



South African Reserve Bank

June Monetary Policy Review

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2 June 2015 • Pretoria



Headlines

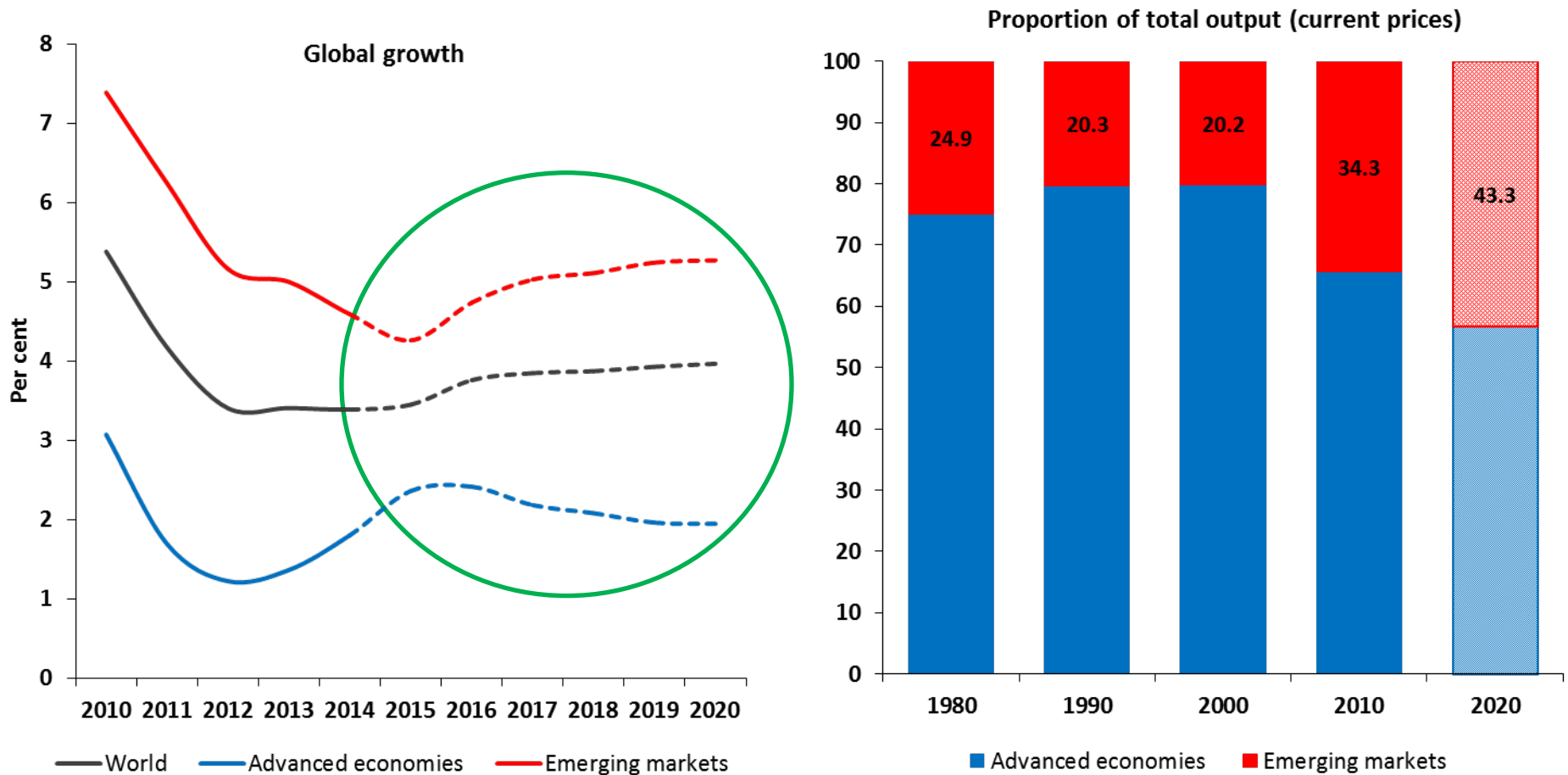
- **Evolving global conditions**
- **Headline CPI likely to be sticky around 6% as petrol impact dissipates**
- **Underlying inflation and expectations persistent**
- **Output gap still negative, but potential growth lower**
- **Risks to inflation high...**
 - **Food, electricity, remuneration, currency**
- **Monetary policy remains in a gradual tightening cycle**

Overview of the presentation

- I. The world economy
- II. Growth and the GDP forecast
- III. Inflation and the inflation outlook

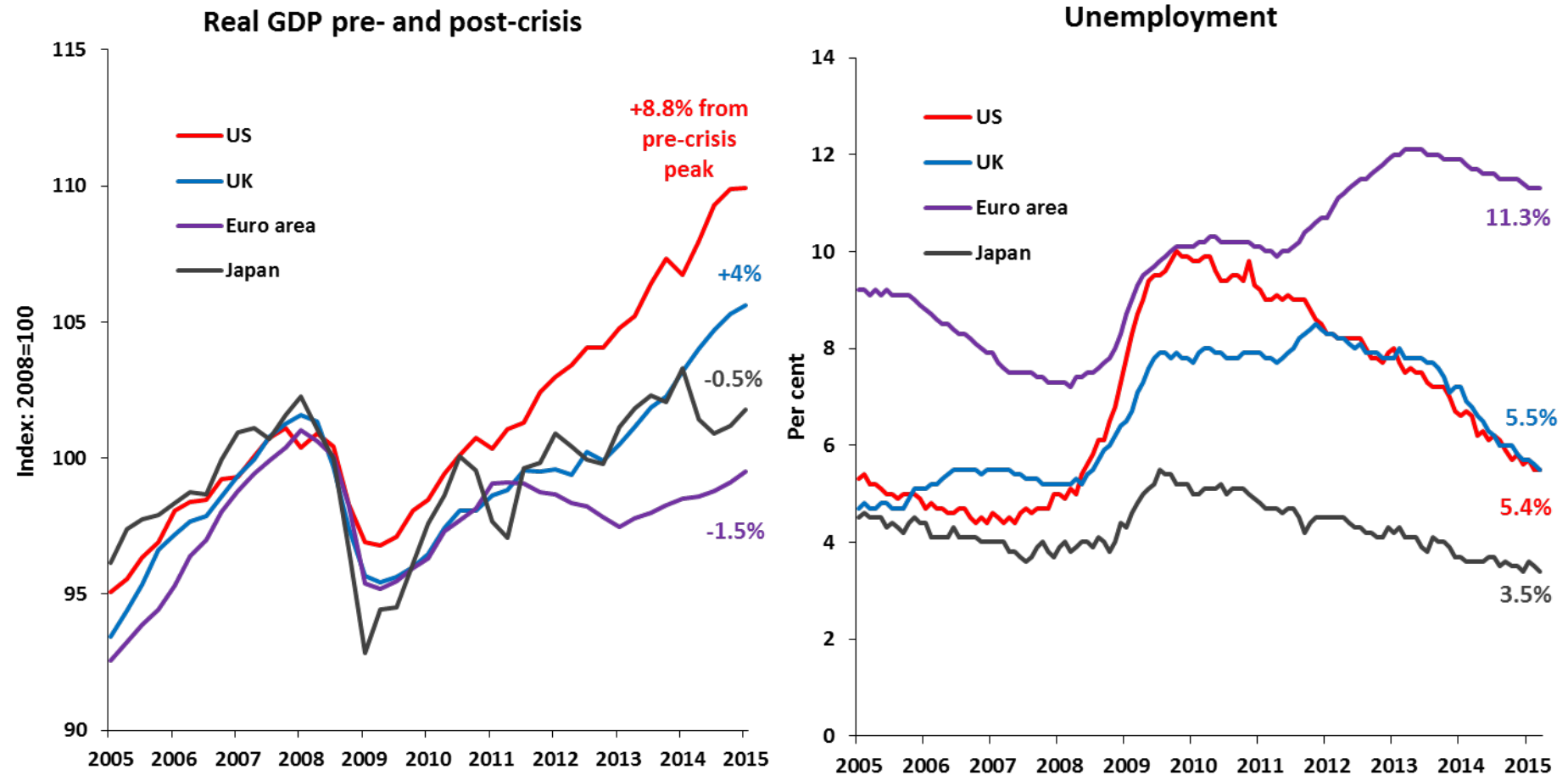
I. The world economy

Modest global recovery shaped by mixed AE fortunes & EM weakness – longer term acceleration will be EM driven



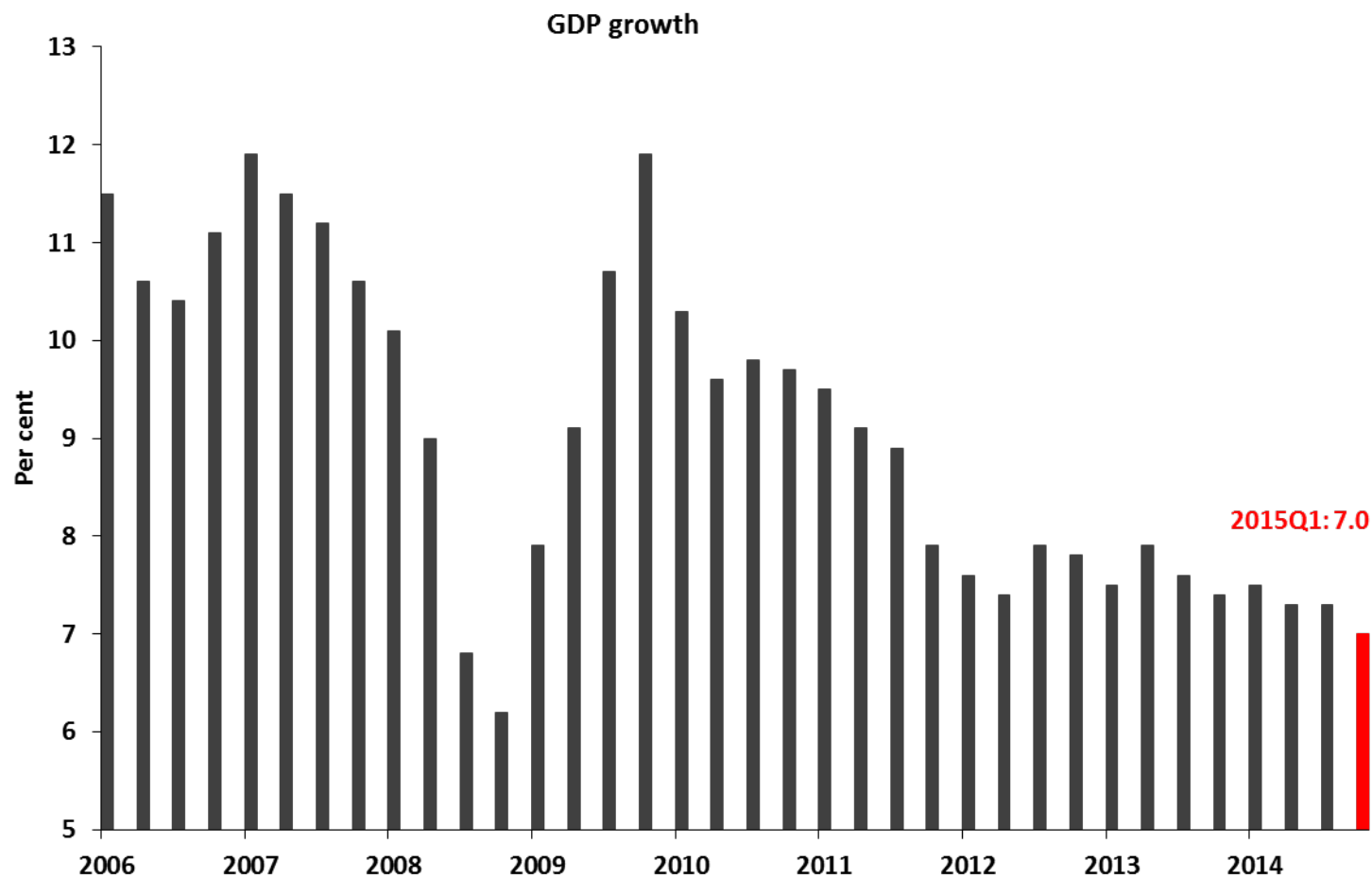
Source: International Monetary Fund

The advanced economy recovery is chiefly a US-UK story...



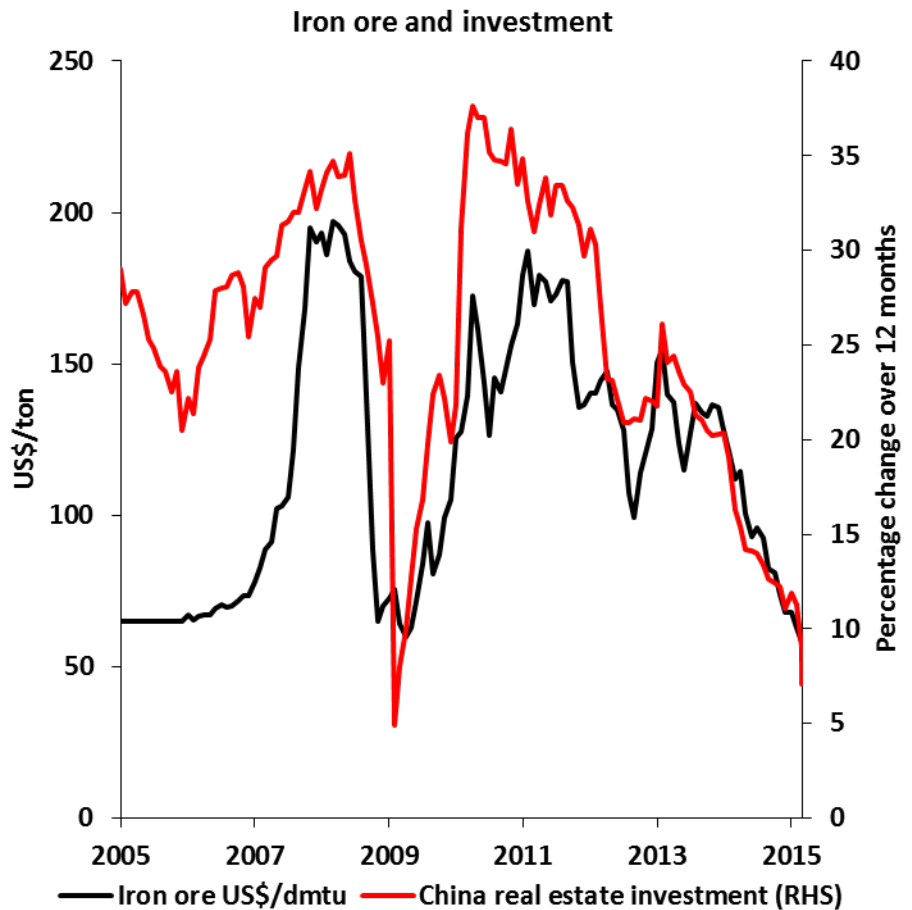
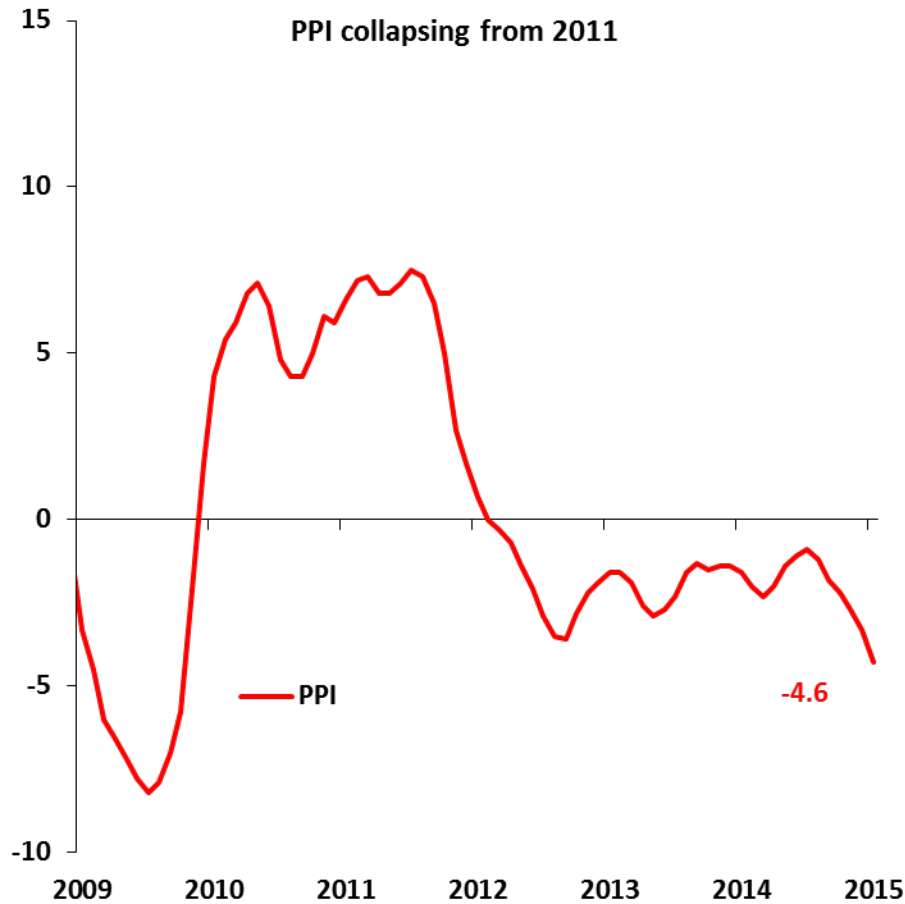
Source: Various national statistical agencies

China's economy is slowing and rebalancing...



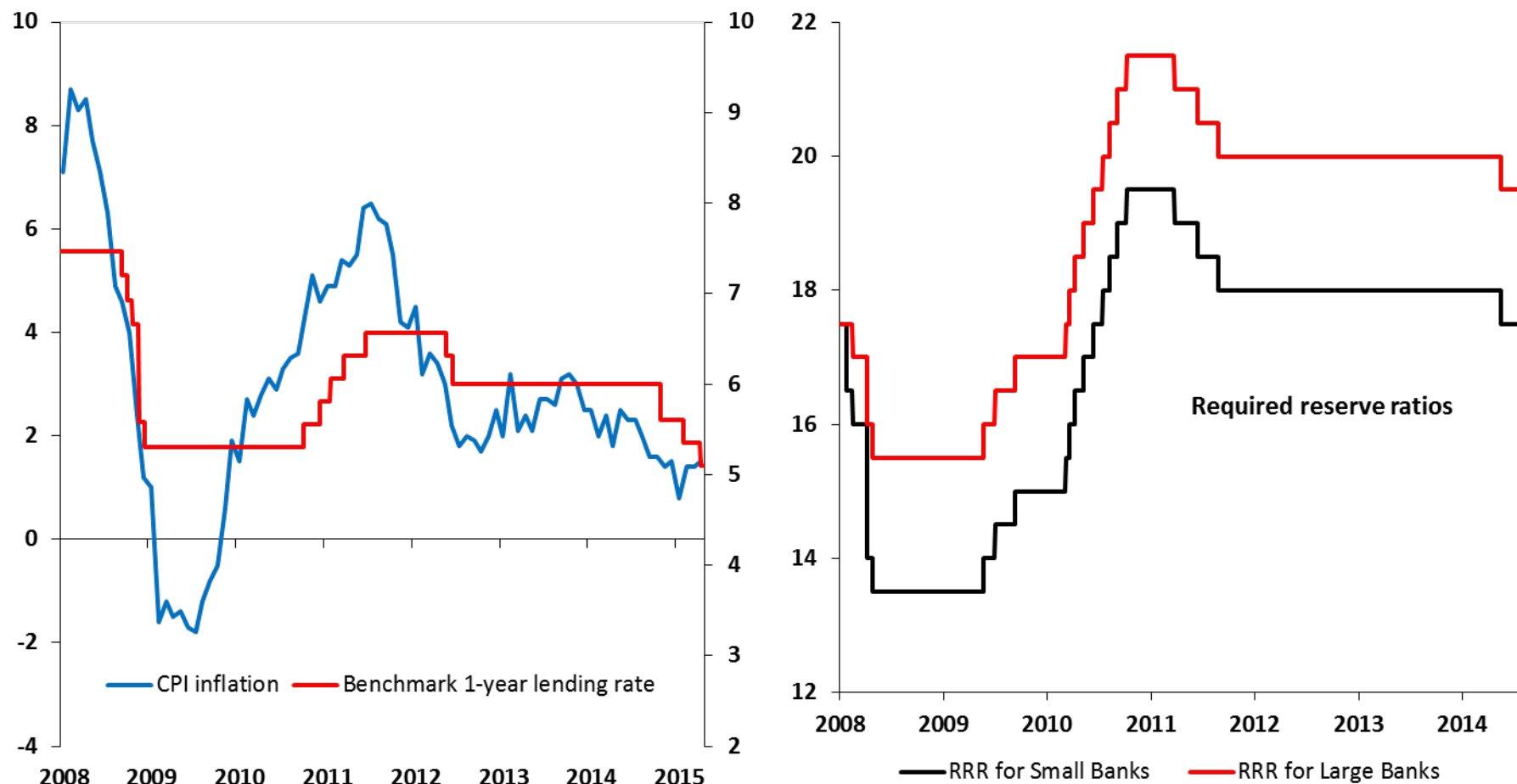
Source: National Bureau of Statistics of China

...with important consequences for commodity prices



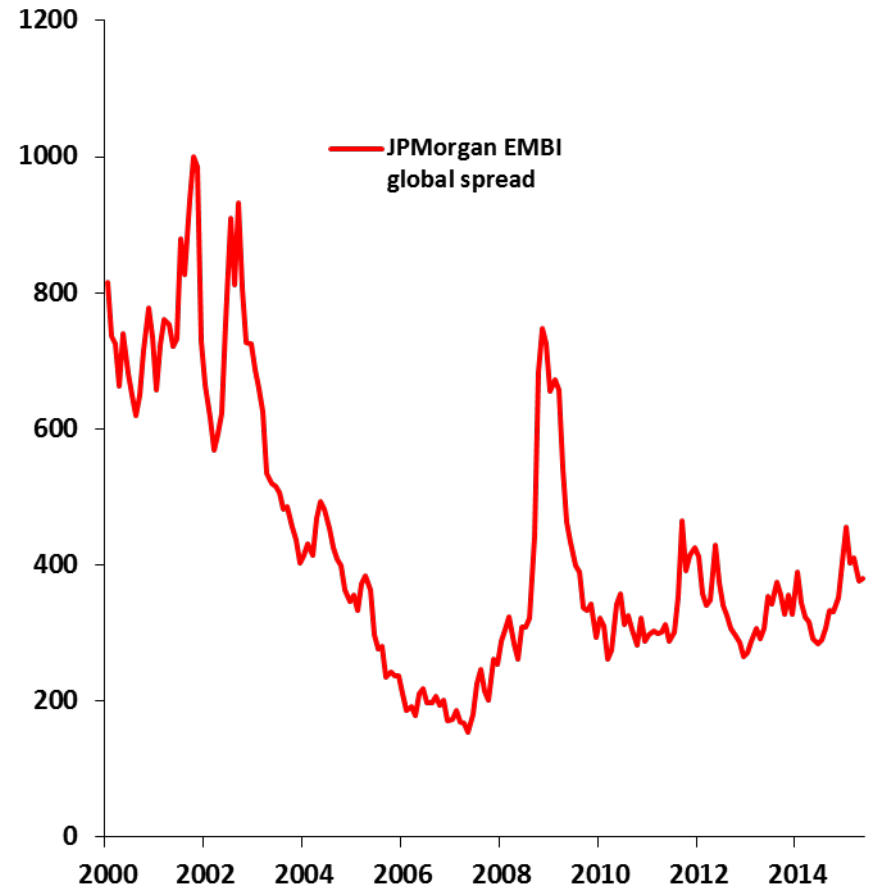
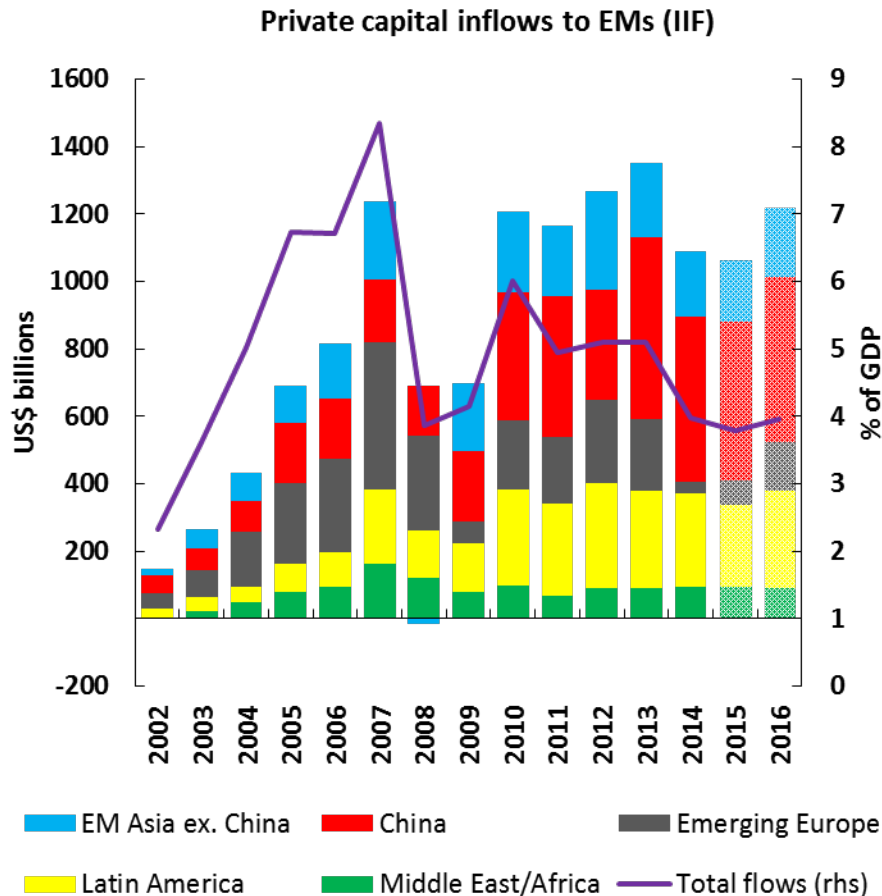
Sources: National Bureau of Statistics of China, World Bank and Bloomberg

Chinese monetary policy easing as inflation falls & GDP slows



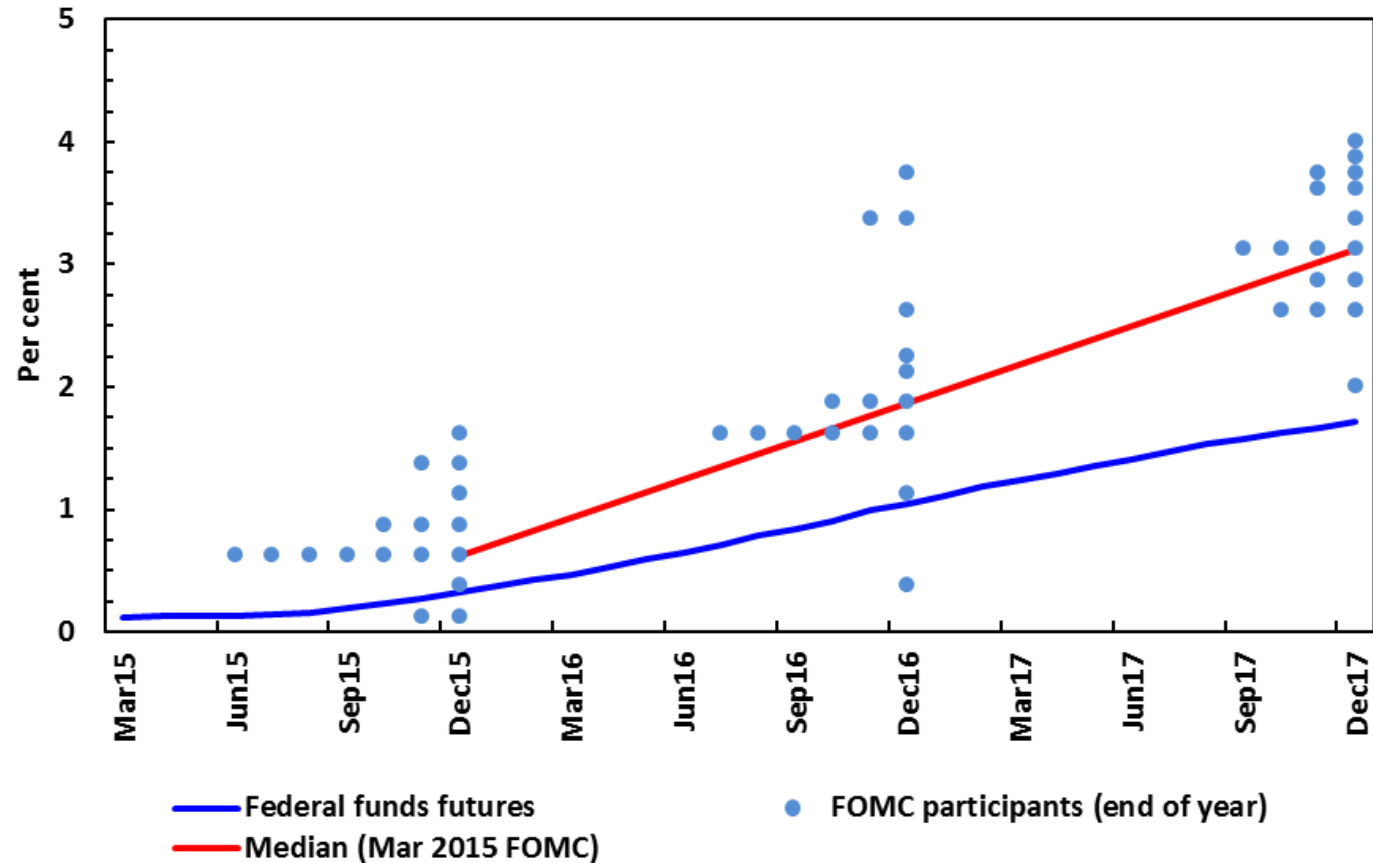
Sources: National Bureau of Statistics of China and People's Bank of China

Global monetary conditions continue to support financing in EMs



Sources: The Institute of International Finance and Bloomberg

...but at risk of reversal as monetary conditions tighten

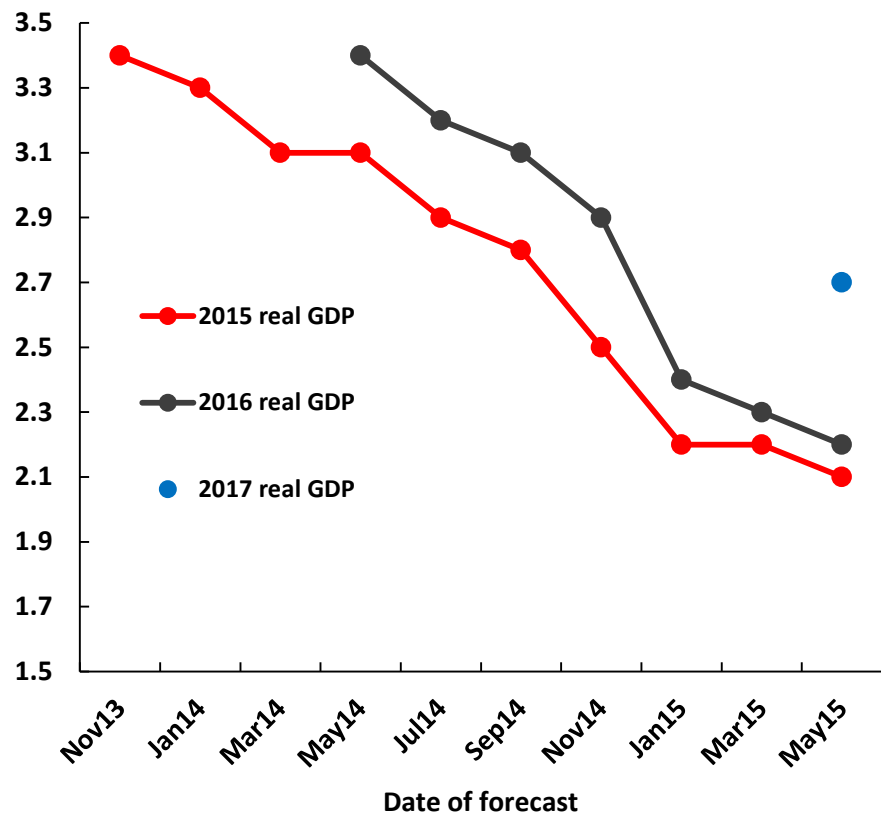


Sources: US Federal Reserve and Bloomberg

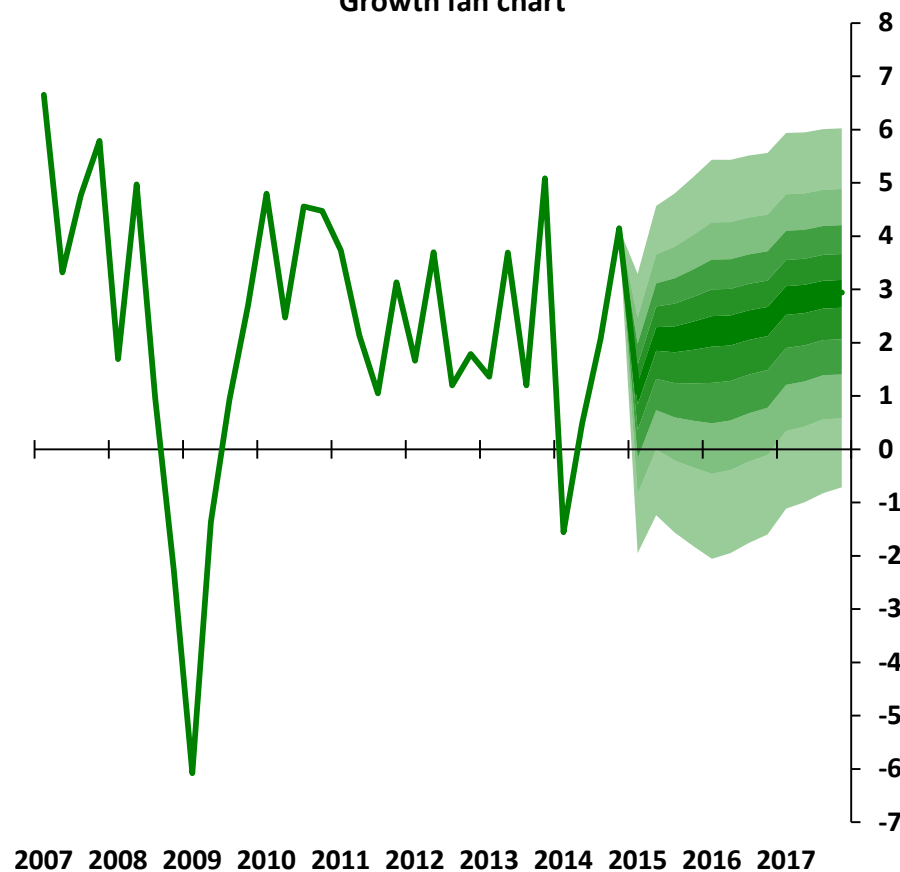
II. Growth and the GDP forecast

SA growth forecasts closer to 2%, with pick up late in the period

Growth forecasts over time

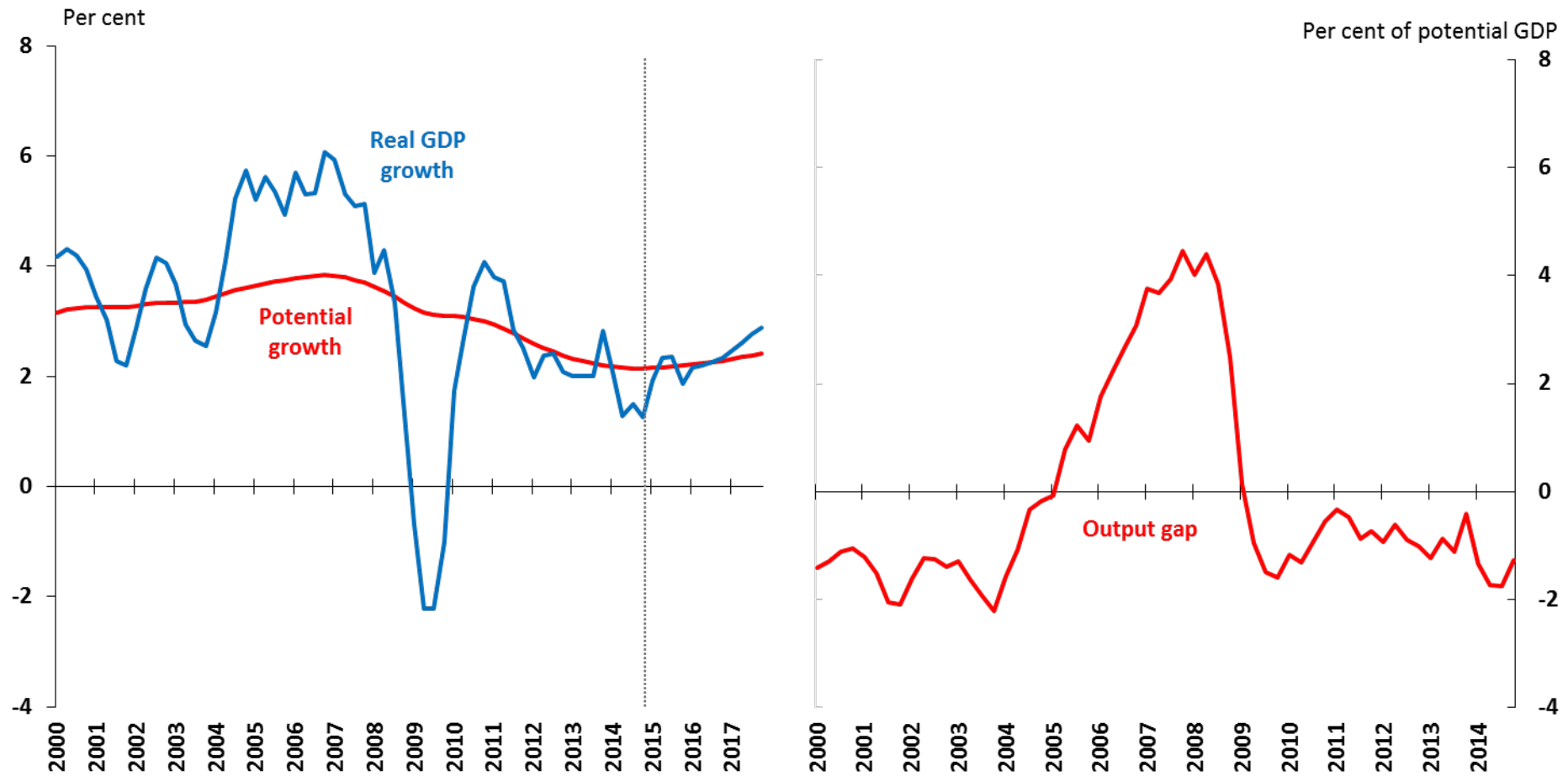


Growth fan chart



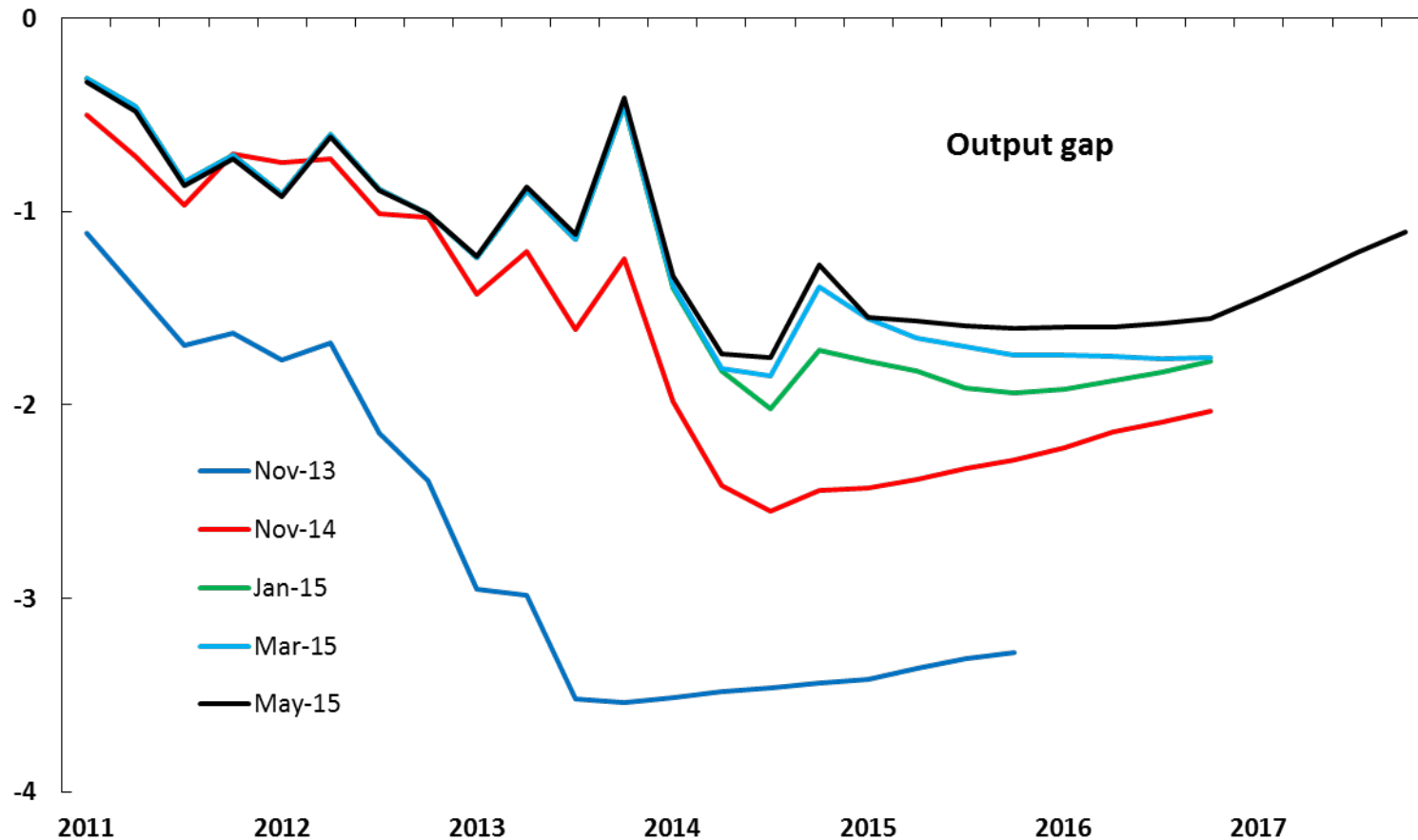
Source: South African Reserve Bank

Lower potential but output gap still negative



Source: South African Reserve Bank

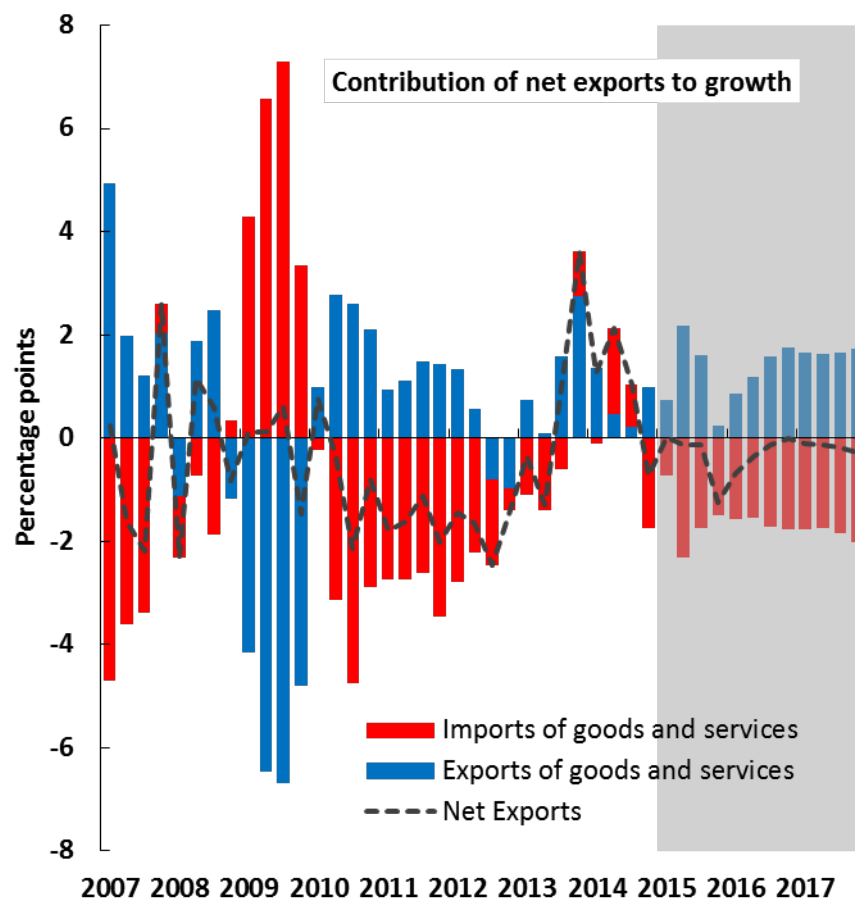
Improved measures of potential have narrowed the output gap estimate



Source: South African Reserve Bank

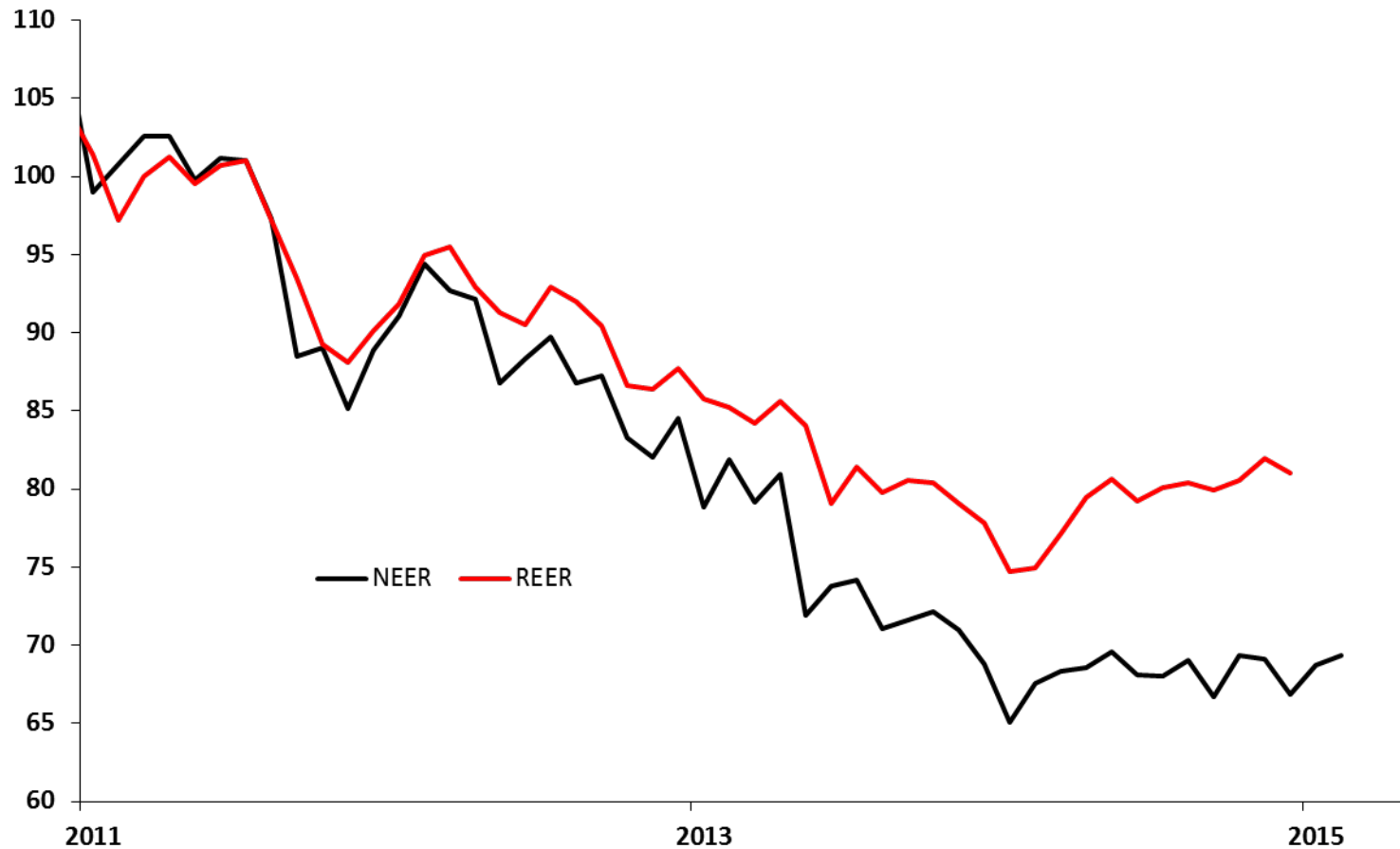
Weak global demand results in low and volatile exports

Average growth	2000-2007	2011-2014
World Trade	6.8	3.6
AE imports	4.6	1.4
EM imports	11.4	6.0



Sources: CPB Netherlands Bureau for Policy Analysis and South African Reserve Bank

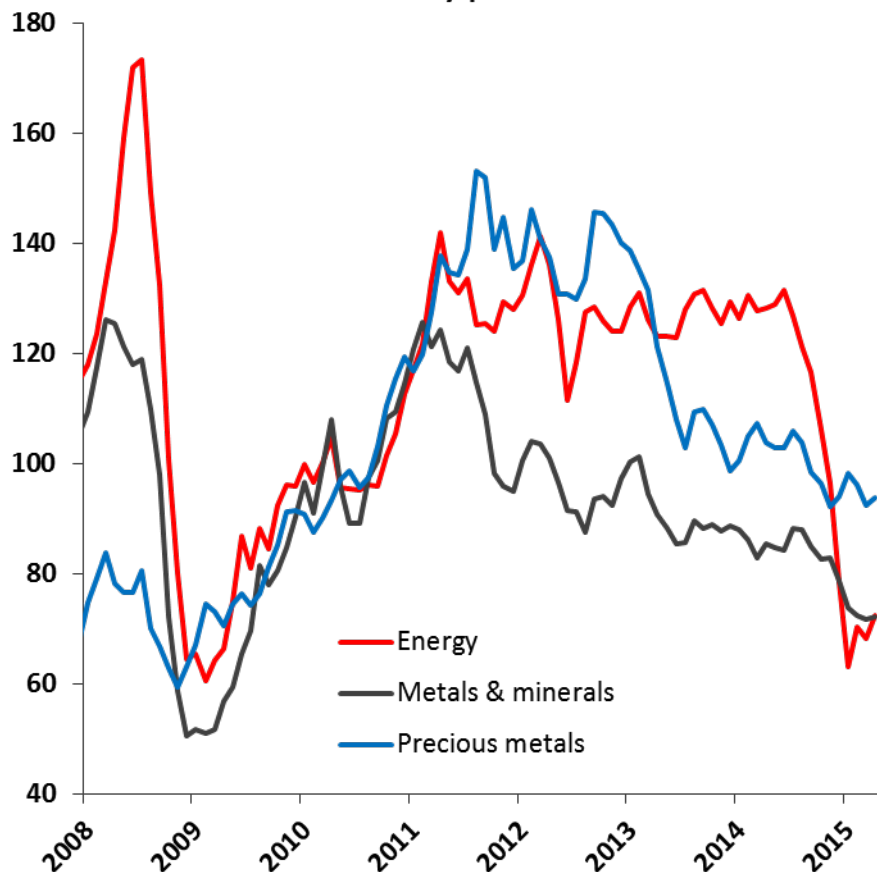
... and inflation diluting competitiveness gains...



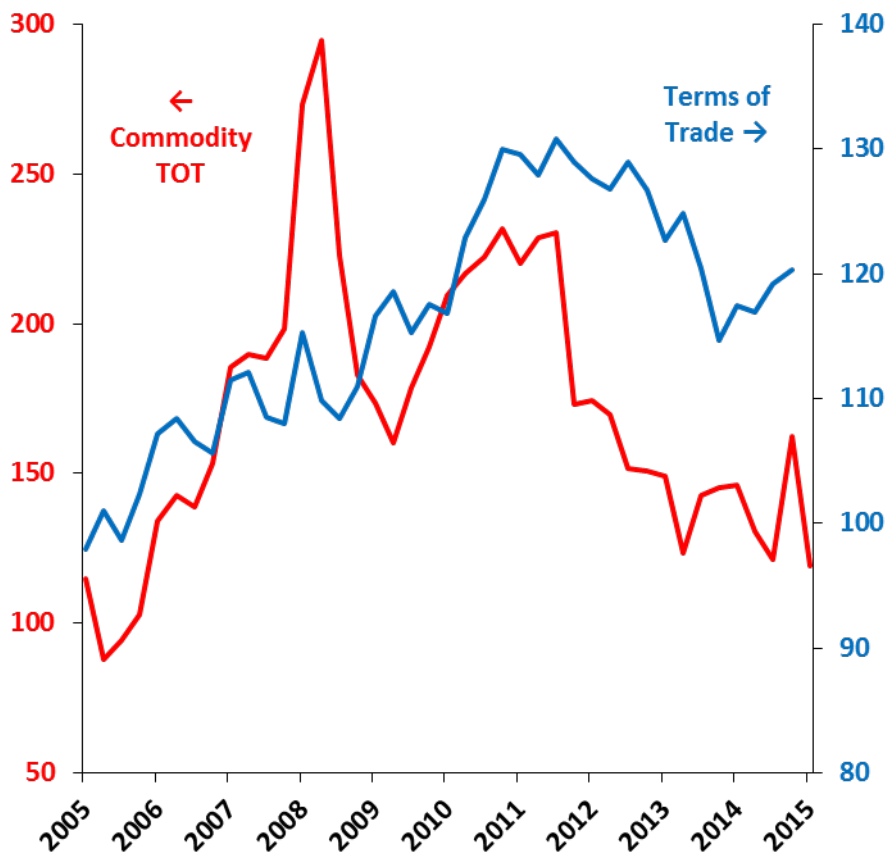
Source: South African Reserve Bank

... while commodity prices decline ... CSC over?

World commodity prices have fallen

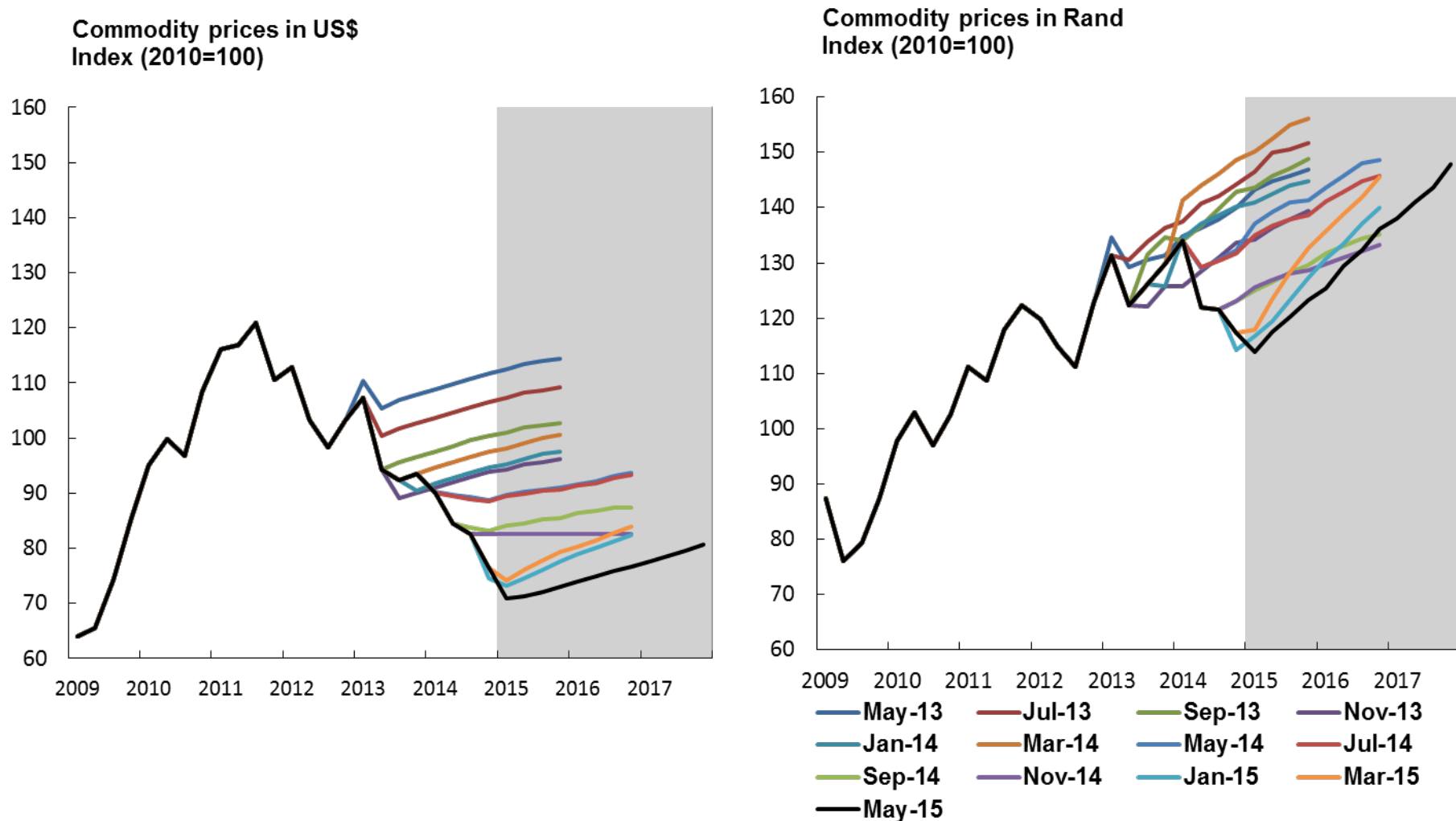


SA's Terms of Trade have declined



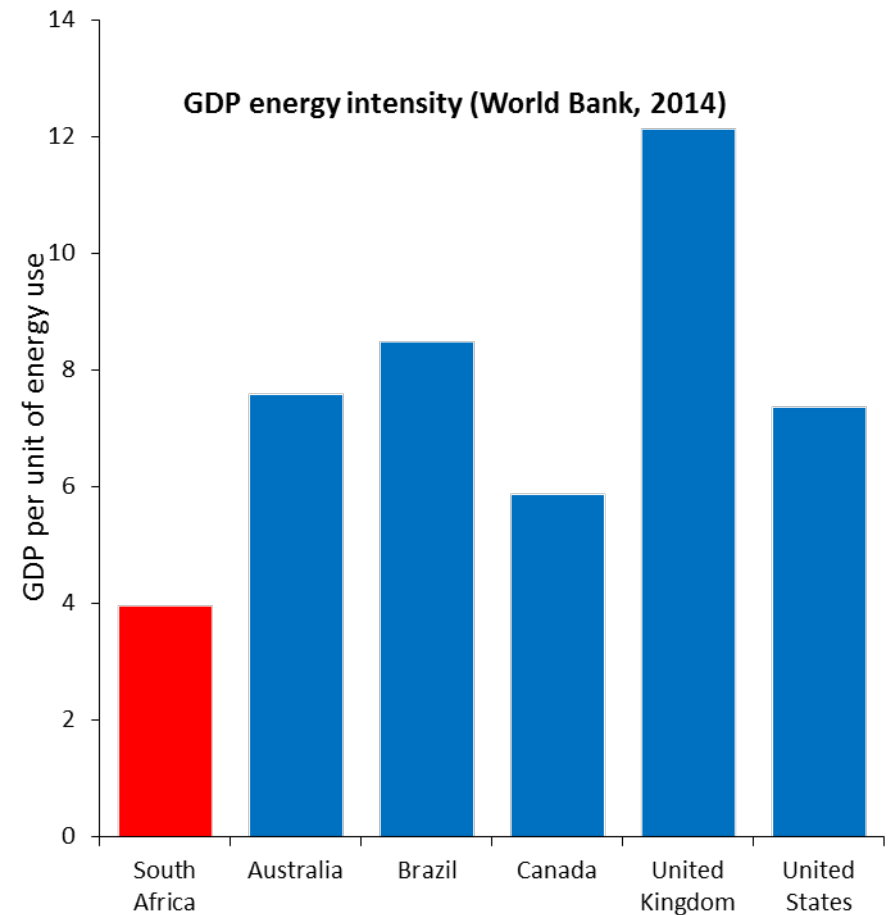
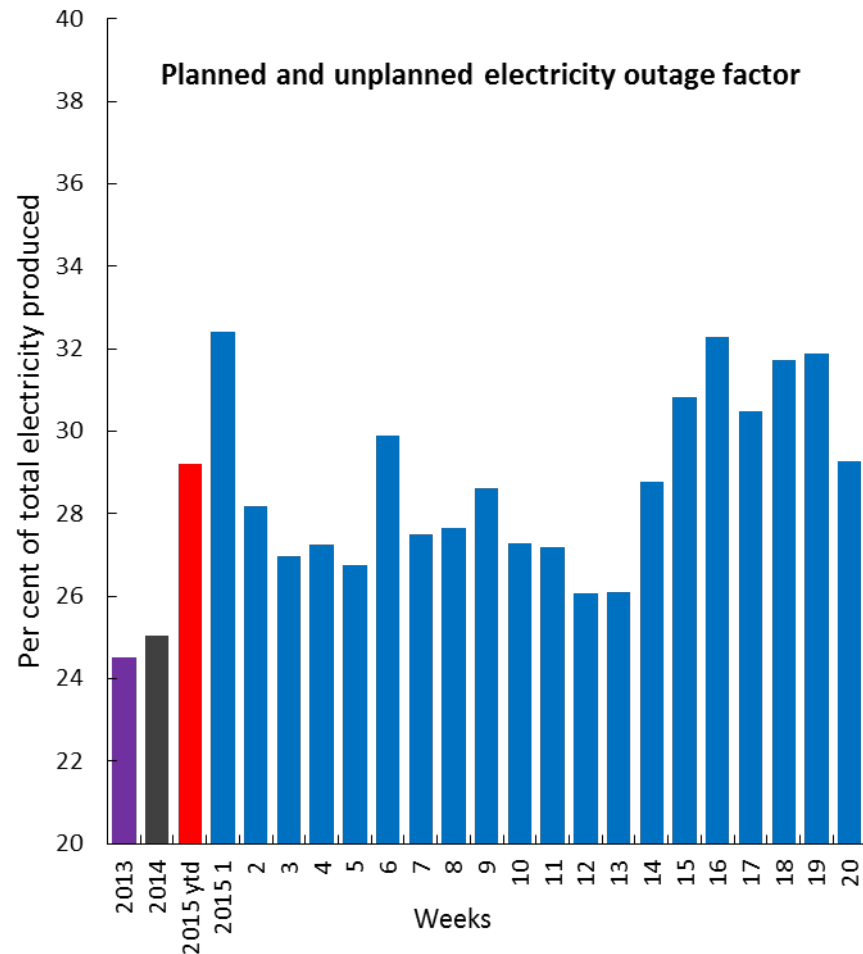
Sources: Citibank, World Bank and South African Reserve Bank

Commodity price assumptions down 37% in two years



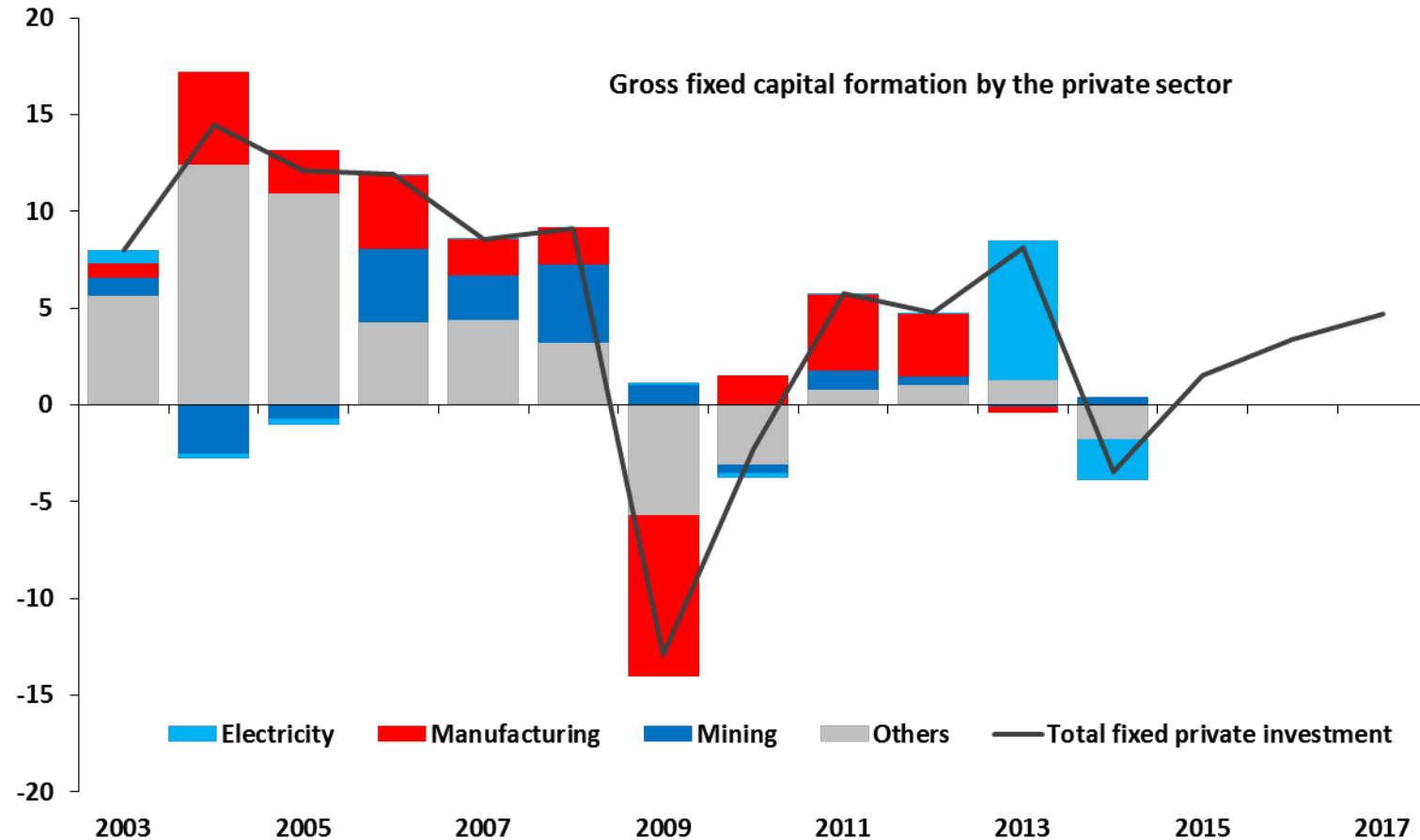
Source: South African Reserve Bank

Shortages in energy intensive economy hit hard



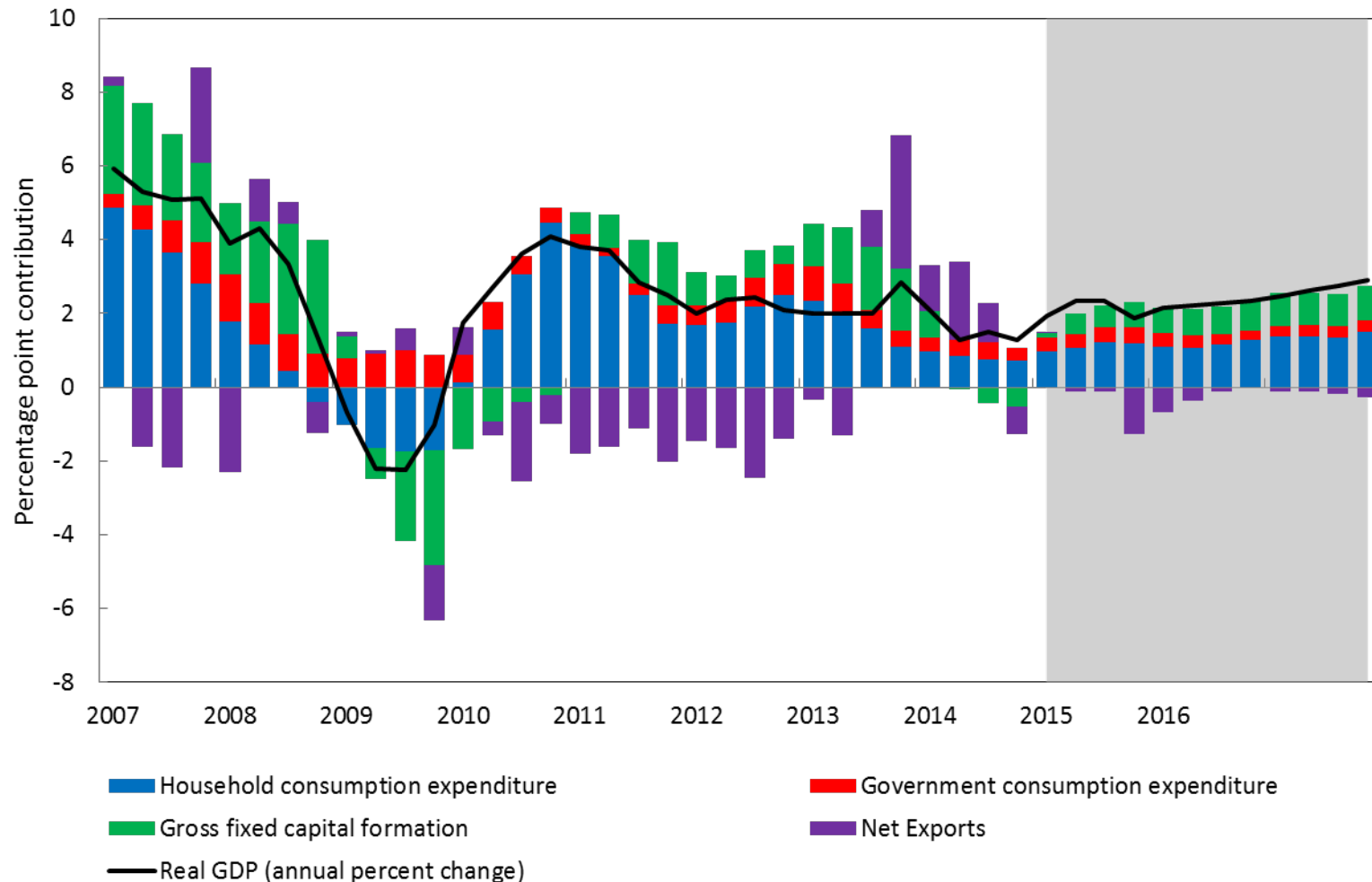
Sources: Eskom, World Economic Forum and World Bank

...curtailing investment (outside electricity sector)



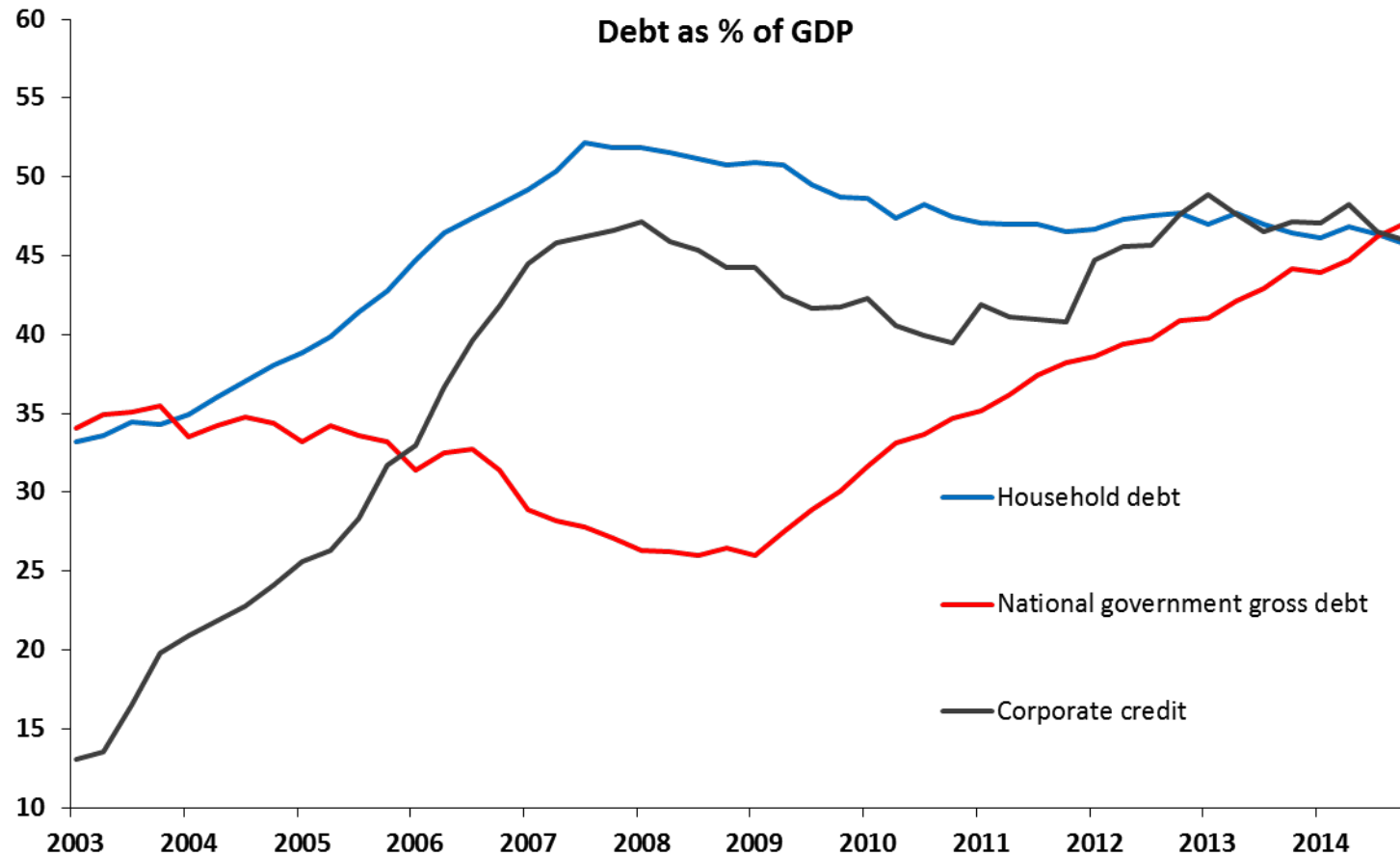
Sources: Statistics South Africa and South African Reserve Bank

Household consumption still underpins growth forecast



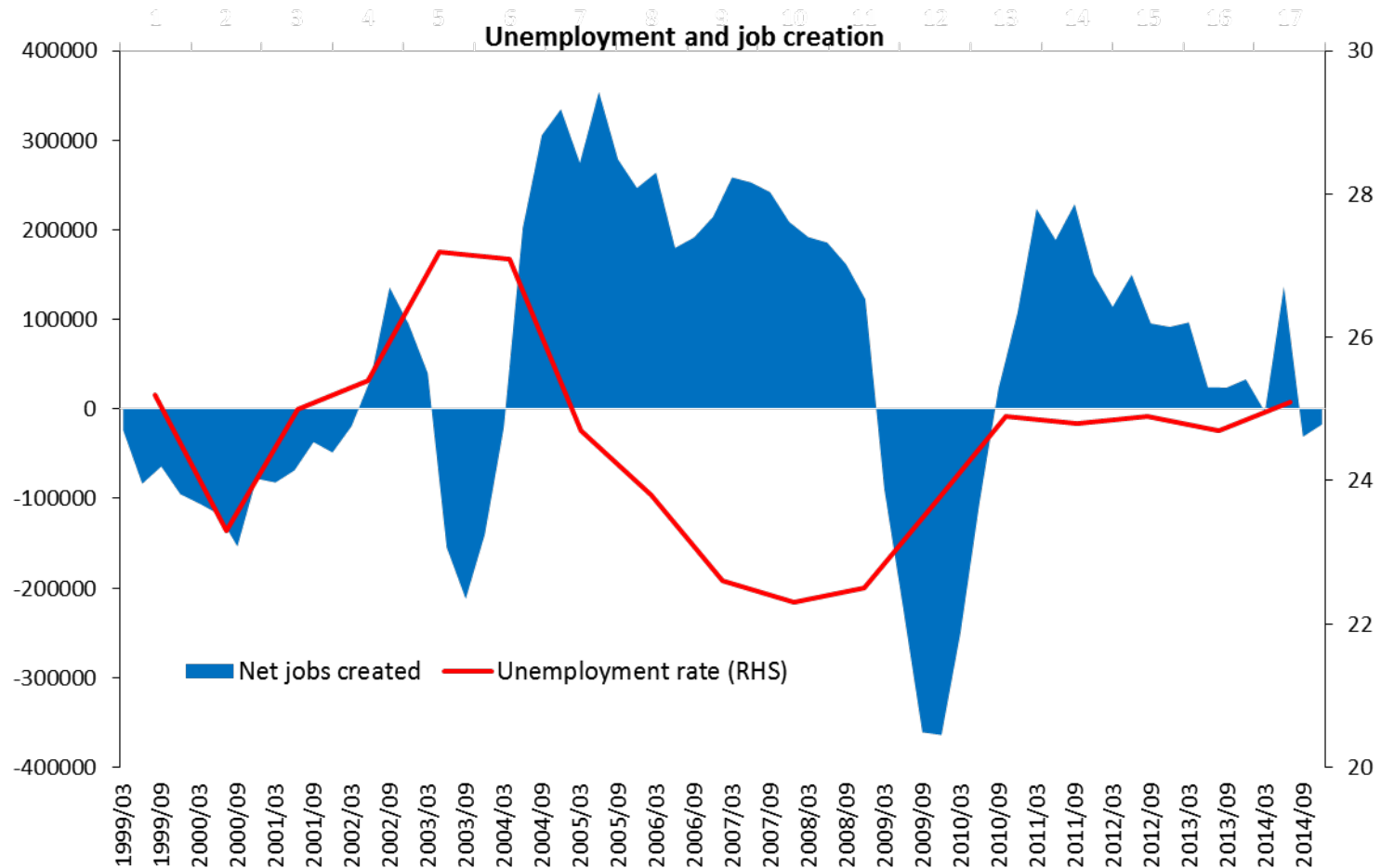
Source: South African Reserve Bank

...while debt to GDP burdens weigh against further leverage



Sources: National Treasury and South African Reserve Bank

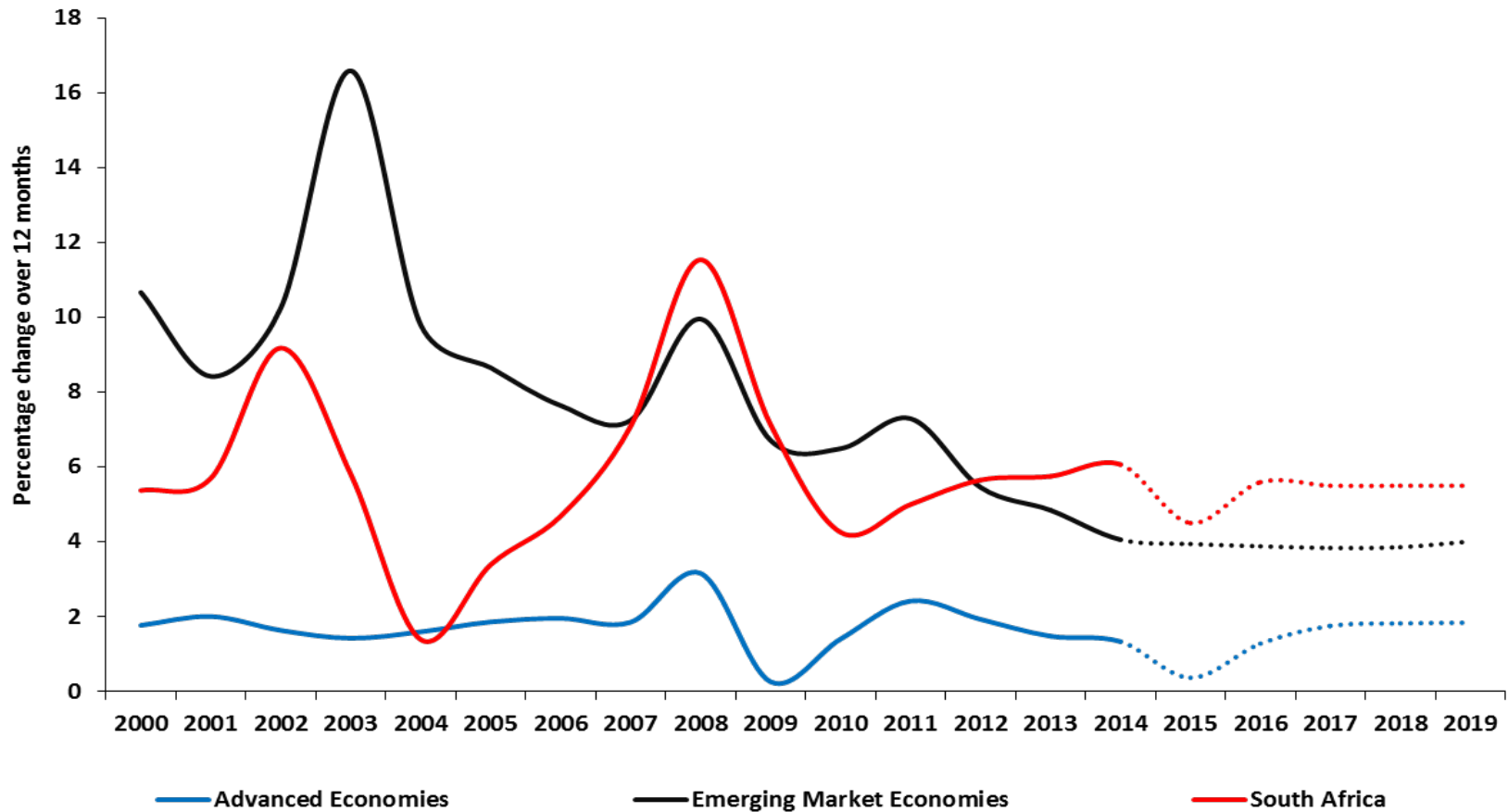
And net job creation tailing off



Sources: Statistics South Africa and South African Reserve Bank

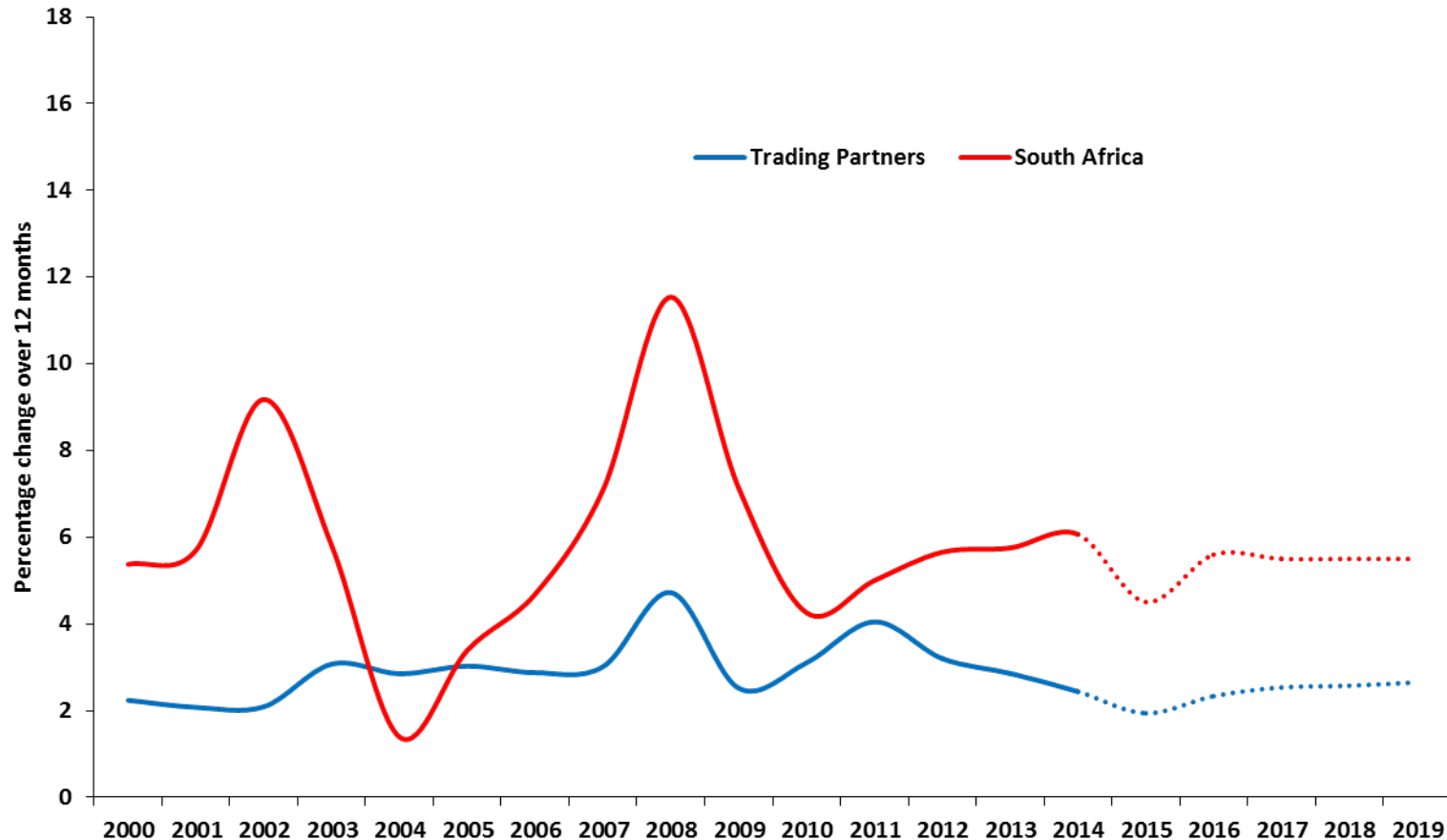
III. Inflation and the inflation outlook

World inflation unusually low due to weak demand... falling food & oil prices



Sources: South African Revenue Service, World Bank and South African Reserve Bank

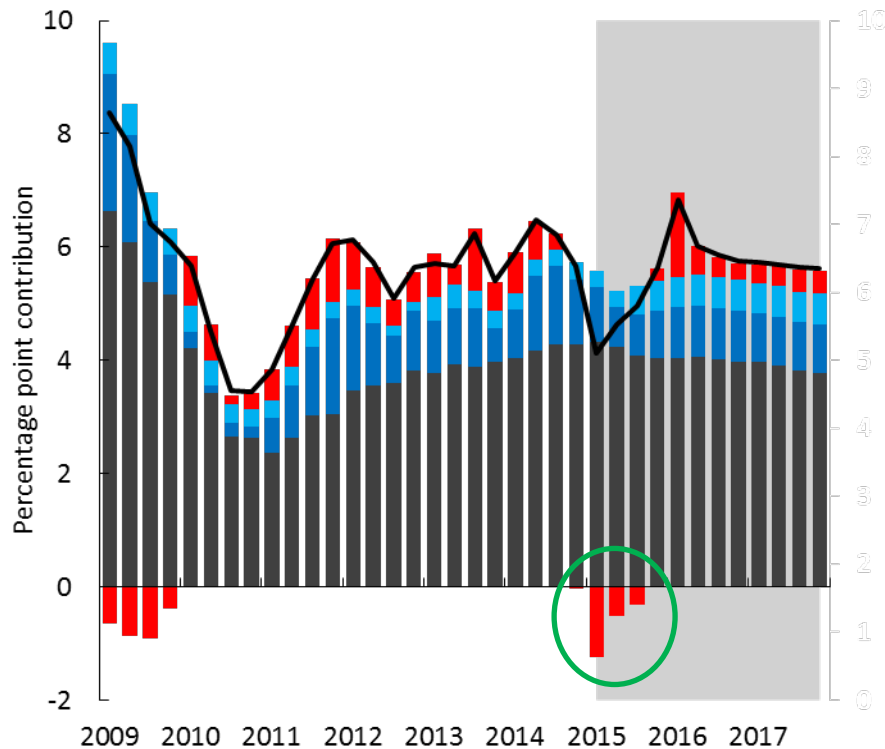
South African inflation running ahead



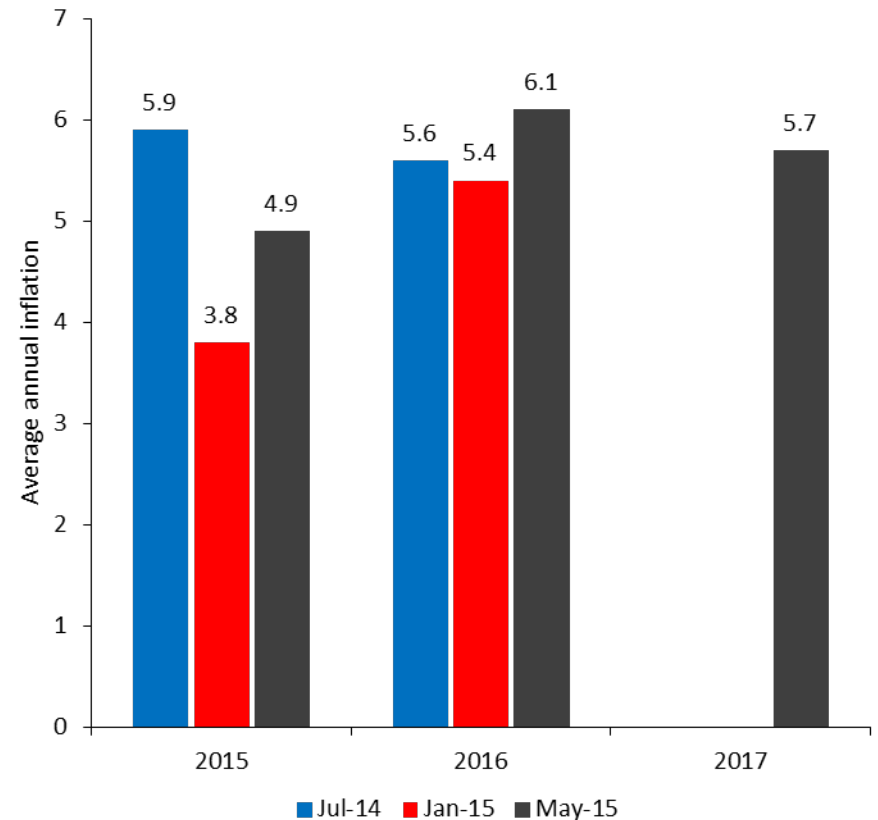
Sources: South African Revenue Service, World Bank and South African Reserve Bank

The inflation respite from cheap oil was brief

Contributions to headline inflation

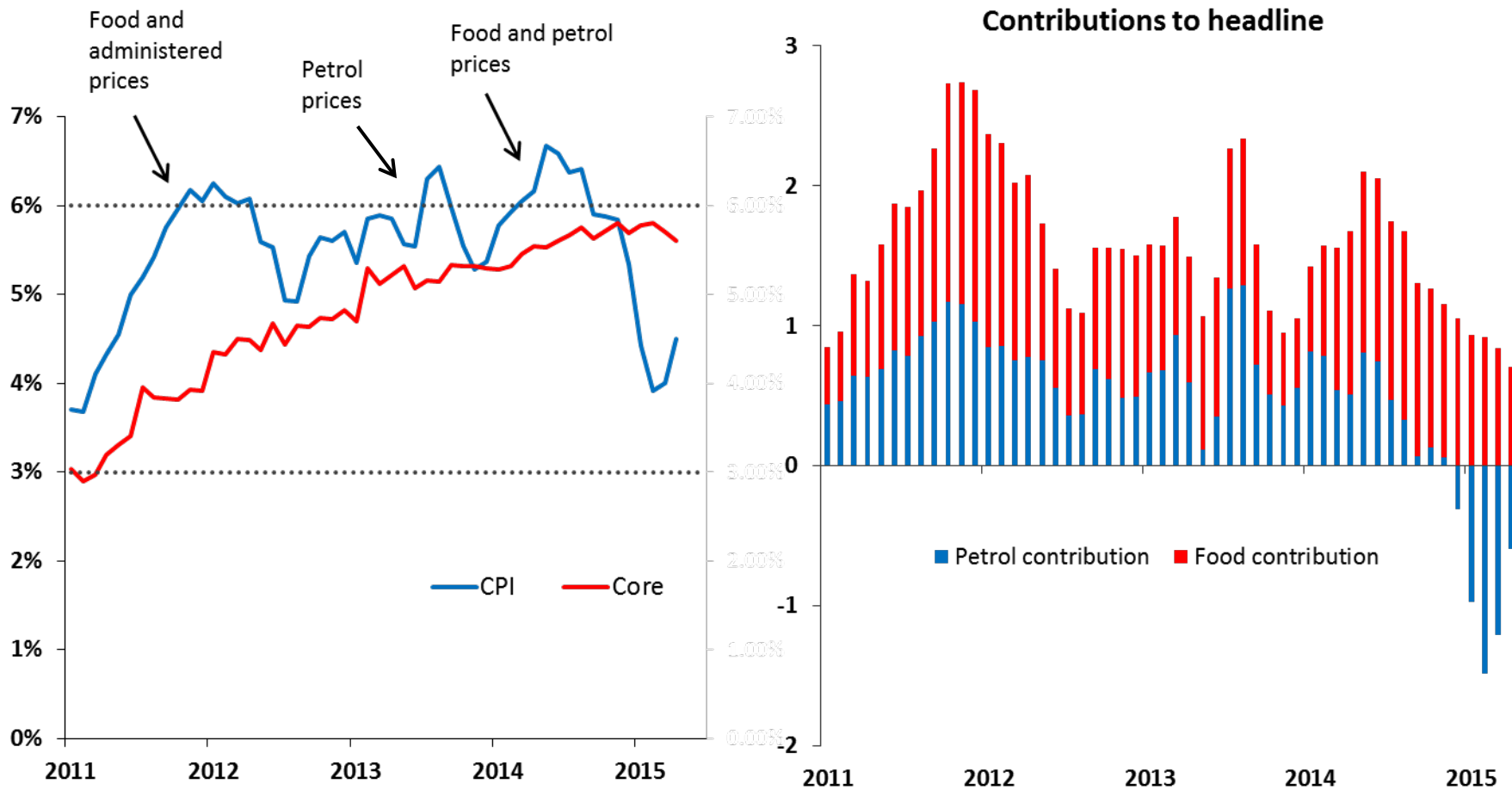


CPI forecasts at three different MPC meetings



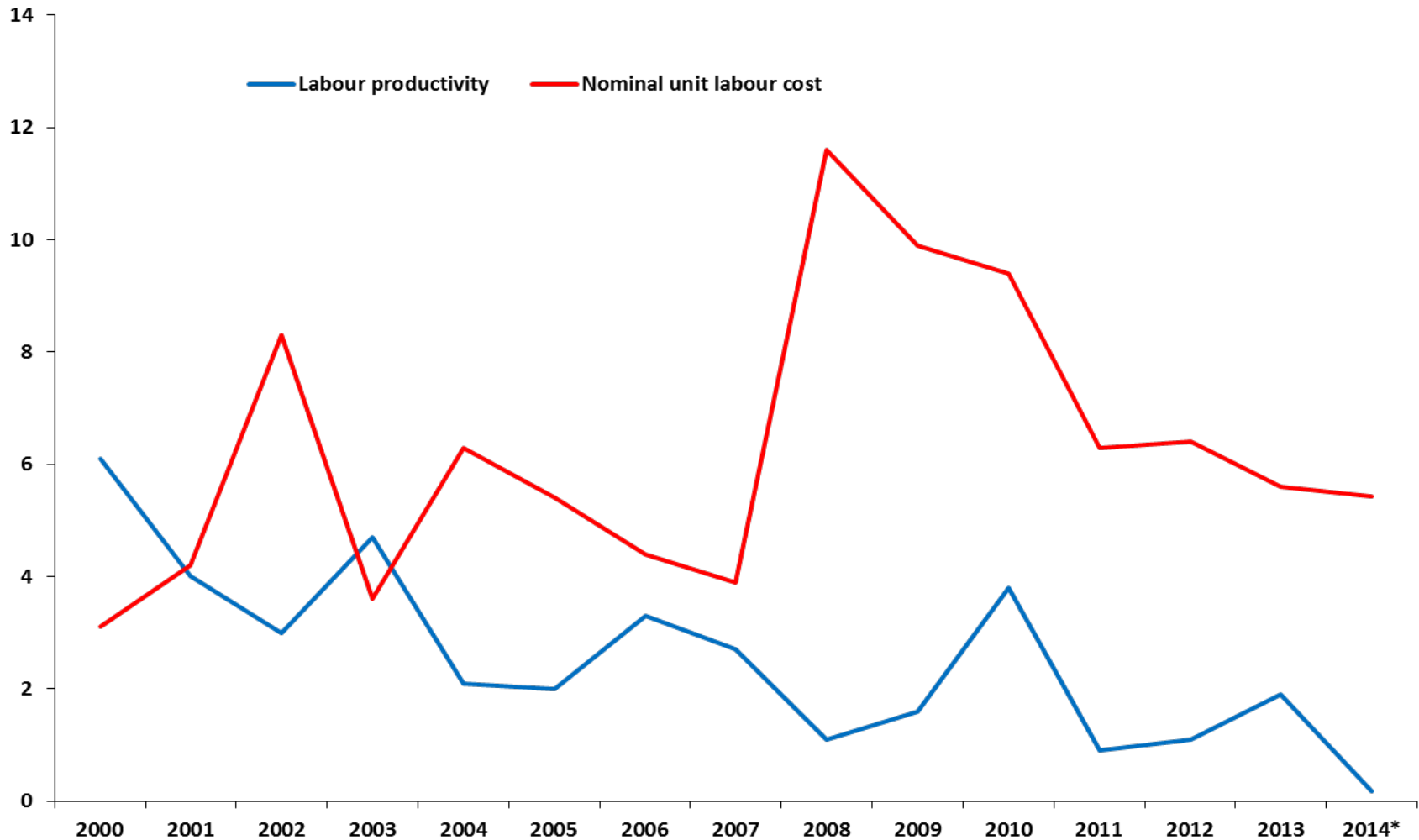
Sources: Statistics South Africa and South African Reserve Bank

Higher inflation propelled by a series of supply shocks...



Source: Statistics South Africa

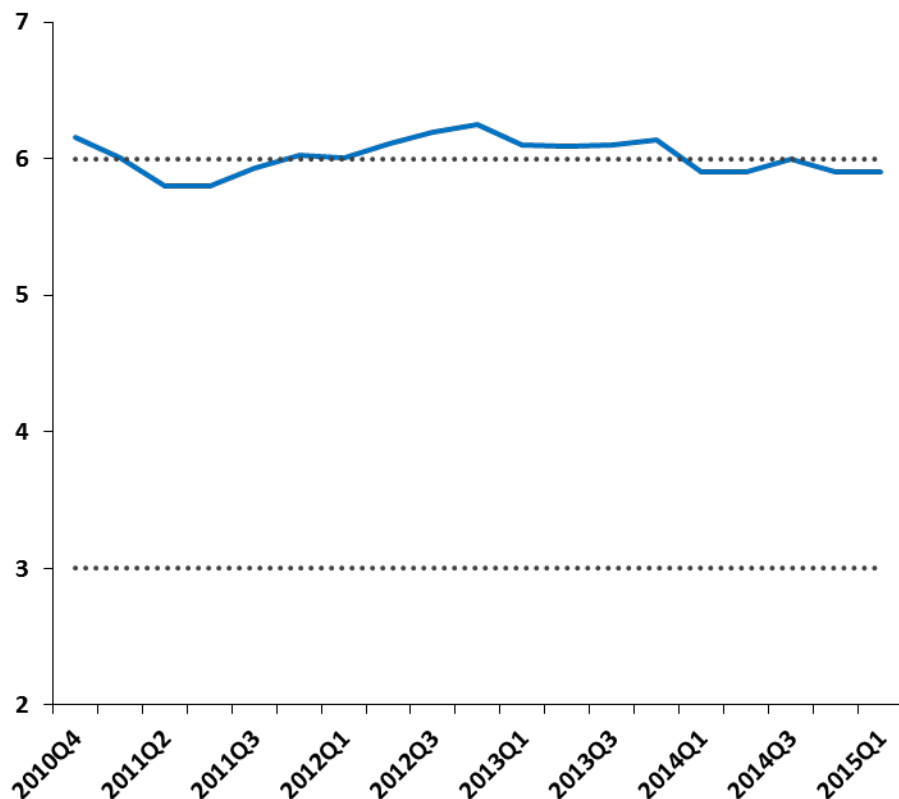
...as well as high unit labour cost growth



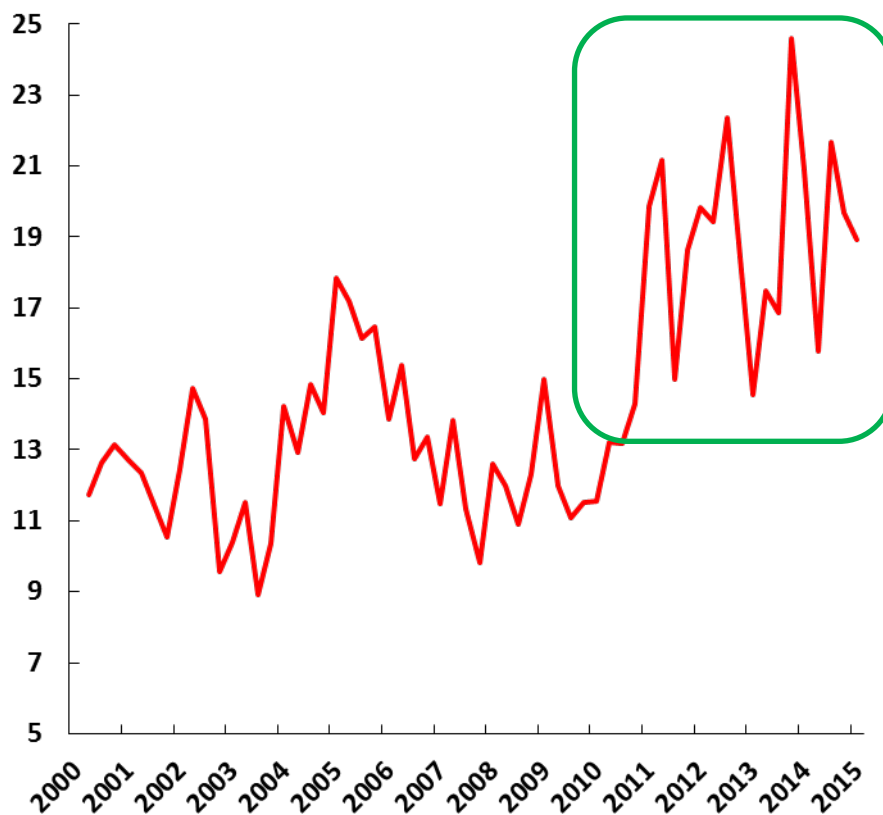
Source: South African Reserve Bank

Not unhinging expectations, but fostering convergence

Average inflation expectations,
for two years ahead (BER survey)

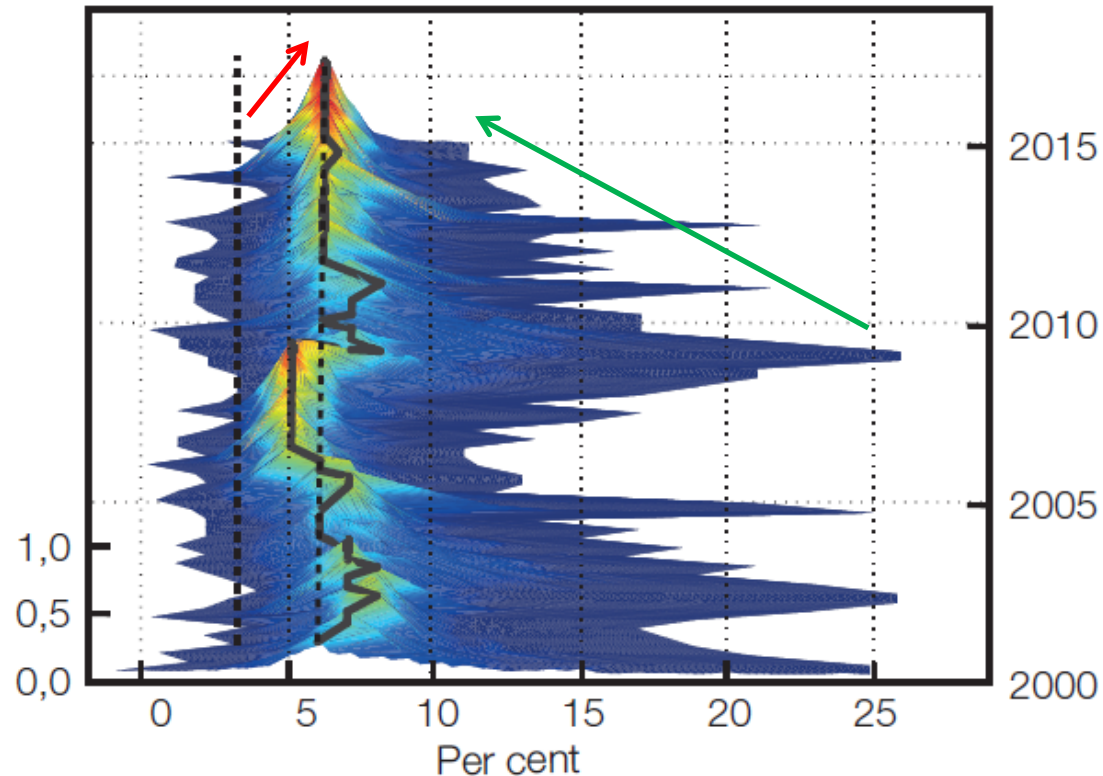


Proportion of respondents at the mode



Sources: Bureau for Economic Research and South African Reserve Bank

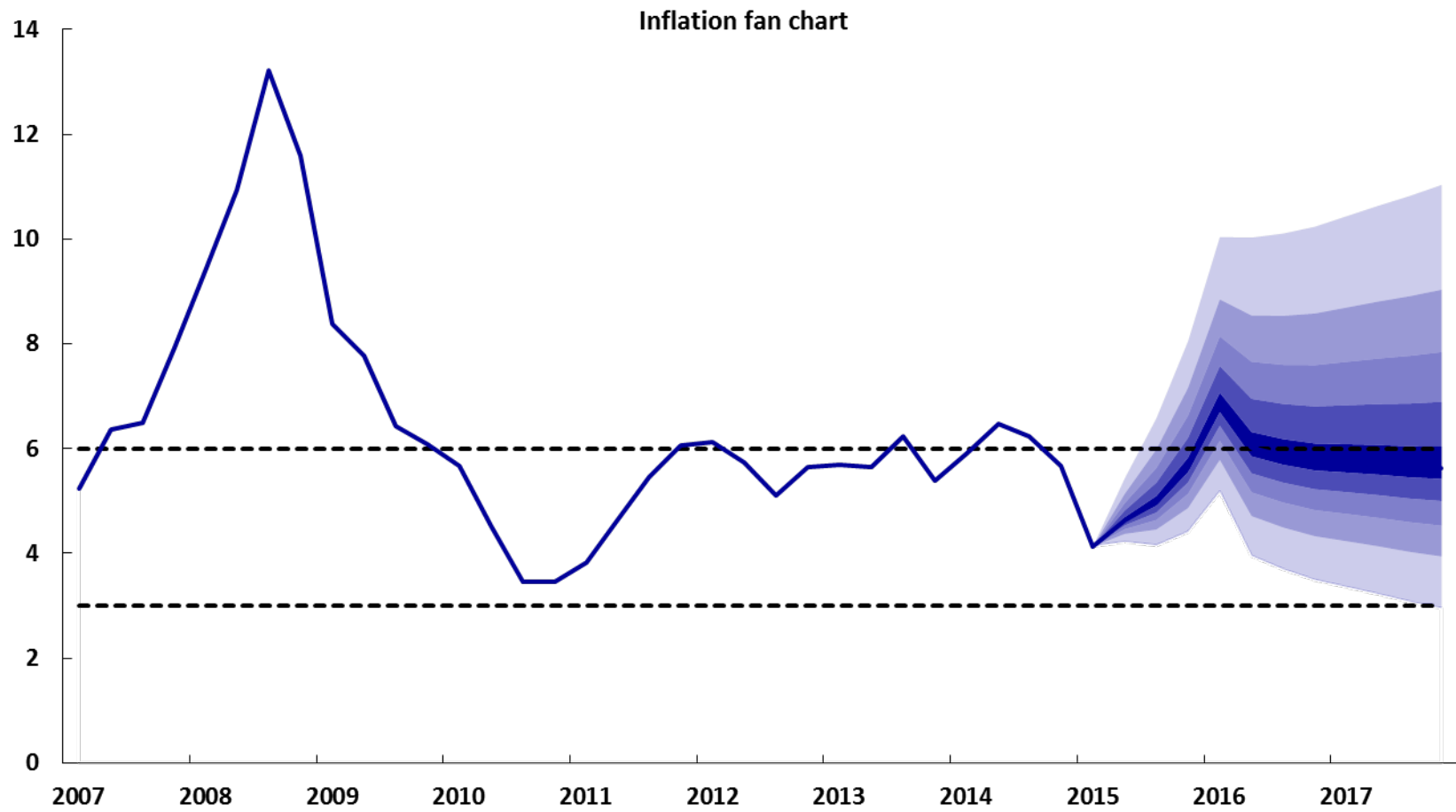
Convergence around the top of the target range



* This graph illustrates the distribution of inflation expectations over time. 'Higher' peaks (i.e. red colouring) imply that expectations are converging

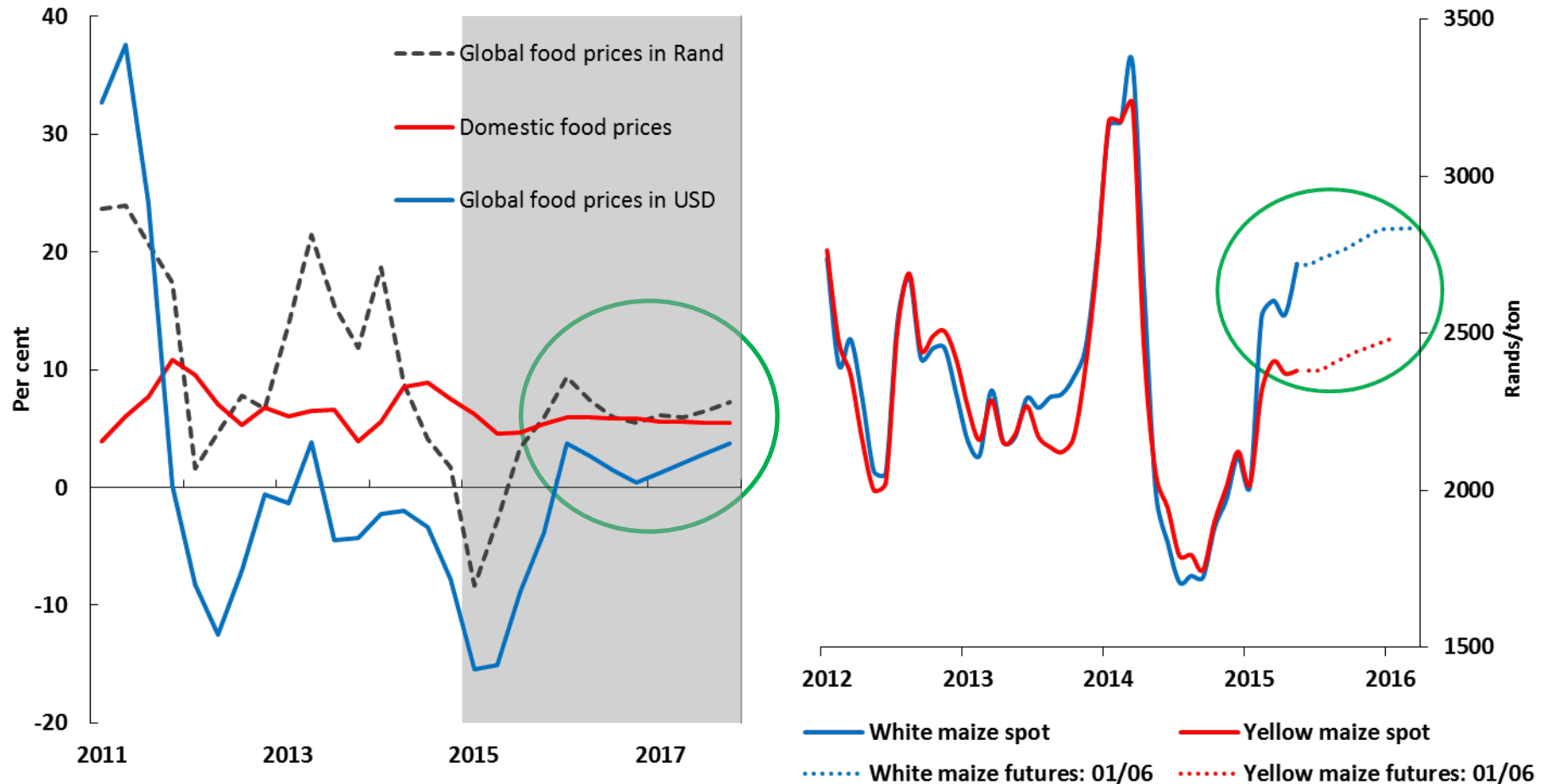
Source: Hassan, Shakill, Siobhan Redford, and Franz Ruch. 2015. Dispersion of Inflation Expectations. SA Reserve Bank, Working Paper (forthcoming).

Forecast at top of the target and risks to the upside



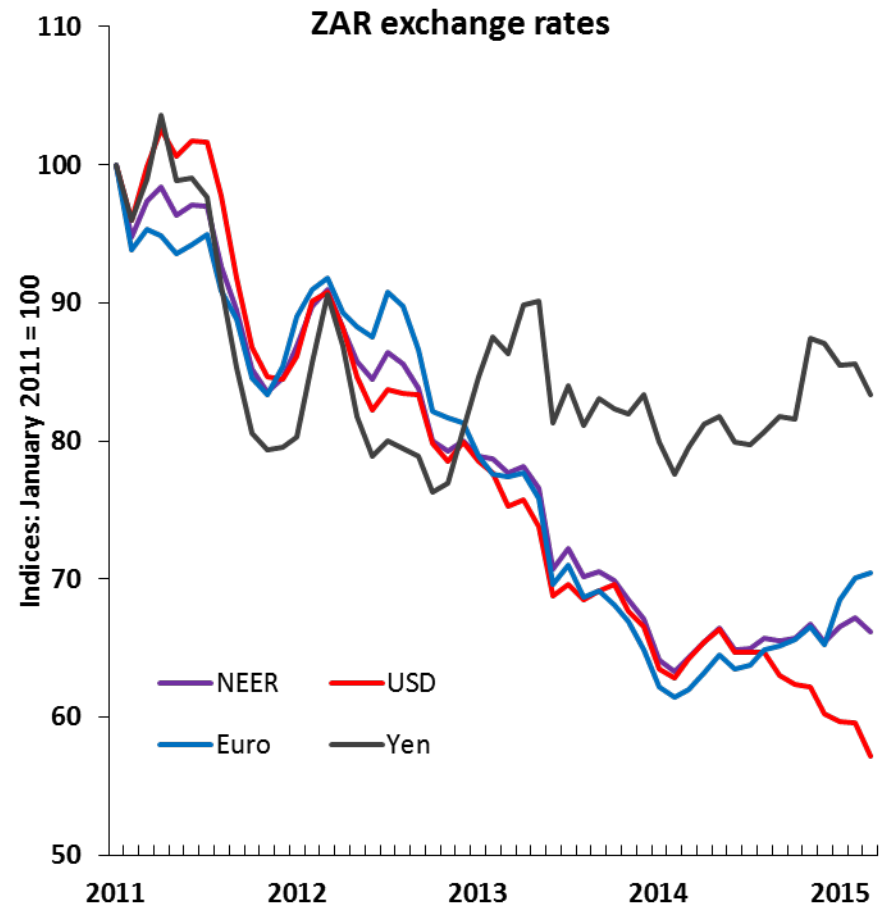
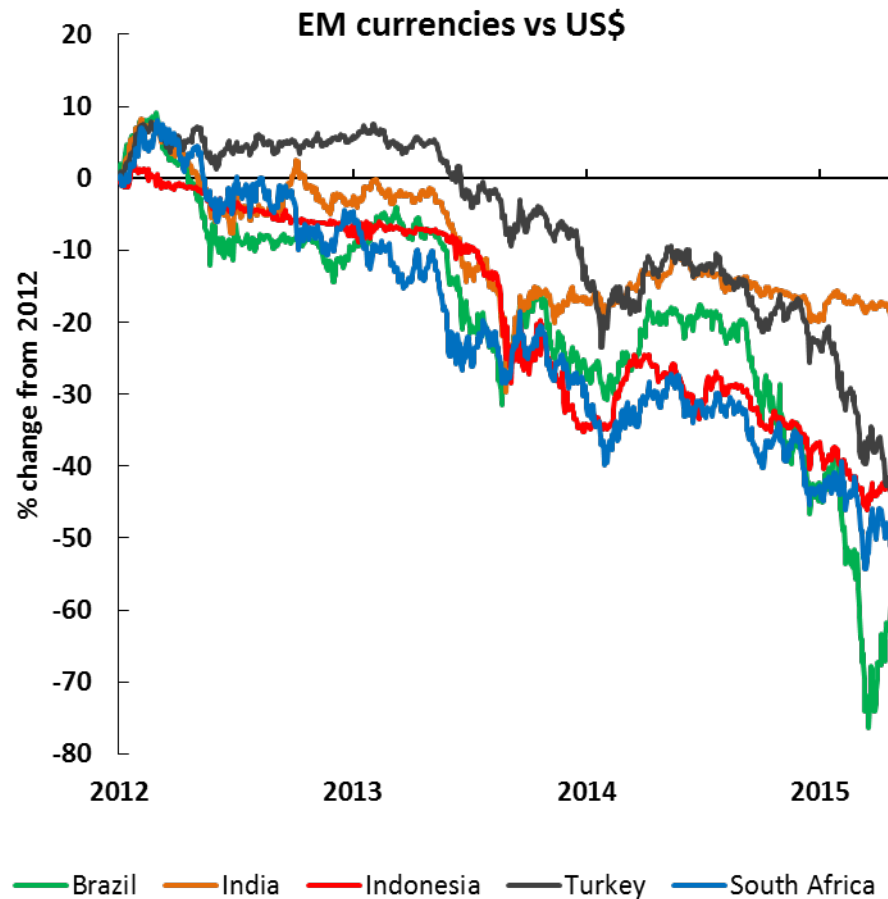
Source: South African Reserve Bank

World food prices low, but currency and drought keeping SA prices buoyant



Sources: International Monetary Fund, South African Futures Exchange and South African Reserve Bank

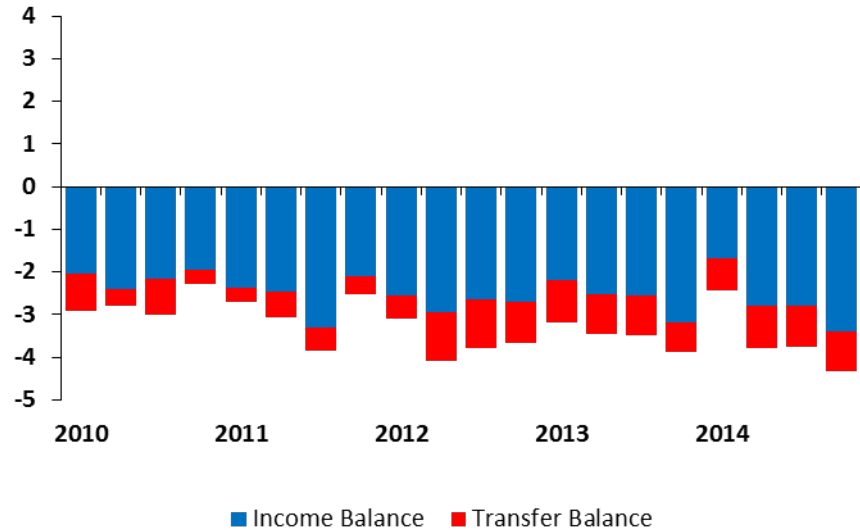
Depreciation to the USD sustained but EMs still exposed



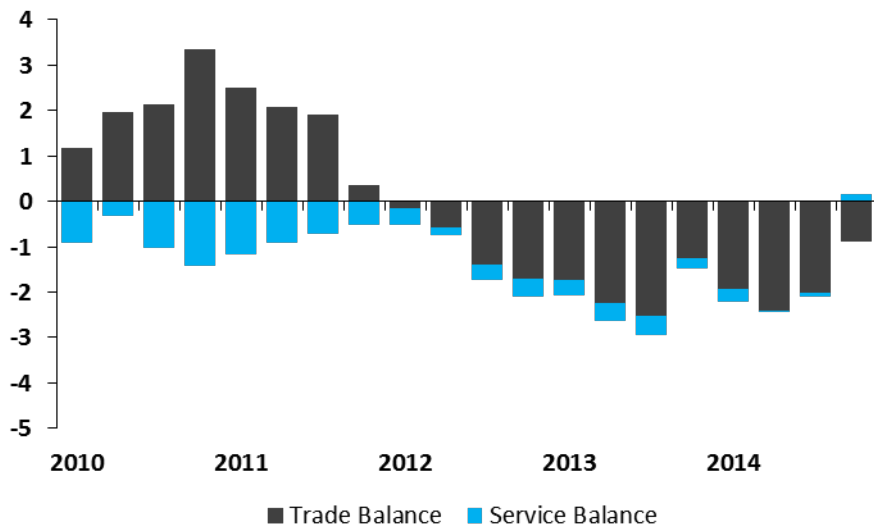
Sources: Bloomberg and South African Reserve Bank

South Africa's current account deficit narrowing slowly

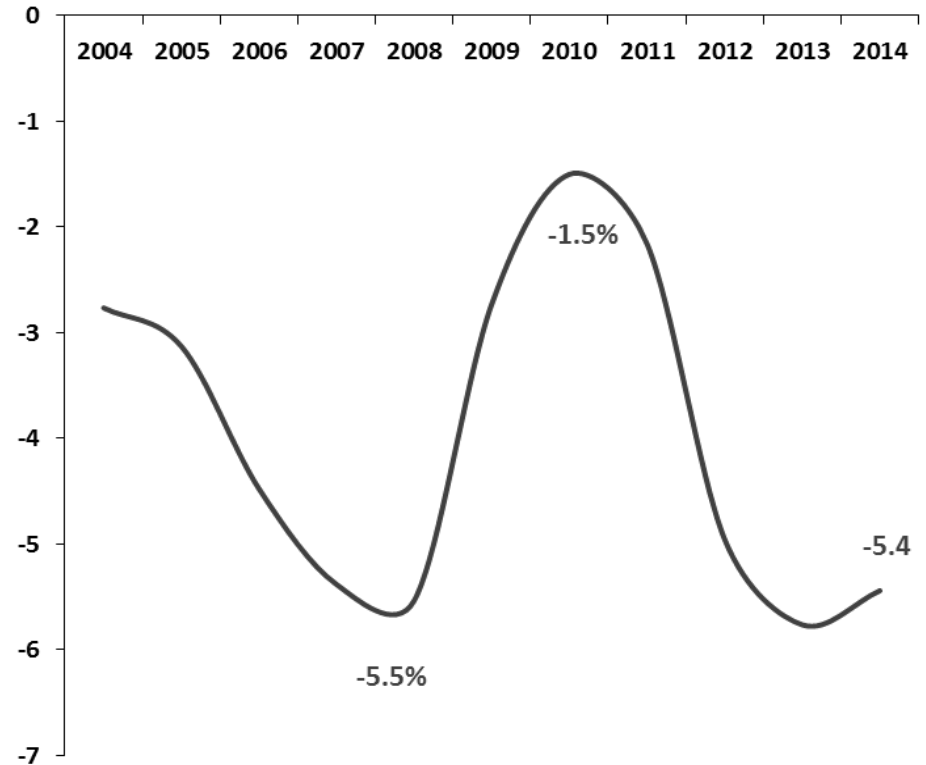
Percentage of GDP



Percentage of GDP

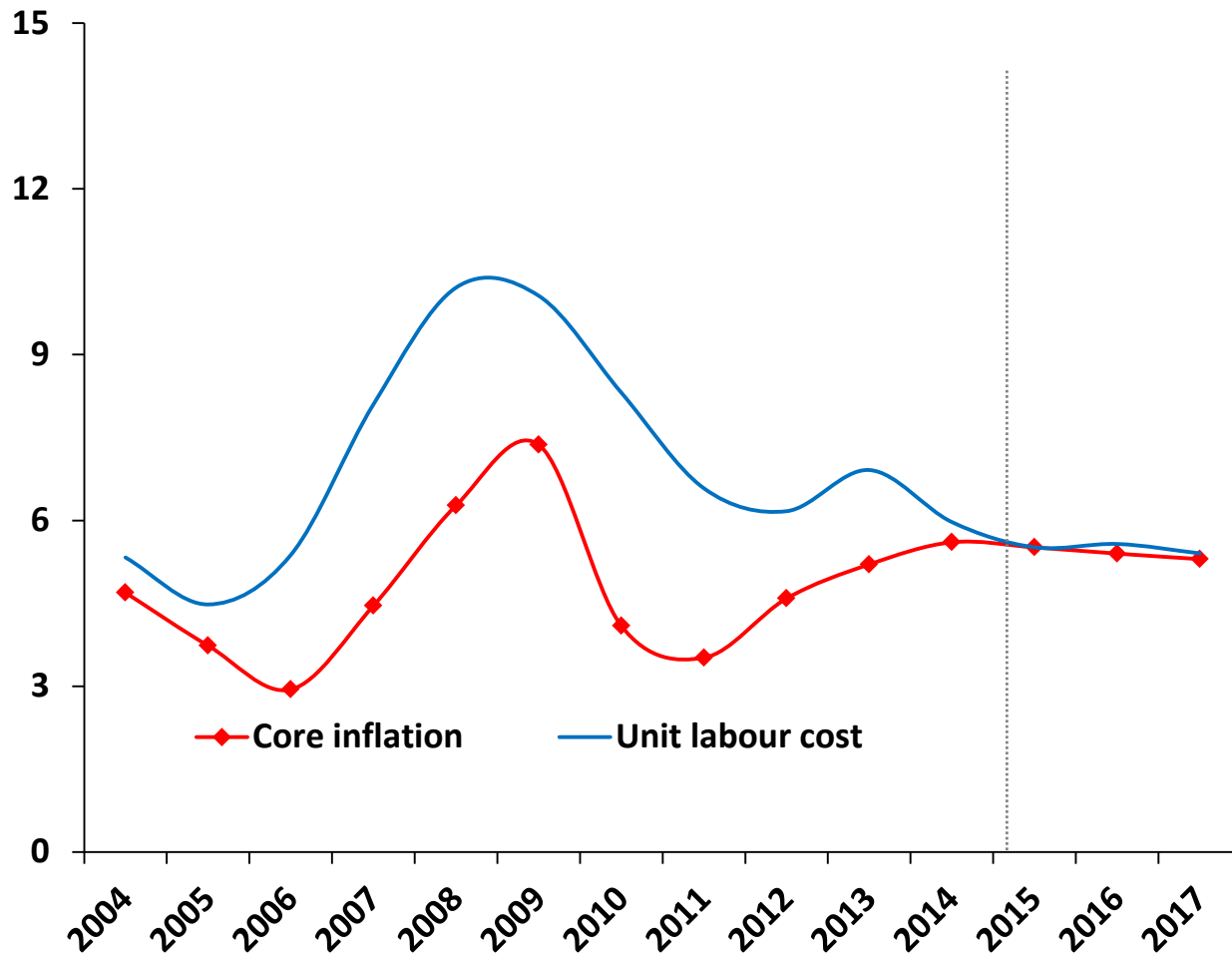


Percentage of GDP



Source: South African Reserve Bank

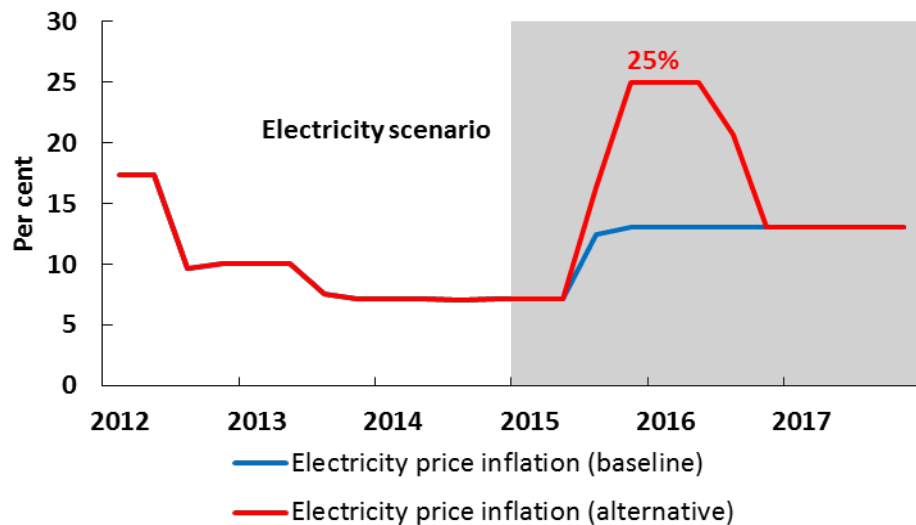
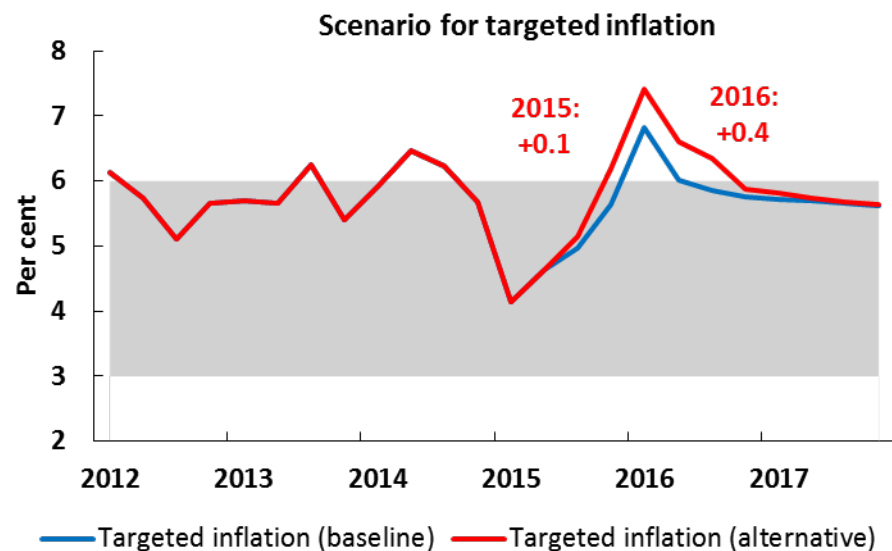
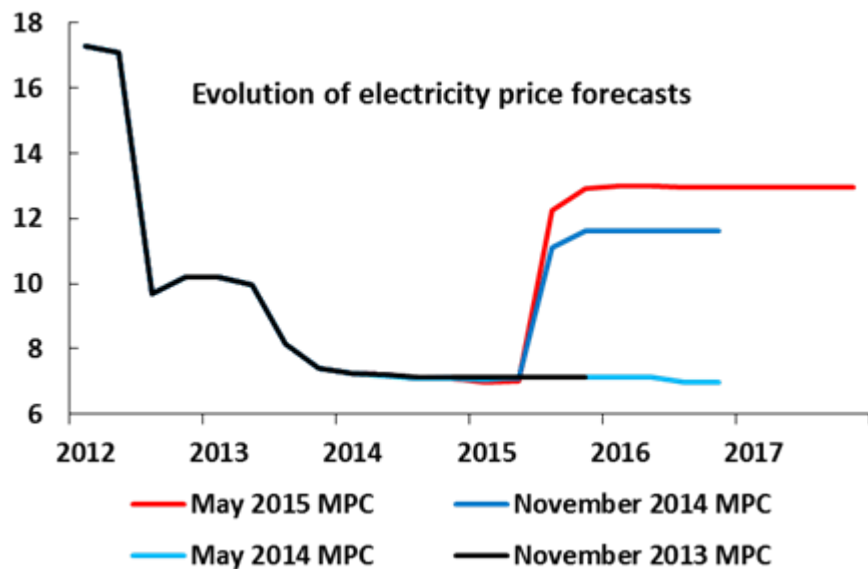
Unit labour costs expected to moderate somewhat, with risks



Strike risks:	
2015	Public sector Coal and gold industries
2016	Vehicle production, fuel, retail motor sectors

Sources: Statistics South Africa and South African Reserve Bank

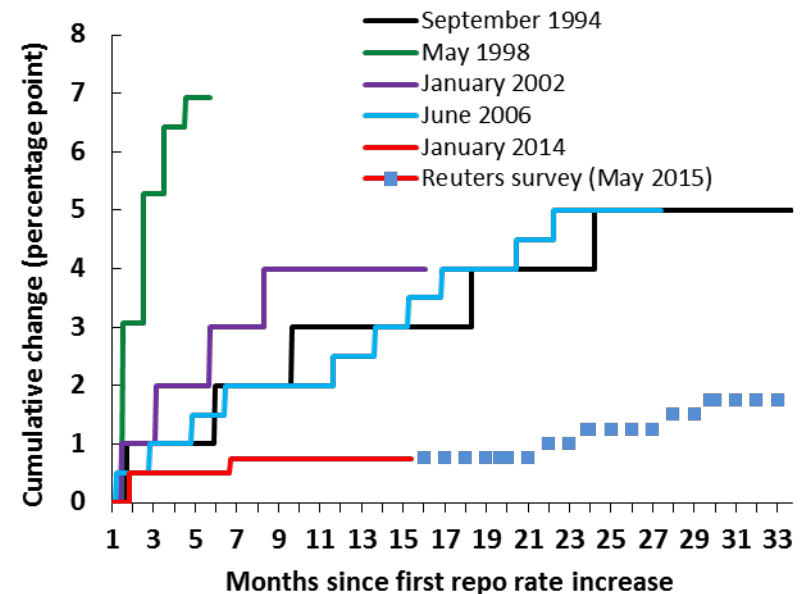
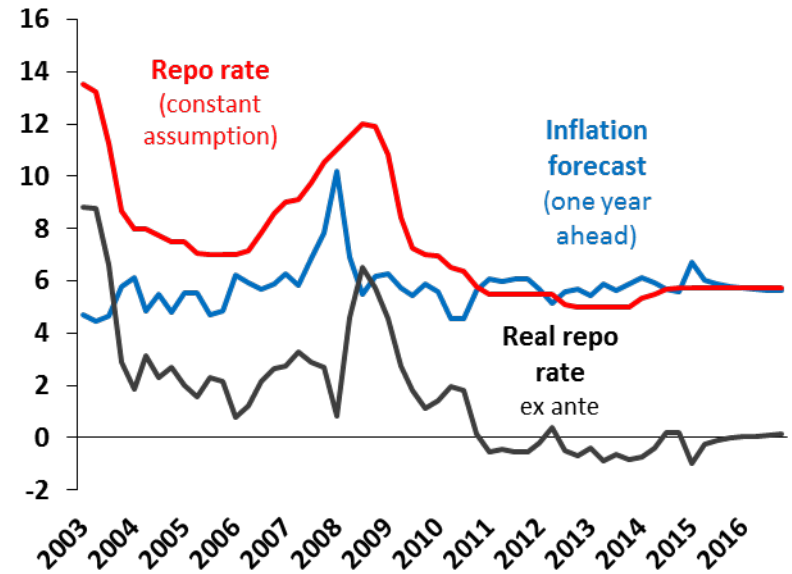
Electricity prices have the potential to shock



Source: South African Reserve Bank

Monetary policy shaped by an array of factors...

- Reversal of global financial conditions as rates change... speed & timing
- Potential growth lower from lower GFCF, electricity and competitiveness loss
- Aggregate demand headwinds...
 - Declining terms of trade
 - High leverage
 - Policy at full extension
- Inflation forecast: 4.9 in 2015, 6.1 in 2016, 5.7 in 2017
- Risks... food, electricity, remuneration, currency
- Sustained breach as core & expectations high?
- Gradual normalisation path



Sources: Reuters, Statistics South Africa and South African Reserve Bank