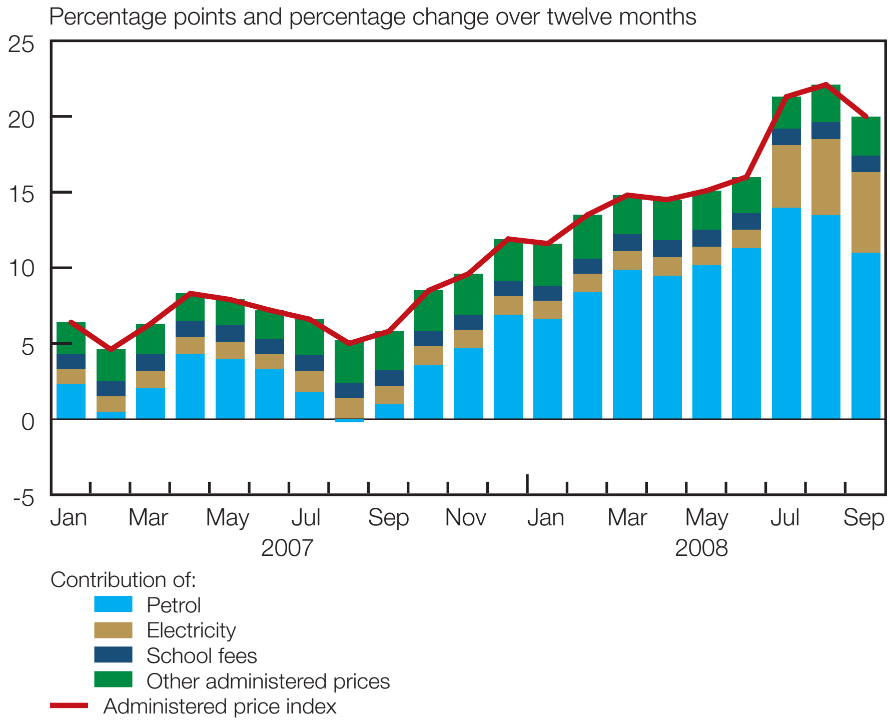
Figure 5 CPIX: Goods and services inflation



Source: Statistics South Africa

points in July, before receding to 11,0 percentage points in September. The contribution of electricity prices to the API inflation rate has also become more significant, following the regulator's approval of price increases. After contributing 1,2 percentage points between September 2007 and June 2008, the electricity component's contribution increased to 4,1 percentage points in July, to 5,0 percentage points in August and to 5,3 percentage points in September 2008.

Figure 6 Administered price index



Source: Statistics South Africa

If petrol prices are excluded from the API, the inflation rate for the remaining administered prices declined from 7,2 per cent in April 2008 to 6,9 per cent in June, before increasing sharply to 12,6 per cent in September.

The inflation rate measured in terms of the year-on-year change in the production price index (PPI) increased from 11,9 per cent in March 2008 to 19,1 per cent in August, before declining to 16,0 per cent in September. Owing to Statistics South Africa's release of new PPI data in early 2008, consistent year-on-year comparisons for the overall PPI will only be possible from the February 2009 release. For the components of the index, the annual growth rate of food prices at the agricultural level declined from 18 per cent in March 2008 to 1,8 per cent in July and further to -4,5 per cent in September. However, the rate of increase in food prices at the manufacturing level remained between 19,1 per cent and 20,8 per cent over the period.

Box 3 Changes in the consumer price index weights

Statistics South Africa will publish the consumer price index (CPI) on the basis of a new basket of goods and services, and associated weights from the January 2009 release.[3] There will be a number of significant changes in the weights of important expenditure groups for the new CPI, which are listed in Table B3.1. Relative to the previous weight for the category, *communication* experienced the smallest change, while the largest change occurred in the *alcoholic beverages and tobacco* category.

3 Background information on the process followed in compiling the new CPI was provided in the November 2007 *Monetary Policy Review* (Box 1).

Table B3.1 Comparison of the category weights of the inflation target measures
Per cent

	CPIX (metropolitan and other urban areas)	CPI (all urban areas)
Food and non-alcoholic beverages	26,92	15,68
Alcoholic beverages and tobacco	3,05	5,58
Clothing and footwear	4,06	4,11
Housing and utilities	15,55	22,56
Household contents, equipment and maintenance	8,37	5,86
Health	6,13	1,47
Transport	15,01	18,80
Communication	3,19	3,22
Recreation and culture	3,79	4,19
Education	3,77	2,19
Restaurants and hotels		2,78
Miscellaneous	10,16	13,56

Source: Statistics South Africa

The weight for the *food and non-alcoholic beverages* category will be reduced from 26,92 per cent to 15,68 per cent. Significant changes were introduced in the way the data underlying the expenditure weights were collected in the Income and Expenditure Survey (IES) 2005/06. In previous surveys, the respondents were asked to recall what they had purchased over the previous week or month, and the cost of each item (per quantity bought). IES 2005/06, instead, asked respondents to record in a diary how much they had purchased and the cost of the goods.

The weight of the *alcoholic beverages and tobacco* category will be increased from 3,05 per cent to 5,58 per cent. Since consumption of these goods has been found to be underreported in surveys, data on excise taxes and sales volumes by producers were also considered in calculating the weight for this expenditure group. This resulted in the estimated annual consumption of alcoholic beverages and tobacco being taken into consideration for construction of the CPI 2009 weights; increasing from R8 billion (in IES 2005/06) to R43,6 billion.

The jump of 7,01 percentage points in *housing and utilities* to 22,56 per cent can be attributed to the fact that the consumer price index excluding mortgage interest cost for metropolitan and other urban areas (CPIX) measure does not include the interest component of owner-occupied housing when measured according to the user cost approach, while the new CPI measures owner-occupied housing according to the rental equivalence approach (see Box 2).

Expenditure on *health services* has a lower weight in the new CPI, declining from 6,13 per cent to 1,47 per cent. This category has undergone a number of changes in the methodology employed to collect data. First, for the forthcoming CPI a survey of doctors, dentists and hospitals was undertaken instead of the previously used National Health Reference Price List. The NHRPL is a list published by the Department of Health that provides guidelines as to how much should be charged for consultations, medication, treatment, operations and so on. However, the list contains only recommendations that are not legislated or required. Second, the cost of health care now includes only expenses incurred by individuals, excluding contributions made by medical aids and employers. Finally, medical aid contributions and any health insurance were removed from this category and captured under insurance in the *miscellaneous* category.

There are also a number of reasons underlying the increase of 3,79 percentage points to 18,80 per cent in the weight of *transport* in the new CPI. First, there will be an increase in the weight of new purchases (of vehicles). This is mostly attributable to a change in the method used to record the purchase of a new vehicle. Previously, those who had paid cash would reflect a one-off payment to that value, while those who had paid for their cars on credit would only reflect the payments made each year. Over twelve months therefore the sum of the monthly cost was recorded. In the new CPI the full value of the car is recorded regardless of the payment option chosen. Second, at the time the IES was undertaken in 2004–2006, the robust economic performance of the economy meant that new car sales were increasing at an average rate of 20 per cent per annum and this is reflected in their higher weight. Third, the weight of *public transport* will also experience an increase from 2,29 per cent to 2,73 per cent; most likely due to the inclusion of expenditure on minibus taxis in the CPI (this was previously excluded).

The *education* category, whose weight declined from 3,77 per cent to 2,19 per cent, has not experienced any major change in measurement methodology. The relatively large decline in weight is a result of people changing their spending patterns.

Finally, the weight for the *miscellaneous* category increases from 10,16 per cent to 13,56 per cent. This expenditure group has experienced a major change in its overall composition in that it will now include *insurance* and *personal care products*. The *insurance* item, which includes transport, household and health-related insurance, itself experienced a large increase in its weighting. This is mostly attributed to the economic growth experienced in South Africa, with the level of medical aid contributions increasing substantially.

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Factors affecting inflation

Monetary policy decisions are made on the basis of current and expected developments in the wider macroeconomy. Recent developments in some of the main variables influencing inflation in South Africa are reviewed in this section, while the outlook for these variables and their likely impact on inflation are discussed in a later section.

International economic developments

The two global themes that have continued to evolve more emphatically during the period under review comprise the further slowing of economic growth and rising headline inflation. The most recent International Monetary Fund (IMF) data show that world growth in real gross domestic product (GDP) was 5,0 per cent in 2007 and will slow to an estimated 3,9 per cent in 2008 against the backdrop of increasing turmoil in global financial markets and stagnating growth in the advanced economies (Table 2). The IMF forecasts that the pace of world inflation will accelerate to 6,2 per cent in 2008 from 4,0 per cent in 2007, largely because of the run-up in oil and food prices through the first half of 2008. It is nevertheless becoming increasingly clear that the slowdown could reduce inflation pressures in some countries and that emerging-market countries have not decoupled from the downturn in the advanced countries.

Table 2 Annual percentage change in real gross domestic product and consumer prices

	Real GDP		Consumer prices*	
	2007	2008 (estimate)	2007	2008 (estimate)
World	**5,0**	**3,9**	**4,0**	**6,2**
Advanced economies	**2,6**	**1,5**	**2,2**	**3,6**
United States	2,0	1,6	2,9	4,2
Japan	2,1	0,7	0,0	1,6
Euro area	2,6	1,3	2,1	3,5
United Kingdom	3,0	1,0	2,3	3,8
Other advanced economies	4,7	3,1	1,9	4,4
Other emerging-market and developing countries	**8,0**	**6,9**	**6,4**	**9,4**
Africa	6,3	5,9	6,2	10,2
Central and eastern Europe	5,7	4,5	5,6	7,8
Commonwealth of Independent States	8,6	7,2	9,7	15,6
Developing Asia	10,0	8,4	5,4	7,8
China	11,9	9,7	4,8	6,4
India	9,3	7,9	6,4	7,9
Middle East	5,9	6,4	10,6	15,8
Western hemisphere	5,6	4,6	5,4	7,9

* Zimbabwe excluded

Source: IMF *World Economic Outlook,* October 2008

According to the IMF, the United States (US) economy is expected to perform slightly better in 2008 than initially forecast. Although the housing market continues to weigh on consumption and investment, growth is expected to slow to 1,6 per cent in 2008 from 2,0 per cent in 2007. However, the IMF warned that the US economy was projected to contract moderately during the second half of 2008 as the market value of the US housing stock was rapidly reduced by a continued decline in US housing prices, and with it the collateral value of many banking assets. These factors have affected, and are likely to continue to impact adversely on, overall business volumes and earnings. Inflation in the US is projected to increase from 2,9 per cent in 2007 to 4,2 per cent in 2008.

After advancing strongly in the first quarter of 2008, momentum in Japan's economy quickly waned, and real GDP contracted at an annualised rate of 3 per cent in the second quarter on broad-based weakness in personal consumption, business investment, residential construction and exports. The IMF forecasts real GDP growth in Japan of 0,7 per cent in 2008 compared with the 2,1 per cent recorded in 2007. The inflation data for Japan are mixed and although wholesale prices have been rising at the fastest pace since 1981, there has thus far been little feed-through to consumer prices; at least outside of food and energy. Inflation in Japan is projected to rise to 1,6 per cent in 2008.

Economic growth in the euro area remained robust in 2007 and surprised to the upside in early 2008. However, as with Japan's experience, growth abruptly turned negative in the second quarter, with GDP contracting by 0,7 per cent to record the first decline since the formation of the Economic and Monetary Union in January 1999. In the euro area the IMF projected lower real GDP growth at about 1,3 per cent in 2008 from the 2,6 per cent recorded in 2007. Inflation in the euro area is projected to increase from 2,1 per cent in 2007 to 3,5 per cent in 2008.

After posting above-trend growth in 2006 and 2007 on the back of robust housing and consumer spending, the United Kingdom economy is now facing strong headwinds from a correction in the housing sector and contagion from financial market turmoil. Most notably, the credit-sensitive housing sector is in the midst of a severe correction that is weighing heavily on a more indebted household sector amid a credit crisis that is limiting access to credit. The IMF forecasts that the UK will grow by 1 per cent in 2008 compared with the 3 per cent recorded in 2007. Inflation in the UK is projected to increase from 2,3 per cent in 2007 to 3,8 per cent in 2008.

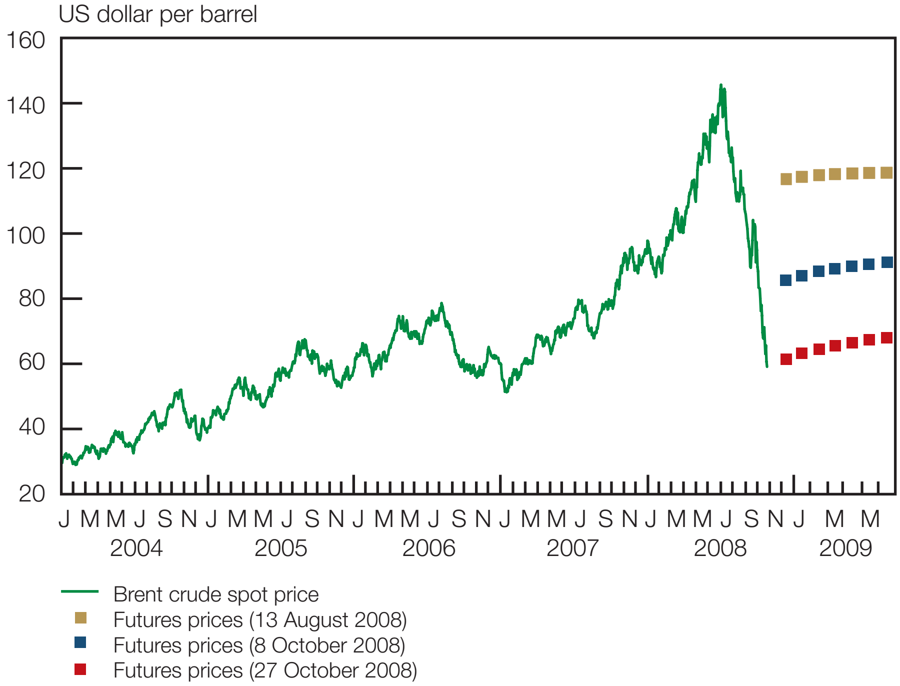
The economic cycle in developing Asia began turning down in early 2008. Domestic demand has softened, as rising food and fuel prices weigh on consumption. The IMF forecasts that China will grow by 9,7 per cent in 2008 compared with 11,9 per cent in 2007. India is expected to record growth of 7,9 per cent in 2008 compared with 9,3 per cent in 2007.

Africa has thus far shown some resilience to the global slowdown and is expected to record a 5,9 per cent growth rate in 2008, compared with 6,3 per cent in 2007. The surge in commodity prices during the first half of 2008 benefited many countries in sub-Saharan Africa. However, economic expansion in most countries in sub-Saharan Africa is expected to moderate in 2008 as their terms of trade deteriorate. Inflation in Africa at the aggregate level is expected to rise from 6,2 per cent in 2007 to 10,2 per cent in 2008.

Oil prices

The past twelve months have delivered a volatile oil market. During this period, international crude oil prices rose to new record levels before declining again significantly as concerns about inadequate supply were superseded by evidence of slowing demand. Figure 7 shows that in September 2007 the price of Brent crude oil averaged US$77 per barrel. By early July 2008 it had reached an all-time record level of US$146 per barrel, and in May–July 2008 the average monthly price measured in constant US dollar terms had surpassed the level recorded in November 1979. However, by late October 2008 the price had plunged by 60 per cent to below US$59 per barrel due to increasing concerns about slower global economic growth.

Figure 7 Price of Brent crude oil



Source: Bloomberg

In May 2008 oil prices rose strongly on the resurgence of the super-spike view that lack of adequate supply growth coupled with non-Organisation for Economic Co-operation and Development (OECD) demand growth would ensure sustained higher prices over the medium term. The oil price surged to consecutively higher levels in subsequent months, but by August 2008 inventory levels began indicating more demand reduction than had been expected and analysts began lowering their energy price forecasts. As the price of oil plunged, production cuts were announced by the Organization of the Petroleum Exporting Countries (OPEC) on 9 September and 24 October 2008, but the announcements created uncertainty in the market about the effective size of the production cuts involved and the likely impact on prices.

Central bank interest rate developments

Financial market turbulence essentially ended the G-7 tightening cycle in mid-2007 (Table 3). Some G-7 central banks reversed course, including the US Federal Reserve, Bank of England and the Bank of Canada, but inflation concerns initially prevented the European Central Bank (ECB) from following suit. However, central banks increasingly began engaging in closer consultation and have co-operated in joint actions throughout the current financial crisis. These actions included the provision of liquidity to reduce strains in financial markets and a co-ordinated round of interest rate cuts aimed at unfreezing interbank lending markets.

Since the second half of 2007, the US Federal Open Market Committee (FOMC) has deployed a range of policy tools to deal with the combination of economic weakness and financial market distress. Most notably, in the 14-month period to 27 October 2008, the FOMC lowered the federal funds target by a cumulative 375 basis points to 1,5 per cent. Moreover, it cut the discount rate by an even larger 450 basis points, thereby reducing the penalty for banks borrowing money from the discount window to just 25 basis points. The central bank also sought to enhance both domestic and international market liquidity by introducing a number of new programmes, including the Primary Dealer Credit Facility aimed at providing an overnight loan facility to primary dealers. At the end of September 2008 the US Federal Reserve also boosted its currency-swap facility, which allows foreign central banks to pump dollars into their illiquid banking systems, to a total of US$620 billion from the previous US$290 billion. Shares in the swap arrangements were apportioned to the ECB, the Bank of Japan, the Bank of England, the Bank of Canada, the National Bank of Denmark, Norges Bank of Norway, the Reserve Bank of Australia, the Riksbank of Sweden and the Swiss National Bank. The move was aimed at allowing other central banks to increase volumes of dollar-denominated lending to their banking systems for one-week periods amid a shortage of dollars in interbank money markets. The US Federal Reserve announced on 6 October 2008 that it would start paying interest on banks' required and excess reserve balances and that it would also expand one if its key lending programmes for cash-strapped banks. The next day the creation of the Commercial Paper Funding Facility was announced to complement the US Federal Reserve's existing credit facilities to help provide liquidity to term funding markets.

Table 3 Selected central bank interest rates
Per cent

Countries	1 Jan 2008	27 Oct 2008	Latest decision (change in percentage points)	
United States	4,25	1,50	8 Oct 2008	(-0,50)
Japan	0,50	0,50	14 Oct 2008	(0,00)
Euro area	4,00	3,75	8 Oct 2008	(-0,50)
United Kingdom	5,50	4,50	8 Oct 2008	(-0,50)
Canada	4,25	2,25	21 Oct 2008	(-0,25)
Denmark	4,25	5,50	24 Oct 2008	(+0,50)
Sweden	4,00	3,75	23 Oct 2008	(-0,50)
Switzerland	2,75	2,50	8 Oct 2008	(-0,25)
Australia	6,75	6,00	7 Oct 2008	(-1,00)
New Zealand	8,25	6,50	23 Oct 2008	(-1,00)
Israel	4,25	3,50	27 Oct 2008	(-0,25)
China	7,47	6,93	8 Oct 2008	(-0,27)
Hong Kong	5,75	2,00	9 Oct 2008	(-0,50)
Indonesia	8,00	9,50	7 Oct 2008	(+0,25)
Malaysia	3,50	3,50	24 Oct 2008	(0,00)
South Korea	5,00	4,25	27 Oct 2008	(-0,75)
Taiwan	3,375	3,25	9 Oct 2008	(-0,25)
Thailand	3,25	3,75	8 Oct 2008	(0,00)
India	7,75	8,00	20 Oct 2008	(-1,00)
Brazil	11,25	13,75	10 Sep 2008	(+0,75)
Chile	6,00	8,25	9 Oct 2008	(0,00)
Mexico	7,50	8,25	17 Oct 2008	(0,00)
Czech Republic	3,50	3,50	25 Sep 2008	(0,00)
Hungary	7,50	11,50	22 Oct 2008	(+3,00)
Poland	5,00	6,00	24 Sep 2008	(0,00)
Russia	10,00	11,00	11 Jul 2008	(+0,25)
Turkey	15,75	16,75	22 Oct 2008	(0,00)
Iceland	13,75	12,00	15 Oct 2008	(-3,50)

Source: National central banks

The ECB raised its key lending rate by 25 basis points to 4,25 per cent in July 2008. At the end of September 2008 the ECB launched a special term refinancing operation aimed at improving the overall liquidity position of the euro area banking system. After equity markets across the world had plunged in late September and early October 2008 on fears that frozen money markets would stall business activity and send industrialised nations spiralling into recession, the ECB, the Bank of Canada, the Bank of England, the

US Federal Reserve, Sveriges Riksbank and the Swiss National Bank announced a co-ordinated reduction in policy interest rates of 50 basis points on 8 October 2008. Inflationary pressures had started to moderate in a number of countries, partly reflecting the decline in energy and other commodity prices. There was also evidence that inflation expectations were declining and that the intensification of the financial crisis had diminished the upside risks to price stability further while augmenting the downside risks to growth.

Iceland's central bank slashed its benchmark interest rate by 3,5 percentage points on 15 October in an attempt to prevent the failure of three large banks from pushing the economy into a recession. On the same day Norway's central bank cut the overnight deposit rate (for the first time since March 2004) by half a percentage point to 5,25 per cent on concerns that the global financial crisis looked set to impact on economic growth. The Bank noted that falling home prices and higher borrowing costs had weakened consumer demand and dampened economic growth, and that although inflation remained high, the forces that had fuelled inflation had diminished.

Furthermore, interest rates were reduced in certain countries in the Asia–Pacific region due to concerns about economic growth. Asian central banks started cutting interest rates, judging that they needed to counter the effect of the US financial crisis on their export-dependent economies. While the contagion from the turmoil is not expected to infect Asia's banking systems, the credit crisis is beginning to hurt exports. Fewer orders for made-in-Asia goods are cooling industrial production in China, Singapore and Taiwan, among others. Taiwan's central bank reduced interest rates by 25 basis points to 3,25 per cent on 9 October 2008, noting that the global financial crisis had heightened the risk of an economic slowdown. Australia's central bank lowered borrowing costs on 2 September and again on 7 October, while New Zealand's central bank lowered borrowing costs on 11 September and again on 23 October. The People's Bank of China joined the co-ordinated action by central banks on 8 October 2008, cutting its benchmark interest rate by 0,27 of a percentage point. The move came just three weeks after China's previous rate cut, which also trimmed the one-year lending rate by 0,27 of a percentage point. The Hong Kong Monetary Authority also reduced its benchmark interest rate on 9 October, while the Bank of Korea cut the seven-day repurchase rate by a record 75 basis points on 27 October 2008. Inflation has slowed in Thailand and policy-makers in the Philippines and Indonesia have forecast that inflation rates will slow before the end of the year. India's central bank unexpectedly lowered its key repurchase rate for the first time since 2004 from 9 per cent to 8 per cent on 20 October 2008. The action came after the bank had reduced the cash reserve ratio by 2,5 percentage points to 6,5 per cent, effective from 11 October.

Among the so-called BRIC (Brazil, Russia, India and China) economies, only India and China have joined global policy-makers around the world in cutting interest rates to avert a recession. However, the Central Bank of the Russian Federation lowered all three of its reserve requirements to 0,5 per cent for the second time in a month on 14 October, and Brazil's central bank reduced reserve requirements on 13 October for the fourth time in three weeks.

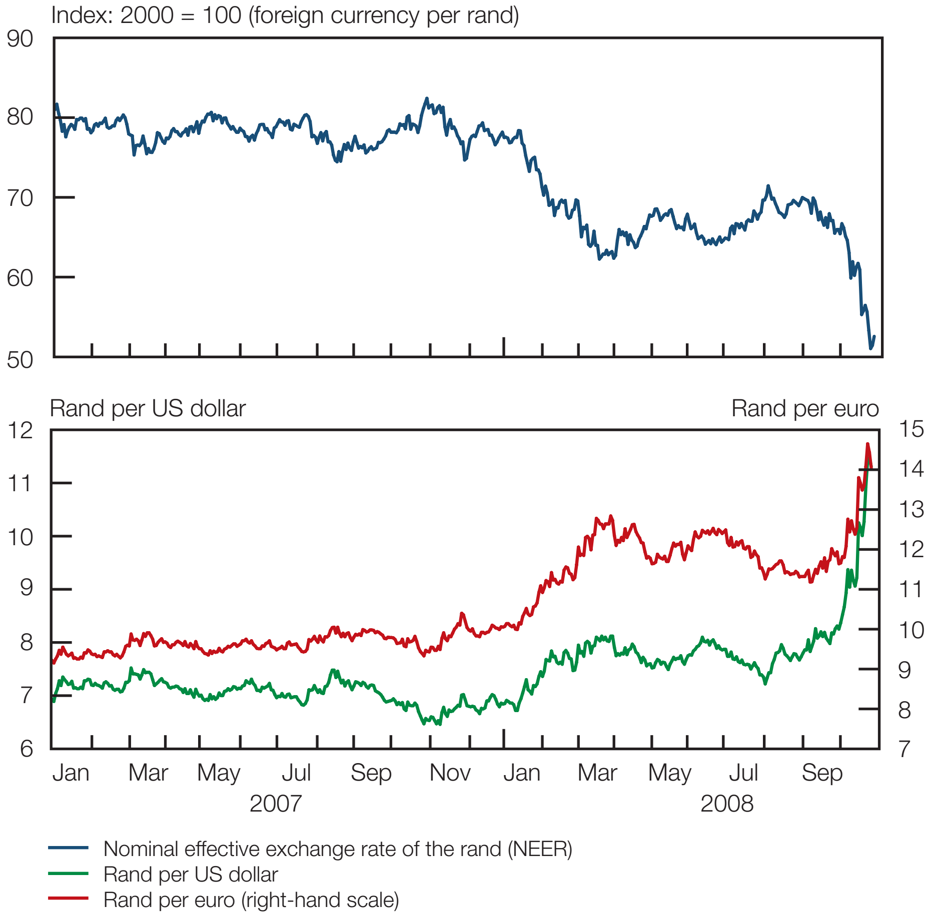
Several other central banks increased interest rates in recent months due to rising inflationary pressures. Since April 2008, interest rates have been tightened in countries such as Brazil, Chile, Denmark, Hungary, Indonesia, Mexico, Poland, Russia, Thailand and Turkey.

On 3 October 2008 the US Congress approved a US$700 billion package to rescue ailing banks, while various other governments pushed ahead with their own emergency measures in this regard. These moves complemented interest rate cuts around the world as central banks and governments struggled to contain the spreading financial crisis.

Exchange rate developments

Since the publication of the previous *Monetary Policy Review* in May 2008 the exchange rate of the rand has depreciated against the US dollar by approximately 49 per cent; from R7,60 at the beginning of May 2008 to R11,31 on 27 October 2008 (Figure 8). Over the same period, the rand depreciated by around 19 per cent against the euro. When measured against a basket of 13 currencies, that is, in terms of the nominal effective exchange rate of the rand (NEER), the currency depreciated by 22 per cent; from 68 index points on 5 May 2008 to 53 index points on 27 October 2008.

Figure 8 Exchange rates of the rand



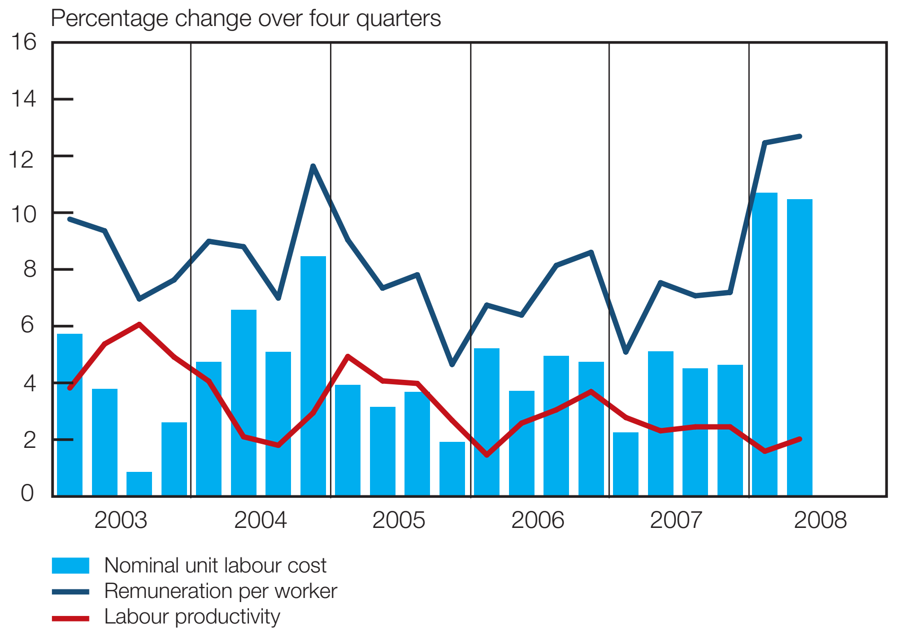
The exchange rate movements during the period under review were largely due to increased volatility in the global financial markets. Concerns about the size of the South African current-account deficit were also a factor, although emerging-market currencies in general traded under unfavourable conditions due to risk aversion as investors reduced their exposures to riskier assets. This phenomenon has persisted due to concerns over the impact of the global credit crisis on the world economy, despite the US$700 billion rescue plan approved by the US authorities.

The depreciation of the rand against the dollar was also attributable to the strengthening of the US dollar against the major currencies. Between 5 May and 27 October 2008 the US dollar strengthened from US$1,55 to US$1,24 to the euro, and from US$1,97 to US$1,54 to the British pound. Furthermore, sharp declines in commodity prices added to pressure on the rand. The price of platinum dropped from US$1 910,50 per ounce on 5 May 2008 to US$784,50 per ounce on 27 October 2008, while the gold price declined from US$854,25 per ounce to US$720,50 per ounce over the same period.

Labour markets

Evidence of increased inflationary pressure emanating from the labour markets is discernible from Figure 9. Wage inflation measured in terms of the year-on-year growth in nominal remuneration per worker in the formal non-agricultural sector, which grew by just over 7 per cent in the last two quarters of 2007, rose by 12,5 per cent in the first quarter and by 12,7 per cent in the second quarter of 2008. The growth in labour productivity (the ratio of real value added to employment in the formal non-agricultural sector) was 1,6 per cent in the first quarter and 2,0 per cent in the second quarter. Economy-wide unit labour cost, measured as wage inflation adjusted for productivity changes in the formal non-agricultural sector, rose by 10,7 per cent in the first quarter of 2008 and 10,5 per cent in the second quarter, after having recorded an increase of 4,6 per cent in the final quarter of 2007.

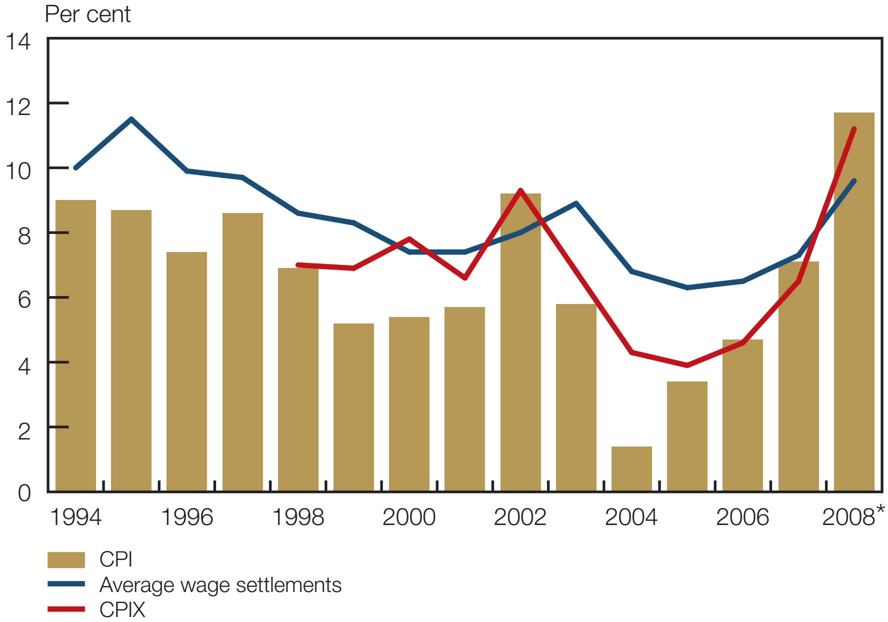
Figure 9 Remuneration per worker, labour productivity and unit labour cost in the formal non-agricultural sector



Sources: Statistics South Africa and SARB calculations

The results of the wage settlements survey published by Andrew Levy Employment Publications in September 2008 also indicate a rising trend in recent months. Figure 10 shows that the average level of wage settlements was 9,6 per cent for the first nine months of 2008, compared with an average of 7,3 per cent for 2007 as a whole.

Figure 10 Average annual inflation and wage settlements



* Data for 2008 are for the first nine months of the year

Sources: Andrew Levy Employment Publications and Statistics South Africa

Demand and output

The South African economy grew at an annualised rate of 4,9 per cent in the second quarter of 2008, following a much slower rate of 2,1 per cent attained in the first quarter (Table 4). However, real gross domestic expenditure contracted by 4,2 per cent during the second quarter of the year as a result of slowing growth in total final demand, together with inventory depletion.

Table 4 Growth in real gross domestic product and expenditure components

Per cent*

	2007				2008	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure						
Households	4,9	4,4	3,8	7,0	3,3	1,2
General government	-3,8	8,7	1,2	5,0	12,8	-1,4
Gross fixed capital formation	11,2	12,9	14,1	14,8	16,9	9,1
Changes in inventories (R billions)**	9,1	6,5	-8,7	4,9	9,8	-6,8
Gross domestic expenditure	**2,9**	**5,2**	**0,0**	**6,0**	**14,2**	**-4,2**
Exports of goods and services	4,4	-3,4	21,6	8,3	-27,9	44,2
Imports of goods and services	1,0	0,1	1,1	10,4	10,8	0,6
Gross domestic product	**4,0**	**4,6**	**5,1**	**5,1**	**2,1**	**4,9**

* Quarterly data refer to quarter-on-quarter growth at annual rates of seasonally adjusted data
** Constant 2000 prices

Growth in real final consumption expenditure by households decelerated from an annualised rate of 3,3 per cent in the first quarter of 2008 to 1,2 per cent in the second quarter, continuing the downward trend that began in early 2007. Rising interest rates and debt-servicing costs contributed to a further contraction in real household spending on durable goods, and slower growth in spending on semi-durable goods and non-durable goods. Growth in real household spending on services accelerated from an annualised rate of 4,3 per cent to 6,5 per cent between the first and second quarters of 2008.

Growth in real final consumption expenditure by general government contracted at a rate of 1,4 per cent in the second quarter of 2008. This contraction is mainly attributable to a base effect, where growth in the first quarter increased significantly due to the government's purchase of a submarine which formed part of the Defence Procurement Programme. Growth in real gross fixed capital formation, although still buoyant, slowed to an annualised rate of 9,1 per cent in the second quarter.

Developments in the external sector of the economy resulted in the ratio of the deficit on the current account to GDP declining from 8,9 per cent recorded in the first quarter of 2008 to 7,3 per cent in the second quarter. The growth in the real value of exports of goods and services rebounded from an annualised rate of decline of 27,9 per cent in the first quarter of 2008 to an annualised rate of increase of 44,2 per cent in the second quarter. Growth in the real value of imports of goods and services slowed from an annualised rate of 10,8 per cent in the first quarter of 2008 to 0,6 per cent in the second quarter. The shortfall on the country's net services, income and current transfer account with the rest of the world remained almost unchanged.

South Africa's gross saving as a percentage of GDP increased from 13,9 per cent in the first quarter to 14,9 per cent in the second quarter of 2008. The increase in gross saving resulted in the lowering of South Africa's dependency on foreign capital to finance investment in South Africa. This dependency ratio declined from 39 per cent in the first quarter of 2008 to 32,8 per cent in the second quarter. While the household sector's gross saving ratio increased marginally from 1,3 per cent in the first quarter of 2008 to 1,4 per cent in the second quarter, the corporate sector's gross saving ratio increased from 10 per cent to 11,1 per cent between these two quarters. The ratio of general government gross saving to GDP declined slightly from 2,7 per cent in the first quarter of 2008 to 2,3 per cent in the second quarter.

South Africa's gross international reserve position, after strengthening to US$35 billion at the end of July, lost a little momentum and recorded US$34,4 billion at the end of September as a result of valuation adjustments following the appreciation of the US dollar against other currencies. The international liquidity position also declined from US$34,2 billion at the end of July 2008 to US$33,6 billion at the end of September.

Real-estate and equity prices

The real-estate sector continues to be relatively subdued with the slowdown in the growth of house prices continuing (Figure 11). This is partly a consequence of declining housing affordability, following a sustained period of rising house prices and higher mortgage costs. After reaching a peak of 35,7 per cent in September and October of 2004, the year-on-year rate of increase in the nominal Absa House Price Index was 1,5 per cent in September 2008.[4] Similarly, the year-on-year change in the Standard Bank House Price Index fell sharply from 35,5 per cent in October 2004 to -13,2 per cent in May 2008, before recovering to 3,6 per cent in September 2008. The median house price measured by this index was R580 000 in September 2008. The year-on-year rate of increase in the First National Bank House Price Index has trended downwards since early in 2005, recording 1,8 per cent in September 2008.

4 The Absa House Price Index records the total purchase price of houses in the 80–400 m^2 size category, valued at R2,9 million or less in 2007 and for which loan applications were approved by Absa. The Standard Bank House Price Index is based on the median price of the full spectrum of recorded house prices, while the First National Bank House Price Index is based on the average value of housing transactions financed by First National Bank, adjusted for outliers.

Figure 11 House prices

Percentage change over twelve months

Sources: Absa, Standard Bank and First National Bank

Table 5 presents building statistics published by Statistics South Africa, which show that the level of economic activity in the real-estate sector continued to moderate in 2008. The real value of recorded building plans passed by larger municipalities during January to August 2008, which provides an indication of future construction activity, decreased by 14,9 per cent compared with the period from January to August 2007. Although the annual rate of increase in the real value of building plans passed for non-residential buildings remained positive at 1,8 per cent, that of residential buildings declined by 21,8 per cent, while additions and alterations declined by 12,4 per cent.

Table 5 Real value of building plans passed and buildings completed in larger municipalities

Annual percentage change

	2005	2006	2007	2008*
Building plans passed				
Total	36,3	8,1	-2,4	-14,9
Residential	29,8	2,7	-3,2	-21,8
Non-residential	53,6	31,7	-5,9	1,8
Additions and alterations	41,6	5,0	1,9	-12,4
Buildings completed				
Total	25,7	21,5	9,5	-4,2
Residential	32,7	16,7	1,2	-13,6
Non-residential	6,7	30,6	48,6	12,0
Additions and alterations	18,1	34,0	6,1	9,9

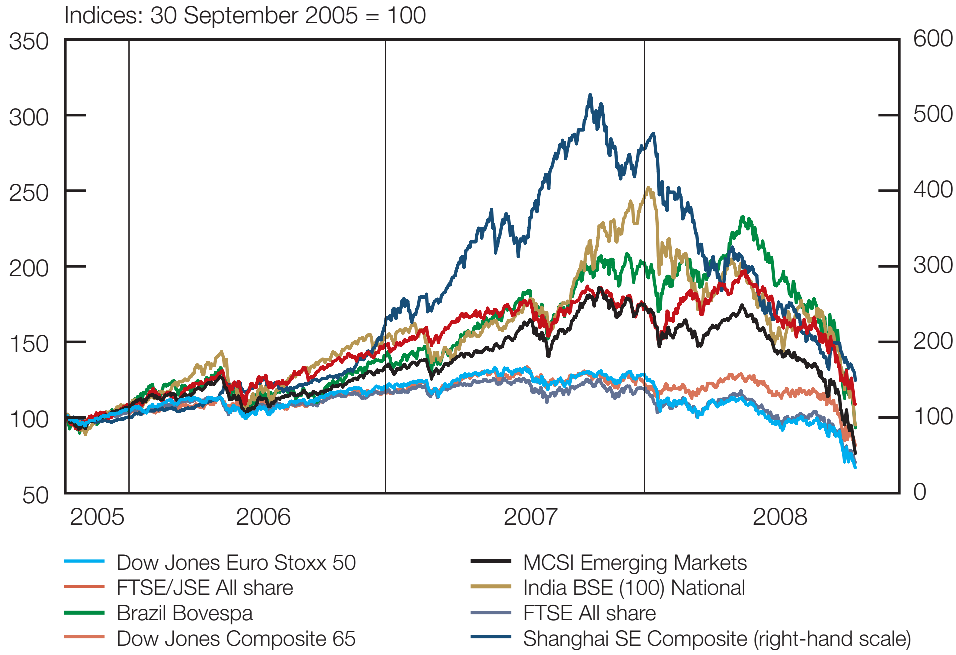
* Data for 2008 are for the first eight months of 2008 compared to the same period the previous year

Source: Statistics South Africa

The real value of buildings reported as completed in larger municipalities during January to August 2008 decreased by 4,2 per cent compared with January to August 2007. The real value of residential buildings completed declined by 13,6 per cent, while increases of 9,9 per cent for additions and alterations and 12,0 per cent for non-residential buildings were reported.

In the period under review share prices on the JSE Limited (JSE) followed global trends. The all-share index (Alsi) traded above the 32 000 level on average in May 2008, but declined to 18 364 index points on 27 October 2008; a decline of over 42 per cent. These trends are consistent with weaker global equity markets, mostly owing to the ongoing global financial crisis and volatile commodity prices. Figure 12 shows the relative performance of various international equity markets over the past three years.

Figure 12 Share price indices



Sources: Datastream and Bloomberg

Fiscal policy

Amid the global financial market crisis and weaker economic activity, the Medium Term Budget Policy Statement (MTBPS) presented by the Minister of Finance on 21 October 2008 depicts a slightly deteriorating fiscal position (Table 6). The revised budget balance amounts to a surplus of R3,2 billion, which represents 0,1 per cent of GDP. This revised budget balance is lower than the surplus of 0,8 per cent of GDP projected in the *Budget Review 2008*. In the medium term, deficits of 1,6 and 1,1 per cent of GDP are projected for the fiscal years 2009/10 and 2010/11 respectively, and a balanced budget is projected for fiscal year 2011/12. These revisions are a consequence of moderating revenue growth due to slower economic growth. Revenues are expected to average 27,4 per cent of GDP between 2009/10 and 2011/12, while expenditures will average 28,3 per cent of GDP over this period.

The revised public-sector borrowing requirement (PSBR) is estimated at 1,3 per cent of GDP in 2008/09 and is projected to rise to 3,0 per cent of GDP in 2009/10, to 3,2 per cent of GDP in 2010/11 and to 2,6 per cent of GDP in 2011/12. The budget deficit and borrowing by state-owned enterprises, most notably Eskom, are the main drivers of the increase in the PSBR. Net loan debt as a share of GDP has been revised upwards to

20,8 per cent from 19,7 per cent of GDP in the *Budget Review* 2008. State debt costs are estimated at 2,3 per cent of GDP for 2008/09 and are expected to assume a declining path in the medium term.

Table 6 Public finance data
R billions and per cent

	2007/08	2008/09		2009/10	2010/11	2011/12
	Actual	Budget	Revised estimates	Medium-term estimates		
Consolidated national government						
Revenue	584,6	650,0	653,5	712,8	783,5	869,2
Expenditure	558,0	631,5	650,3	754,3	814,5	868,6
Budget balance	26,6	18,5	3,2	-41,5	-31,0	0,6
As a percentage of GDP						
Budget balance	1,3	0,8	0,1	-1,6	-1,1	0,0
Total net loan debt	23,3	19,7	20,8	21,4	21,2	19,9
State debt cost	2,6	2,2	2,3	2,0	1,9	1,8
PSBR*	-0,3	1,2	1,3	3,0	3,2	2,6

* PSBR: Public-sector borrowing requirement

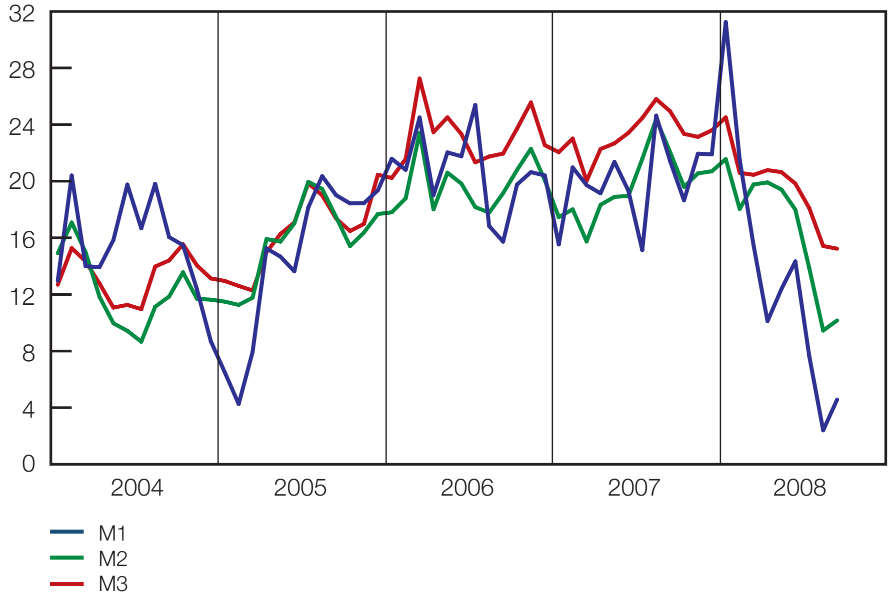
Source: National Treasury Medium Term Budget Policy Statement 2008

Monetary conditions

Figure 13 shows that the twelve-month growth rate of the broad monetary aggregate (M3) declined from 20,1 per cent in April 2008 to 15,2 per cent in September. The corresponding slowing in the growth rate for the narrower M2 was from 19,9 per cent to 10,2 per cent, while that of M1 declined from 10,1 per cent in April to 4,6 per cent in September.

Figure 13 Growth in the monetary aggregates

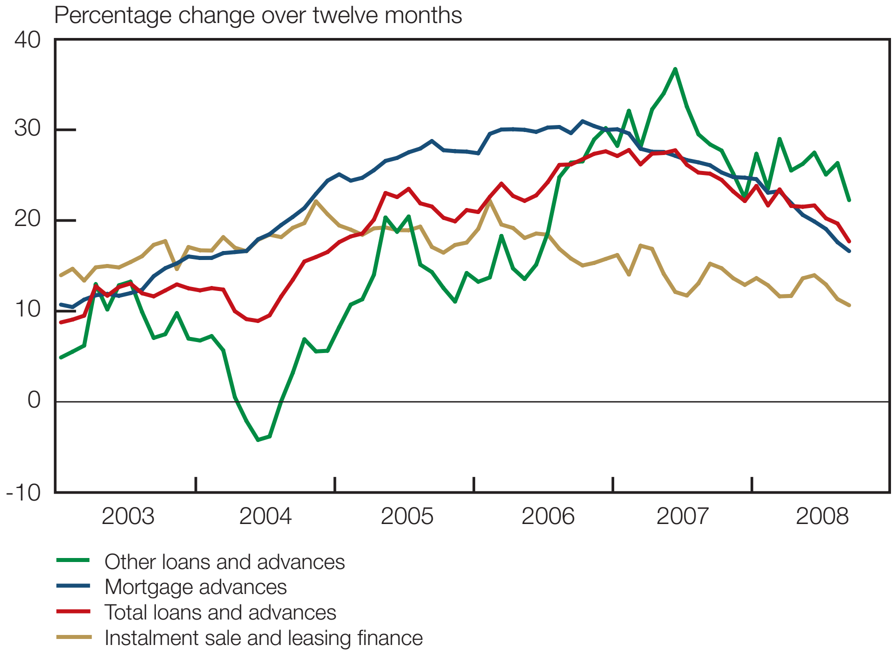
Percentage change over twelve months



Total loans and advances to the private sector[5] have been trending downwards since mid-2007 (Figure 14). In 2008 the year-on-year growth in total loans and advances to the private sector declined from 23,4 per cent in March to 17,7 per cent in September. The growth in the mortgage advances component was influential in this regard, slowing from 23,2 per cent in March to 16,6 per cent in September. The growth in instalment sale credit and leasing finance declined from 11,6 to 10,7 per cent over the period, while growth in the other loans and advances category slowed from 29,0 per cent in March to 22,2 per cent in September.

5 Total loans and advances to the private sector consist of instalment sale credit, leasing finance, mortgage advances, overdrafts, credit-card and general advances. The first three categories are referred to as asset-backed credit, while the last three are referred to as other loans and advances.

Figure 14 Banks' loans and advances

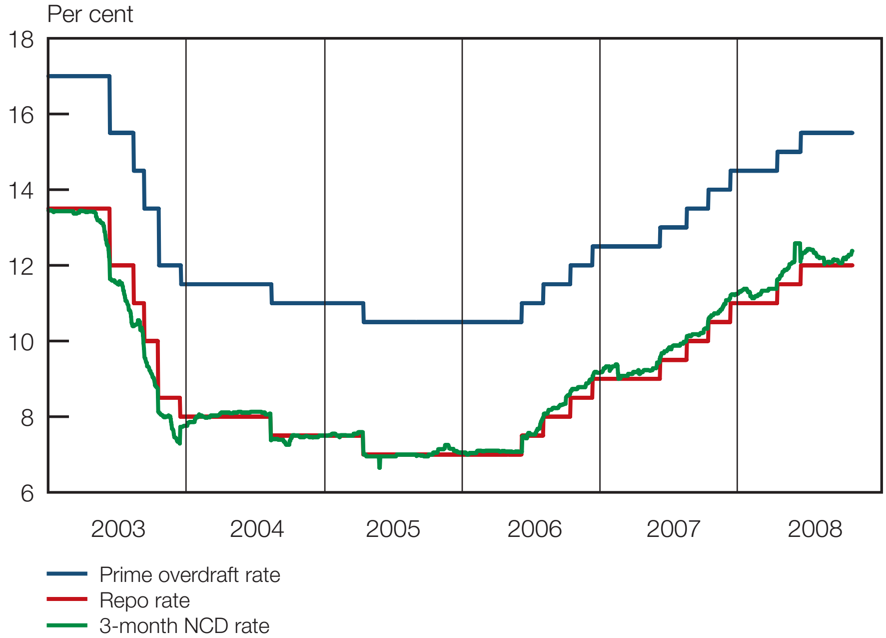


Monetary policy

Inflation has been outside the target range since April 2007. It is generally accepted that a flexible inflation-targeting regime should allow for a deviation from the target in the event of exogenous shocks that are beyond the control of the monetary authorities. This framework also allows for deviations from the target in such instances, to avoid an excessive impact on output variability. Under such circumstances it is appropriate to focus on a reasonable time horizon for bringing inflation back to within the target range. However, to prevent second-round effects, it is important that expectations remain well anchored. Failure to respond to inflation pressures will inevitably cause expectations to become dislodged and result in a further acceleration of inflation.

Since the publication of the previous *Monetary Policy Review* there have been three meetings of the Monetary Policy Committee (MPC). At the first of these meetings, in June, the monetary policy stance was tightened further when the repurchase (repo) rate was increased by 50 basis points, bringing the cumulative increase in the current interest rate cycle to 500 basis points (Figure 15). The repo rate remained unchanged at the subsequent two meetings. During these meetings there was a clear change in the balance of risks. In particular, the exogenous shocks that had had a significant influence on the inflation outlook – mainly food and oil price increases – appeared to have dissipated somewhat, and even reversed in the case of oil. However, by the October meeting, the exchange rate was seen to pose the single biggest risk to the inflation outlook.

Figure 15 The repo and other short-term interest rates



A concern for the MPC over this period was the more generalised nature of the inflation dynamics. While accepting that monetary policy cannot do much to prevent supply-side shocks, such as oil and food price increases, from having first-round effects on inflation, the MPC has had to be mindful of the impact of these shocks on inflation expectations and of the need to act against the emergence of generalised inflation pressures. These pressures became more evident during the past three meetings. By August, when overall year-on-year CPIX inflation measured 13,6 per cent, a measure of core CPIX inflation which excludes food and petrol prices had increased to 8,1 per cent, compared with 5,5 per cent in January 2008. While some of the increase in this core measure can be ascribed to another supply-side shock in the form of electricity price increases, excluding this item as well would have resulted in CPIX inflation of 6,9 per cent in August.

From the MPC meeting of February 2007 until the August 2008 meeting, the inflation forecast of the Bank deteriorated progressively. This was due, to a large extent, to the international oil price continuing to surprise on the upside, and this required a continuous revision of the oil price assumption in subsequent forecast rounds. The prolonged uncertainty surrounding the size of the electricity price increase to be granted to Eskom by the National Energy Regulator of South Africa also contributed to the risk of the administered price assumptions being overshot. Changes in the exchange rate assumption at times also contributed to changes in the forecast. At the June 2008 meeting, year-on-year CPIX inflation was forecast to peak at 12 per cent during the third quarter of 2008, compared with the previous forecast of a peak of 9,3 per cent in the first quarter of 2008. Inflation was expected to return to within the target range in the third quarter of 2010. The subsequent forecasts, in August and October, showed that the peak would be higher, at 13 per cent and 13,3 per cent respectively, although the timing remained unchanged. These two forecasts predicted inflation to return to within the target range by the second quarter of 2010. The most recent forecast is discussed in more detail in a later section of this review.

The two most recent forecasts were also complicated by the impending rebasing and reweighting of the CPI basket, which is to be implemented by Statistics South Africa from January 2009. In trying to account for these changes, certain assumptions had to be made, and the central forecast was therefore subject to additional uncertainty. Partly as a result of these assumptions, there was a significant decline in the inflation trajectory in the first quarter of 2009 in both these forecasts. This meant that although inflation was expected to exceed the upper end of the inflation target range for some time, the extent of the deviation from the target was now much lower than previously expected.

Despite these developments, the MPC had to consider the fact that inflation expectations were no longer well anchored within the inflation target range. The inflation expectations survey conducted on behalf of the Bank by the Bureau for Economic Research (BER) at Stellenbosch University showed that this was particularly the case for trade unionists and business people. The expectations of analysts, which were also reflected in the Reuters consensus forecast, were more favourable and more or less in line with those of the Bank. Nevertheless, while there was a progressive deterioration in the inflation outlook, there was still an expectation that inflation would moderate over the coming years. However, the average expectation was that inflation would remain above the target range in 2009 and 2010.

The trends in wage settlements were also viewed by the committee as an indication that inflation expectations were not well anchored. Nominal wage settlements were increasing consistently although they were still generally below the inflation rate.

The balance of risks to the inflation forecast, as assessed by the MPC, changed during the past few months. In general, the main risks identified emanated from electricity, food and petrol prices. During the past period, the major change in the risk profile related to international oil prices and the exchange rate. At the August meeting oil was still regarded as one of the major upside risk factors. At that time it was trading at levels of around US$140 per barrel and there were no indications that this trend was about to be reversed. By the following meeting oil prices had declined to around US$112 per barrel, but there was still uncertainty as to whether this trend would be sustained. Oil prices fell by a further US$30 per barrel by the time of the October meeting. The committee was of the view that although oil could resume its upward trend at any time, the degree of upside risk had declined significantly.

While the risks posed by oil prices had subsided, the depreciation of the rand emerged as a significant upside risk. Although the exchange rate had been relatively volatile during the months before the October 2008 MPC meeting, it was at levels of around R8,00 against the US dollar at the July and August meetings. By the time of the October meeting, heightened risk aversion in the global financial markets put pressure on a number of emerging-market currencies. The rand was no exception in this regard and at the time of the meeting the rand was trading at around R9,10 against the US dollar, having reached a level of around R9,45 at one stage. The MPC noted that the extent of the risk to the inflation outlook would depend to a significant degree on the sustainability of these levels. It noted that if the exchange rate were to revert to levels of the previous month, the degree of pass-through would likely be muted.

Food prices continued to pose an upside risk, but the MPC noted that the extent of this risk appeared to be declining, despite the elevated level of food price inflation. Wheat, maize and rice prices had declined in global and domestic markets during 2008, and agricultural food inflation at the production price level decelerated over the period. Manufactured food producer price inflation remained high, which indicated that overall food prices were likely to remain elevated in the short run.

The inflation momentum over the past two years has been caused by both exogenous shocks and strong domestic demand. While monetary policy cannot prevent the first-round effects of supply-side shocks, it can, however, impact directly on household consumption expenditure. In the past few months there was clear evidence that consumption was responding to the change in the monetary policy stance. Household consumption expenditure grew at annualised rates of 3,3 per cent and 1,2 per cent in the first two quarters of 2008 respectively, significantly lower than the peak in excess of 9 per cent seen in the final quarter of 2006. The committee also noted continued weaker growth trends in retail and wholesale trade, declining motor vehicle sales and low levels of consumer confidence.

The committee noted that the weaker household consumption trends were also having an impact on credit extension to the private sector, which was showing a steady deceleration. Nevertheless, there was still a concern that the growth rates in credit extension were relatively high. Asset prices and their associated wealth effects also declined significantly over this period. This was particularly the case in the housing and equity markets. The committee was of the view that these wealth effects could constrain consumer demand further in the coming months.

The committee also gave emphasis to the slower growth and widening output gap over this period. This focus was often interpreted by analysts as representing a change in the objective of monetary policy away from inflation and towards growth. Any inflation-targeting central bank would focus on growth and the output gap. Firstly, monetary policy would not want to cause excessive output variability. This is the essence of a flexible inflation-targeting framework. Secondly, the output gap, that is, the difference between potential output and actual output, is one of the main determinants of inflation. A widening output gap – a decline in output growth relative to potential – would reduce pressure on inflation. Estimating potential output is difficult, but research done at the Bank (reported in the *Monetary Policy Review* of May 2006) suggests that potential output growth may be in the region of 4,5 per cent per annum. Over the past months therefore it appeared that the economy was growing below potential, in contrast to the experience of the previous three years. During the period under review, the MPC consistently pointed to signs of moderation in growth. These indicators, apart from the actual growth outcomes, included the persistently declining leading business cycle indicator of the Bank, the declining utilisation of production capacity in manufacturing, the weaker trend in mining and manufacturing output, as well as the low levels of the Investec/BER Purchasing Managers Index (PMI). The Rand Merchant Bank/Bureau for Economic Research (RMB/BER) Business Confidence Index over this period also showed persistent weakness.

Global growth and inflation developments were generally favourable to the domestic inflation outlook over this period. Although there were risks emanating from rising world inflation as a result of global food and energy price developments, most forecasts saw world inflation reasonably under control. During this period global growth prospects were also seen to be deteriorating, and this was particularly the case at the October meeting. This meant that widening output gaps and declining commodity prices were likely to help contain inflation, despite a general trend towards more accommodative monetary policies.

Monetary policy decisions in a number of countries are currently being dominated by financial stability considerations. While the South African Reserve Bank MPC was mindful of the turmoil in the financial markets, the continued stability of the domestic financial system meant that it could maintain its focus on its mandate to achieve price stability. While the market uncertainties and heightened risk make forecasting more difficult, the MPC's view at the most recent two meetings was that the balance of risks was such that an unchanged monetary policy stance was appropriate.

The outlook for inflation

The outlook, risk and uncertainties relating to some of the factors that determine the outlook for inflation are presented in this section.

International outlook

Increasing turmoil in financial markets, and rising food and fuel prices have contributed to lower global growth forecasts and higher global inflation forecasts. The IMF's October 2008 *World Economic Outlook* (*WEO*) indicated that central banks and governments were confronted by the twin problems of slowing economic growth and surging inflation, and that they needed to head off rising inflationary pressure while being mindful of downside risks to growth.

Global economic growth is forecast to slow from 3,9 per cent in 2008 to 3 per cent in 2009 (Table 7). Global inflation, driven mainly by escalating food and energy prices, is projected at 6,2 per cent for 2008 and 4,6 per cent for 2009. Inflation pressures are expected to be most pronounced in the emerging and developing economies where food carries a relatively large weight in consumption expenditure. However, the recent easing of oil prices and some other commodity prices could serve to reduce these pressures.

Table 7 IMF projections of world growth and inflation for 2008 and 2009*
Per cent

	Real GDP			Consumer prices**		
	2008		2009	2008		2009
World	**(3,7)**	**3,9**	**3,0**	**(4,7)**	**6,2**	**4,6**
Advanced economies	**(1,3)**	**1,5**	**0,5**	**(2,6)**	**3,6**	**2,0**
United States	(0,5)	1,6	0,1	(3,0)	4,2	1,8
Japan	(1,4)	0,7	0,5	(0,6)	1,6	0,9
Euro area	(1,4)	1,3	0,2	(2,8)	3,5	1,9
United Kingdom	(1,6)	1,0	-0,1	(2,5)	3,8	2,9
Other advanced economies	(3,3)	3,1	2,5	(3,0)	4,4	3,3
Other emerging-market and developing countries	**(6,7)**	**6,9**	**6,1**	**(7,4)**	**9,4**	**7,8**
Africa	(6,3)	5,9	6,0	(7,5)	10,2	8,3
Central and eastern Europe	(4,4)	4,5	3,4	(6,4)	7,8	5,8
Commonwealth of Independent States	(7,0)	7,2	5,7	(13,1)	15,6	12,6
Developing Asia	(8,2)	8,4	7,7	(5,9)	7,8	6,2
China	(9,3)	9,7	9,3	(5,9)	6,4	4,3
India	(7,9)	7,9	6,9	(5,2)	7,9	6,7
Middle East	(6,1)	6,4	5,9	(11,5)	15,8	14,4
Western hemisphere	(4,4)	4,6	3,2	(6,6)	7,9	7,3

* IMF projections for 2008 as at April 2008 in parentheses
** Zimbabwe excluded

Source: IMF *World Economic Outlook*, October 2008

The global economic downturn is expected to deepen during the latter half of 2008, primarily due to the ongoing financial market crisis. While some advanced economies are moving closer to a recession, growth in the emerging economies is also slowing and reflecting an increasingly synchronised deceleration in economic activity. Growth in the advanced economies is expected to decline to 1,5 per cent in 2008 and further to 0,5 per cent in 2009.

US growth is expected to decline to 1,6 per cent during 2008 and further to 0,1 per cent during 2009. Stronger than expected consumption in the first half of 2008 was fuelled by tax rebates and may be of a temporary nature as consumption increasingly reflects the impact of continued declines in house prices and deteriorating net wealth positions, together with increasingly difficult access to credit and rising unemployment. An unexpected slowdown in export growth could also impact negatively on the US growth outlook. Other downside risks to the US growth outlook include a deepening of the housing correction through 2009. Together with recent declines in oil prices, productivity increases, moderate wage increases and a widening output gap, inflationary pressures in the US are likely to decline. US inflation rates of 4,2 per cent and 1,8 per cent are projected for 2008 and 2009 respectively.

Risks to Japan’s growth outlook are mainly to the downside. These downside risks include the possibility of a severe global slowdown, as well as the impact of relatively high commodity prices on corporate profits and the incomes of households. Japan’s growth is projected to slow to 0,7 per cent in 2008 and 0,5 per cent in 2009.

The IMF’s October 2008 *WEO* projects euro area growth of 1,3 per cent for 2008, slowing further to 0,2 per cent during 2009. Inflation rates of 3,5 per cent for 2008 and 1,9 per cent for 2009 are projected for the euro area. These projections are in line with those of the ECB, which in August projected growth of between 1,1 per cent and 1,7 per cent for 2008 and between 0,6 per cent and 1,8 per cent for 2009. The ECB forecasts an average Harmonised Index of Consumer Prices (HICP) inflation rate of between 3,4 per cent and 3,6 per cent in 2008 and a lower projected range of 2,3 per cent to 2,9 per cent for 2009. Higher wage increases together with lower labour productivity growth, resulting in higher unit labour costs, will contribute to the projected higher 2008 inflation range. However, the pressure from unit labour cost may be partly offset by profit margin movements resulting from weaker economic activity during 2008.

For the UK, the IMF has revised its 2008 growth forecast from 1,6 per cent to 1 per cent and projects a contraction in real output of 0,1 per cent for 2009. The inflation forecast for 2008 has been revised upwards by the IMF to 3,8 per cent, from 2,3 per cent in 2007, while inflation of 2,9 per cent is projected for 2009. The Bank of England’s August 2008 *Inflation Report* describes the risks to the UK’s growth outlook as tilted to the downside over the medium term, while risks to the UK inflation outlook are on the upside. As is the case in the US, household consumption will be dampened by tight credit conditions and a weakening housing market.

Difficult access to external financing and slowing global trade are external factors that may impact negatively on growth in the emerging-market and developing countries. Domestic demand will also be adversely affected by deteriorating financial conditions and housing-market corrections. Although commodity prices have moderated somewhat during the second half of 2008, wage demands may continue to place pressure on inflation in these countries. The IMF has significantly increased its inflation forecast for the emerging-market and developing countries to 9,4 per cent for 2008 and 7,8 per cent for 2009, and GDP growth in these countries is expected to decline to 6,9 per cent in 2008 and 6,1 per cent in 2009.

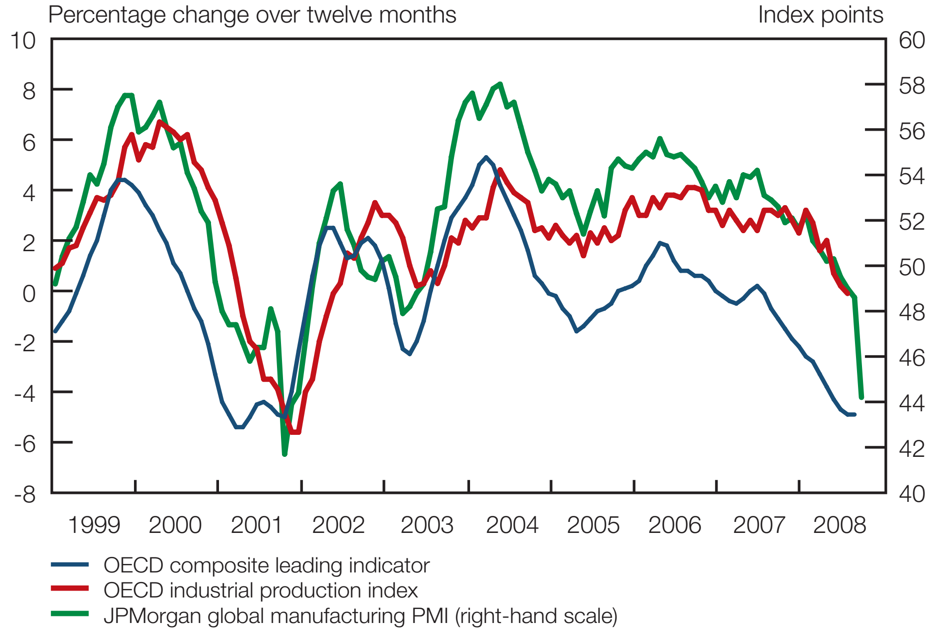
The IMF projected growth in Africa to remain around 6 per cent during both 2008 and 2009, while inflation is forecast at 10,2 per cent for 2008 and 8,3 per cent for 2009.

The IMF's growth projection for developing Asian countries is for growth of 8,4 per cent in 2008 and 7,7 per cent in 2009. Inflation of 7,8 per cent in 2008 and 6,2 per cent in 2009 is projected for these countries. The Asian Development Bank (ADB) is less optimistic and expects growth to slow slightly against the backdrop of the international financial crisis from 7,5 per cent in 2008 to 7,2 per cent in 2009. The contribution of the prices of food, energy and other raw materials towards increased inflation in the region has resulted in an ADB inflation forecast of 7,8 per cent for 2008 and 6,0 per cent for 2009.

With forecasts of 9,7 per cent for 2008 and 9,3 per cent for 2009, the IMF projects a strong growth outlook for China. The IMF has increased its inflation forecast for China for 2008 from 5,9 per cent to 6,4 per cent and projects an inflation rate of 4,3 per cent for 2009. India's growth is expected to slow from 7,9 per cent in 2008 to 6,9 per cent in 2009, while inflation is set to slow from 7,9 per cent to 6,7 per cent over the period.

Supporting the IMF and other global forecasts, the composite leading indicator compiled by the OECD also projects a continuing slowdown in economic activity in some major OECD countries (Figure 16). The OECD composite leading indicator continued to fall, recording a decline of 4,9 points in August 2008 compared with the same month of the previous year. This decline reflects slowing economic activity for countries such as the US, the euro area, Japan, the UK, Canada, France, Germany and Italy. While the non-OECD country data point towards a possible increase in economic activity for Brazil, slowing economic activity is projected for India, China and Russia.

Figure 16 Selected indicators of global economic activity



Sources: OECD and JPMorgan

A signal that the downturn in global manufacturing is set to become broader and deeper was provided by the JPMorgan Global Manufacturing PMI, which fell to 44,2 index points in September 2008 from 48,6 in August. The downturn was larger than anticipated and was the lowest reading since November 2001, as manufacturing conditions continued to weaken in the US, the euro area, the UK, Japan and Russia.

Global oil demand was projected in early October 2008 by the International Energy Agency to increase by 0,5 per cent in 2008 (averaging 86,5 million barrels per day). The OECD supply is projected to decline by 400 000 barrels per day to 19,4 million barrels per day in 2008, while non-OECD supply is expected to remain unchanged at 27,8 million barrels per day during the same period. Non-OPEC supply is expected to decrease by 200 000 barrels per day to 49,9 million barrels per day in 2008. On 27 October 2008 the futures prices for Brent crude oil to be delivered in May and June 2009 were around US$67 per barrel and US$68 per barrel respectively.

Outlook for domestic demand and supply

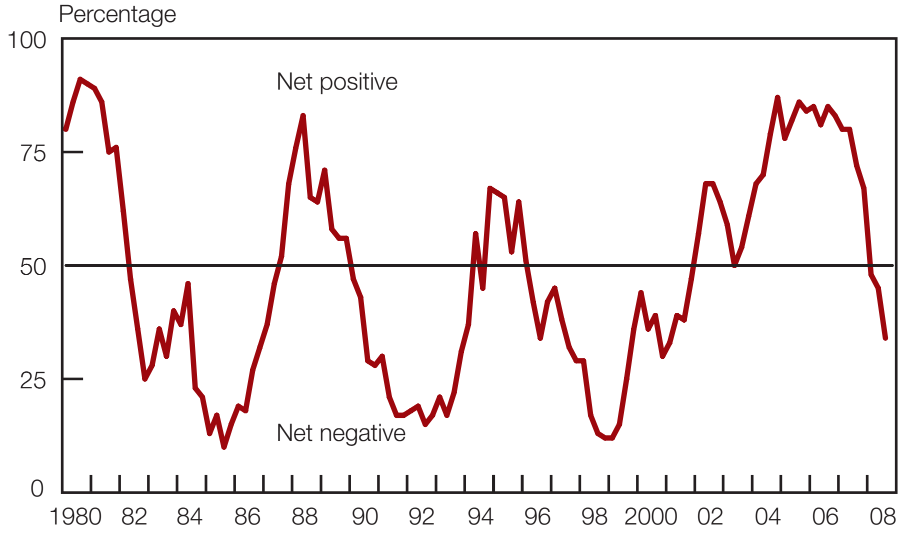
There is a general expectation that domestic growth will moderate during 2009 due to weaker economic conditions before improving in 2010. According to the latest Reuters consensus forecasts surveyed in October 2008, the South African economy is expected to grow by 3,3 per cent in 2008, 3,2 per cent in 2009 and 4,3 per cent in 2010. These forecasts represent the mean of 21 individual forecasts for 2008 and 2009, and the mean of 17 forecasts for 2010. They range from 1,8 to 4,4 per cent for 2008, from 1,8 to 5,3 per cent for 2009, and from 3,9 to 5,5 per cent for 2010.

The National Treasury in its MTBPS expects real economic growth of 3,7 per cent in 2008 and 3 per cent in 2009. Depending on international economic developments and trends in public-sector capital expenditure together with private-sector investment momentum, GDP growth is expected to recover to around 4 per cent in 2010 and 4,3 per cent in 2011.

Surveys of consumer and business confidence indicate that confidence levels in the economy are currently low. Consumer confidence, measured by the First National Bank/Bureau for Economic Research (FNB/BER) Consumer Confidence Index as the percentage of respondents expecting an improvement in conditions less the percentage expecting deterioration, declined from +12 in the first quarter of 2008 to -6 in the second quarter before increasing to -1 in the third quarter. Consumer confidence in the second quarter of 2008 was at its lowest level since the first quarter of 2004 when it registered -7. The small rise in consumer confidence in the third quarter can be attributed to consumers' views on the economy and the expected status of their own finances. In terms of the components of the overall index, the sub-index measuring the percentage of consumers expecting an economic improvement in the coming year exceeded the percentage expecting deterioration by 2 per cent. Furthermore, the sub-index measuring the net percentage of consumers expecting their finances to improve during the next 12 months rose from 5 per cent in the second quarter of 2008 to 13 per cent in the third. However, the final sub-index, measuring the net percentage of consumers rating the present as an inappropriate time to buy durable goods, increased from 9 per cent to 17 per cent, the most unfavourable level since the first quarter of 2004.

The level of business confidence, measured in terms of the RMB/BER Business Confidence Index, declined to its lowest level in six years in the second quarter of 2008 (Figure 17). The index measures business confidence on a scale of 0 to 100, with 0 indicating an extreme lack of confidence, 50 neutrality and 100 extreme confidence. After recording levels of around 85 in 2006, the index declined to 45 in the second quarter of 2008 and to 34 in the third quarter of 2008. All subcomponents declined between the second and third quarters of 2008. The largest decreases occurred among new vehicle traders and wholesalers; declining by 23 and 18 index points respectively. Building contractors' confidence declined from 47 index points to 41 index points. Manufacturers' confidence fell from 37 to 30 index points due to weaker domestic orders, rising levels of finished goods inventories and declining profit margins, while retailers' confidence declined by 4 index points to a level of 49 in the third quarter of 2008. The net negative sentiment that prevailed can be attributed to a contraction in business volumes, the impact of high interest rates, reduced profitability, declining household spending as well as increases in energy costs.

Figure 17 RMB/BER Business Confidence Index



Sources: Rand Merchant Bank and Bureau for Economic Research

Although the Investec/BER PMI, a barometer of manufacturing activity, remained below the critical level of 50 index points, it rose from a seasonally adjusted 42,8 index points in July 2008 to 47 index points in August and September. Input price inflation slowed as pressure from international commodity prices receded, and purchasing managers' estimates of business conditions in six months' time were revised upwards in both August and September. The recent PMI results suggest a possible bottoming of the deterioration in manufacturing business conditions, although the deterioration in the global economic outlook is viewed as presenting a significant threat to a recovery.

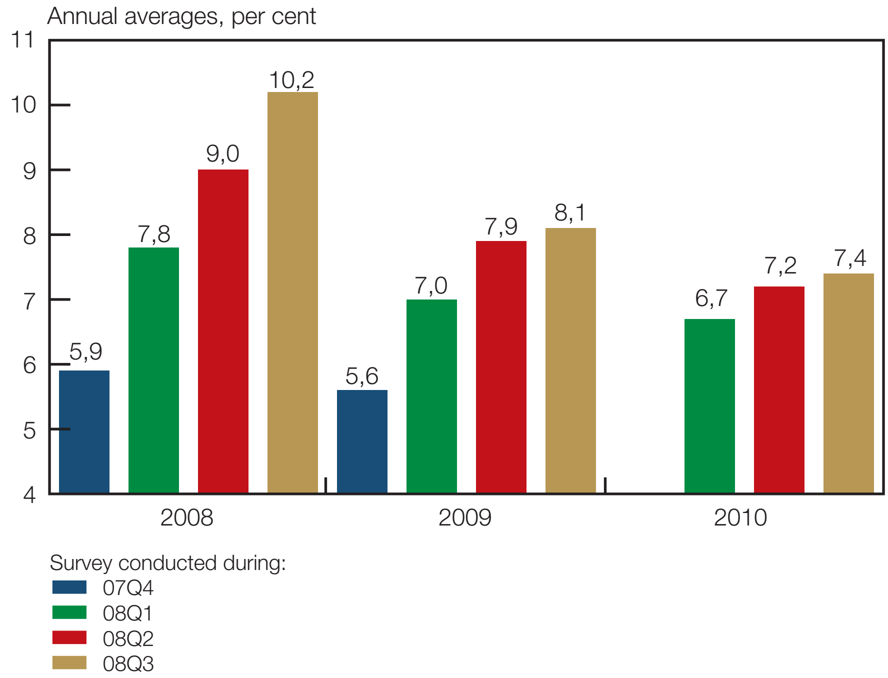
The FNB Civil Construction Confidence Index, which reflects the proportion of managers expressing satisfaction with current conditions in the industry, decreased from an index value of 71 in the second quarter of 2008 to 69 in the third quarter of 2008. Tendering competition increased during the third quarter of 2008, reflecting weak demand conditions. Overall profitability of survey respondents suffered due to thin gross margins.

The BER Retailer Confidence Index declined from 53 index points in the second quarter to 49 in the third quarter of 2008. Wholesaler confidence declined considerably from 51 to 33 index points; the lowest level in seven years. The downturn in retailer and wholesaler confidence is due to disappointing sales growth, lower profitability and rising inventory levels during the third quarter. However, purchase and selling price increases have remained high, also evidenced by record-high PPI and CPIX inflation data during the third quarter. Retailers and wholesalers alike expect business conditions to deteriorate further on weak sales volumes during the fourth quarter of 2008.

Indicators of inflation expectations

Inflation expectations for the forecast period from 2008 to 2010 obtained from the BER survey conducted during the third quarter of 2008 show that CPIX inflation expectations increased relative to the second-quarter survey. However, the survey results also show that average inflation expectations are expected to decline over the forecast years, although they remain above the upper limit of the CPIX inflation target range. As depicted in Figure 18, CPIX inflation expectations for 2008 increased by 1,2 percentage points to 10,2 per cent, by 0,2 percentage points to 8,1 per cent for 2009, and by 0,2 percentage points to 7,4 per cent for 2010.

Figure 18 BER surveys of CPIX inflation expectations



Source: Bureau for Economic Research, Stellenbosch University

Financial analysts revised their forecasts upwards by the biggest margin, compared to the other groups surveyed (Table 8). Although all groups expect CPIX inflation to decline over the forecast horizon, only financial analysts expect a movement of inflation back to within the target range by 2010. Business expects CPIX inflation to remain outside the target band for the forecast period, while trade unions expect CPIX inflation to decline in 2009, but to rise again in 2010 and also remain outside the target range.

Table 8 BER survey of CPIX inflation expectations: Third quarter 2008*
Per cent

	2008		2009		2010	
1. Financial analysts	(9,6)	11,3	(7,0)	7,3	(5,8)	5,9
2. Business	(8,8)	9,7	(8,7)	8,8	(8,3)	7,8
3. Trade unions	(8,6)	9,6	(8,1)	8,2	(7,4)	8,5
Average 1–3	(9,0)	10,2	(7,9)	8,1	(7,2)	7,4

* Second-quarter 2008 results in parentheses

Source: Bureau for Economic Research, Stellenbosch University

The September 2008 Reuters survey of long-term forecasts for the South African economy (Table 9) shows that although CPIX inflation expectations remain high, they are expected, on average, to decline over the forecast horizon, moving back to within the target range in 2010. It is expected that CPIX inflation will average 11,6 per cent in 2008, representing a 0,2 percentage point upward revision from the August 2008 survey. For 2009 and 2010, the mean CPIX inflation forecasts are unchanged from the previous survey result at 7,5 and 5,9 per cent respectively.

Table 9 Reuters survey of CPIX forecasts: September 2008*
Per cent

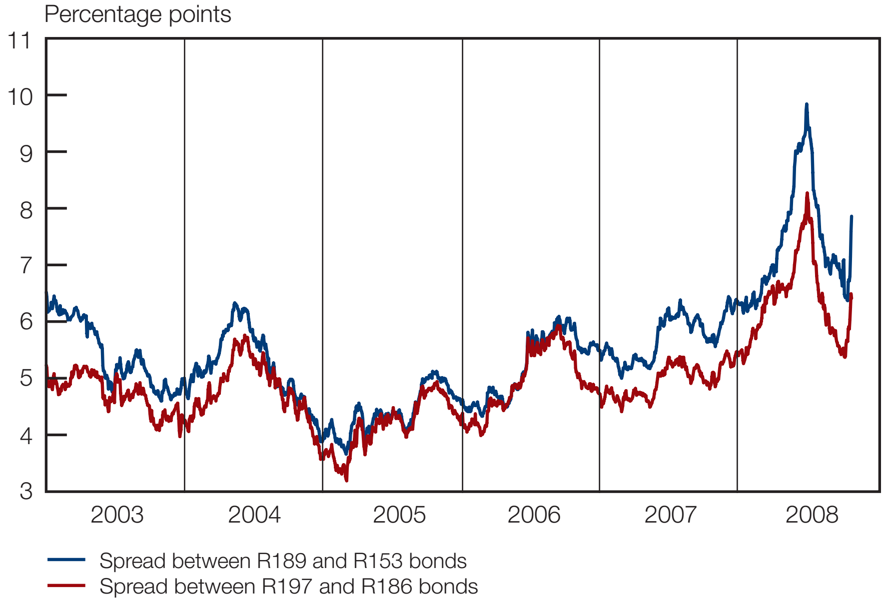
	2008	2009	2010
1. Mean	(11,4) 11,6	(7,5) 7,5	(5,9) 5,9
2. Median	(11,4) 11,5	(7,2) 7,2	(5,9) 5,9
3. Highest	(12,2) 12,2	(9,4) 9,4	(6,3) 6,5
4. Lowest	(11,0) 11,2	(6,6) 6,2	(5,3) 5,3
Number of forecasters	(18) 20	(17) 19	(13) 16

* August 2008 survey results in parentheses

Source: Reuters

Break-even inflation rates, measured as the difference between the yields on South African CPI inflation-linked bonds and conventional nominal bonds of similar maturity, suggest that inflation expectations peaked at the beginning of July 2008 and then declined sharply until October when they began rising again (Figure 19). Break-even inflation rates obtained from the R189 (maturing 2013) inflation-linked bonds remained above the inflation target, rising from 6,3 per cent at the beginning of 2008 to a peak of 9,8 per cent at the beginning of July. These rates then receded to 6,4 per cent by the middle of October, before rising once more to 7,9 per cent on 24 October 2008. Those obtained from the R197 (maturing 2023) inflation-linked bonds peaked at 8,3 per cent at the beginning of July 2008 after which they declined to 5,4 per cent in early October before rising to 6,4 per cent on 24 October 2008. However, break-even inflation rates

Figure 19 Break-even inflation rates

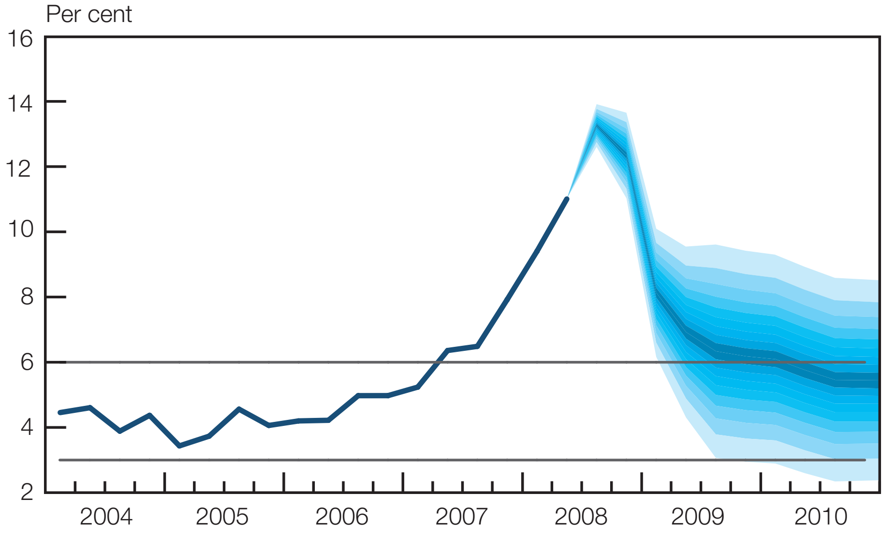


reflect not only inflation expectations, but also changes in perceived uncertainty about future inflation and in the perception of liquidity risk, and thus need to be interpreted cautiously.

The South African Reserve Bank inflation forecast

The latest quarterly inflation projections of the core inflation forecasting model of the Bank, as presented to the MPC on 8 and 9 October 2008, are reproduced in Figure 20. The central projection of the baseline forecast suggests that inflation is expected to peak at an average rate of 13,3 per cent in the third quarter of 2008 and after a significant decline in the first quarter of 2009, to average 6,9 per cent in the calendar year 2009. Consumer price inflation is expected to return to within the inflation target range in the second quarter of 2010 and to average 5,5 per cent in the final quarter of that year.

Figure 20 Inflation forecast



Note: The fan chart uses confidence bands to depict varying degrees of certainty. The darkest band of the fan chart covers the most likely 10 per cent of probable outcomes foreseen for inflation, including the central projection. Each successive band, shaded slightly lighter and added on either side of the central band, adds a further 10 per cent to the probability until the whole shaded area depicts a 90 per cent confidence interval (see Box 4 "Understanding the fan chart" on p. 27 of the March 2001 *Monetary Policy Review).*

The decline in the projected inflation rate between the fourth quarter of 2008 and the first quarter of 2009 is largely related to the announced rebasing and reweighting of the CPI basket that will be introduced by Statistics South Africa in January 2009. To account for these effects, a number of additional assumptions have had to be made to prepare the forecast, resulting in further uncertainties around the forecast.

In addition to the uncertainties surrounding the estimates for the rebasing and reweighting exercise, there are numerous other risks associated with the inflation forecast. These include the recent deterioration in the inflation expectations and related higher wage settlements. The international financial markets turmoil has also caused renewed risks to the inflation outlook, with the main upside risk to the inflation forecast coming from exchange rate developments and the main downside risk from oil price developments.

Assessment and conclusion

The volatile and uncertain financial market environment will continue to complicate monetary policy decision-making for some time. Whereas initially the crisis appeared to be confined to financial markets, the turmoil has directly affected the real sectors in a number of advanced economies and a global slowdown is expected. The South African economy cannot expect to be immune from these developments, but because the domestic banking system has remained relatively unaffected, the impact on growth is unlikely to be as severe as may be the case in other countries. The strong domestic infrastructure expenditure programme is also likely to help underpin growth.

One of the consequences of the financial turmoil has been a decline in commodity prices. From a narrow inflation perspective this means that one of the biggest risk factors to the inflation outlook has subsided significantly. This, in conjunction with the widening output gap and the subdued household consumption expenditure, indicates that some of the pressures on inflation may be abating. However, another risk has emerged in the form of the rand exchange rate which, along with other emerging-market currency exchange rates, has been negatively affected by the global turmoil. The impact of the exchange rate on the inflation outlook will depend, to a significant degree, on the extent to which these new levels are sustained.

The Bank's current forecast is for inflation to have peaked in the third quarter of 2008, and eventually to return to within the inflation target range by the second quarter of 2010. However, in a world of heightened turmoil and uncertainty, the risks to the outlook are amplified. Monetary policy will continue to focus on the expected medium-term inflation outcomes and will act appropriately to ensure that inflation returns to within the inflation target range over a reasonable time frame.

Statements issued by
Mr T T Mboweni,
Governor of the South African Reserve Bank

Statement of the Monetary Policy Committee

12 June 2008

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 outlook for inflation remains bleak in an environment of sustained increases in international oil and food prices. An increasing number of countries are experiencing intensified inflation pressures, and the risk to both global and domestic inflation is seen to be firmly on the upside against the backdrop of a slowing international and domestic economy. Domestically, price increases have become more broad-based, and inflation expectations have deteriorated further. Adding to the inflation uncertainty is the impending announcement of the electricity price increases to be granted to Eskom.

Recent developments in inflation

CPIX inflation measured 10,4 per cent in April 2008, compared with 10,1 per cent in the previous month. Sustained food and petrol price pressures were primarily – but not only – responsible for this trend. Petrol prices increased at a year-on-year rate of 30,5 per cent, while food prices increased by 15,9 per cent. Together these two categories accounted for over half of the increase in CPIX. Broad-based pressures are also intensifying. If food and energy were excluded, CPIX inflation would have measured 6,1 per cent. The stronger underlying inflation trend has been driven by price increases in a range of categories, notably clothing and footwear, water, household consumables, and fuel and power.

Year-on-year producer price inflation measured 12,4 per cent in April, compared with 11,9 per cent in March. Agricultural food output price increases declined to a year-on-year rate of 6 per cent in April, compared with a recent peak of 27 per cent in October 2007. Manufactured food price increases remained elevated at around recent highs of around 20 per cent.

The outlook for inflation

The most recent central forecast of the South African Reserve Bank (the Bank) indicates a further deterioration in the inflation outlook when compared with the previous forecast. CPIX inflation is now expected to peak at around 12 per cent in the third quarter of 2008 and to return to within the inflation target range by the third quarter of 2010. The previous forecast was for a peak of 9,3 per cent in the first quarter of 2008. The deterioration in the forecast is a result of higher-than-expected inflation outcomes, a more depreciated exchange rate of the rand, as well as further upward revisions in international oil price projections over the forecast period. As with the previous forecast, the possibility of an electricity price increase in excess of that granted to Eskom in December 2007 has not been factored into the central forecast.

The forecasts made by private-sector analysts have also deteriorated since the previous MPC meeting. According to the May 2008 Reuters consensus forecast, CPIX inflation is expected to peak at 11,3 per cent in the third quarter of 2008. Most respondents see inflation back within the target range during 2010. Break-even inflation rates, measured as the yield differential between conventional government bonds and inflation-linked bonds, also indicate a deterioration of inflation expectations and are now firmly above the upper end of the target range.

Deteriorating inflation expectations are also evident in the survey conducted on behalf of the Bank by the Bureau for Economic Research (BER) at Stellenbosch University. During the second quarter of 2008, CPIX inflation expectations in respect of all forecast years increased further. CPIX inflation is now expected to average 8,9 per cent in 2008, up from 7,8 per cent in the previous survey. Some moderation is then forecast for 2009 and 2010 when CPIX inflation is expected to average 7,9 per cent and 7,2 per cent respectively.

The main risks to the inflation outlook emanate from the possibility of further electricity price increases, which will be announced next week by the National Energy Regulator of South Africa (Nersa); petrol and food price increases; and the exchange rate.

There has been no respite from the acceleration in the international oil prices which has continued to surprise on the upside. In recent days North Sea Brent crude oil prices reached levels of almost US$140 per barrel, compared with US$107 per barrel at the time of the previous MPC meeting. Domestic petrol prices increased by 55 cents and 50 cents per litre in May and June respectively, bringing the cumulative increase in the petrol price since January 2008 to about R2,50 per litre. A further increase is possible in July.

Food prices still pose an upside risk to the inflation outlook although some positive domestic developments may partially offset the global trends. Despite higher international maize prices, the domestic spot price of maize declined in response to the release of the domestic crop estimates. Nevertheless, the depreciation of the rand exchange rate in recent weeks limited this decline. International wheat and rice prices are still high, but wheat prices have declined from their recent record levels. As noted earlier, agricultural producer price inflation declined significantly in April, but it is still too early to know if this trend will be sustained.

The exchange rate of the rand against the US dollar is little changed from the levels prevailing at the time of the previous MPC meeting, when it was trading at around R7,90 to the US dollar. However, the rand has been relatively volatile and the related uncertainty poses a risk to the inflation outlook. In May the rand appreciated to around R7,50 to the US dollar, to a large extent as a result of speculation relating to a sizeable FDI transaction which did not subsequently materialise.

The volatility of the rand is also explained by fluctuations of the US dollar against other major currencies, commodity price movements, domestic growth concerns and expectations regarding any further monetary policy actions in South Africa. The rand also remains vulnerable to possible negative perceptions related to the further widening of the current-account deficit of the balance of payments in the first quarter of 2008. This development was a result of higher crude oil prices and strong demand for capital goods imports related to infrastructural investment projects. The volume of mining exports declined as a result of electricity load-shedding to the mines. To date, the current-account deficit, including that in the first quarter, has been adequately financed.

Despite these upside risks, there are a number of offsetting effects which confirm the responsiveness of the economy to the less accommodative monetary policy stance of the Bank.

Growth in household consumption expenditure has continued to decline in response to higher interest rates and slower growth in households' real disposable income. Real final consumption expenditure by households grew at an annualised rate of 3,3 per cent in the first quarter of 2008 compared with 3,8 per cent in the previous quarter, having peaked at around 9 per cent in the final quarter of 2006. The recent quarter-on-quarter moderation was due to an 8,1 per cent contraction in spending on durable goods. The total number of new vehicles sold in May 2008 was 24,6 per cent lower than in May 2007. Both commercial and passenger vehicle sales registered significant declines.

Retail sales growth has also continued to moderate. On a year-on-year basis, real retail sales declined by 1,7 per cent in March, while growth in the first quarter of 2008 compared with the same quarter in 2007 measured 0,6 per cent.

Reflecting these expenditure trends, growth in credit extension to the private sector also showed some signs of moderation, although still at relatively high levels. Twelve-month growth in banks' total loans and advances extended to the private sector declined to 21,5 per cent in April 2008, compared with 23,6 per cent in March. Year-on-year growth in mortgage advances declined to 21,9 per cent in April, while growth over the same period in instalment sale credit and leasing finance declined to 11,8 per cent, reflecting the downward trend in motor vehicle and other durable goods consumption. Household debt as a ratio of disposable income increased to 78,2 per cent from 77,6 per cent, while the ratio of debt service cost to disposable income increased from 10,9 per cent to 11,3 per cent.

The economy has shown signs of slowing down following a number of years of growth above the estimated potential growth rate. In the first quarter of 2008, growth in real gross domestic product was an annualised rate of 2,1 per cent compared with 5,3 per cent in the previous quarter. Despite a strong performance by the agricultural sub-sector, the primary sector contracted by 13,0 per cent, mainly as a result of electricity supply constraints. The slowdown was fairly broad-based, with growth in the secondary sector declining to 1 per cent. The utilisation of production capacity in manufacturing declined in the first quarter of 2008, while the Investec/BER Purchasing Managers Index (PMI) shows that the manufacturing sector continues to face low growth in new sales orders and strong pressure on input costs, despite an improvement in manufacturing output growth in April. Overall business confidence, as measured by the RMB/BER Business Confidence Index declined further in the second quarter of 2008. Gross fixed capital formation, however, has remained relatively robust.

The all-share index on the JSE Limited reached new highs in recent weeks, but has moderated since then. However, while the all-share index has increased by about 6 per cent since the beginning of 2008, this has been due primarily to the resources sector which has increased by about 26 per cent as a result of high commodity prices. The industrial index is almost unchanged while the financial index has declined by over 23 per cent over the same period. There is evidence that house prices are beginning to decline. According to the Absa House Price Index, house prices in the middle segment of the market have been declining marginally in nominal terms on a month-on-month basis since February 2008. The Standard Bank index shows that the median house price declined by 13,3 per cent in May on a year-on-year basis.

The outlook for the global economy remains uncertain although there is some tentative evidence that the worst of the banking and credit crisis may be over. Global growth is also expected to remain subdued, but there is uncertainty regarding the extent and duration of the slowdown. Many countries are experiencing increasing inflationary pressures and are facing the challenge of dealing with higher inflation and slowing growth. As the inflation pressures have intensified, monetary policy is becoming more focused on this threat, and an increasing number of central banks have adopted a tighter monetary policy stance.

Monetary policy stance

In the light of the further deterioration in the inflation outlook, but mindful that the economy is responding to a less accommodative monetary policy stance, the Monetary Policy Committee has decided that at this stage further tightening of monetary policy is warranted. Accordingly the repurchase rate will be increased by 50 basis points to 12 per cent per annum with effect from 13 June 2008. The MPC remains committed to bringing inflation back to within the target range over a reasonable time period.

Statement of the Monetary Policy Committee

14 August 2008

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 outlook for inflation remains uncertain. Food and oil price increases continue to cloud the inflation outlook, but there are tentative signs that these pressures may be moderating. Domestic consumption expenditure also remains subdued. However, electricity price increases are set to have an impact on inflation going forward, and there is evidence that underlying inflation has maintained some of its upward momentum. Conflicting pressures are being felt from the global economy, which is experiencing slower growth and higher inflation.

While there are clear signs that the economy is responding to the less accommodative monetary policy stance, the MPC had to assess whether recent monetary policy actions are sufficient to bring inflation back to within the inflation target range over the medium term.

Recent developments in inflation

CPIX inflation increased at a year-on-year rate of 11,6 per cent in June 2008, compared with 10,9 per cent in May. Food price inflation accelerated from 16,9 per cent in May to 18,2 per cent in June, mainly as a result of significant increases in the prices of grain products, as well as fats and oils. Petrol prices increased by almost 36 per cent in June, and together with food prices accounted for about 56 per cent of the increase in CPIX. However, if food and petrol were excluded, CPIX inflation would have measured 6,3 per cent. Services price inflation has been increasing consistently over the past few months and reached a level of 6,7 per cent in June.

Producer price inflation increased at a year-on-year rate of 16,8 per cent in June, driven mainly by petroleum products and mining output prices. Food price increases at the producer price level continue to show some moderation. Agricultural food price increases measured 2,0 per cent in June, while manufactured food price increases, while still high, measured 19,4 per cent, compared with a peak of 20,4 per cent in March 2008.

The outlook for inflation

The central forecast of the Bank has been complicated by the impending rebasing and reweighting of the CPI basket, to be implemented by Statistics South Africa from January 2009. In trying to account for these changes, certain assumptions have to be made, and the central forecast is therefore subject to additional uncertainty.

The central forecast generated on the above basis indicates a near-term deterioration of the inflation outlook when compared with the previous forecast. CPIX inflation is expected to peak at an average rate of around 13 per cent in the third quarter of 2008, compared with 12 per cent. Thereafter, inflation is expected to decline significantly in the first quarter of 2009, partly as a result of the reweighting and rebasing effects. Inflation is then expected to decline gradually, and to fall below the upper end of the inflation target range in the second quarter of 2010. Inflation is expected to average about 7,2 per cent in 2009 and 5,9 per cent in 2010. The forecast takes account of the additional electricity price increases granted to Eskom in June. However, there is some uncertainty about the timing of these increases, or the full extent of the increases that will be passed on to household consumers by the municipalities.

Forecasts by private-sector economists have also been influenced by the coming technical adjustments to the inflation basket. Between June and July, the Reuters consensus CPIX forecast for 2009 declined from 8,2 per cent to 7,5 per cent, while the forecast for 2010 declined from 6 per cent to 5,9 per cent. Since July, the break-even inflation rates, measured as the yield differential between conventional government bonds and inflation-linked bonds, have also reflected some improvement in medium-term inflation expectations. The yield curve moved down markedly, particularly at the long end of the curve, with the R157 having declined by about 100 basis points since the previous MPC meeting.

The higher inflation outcomes and expectations have had an impact on wage settlements. According to the Wage Settlement Survey of Andrew Levy Employment Publications, the average level of wage settlements for the first half of 2008 was 8,3 per cent, compared with 6,8 per cent in the same period in 2007. Unit labour costs increased by 10,2 per cent in the first quarter of 2008, compared with the same quarter in the previous year, while unit labour cost increases in manufacturing measured 6,6 per cent. These trends, while not unexpected, were noted by the MPC.

Significant risks to the inflation outlook remain, although there are tentative signs that some of the risk factors may have moderated somewhat. International oil prices are well below the levels reached in early July 2008 when the price of North Sea Brent crude oil was around US$145 per barrel. Currently oil is trading at around US$112 per barrel, compared with around US$140 per barrel at the time of the previous MPC meeting. These price developments were reflected in domestic petrol price adjustments. In July the price of 95 octane petrol in Gauteng increased by 74 cents per litre, but in August the price declined by 30 cents per litre. If current oil price and exchange rate levels are maintained, a further sizeable decline can be expected in September. It is still too early to tell if the lower international oil price is a temporary phenomenon.

The risks to inflation posed by food price developments remain. Grain product prices in particular appear to have gained some momentum at both the producer price and consumer price levels. As noted earlier, however, manufactured food producer price inflation remains high, but agricultural food inflation has declined to low levels, indicating the possibility of some price relief in the future. The spot price of yellow maize declined in early August following the release of local crop estimates. Wheat prices have also declined on international markets, but nevertheless remain high.

The exchange rate of the rand has exhibited some volatility since the previous meeting of the MPC when it was trading at around R8,00 per US dollar. In late July the rand began to appreciate and reached a level of around R7,20 against the US dollar, but has since depreciated to current levels of around R7,85 per US dollar. On a trade-weighted basis the rand has appreciated by about 4 per cent since the previous meeting.

The outlook for most of the other determinants of inflation has been relatively unchanged since the previous meeting.

Growth in household consumption expenditure appears to have remained subdued. Real retail sales declined on a year-on-year basis in the four consecutive months to June 2008. In May and June retail sales declined by 3,4 per cent and 2,6 per cent respectively. Motor vehicle sales also remain under pressure with the total number of vehicles sold in July declining by over 20 per cent when compared with the same time last year. In the second quarter of 2008, the FNB/BER Consumer Confidence Index experienced its largest quarter-on-quarter decline in 24 years.

Credit extension to the private sector exhibited further moderation, although it still remained at relatively high levels. Growth over twelve months in mortgage advances measured 19,9 per cent in June 2008, while growth in instalment sale credit and leasing finance grew by 14 per cent. Growth in credit extension to households remains on a downward trend.

Real growth in gross domestic product also appears to be lower than the rates achieved in the past few years, although growth in the second quarter is expected to exceed the first quarter growth rate of 2,1 per cent. This improvement will be a result of base effects and improved performances of mining and manufacturing in the second quarter. The expected subdued trend in output growth is evident in a number of indicators. The South African Reserve Bank composite leading business cycle indicator, which has been declining since March 2007, continued its downward trend in May 2008, while the RMB/BER Business Confidence Index also declined significantly in the second quarter of 2008. The Investec/BER Purchasing Managers Index also points to continued slow growth in the manufacturing sector, primarily due to sluggish new sales orders. The utilisation of production capacity in manufacturing declined in both of the first two quarters of 2008. The real value of building plans passed and approved also declined in the past three months.

The lower growth trend has also been reflected in asset prices, and the associated negative wealth effects could moderate consumption expenditure growth further. Equity prices have declined in recent weeks as a result of a weaker economy and lower commodity prices. The all-share index on the JSE Limited has declined by 7 per cent since the beginning of the year, and by about 13 per cent since the previous MPC meeting. All the major sub-indices are lower than they were at the beginning of 2008. The housing market is also subdued, with both the Absa and Standard Bank indices reflecting negative real house price growth.

The global economy is characterised by slowing growth, particularly in the industrialised countries, and intensified inflationary pressures. Growth prospects in the US are being clouded by the persistent weakness in the local housing market and continued financial market uncertainty. Growth in emerging markets also shows some signs of moderation, but nevertheless remains relatively strong. Most central banks have recently either adopted a tighter monetary policy stance or have kept their policy rates unchanged.

The MPC also noted economic developments in Lesotho, Namibia and Swaziland – South Africa's Common Monetary Area (CMA) partners. Food and energy price developments have also intensified in these countries, raising inflation to high levels. Recent developments in real sector indicators have been mixed. Government financial balances are supported by high import duty revenue, and government debt levels are well contained. While interest rates throughout the CMA increased significantly over the past two years, it was noted that most recently not all of the countries have tightened monetary policy.

Monetary policy stance

The MPC has considered recent economic developments and the outlook for inflation and has concluded that, notwithstanding certain risks to future inflation outcomes, the current monetary policy stance is appropriate. Consequently, the repurchase rate will for now remain unchanged at 12 per cent per annum. The MPC will continue to monitor developments closely and will not hesitate to act to deliver on its mandate.

Statement of the Monetary Policy Committee

9 October 2008

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

Since the previous meeting of the MPC the turmoil on global financial markets has intensified. This development has impacted negatively on the outlook for the international economy. As the banking crisis has deepened, global markets have been characterised by declining equity prices, exchange rate volatility and widening spreads on emerging-market debt. The prices of many commodities, including oil, have also declined, although gold is a notable exception by virtue of its safe-haven status.

Governments and central banks have undertaken various actions, both individually and in concert. The South African banking and financial system remains stable. However, domestic financial markets have experienced the impact of these developments. The domestic equity market has suffered losses in line with international markets, and the exchange rate of the rand has been negatively affected by increased global risk aversion, resulting in higher volatility and a significant depreciation. The South African Reserve Bank (the Bank) is monitoring developments closely.

The inflation outlook remains uncertain, as the risk profile has changed somewhat. The outlook has improved on account of the lower oil prices, but the exchange rate has emerged as a significant risk factor.

Recent developments in inflation

CPIX inflation increased from 13,0 per cent in July 2008 to 13,6 per cent in August. Food and petrol price increases were again the main contributors to this rising trend. Food prices increased at a year-on-year rate of 19,2 per cent in August, driven to a significant extent by grain product prices which increased by 36,5 per cent. Petrol prices increased at a year-on-year rate of 45,9 per cent in August, despite the 30 cent per litre reduction in the petrol price in that month. If food and petrol were excluded, CPIX inflation would have measured 8,1 per cent in August, compared with 7,4 per cent and 6,3 per cent in the prior two months. The significant upward trend in this measure was mainly due to electricity price increases of 23,9 per cent and 28,2 per cent in July and August respectively, but it also reflects continued generalised inflation pressures.

Producer price inflation also remained strong. Producer prices increased at a year-on-year rate of 19,1 per cent in August. The rate of increase in agricultural food prices declined to 2,3 per cent, but manufactured food price inflation remained elevated at over 20 per cent.

The outlook for inflation

The most recent central forecast of the Bank shows a moderate improvement in the inflation outlook since the previous MPC meeting, although the peak is slightly higher. As was the case at the previous meeting, some assumptions were made to try to account for the rebasing and reweighting of the CPI basket that will be introduced by Statistics South Africa in January 2009. Inflation is expected to peak at an average rate of

13,3 per cent in the third quarter of this year, and to average 6,9 per cent in 2009, after a significant decline in the first quarter of that year. Consumer price inflation is still expected to return to within the inflation target range only in the second quarter of 2010, and to reach a level of 5,5 per cent in the final quarter of that year.

According to the most recent inflation expectations survey conducted on behalf of the Bank by the Bureau for Economic Research (BER) at Stellenbosch University, CPIX inflation is expected to average 10,2 per cent in 2008 and 8,1 per cent and 7,4 per cent in 2009 and 2010 respectively. The increases in respect of 2009 and 2010 were significantly smaller than the increases observed in the previous survey. However, only the financial analysts expect inflation to return to within the target range by 2010. This is similar to the Reuters consensus survey conducted in August which indicates that inflation is expected to average 7,5 per cent in 2009 and 5,9 per cent in 2010.

Inflation expectations as measured by the yield differential between conventional government bonds and inflation-linked bonds indicated some improvement in expectations over the longer term. The break-even inflation expectation declined from just over 9 per cent in July 2008 to around 6,3 per cent at the end of September. The yield curve has remained inverted but has moved down since the previous meeting.

The continued upward trend in wage settlements also indicates that inflation expectations are not well anchored. According to the Quarterly Economic Survey of Statistics South Africa, year-on-year growth in unit labour cost measured 10,5 per cent in the second quarter of 2008, compared with 10,7 per cent in the previous quarter. The most recent Wage Settlement Survey of Andrew Levy Employment Publications shows that the average wage settlement rate increased to 9,6 per cent in the nine months to September 2008 compared with 8,3 per cent in the six months to June 2008.

The turmoil in international financial markets has resulted in some changes in the balance of risks as perceived by the MPC. The most significant of these changes relate to oil price and exchange rate developments.

The recent depreciation in the rand exchange rate poses a significant upside risk to the inflation outlook. Following the initial rejection by the US Congress of the Troubled Asset Relief Program (TARP), there was significant volatility in foreign-exchange markets as the dollar strengthened against a number of major currencies, particularly against those in emerging-market economies. The domestic foreign-exchange market was also affected, and the rand is currently trading at around R9,12 against the US dollar, compared with R8,00 at the previous MPC meeting. On a trade-weighted basis, the rand has depreciated by around 20 per cent since the beginning of the year and by almost 9 per cent since the previous meeting. The impact of the exchange rate on the inflation outlook will depend, to a significant degree, on the extent to which these new levels are sustained.

In most other instances the risks to the outlook have declined or remained unchanged. International oil prices have declined considerably over the past few weeks. Having peaked at around US$145 per barrel in July 2008, the price of North Sea Brent crude oil (Brent) has declined to current levels of around US$83 per barrel. At the time of the previous MPC meeting Brent was trading at US$112 per barrel. In line with these oil market developments, the price of 95 octane petrol in Gauteng has declined by a total of R1,29 per litre since August. The impact of the lower international oil prices on domestic petrol prices will be offset to some extent by the recent depreciation of the rand against the dollar.

As noted, food price inflation remains elevated, although agricultural price inflation at producer price level has declined further. International rice prices appear to have peaked and both maize and wheat prices are currently below the peaks reached earlier in 2008 in the global and domestic markets. Favourable base effects are also expected to contribute to a declining trend in food price inflation. However, food prices are expected to remain elevated in the short term, as evidenced by high increases in processed food prices at the producer level.

Household consumption expenditure has remained subdued in line with declining growth in disposable income and the less accommodative monetary policy stance. Growth in household consumption expenditure declined to 1,2 per cent in the second quarter of 2008 as expenditure on durable goods contracted by almost 15 per cent. This is reflected in the further decline in motor vehicle sales in September at a year-on-year rate of almost 20 per cent. Retail and wholesale trade sales growth have continued their negative trends. The latest FNB/BER Consumer Confidence Index shows an improvement relative to the second quarter, but remains at levels last seen in 2004.

Credit extension to the private sector exhibited further moderation. Growth over twelve months in total loans and advances to the private sector declined from 21,3 per cent in June 2008 to 19,7 per cent in August. Growth in mortgage advances moderated to 17,6 per cent in August 2008 while instalment sale credit and leasing finance grew by 11,3 per cent. The slower growth in credit extension to households is reflected in the ratio of debt to disposable income which declined in the second quarter of 2008 to 76,7 per cent.

Asset prices have been significantly affected by the recent global market turmoil and the softer trend in commodity prices. The associated negative wealth effects could contribute to a further moderation in consumption expenditure growth. The all-share index on the JSE Limited has declined by about 27 per cent since the beginning of the year, and by about 25 per cent since the previous MPC meeting. The housing market is also subdued with the Absa and Standard Bank House Price indices continuing to record negative real house price growth.

Domestic economic growth appears to be moderating, despite the rebound in the second quarter of 2008 when GDP growth of 4,9 per cent was recorded. This improvement was mainly the result of base effects following the 2,1 per cent growth rate recorded in the first quarter of 2008. Short-term indicators suggest that growth in the third quarter is likely to be subdued and that growth will remain below its estimated potential rate. The composite leading indicator of the Bank declined further in July and the RMB/BER Business Confidence Index also declined further in the third quarter of this year. The manufacturing sector remains under pressure as seen in the weaker trend in the volume of manufacturing production, as well as in the Investec/BER Purchasing Managers Index. Growth in real gross fixed capital formation remained relatively robust, despite declining from 16,9 per cent in the first quarter to 9,1 per cent in the second quarter. Investment expenditure is expected to underpin a positive growth rate.

Developments in the international markets have already had a negative impact on growth in a number of regions and global growth forecasts are being revised down further, particularly in the OECD countries. The slowing world economy is also likely to have an adverse effect on domestic growth prospects. The continuing crisis has led to a generally more accommodative monetary policy stance in a number of countries, and some governments and central banks are taking unprecedented steps to help stabilise the situation. At this stage it is unclear how the crisis will unfold, but heightened risk and uncertainty are likely to persist for some time.

Monetary policy stance

The MPC considered recent developments in the South African economy and the risks to the inflation outlook against the backdrop of conditions prevailing in the international financial markets. The MPC is of the view that an unchanged monetary policy stance is appropriate at this stage. Accordingly, the repurchase rate remains at 12 per cent per annum. The MPC remains committed to, and focused on, the achievement of the Bank's mandate.

Abbreviations

ADB	Asian Development Bank
Alsi	all-share index
API	administered price index
BER	Bureau for Economic Research (Stellenbosch University)
Brent	Brent crude oil
BRIC	Brazil, Russia, India and China
CPI	consumer price index for metropolitan areas
CPIX	consumer price index excluding mortgage interest cost for metropolitan and other urban areas
ECB	European Central Bank
FDI	foreign direct investment
FNB	First National Bank
FOMC	Federal Open Market Committee
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
IES	Income and Expenditure Survey
ILO	International Labour Organisation
IMF	International Monetary Fund
JSE	JSE Limited
MPC	Monetary Policy Committee
MTBPS	Medium Term Budget Policy Statement
NEER	nominal effective exchange rate of the rand
Nersa	National Energy Regulator of South Africa
NHRPL	National Health Reference Price List
OECD	Organisation for Economic Co-operation and Development
OOH	owner-occupied housing
OPEC	Organization of the Petroleum Exporting Countries
PMI	Purchasing Managers Index
PPI	producer price index
PSBR	public-sector borrowing requirement
repo	repurchase
RMB	Rand Merchant Bank
TARP	Troubled Asset Relief Programme
the Bank	South African Reserve Bank
UK	United Kingdom
US	United States
WEO	*World Economic Outlook*