



South African Reserve Bank

June Monetary Policy Review

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2 June 2015 · Pretoria



Headlines

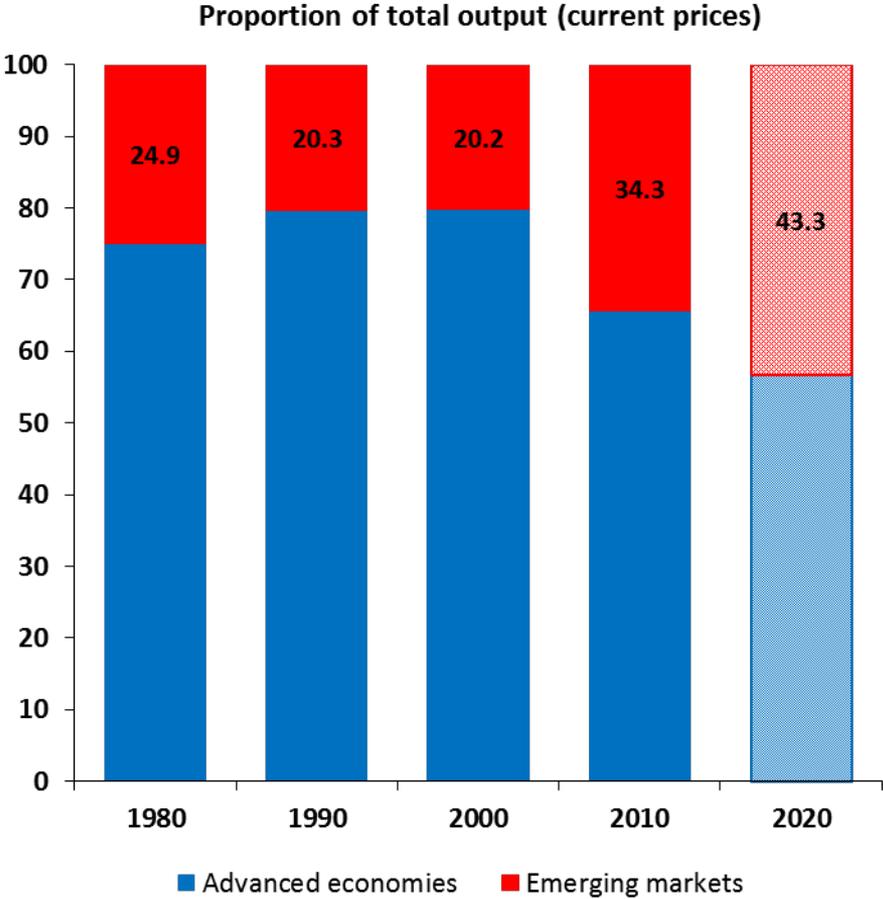
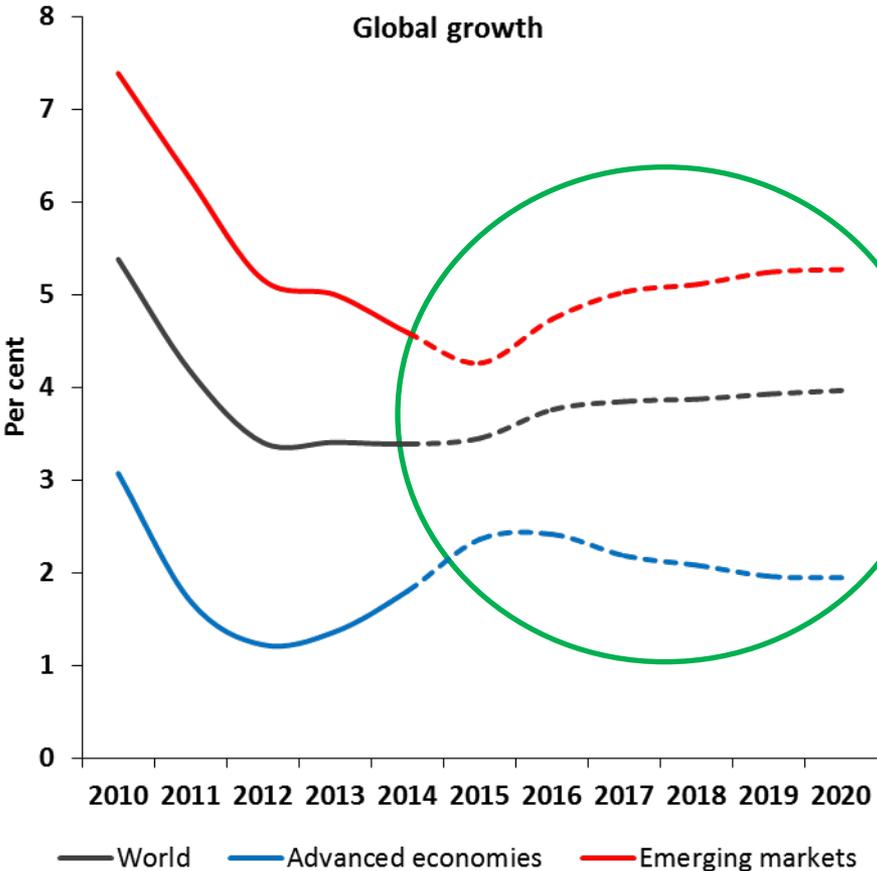
- **Evolving global conditions**
- **Headline CPI likely to be sticky around 6% as petrol impact dissipates**
- **Underlying inflation and expectations persistent**
- **Output gap still negative, but potential growth lower**
- **Risks to inflation high...**
 - **Food, electricity, remuneration, currency**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

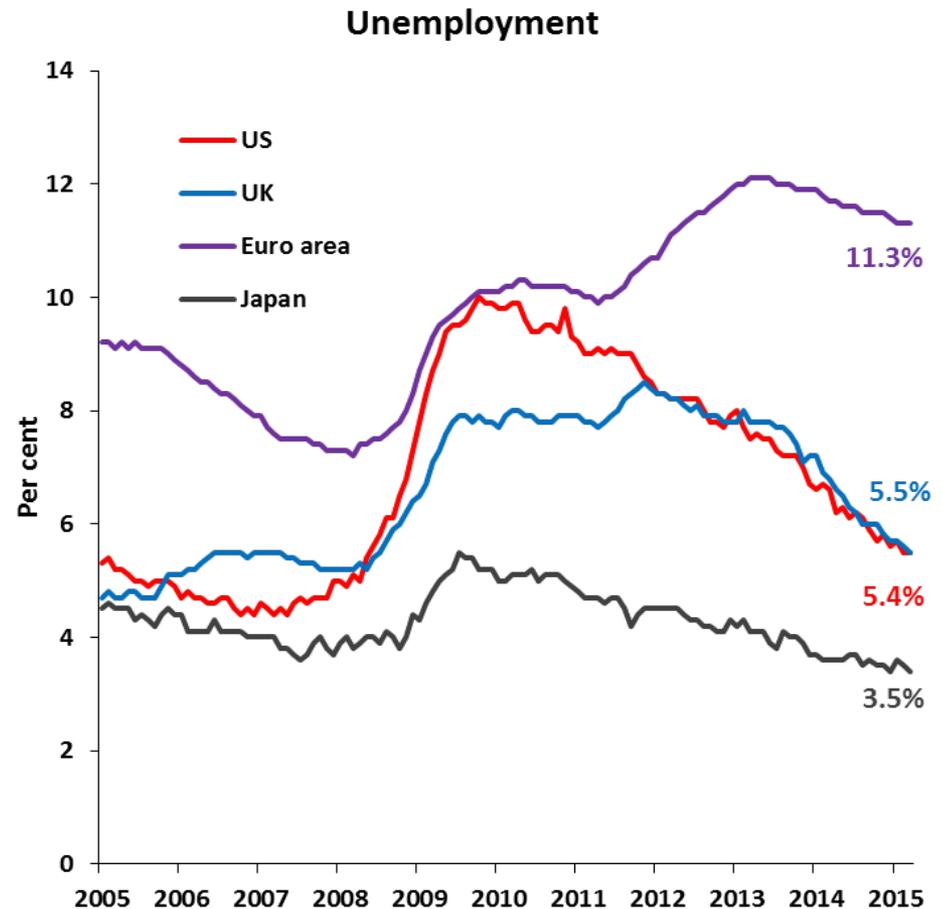
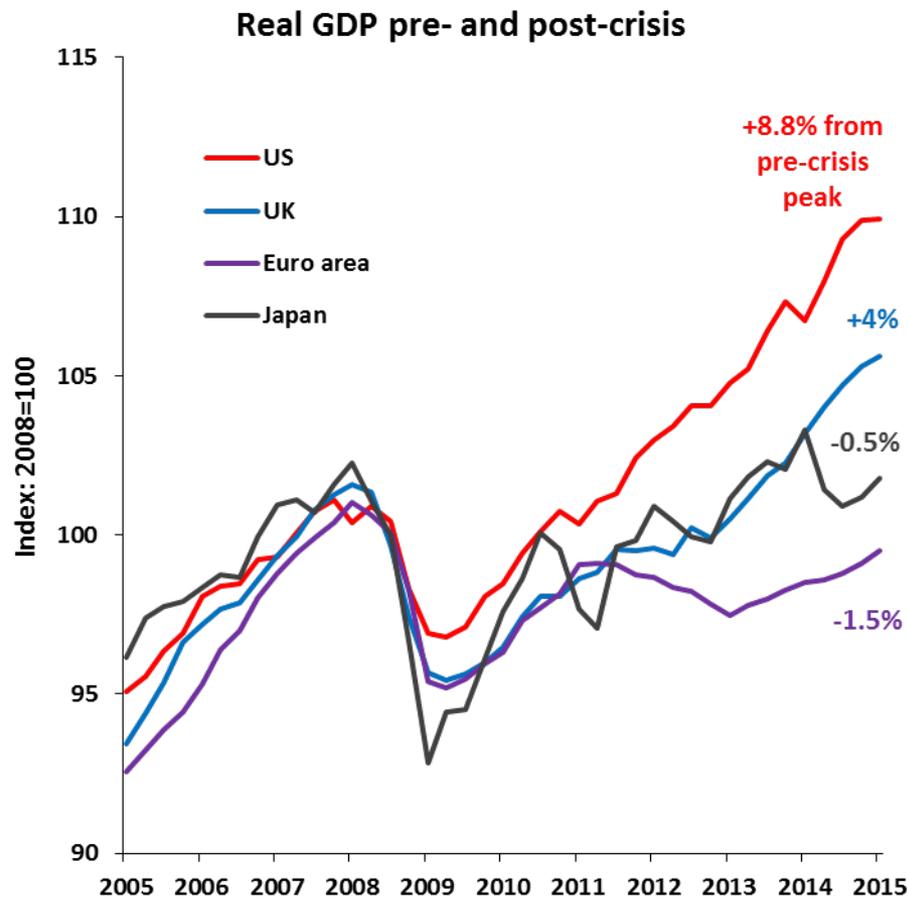
I. The world economy

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



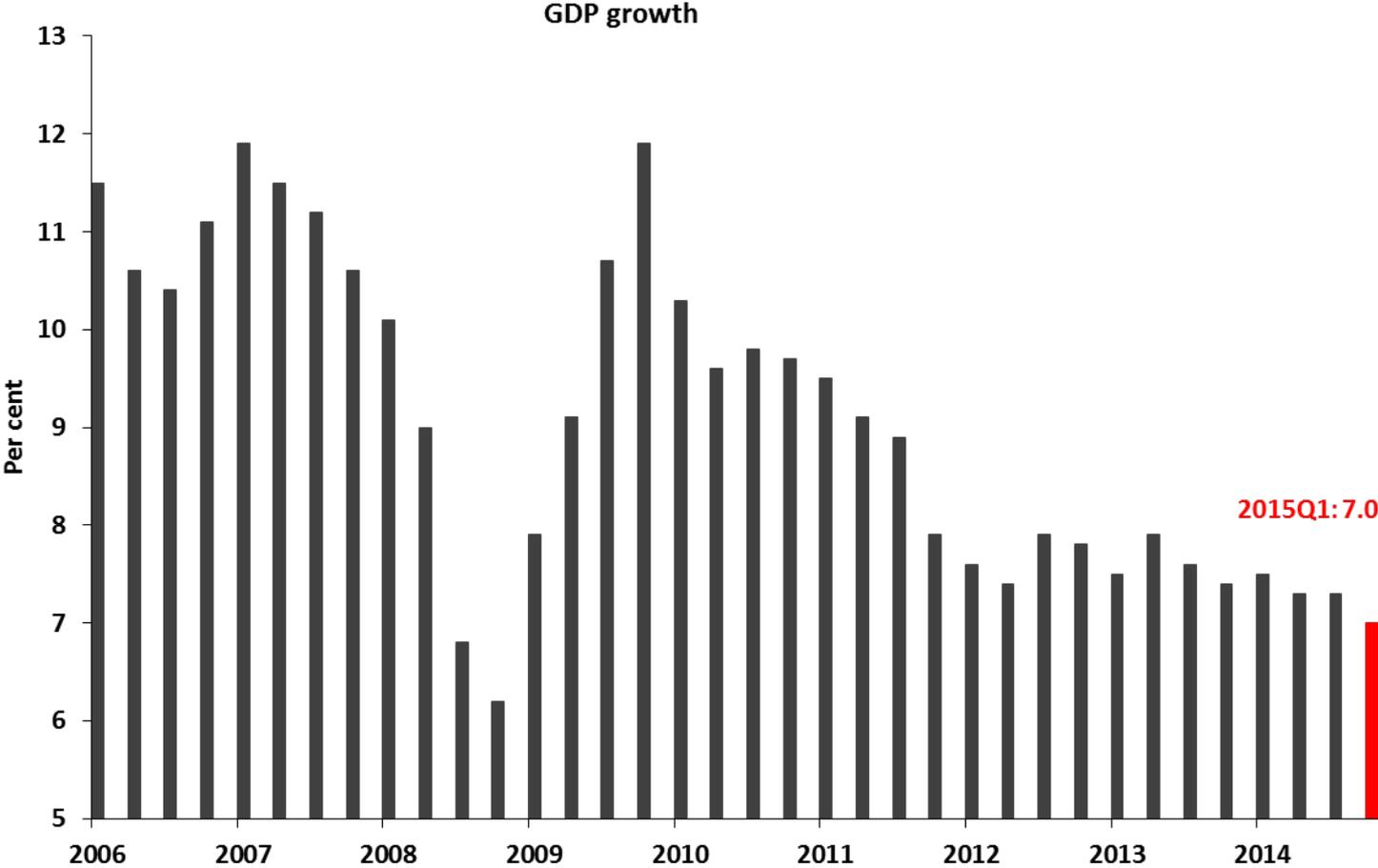
Source: International Monetary Fund

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



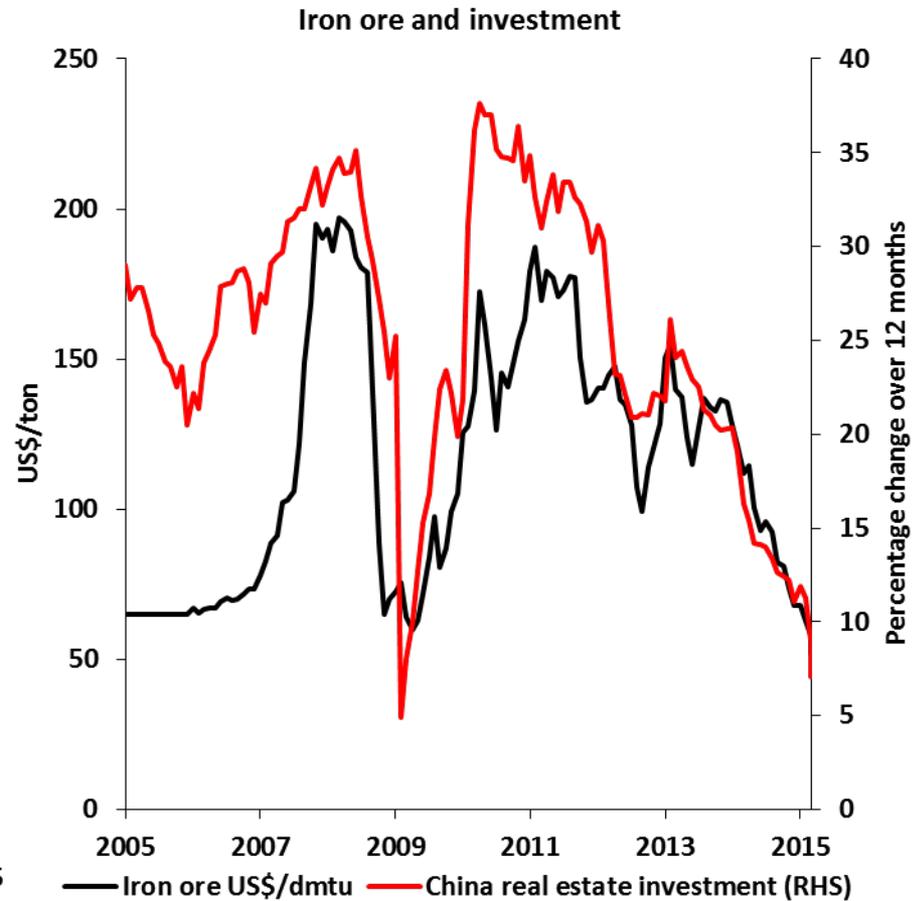
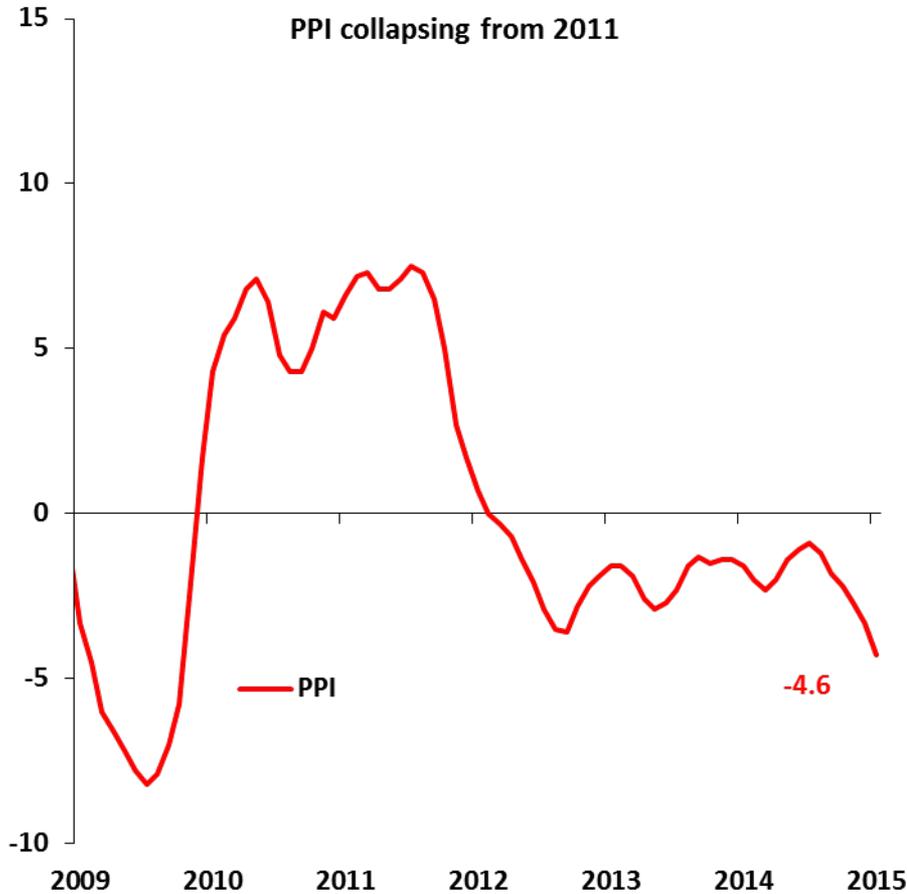
Source: Various national statistical agencies

China's economy is slowing and rebalancing...



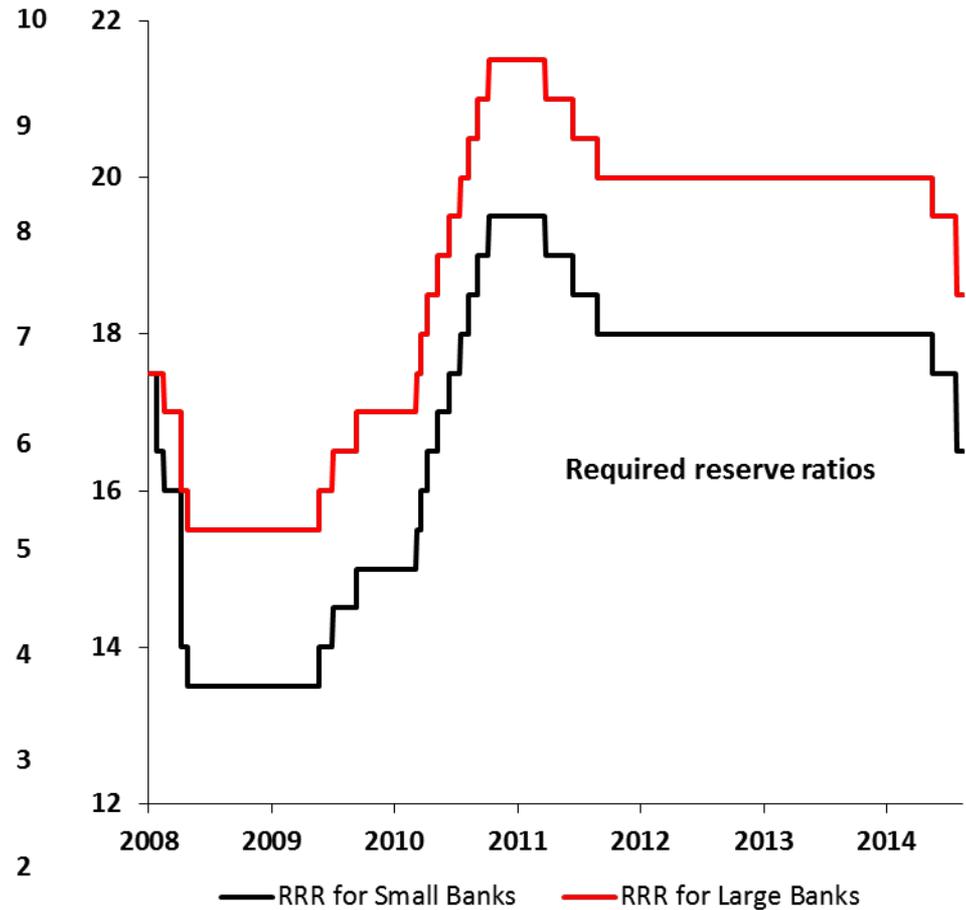
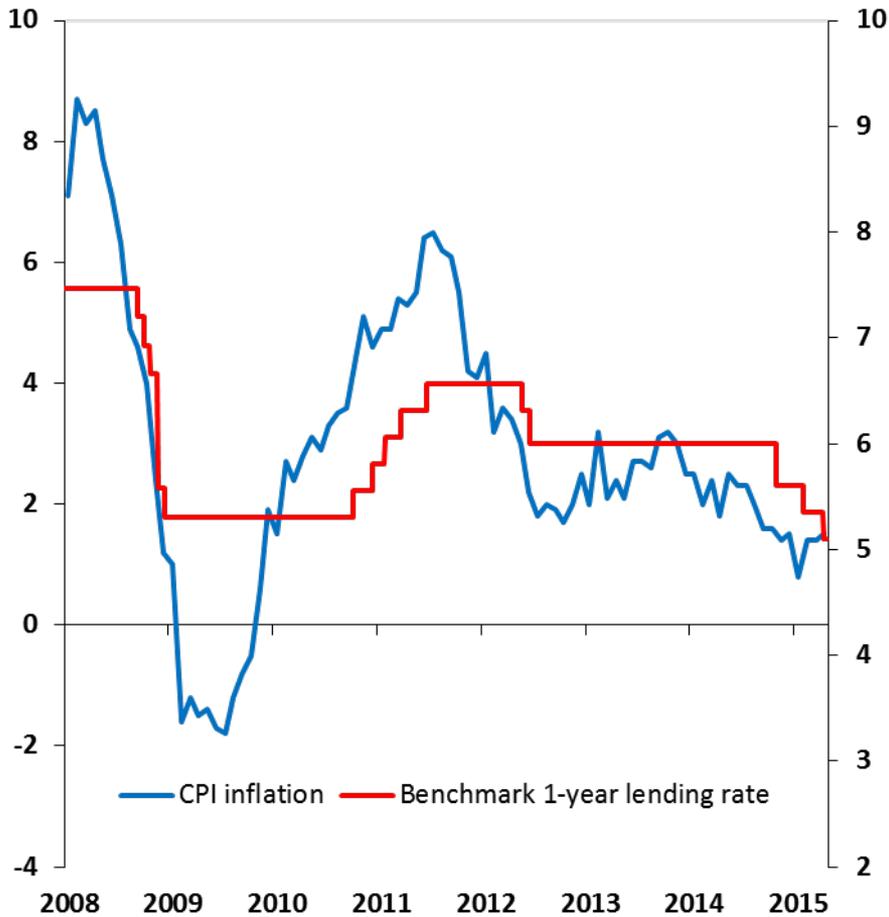
Source: National Bureau of Statistics of China

...with important consequences for commodity prices



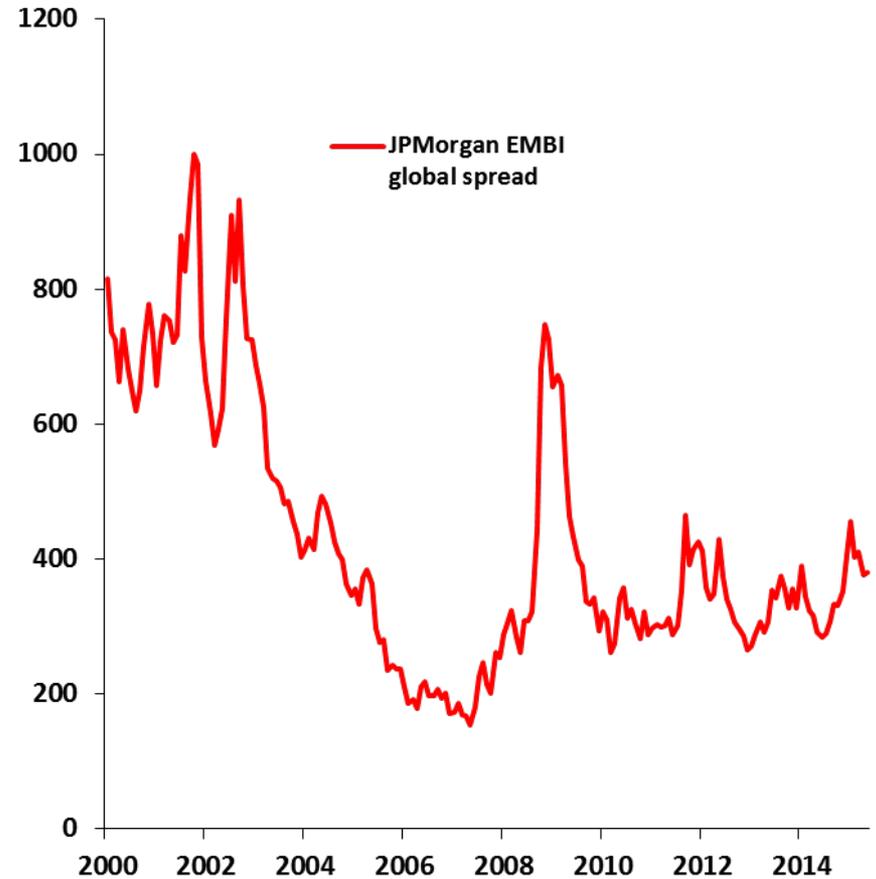
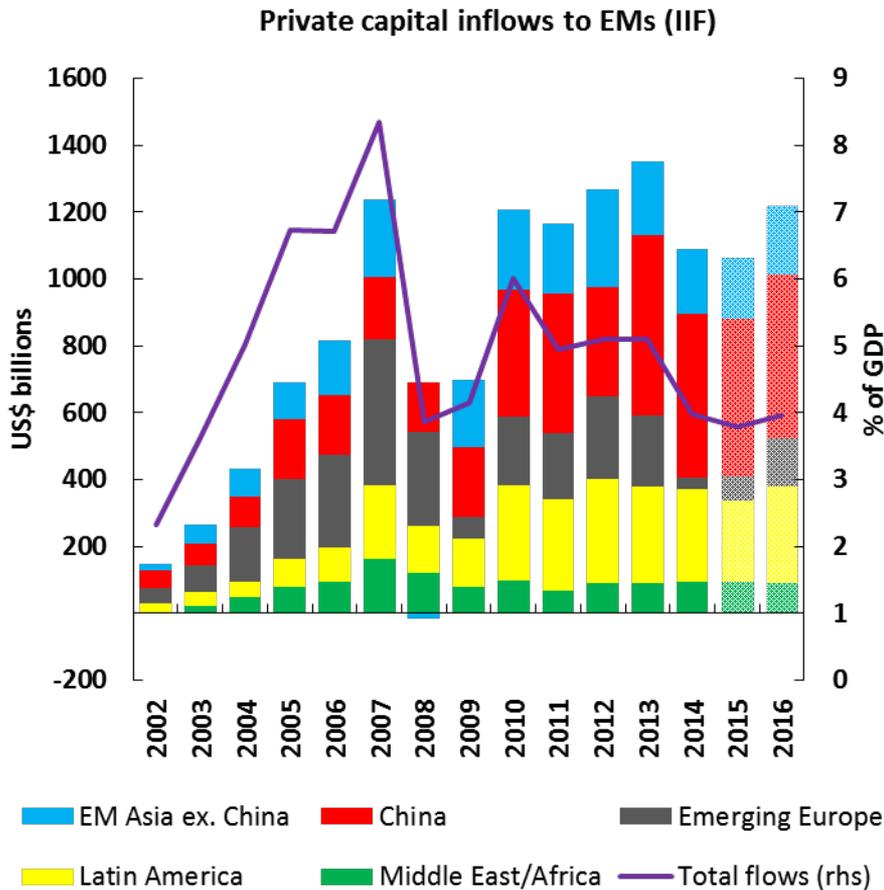
Sources: National Bureau of Statistics of China, World Bank and Bloomberg

Chinese monetary policy easing as inflation falls & GDP slows



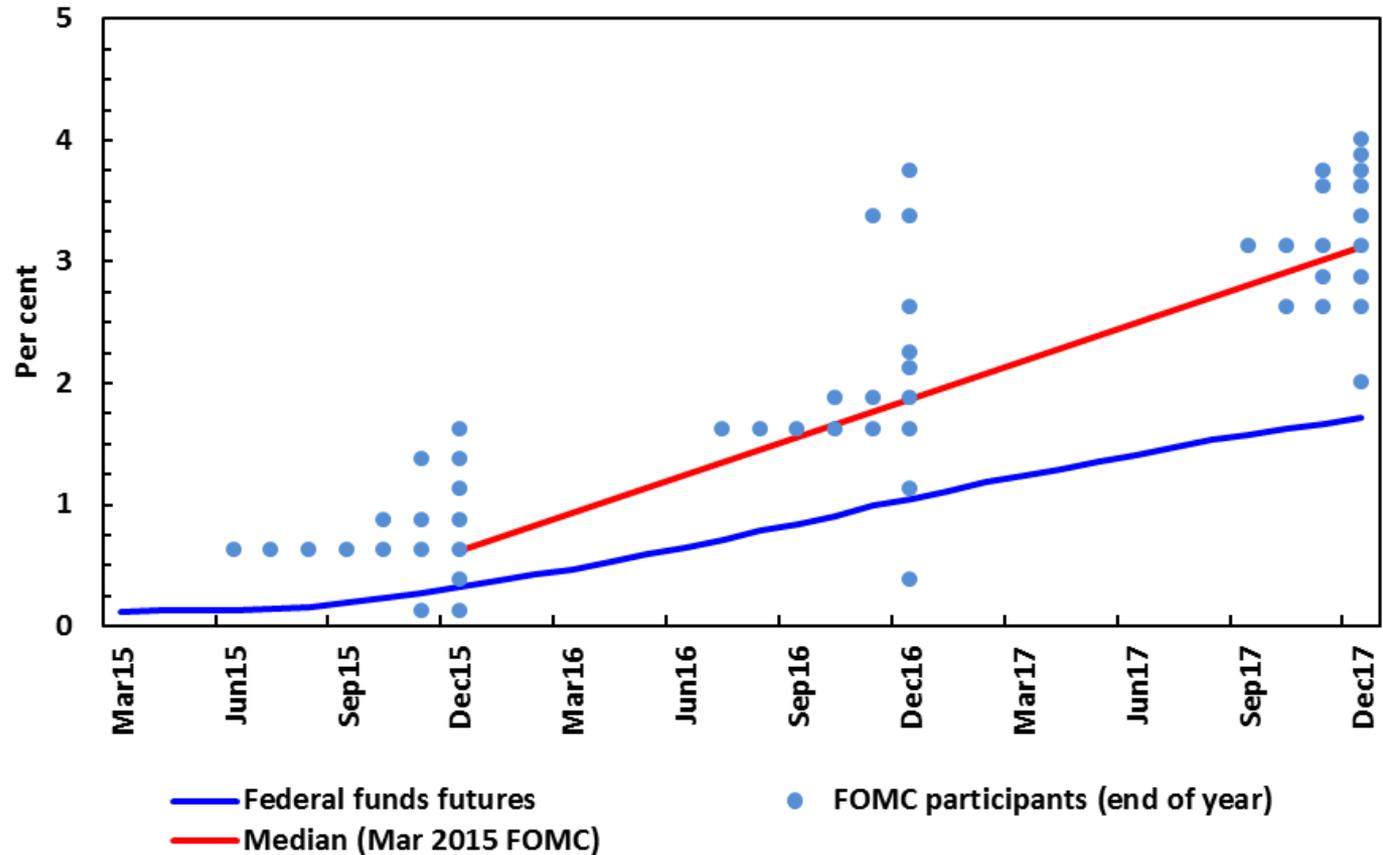
Sources: National Bureau of Statistics of China and People's Bank of China

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

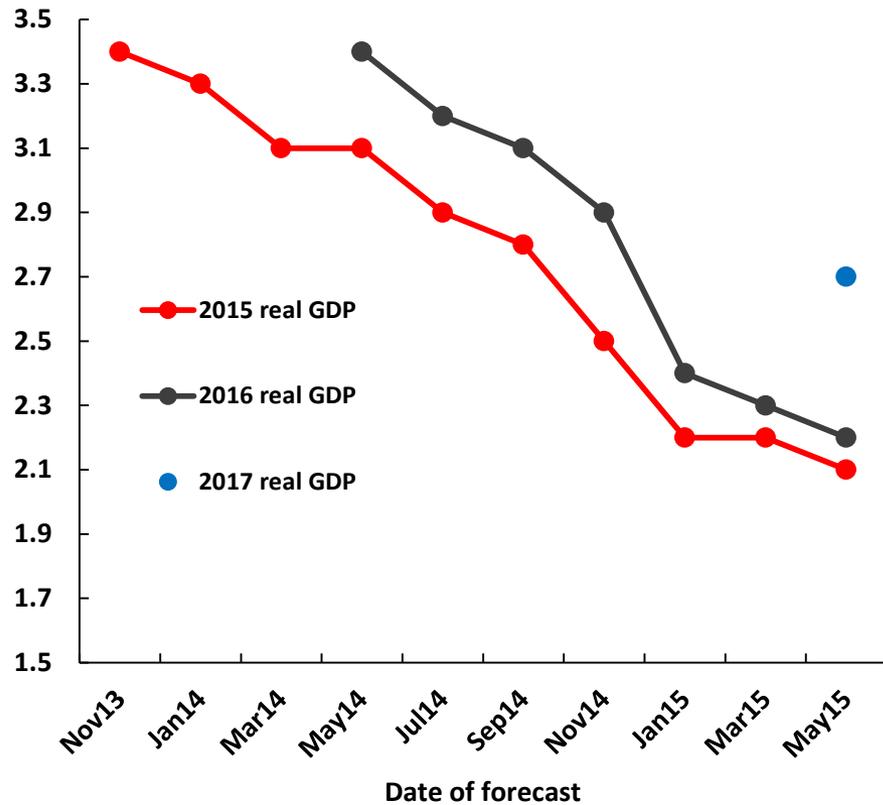


Sources: US Federal Reserve and Bloomberg

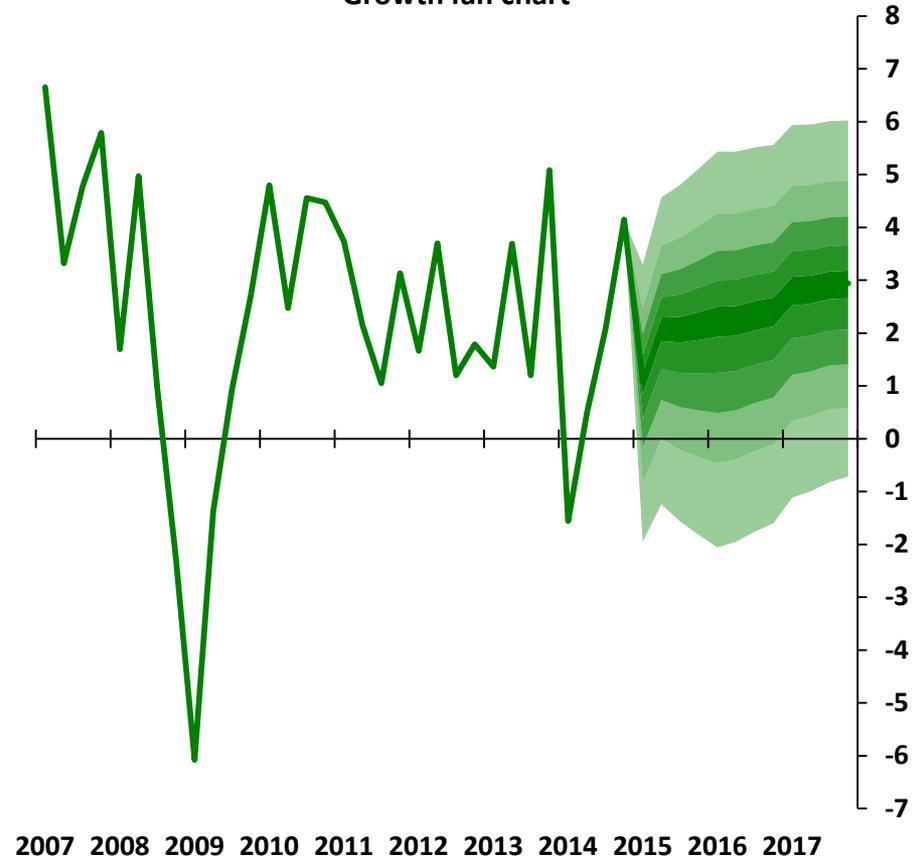
II. Growth and the GDP forecast

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

Growth forecasts over time

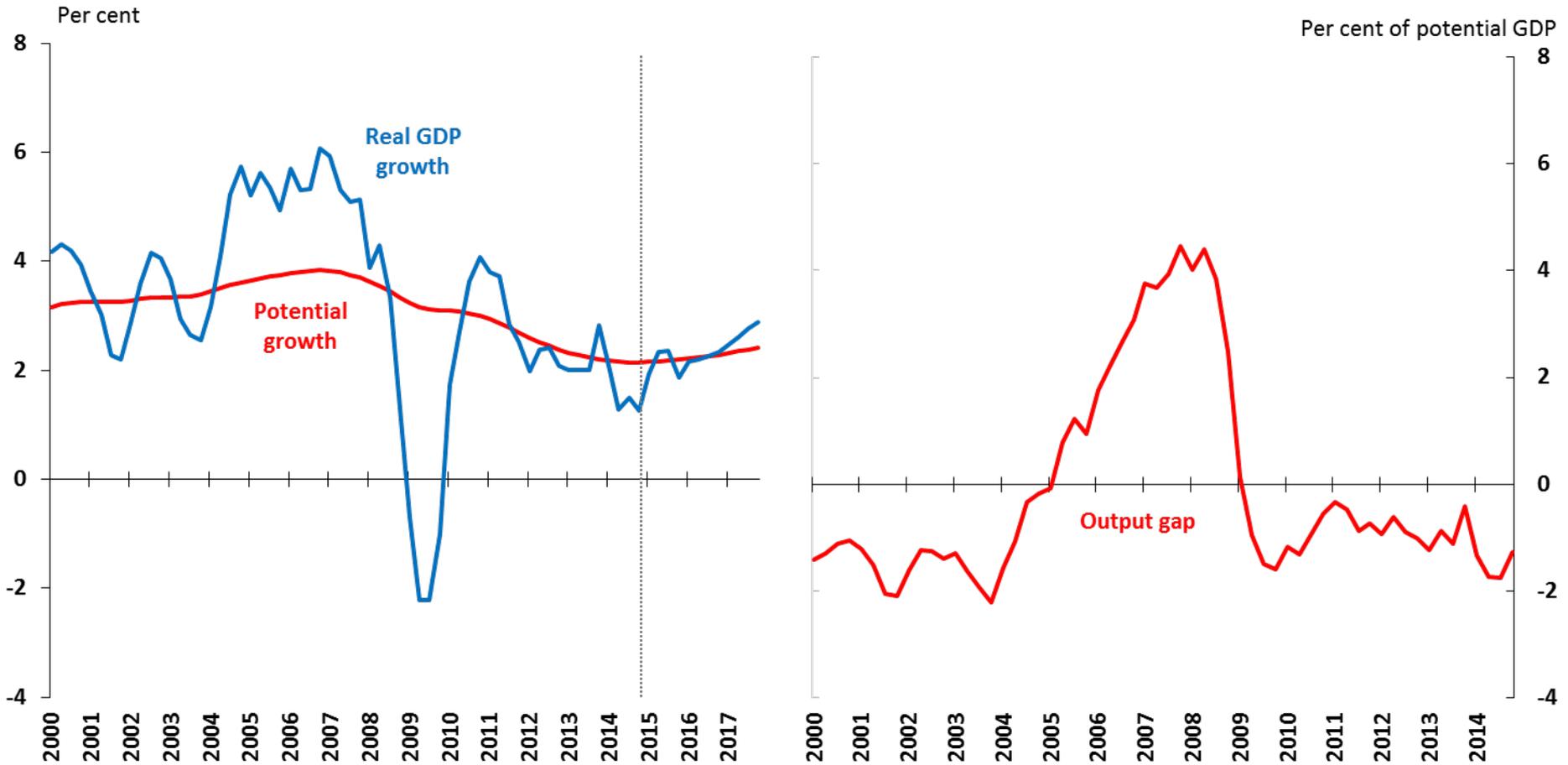


Growth fan chart



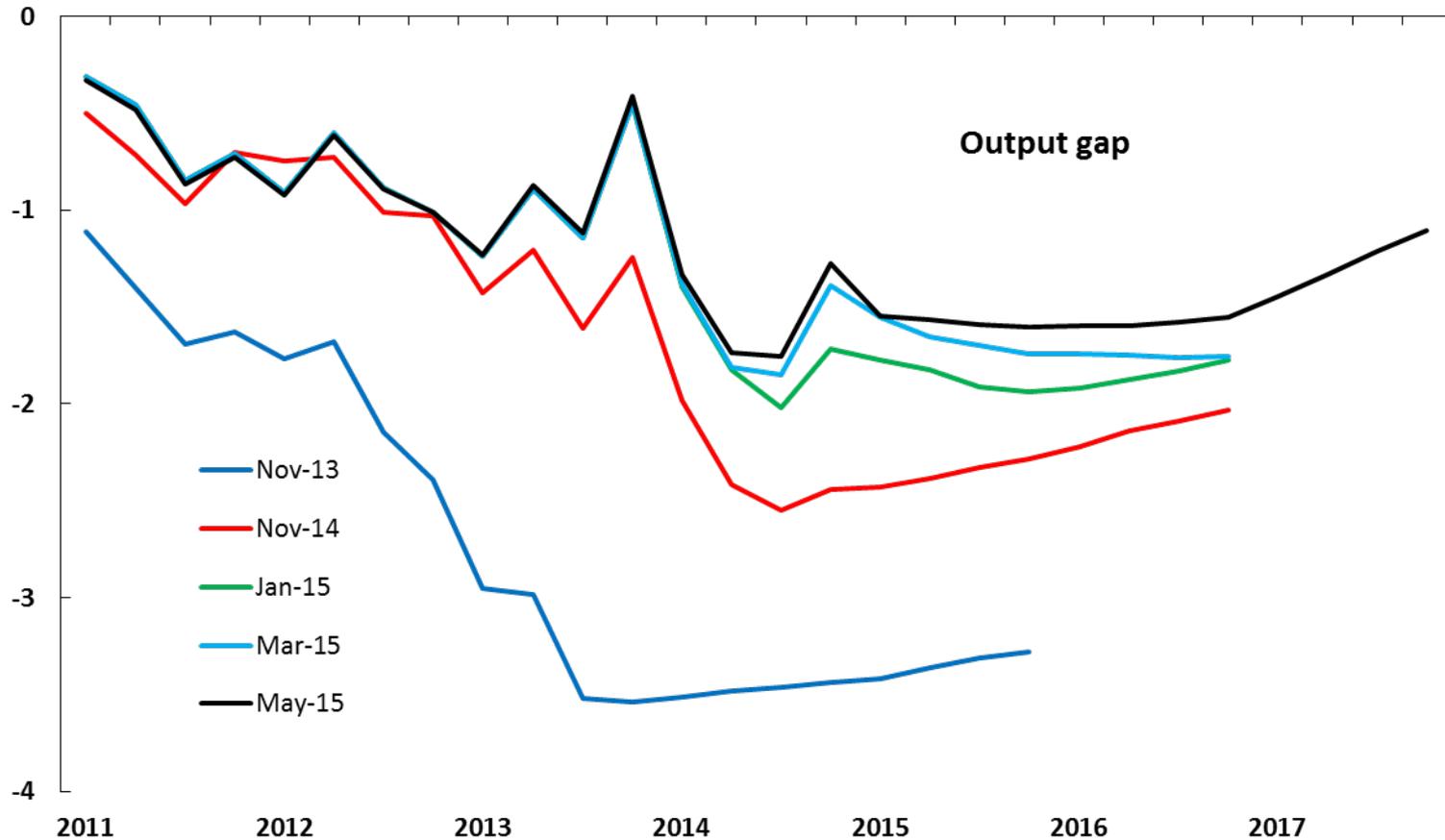
Source: South African Reserve Bank

Lower potential but output gap still negative



Source: South African Reserve Bank

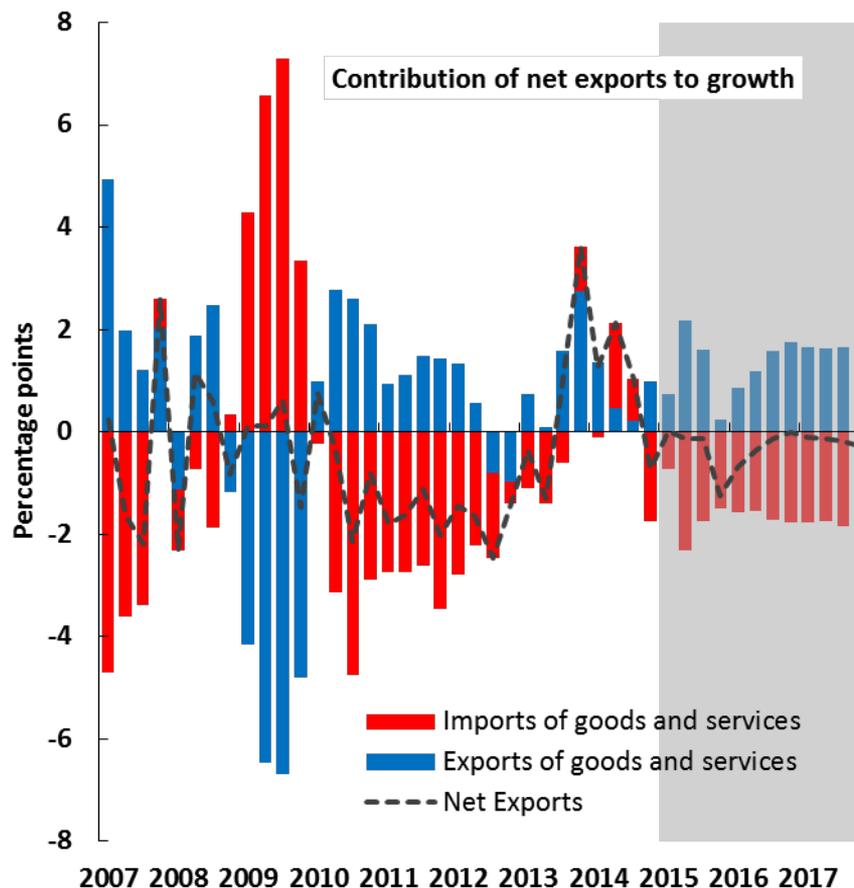
Improved measures of potential have narrowed the output gap estimate



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

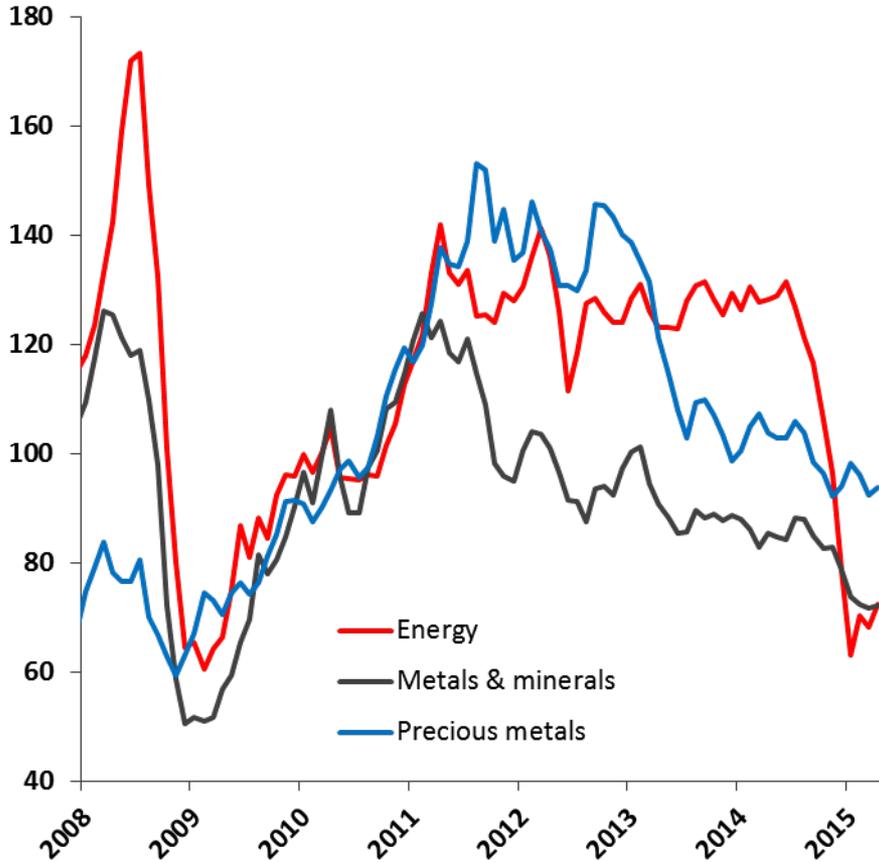
... and inflation diluting competitiveness gains...



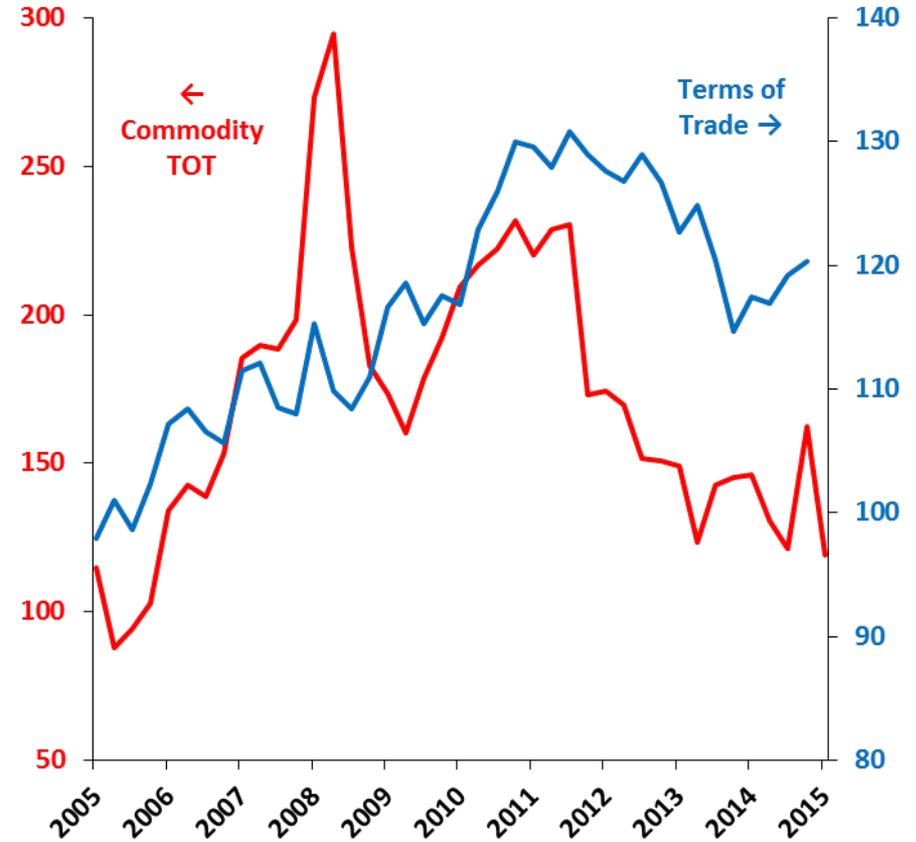
Source: South African Reserve Bank

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

World commodity prices have fallen

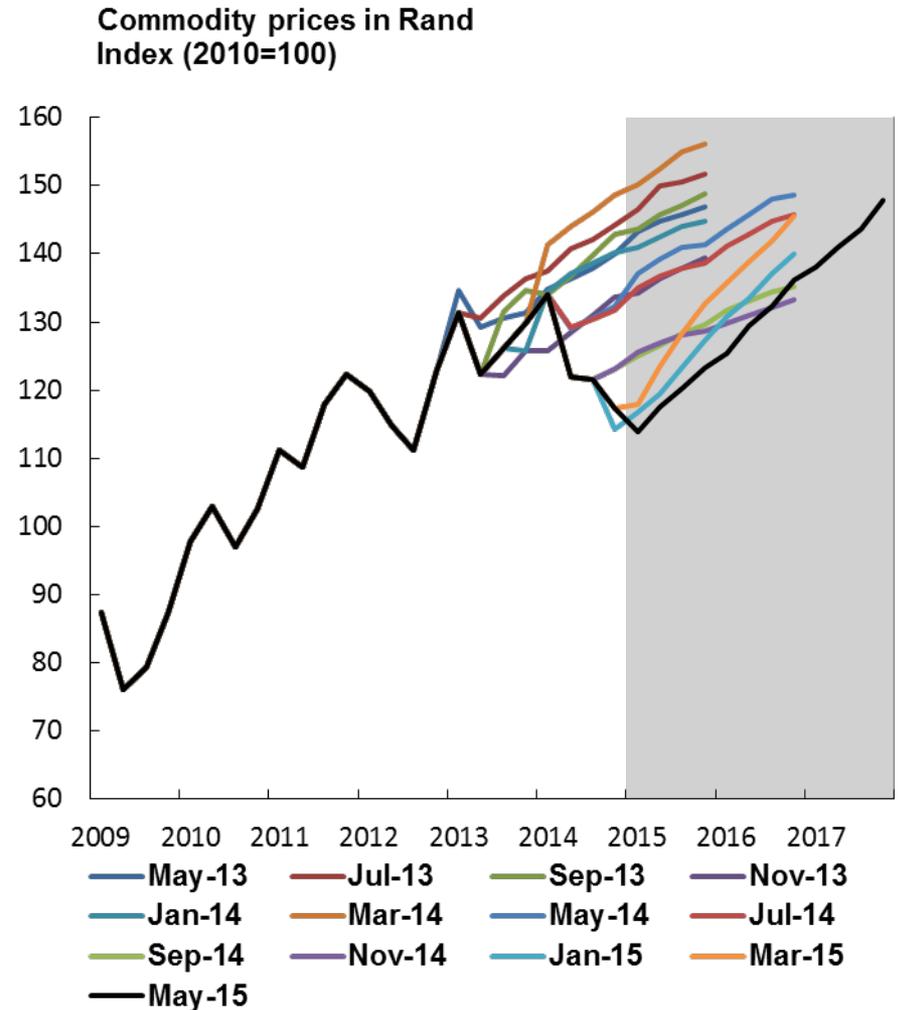
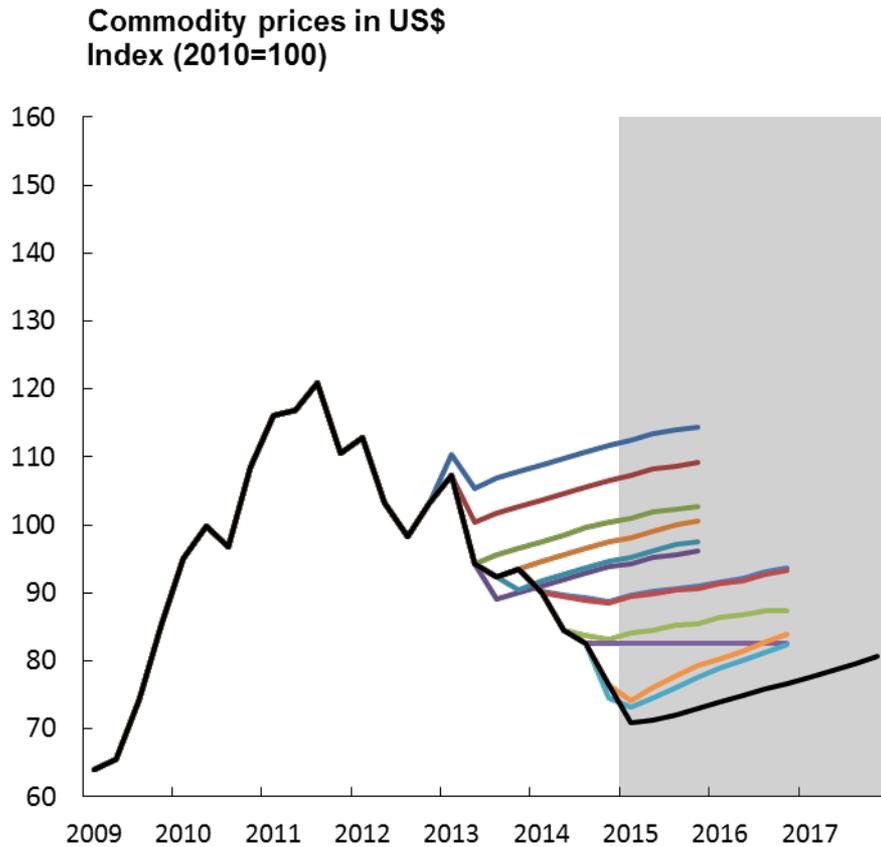


SA's Terms of Trade have declined



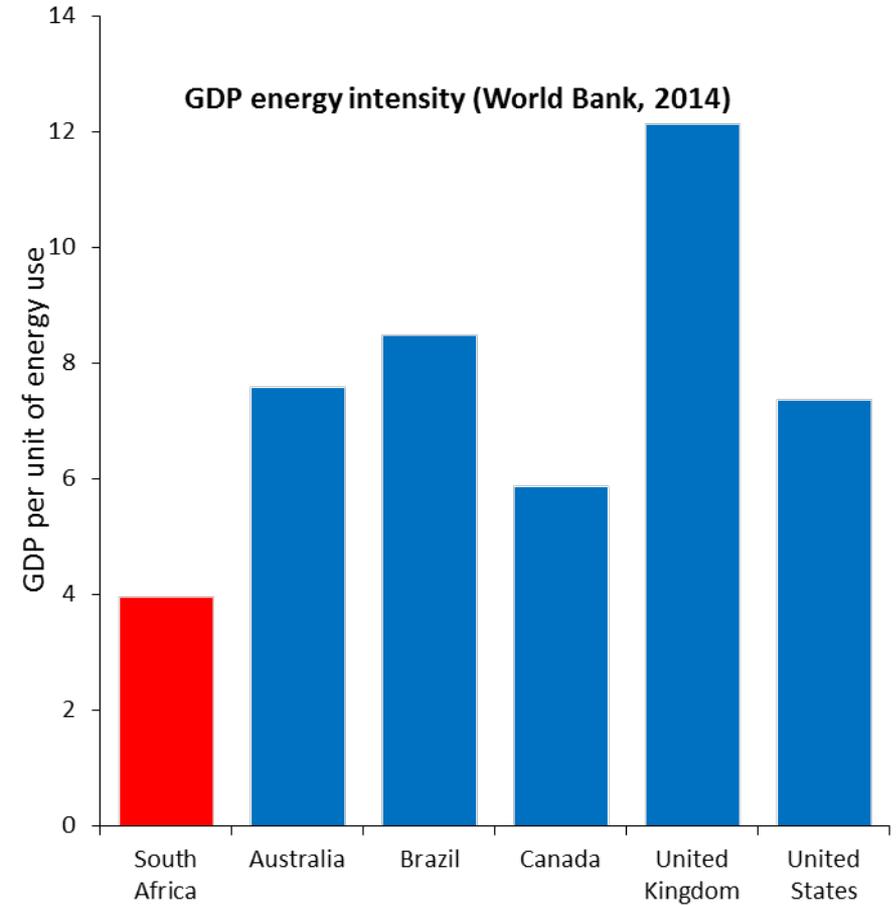
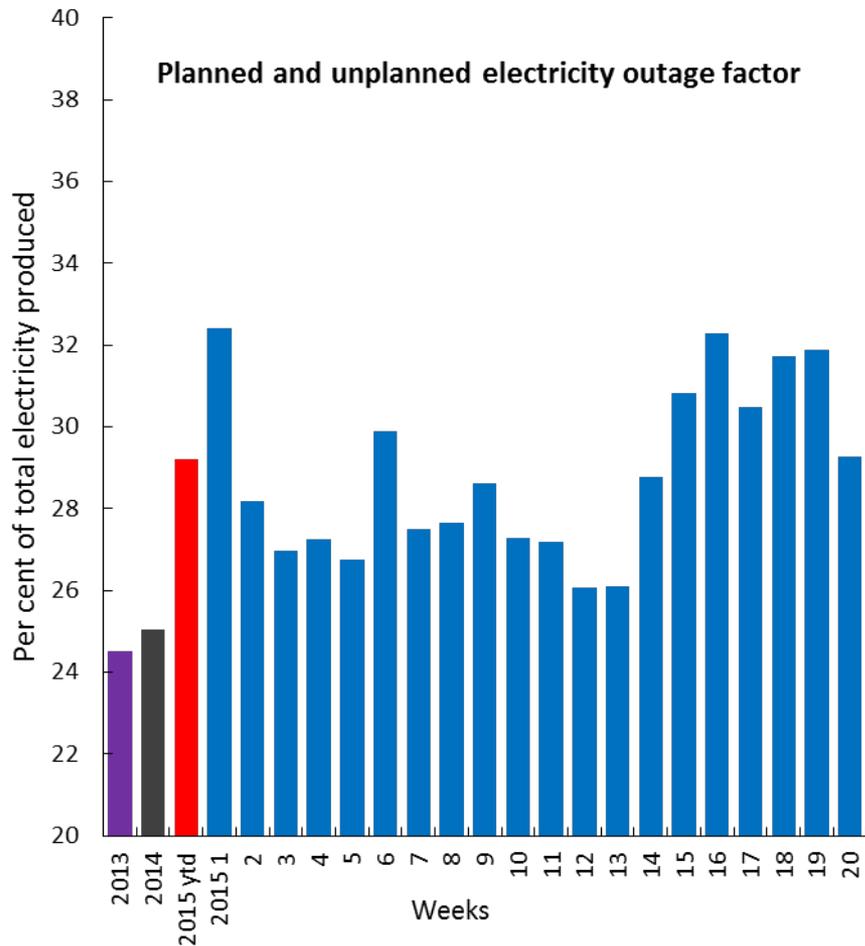
Sources: Citibank, World Bank and South African Reserve Bank

Commodity price assumptions down 37% in two years



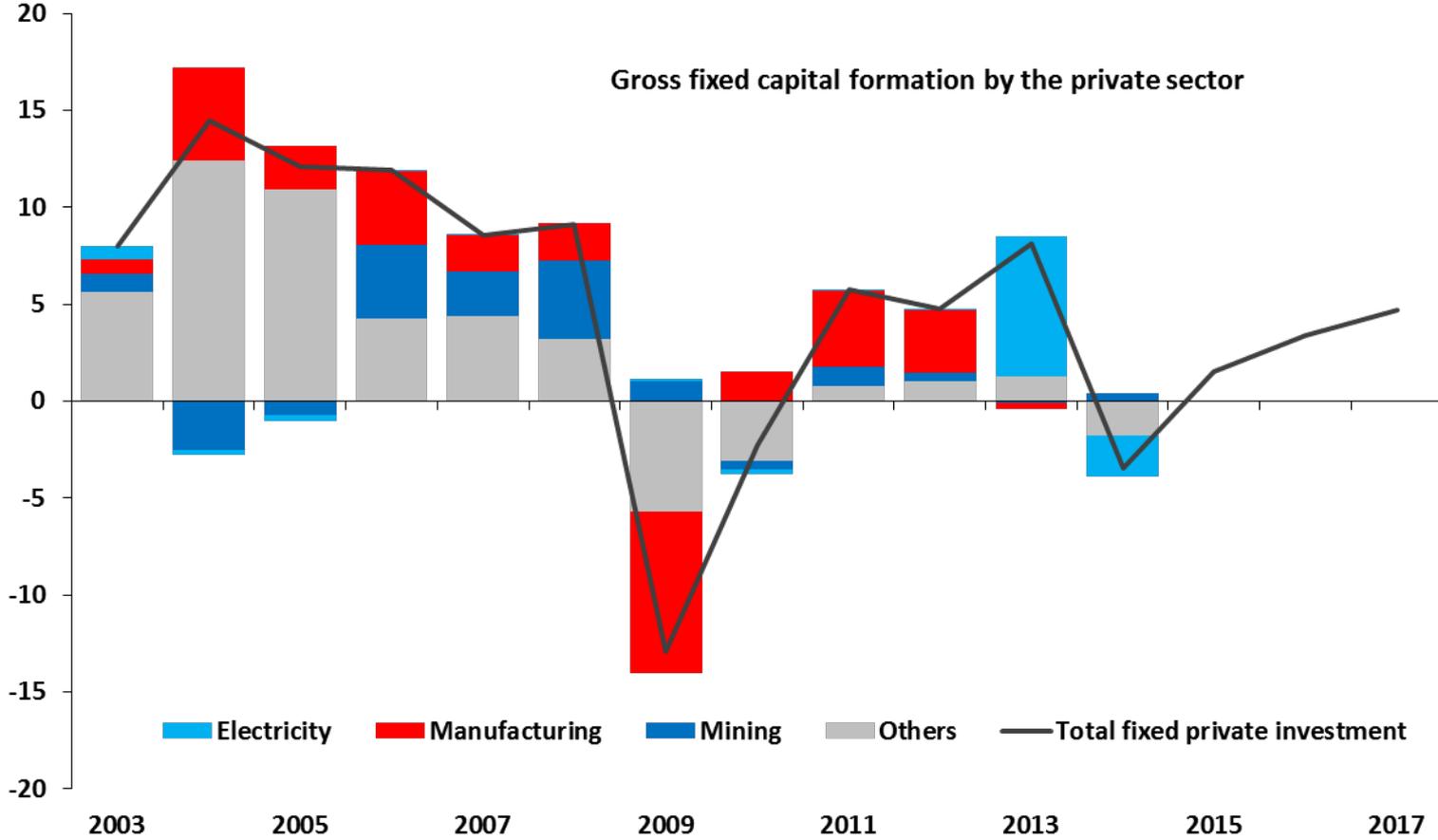
Source: South African Reserve Bank

Shortages in energy intensive economy hit hard



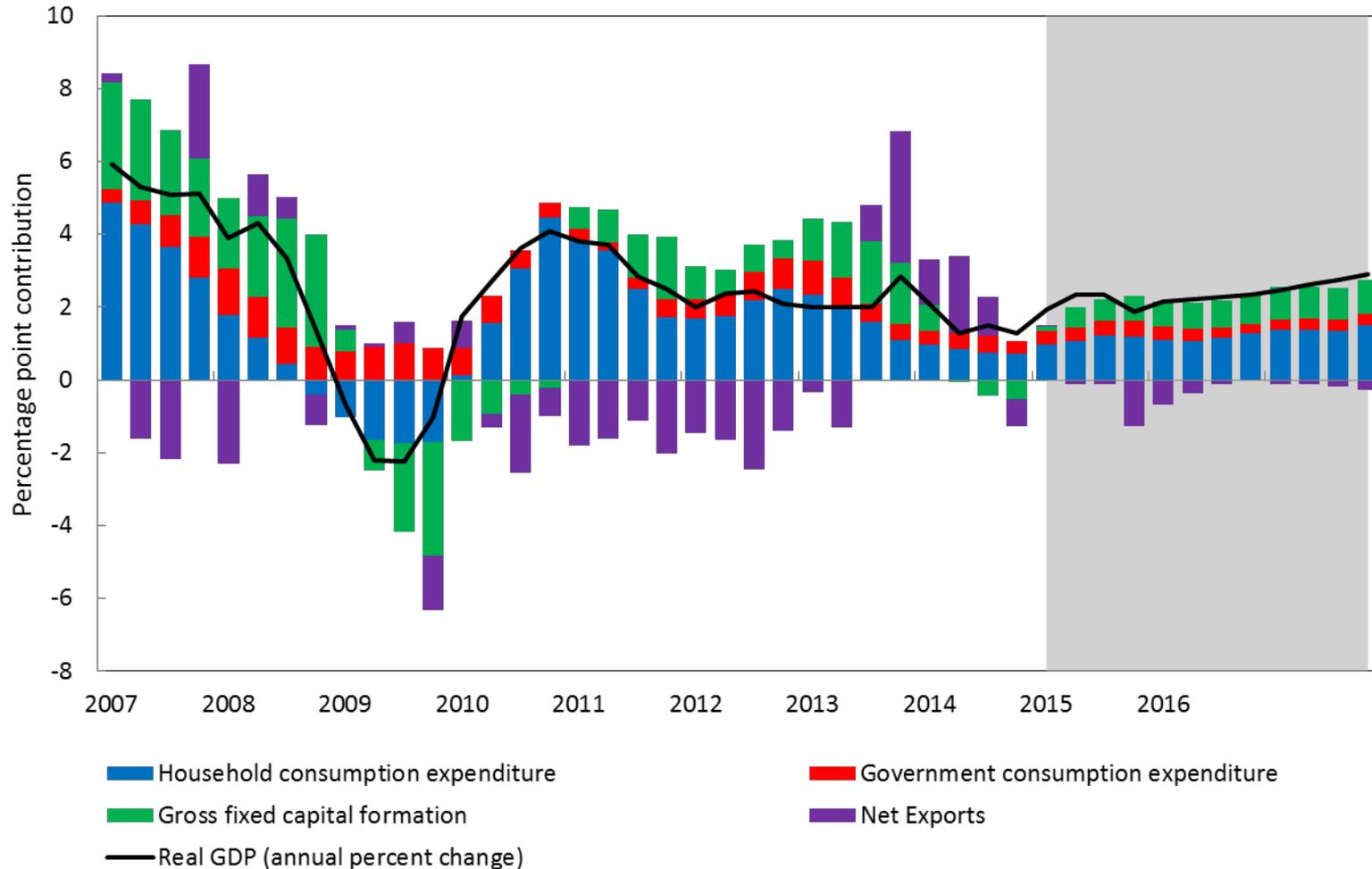
Sources: Eskom, World Economic Forum and World Bank

...curtailing investment (outside electricity sector)



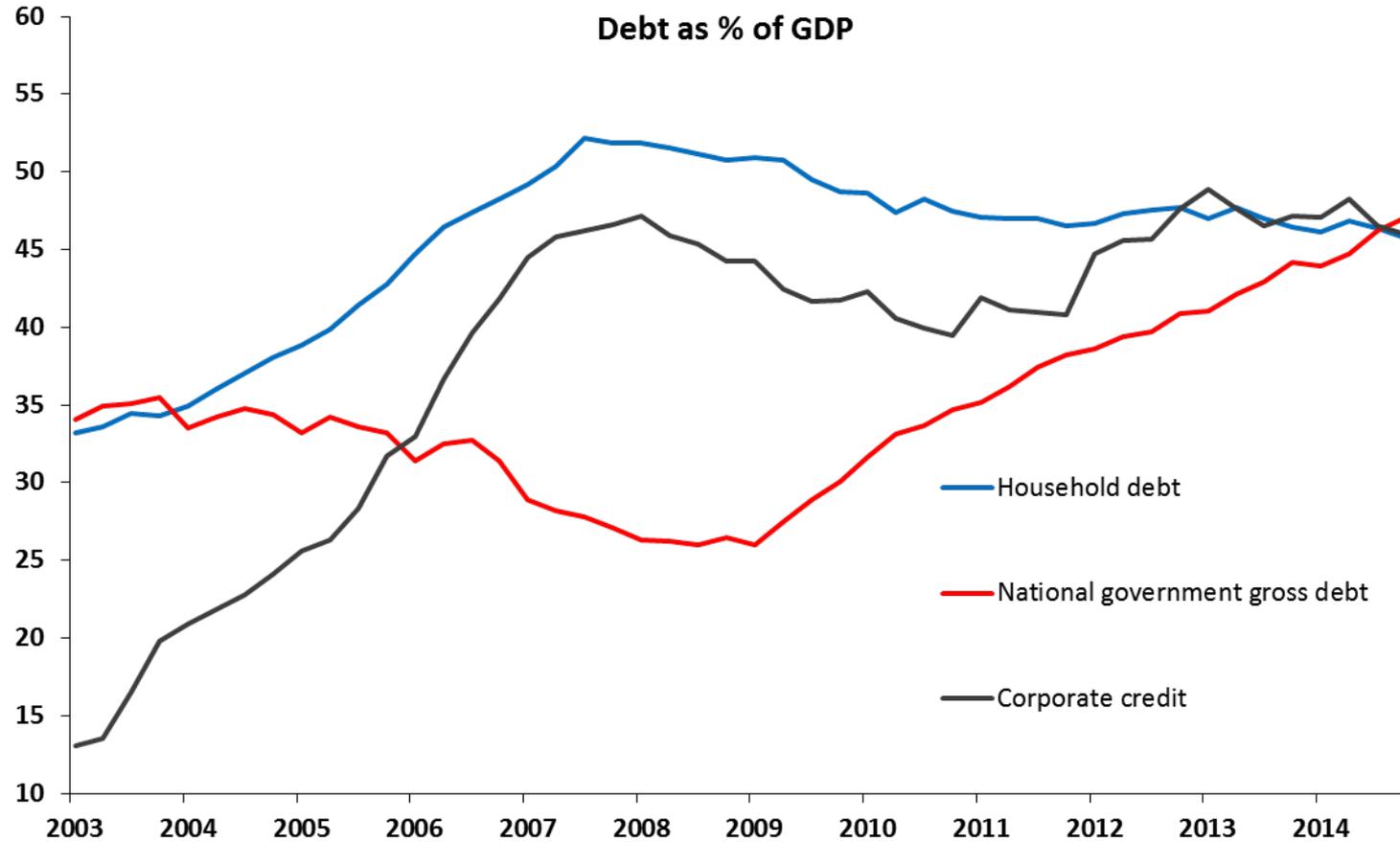
Sources: Statistics South Africa and South African Reserve Bank

Household consumption still underpins growth forecast



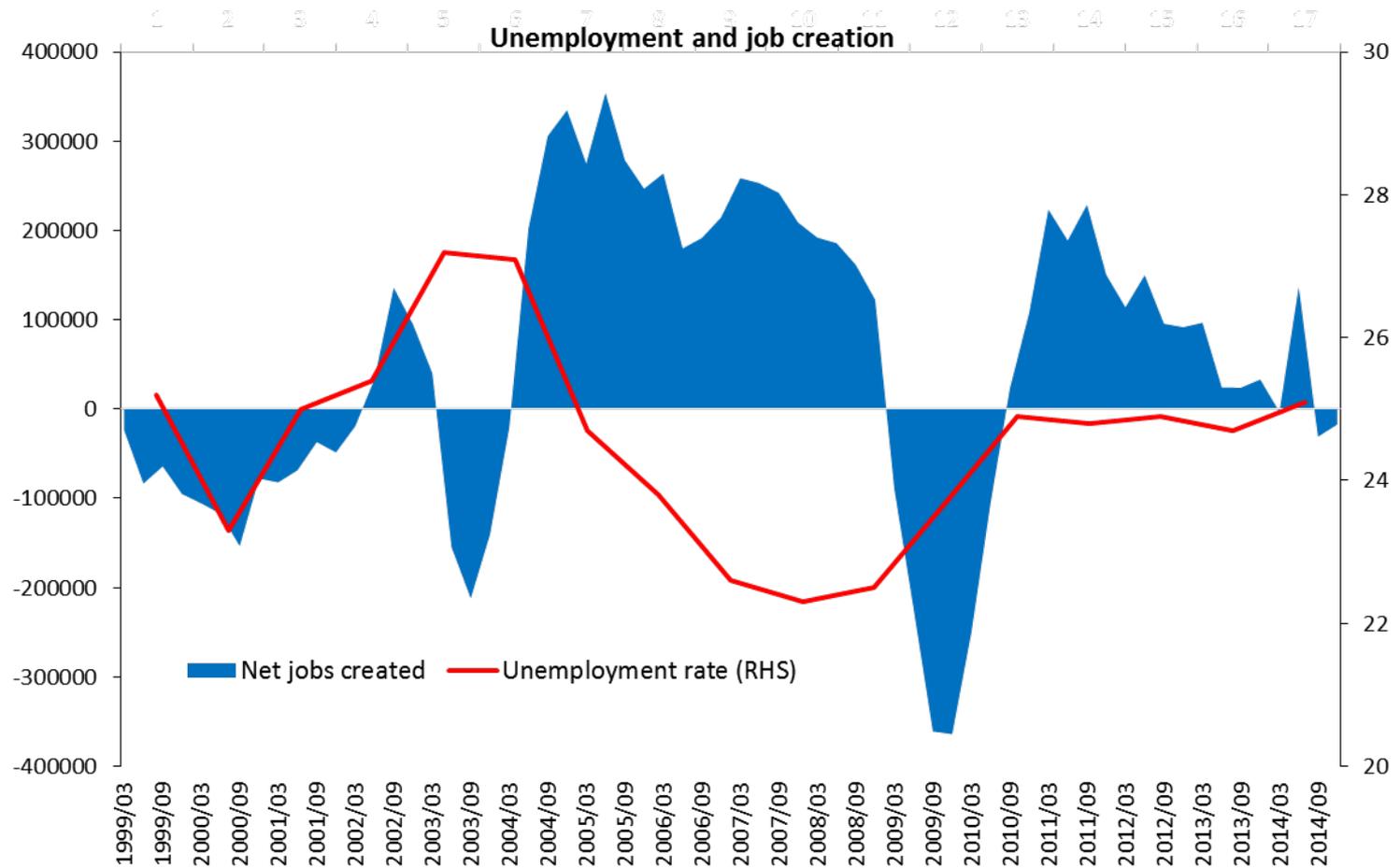
Source: South African Reserve Bank

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



Sources: National Treasury and South African Reserve Bank

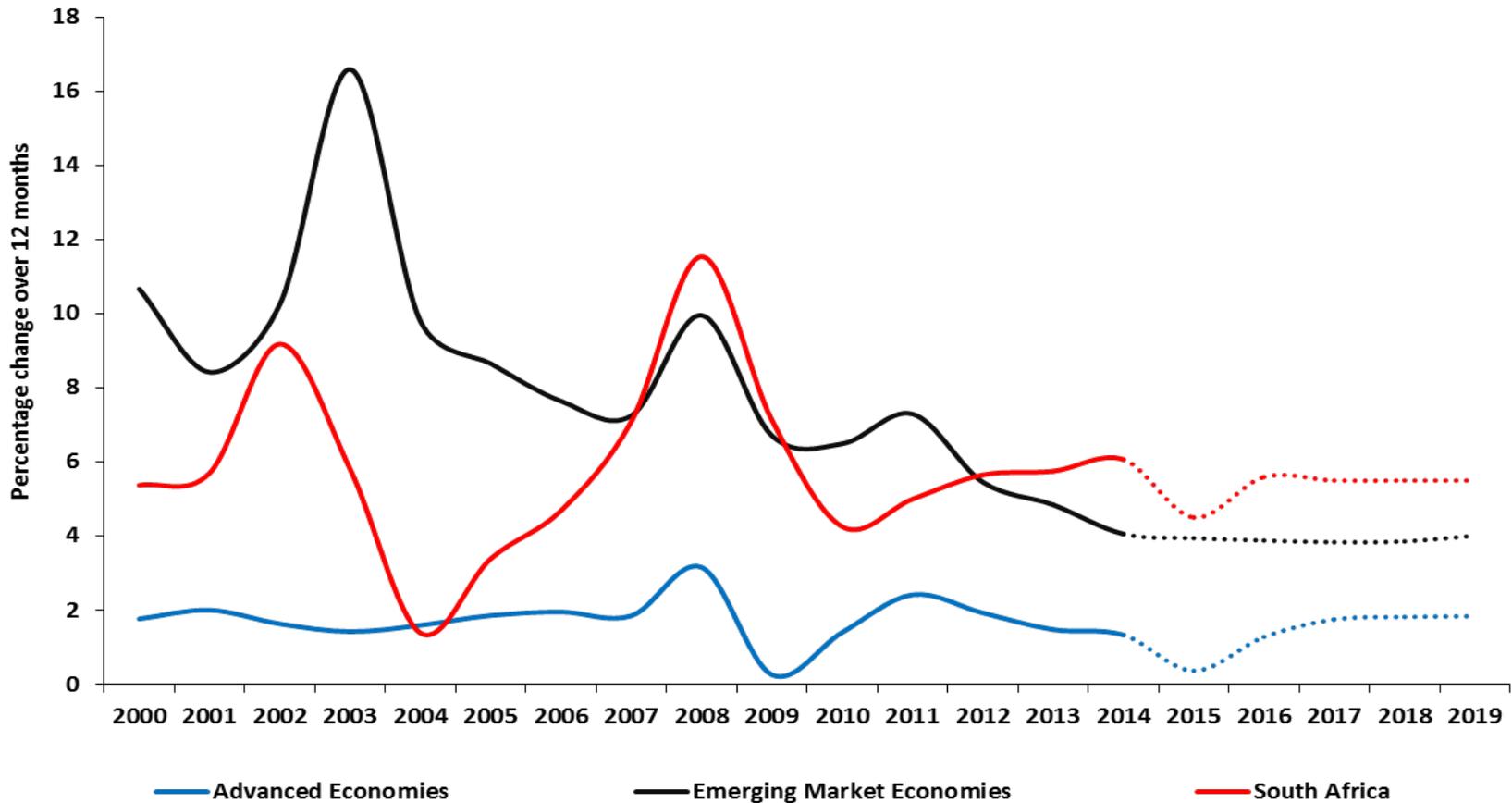
And net job creation tailing off



Sources: Statistics South Africa and South African Reserve Bank

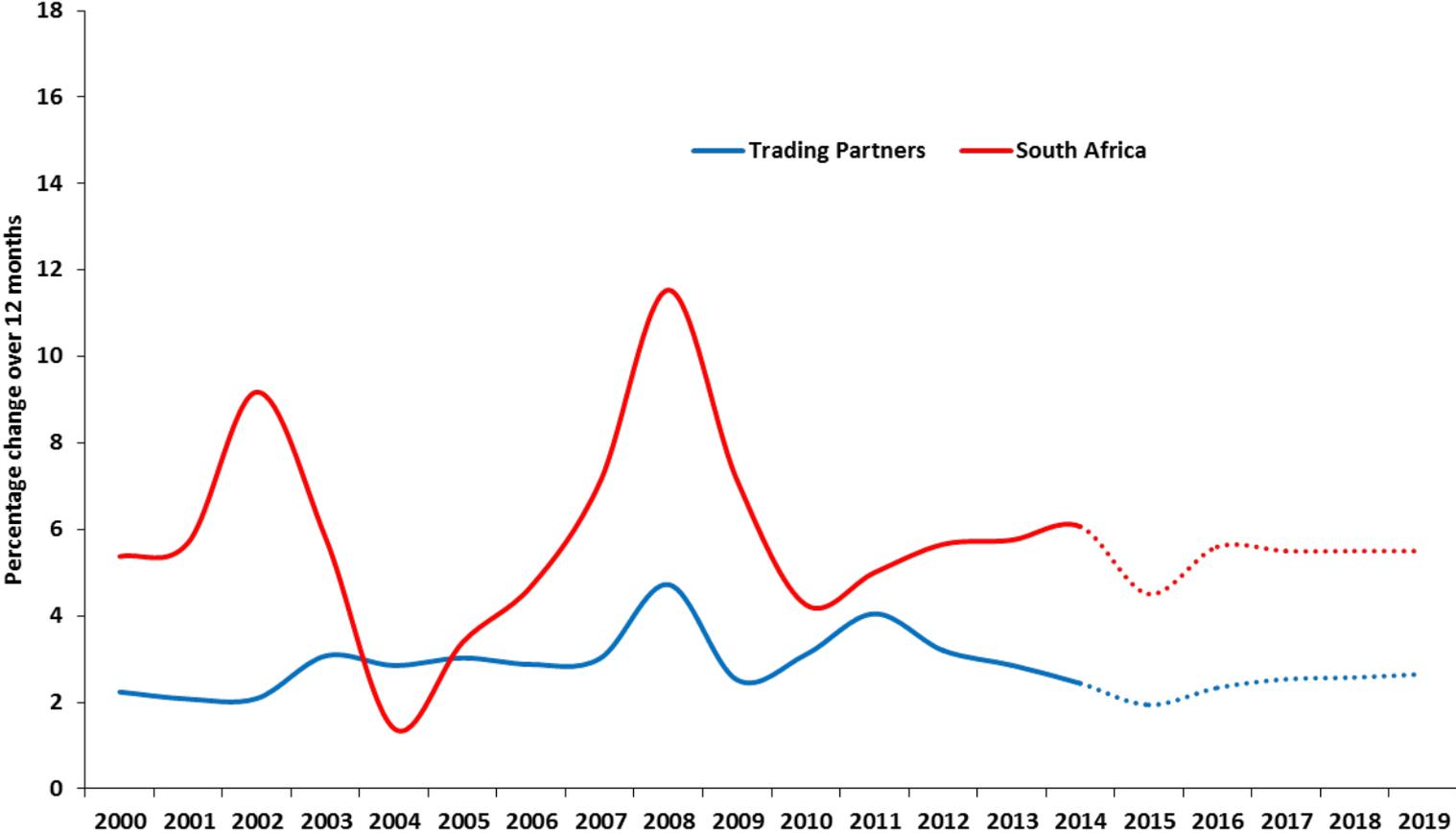
III. Inflation and the inflation outlook

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



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

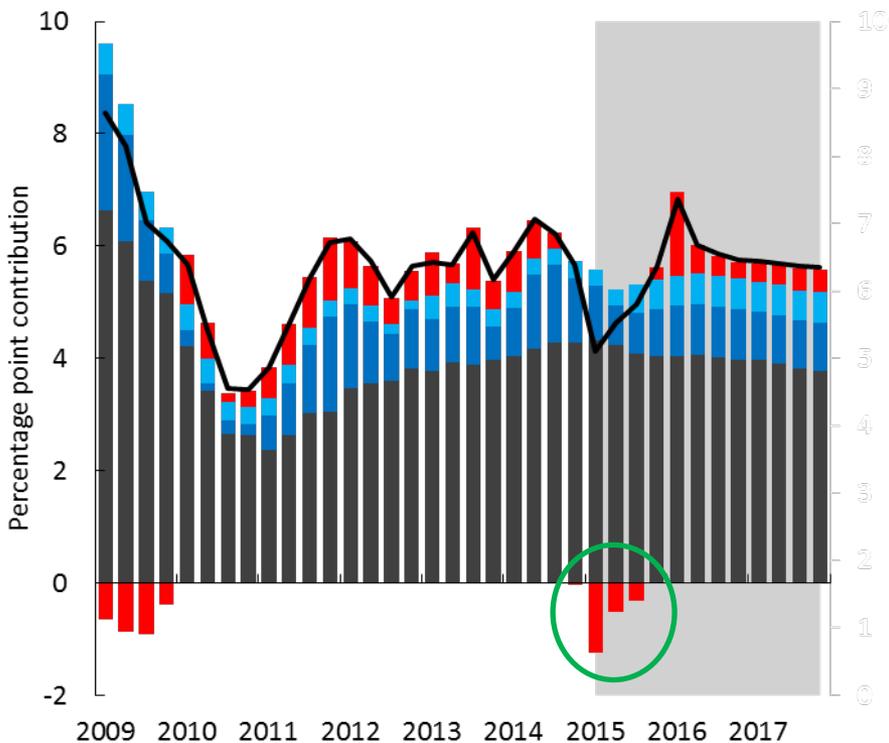
South African inflation running ahead



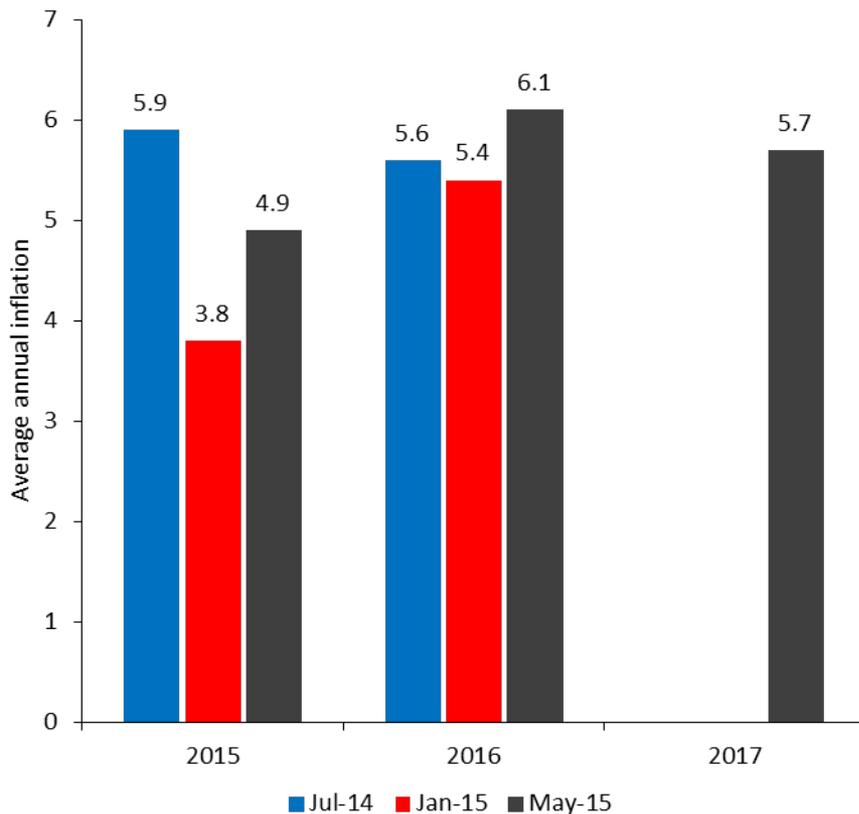
Sources: South African Revenue Service, World Bank and South African Reserve Bank

The inflation respite from cheap oil was brief

Contributions to headline inflation



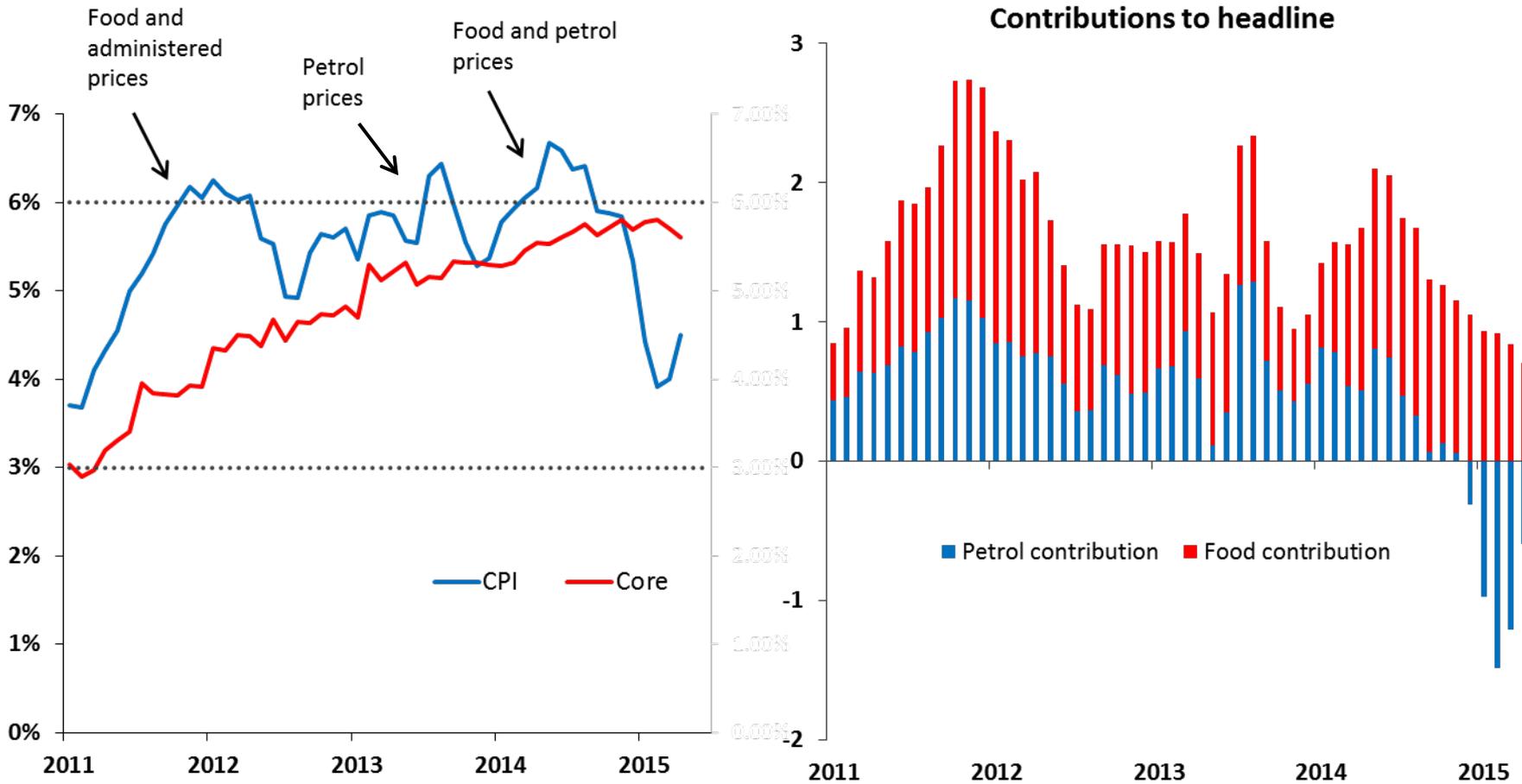
CPI forecasts at three different MPC meetings



- Core inflation
- Food
- Electricity
- Petrol
- Targeted inflation

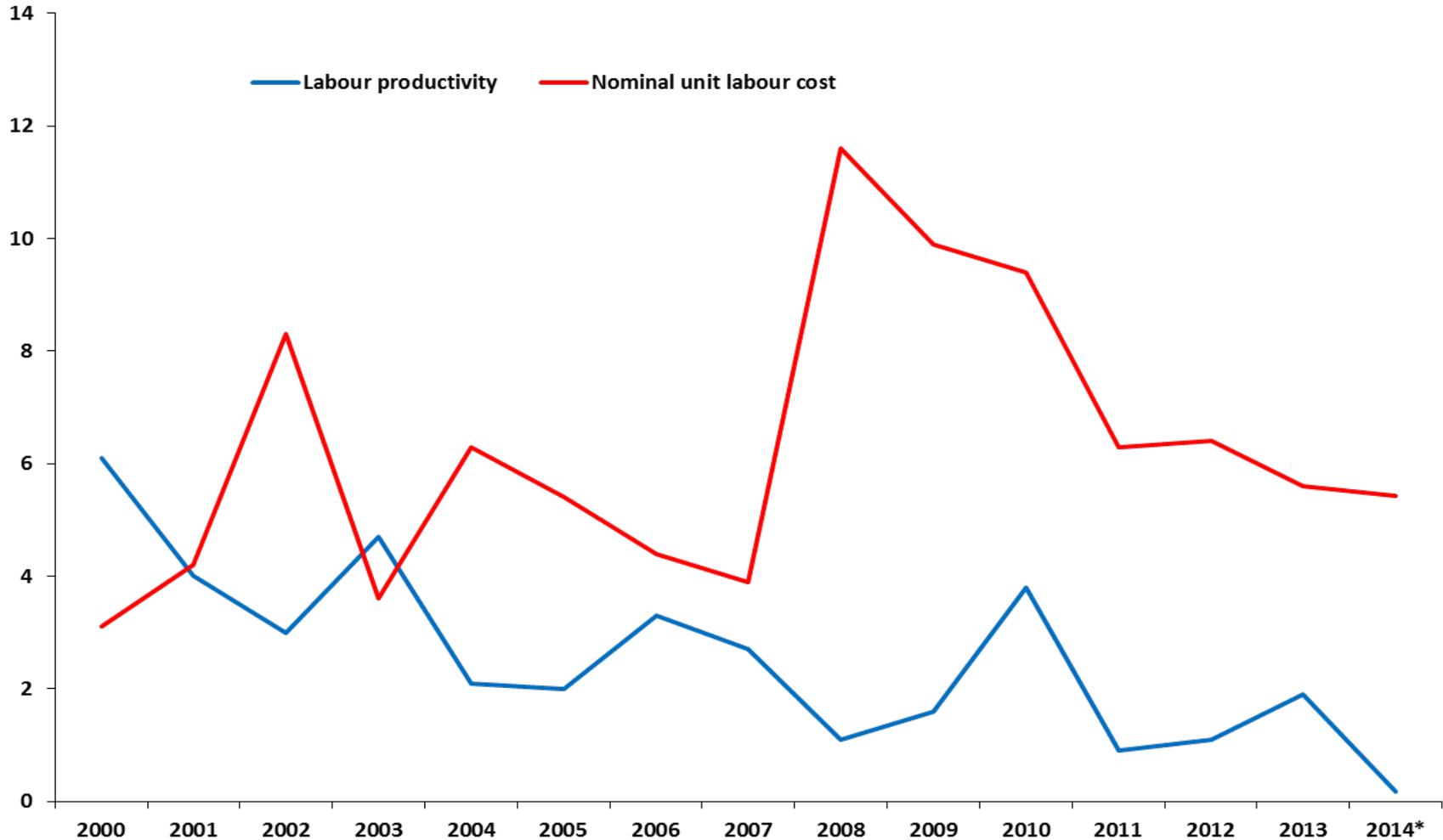
Sources: Statistics South Africa and South African Reserve Bank

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



Source: Statistics South Africa

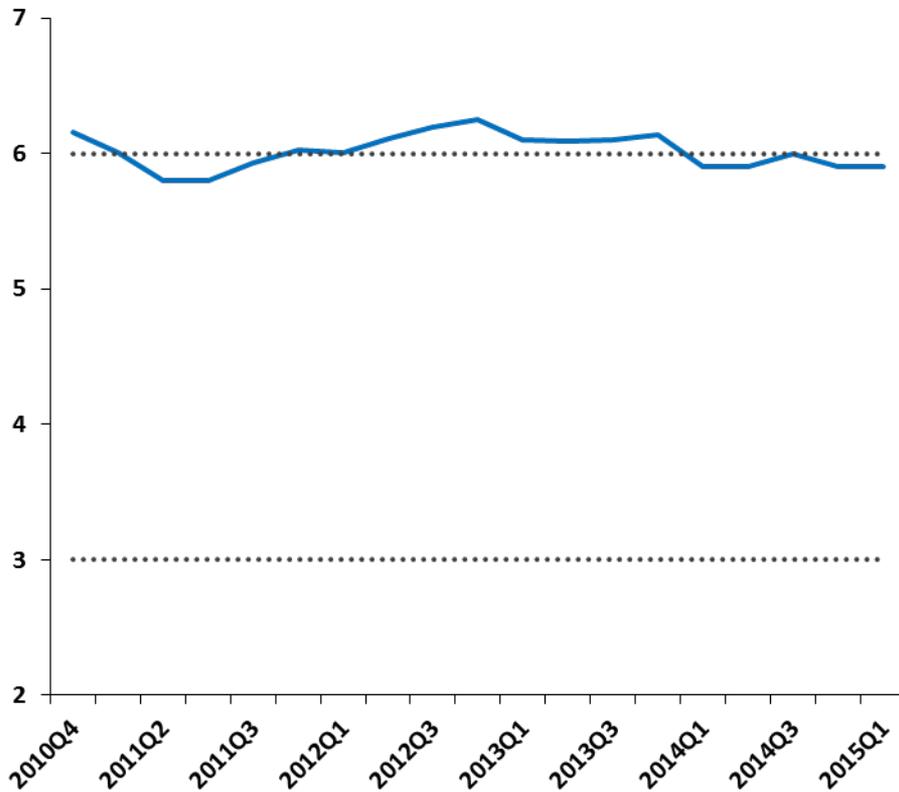
...as well as high unit labour cost growth



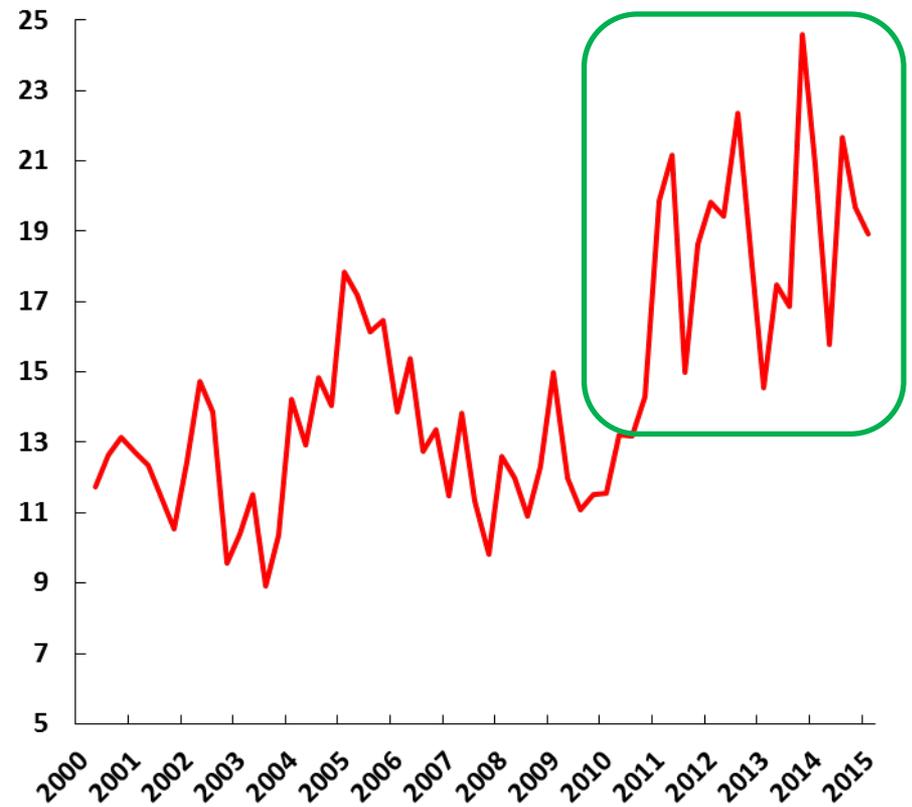
Source: South African Reserve Bank

Not unhinging expectations, but fostering convergence

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

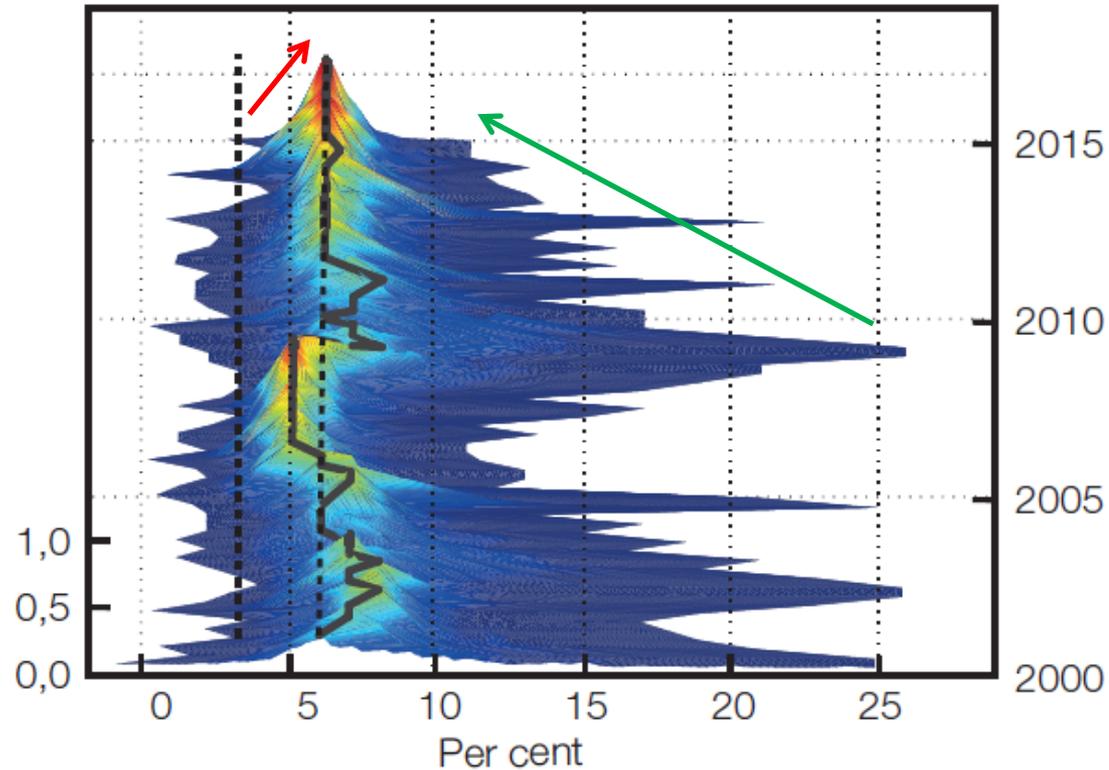


Proportion of respondents at the mode



Sources: Bureau for Economic Research and South African Reserve Bank

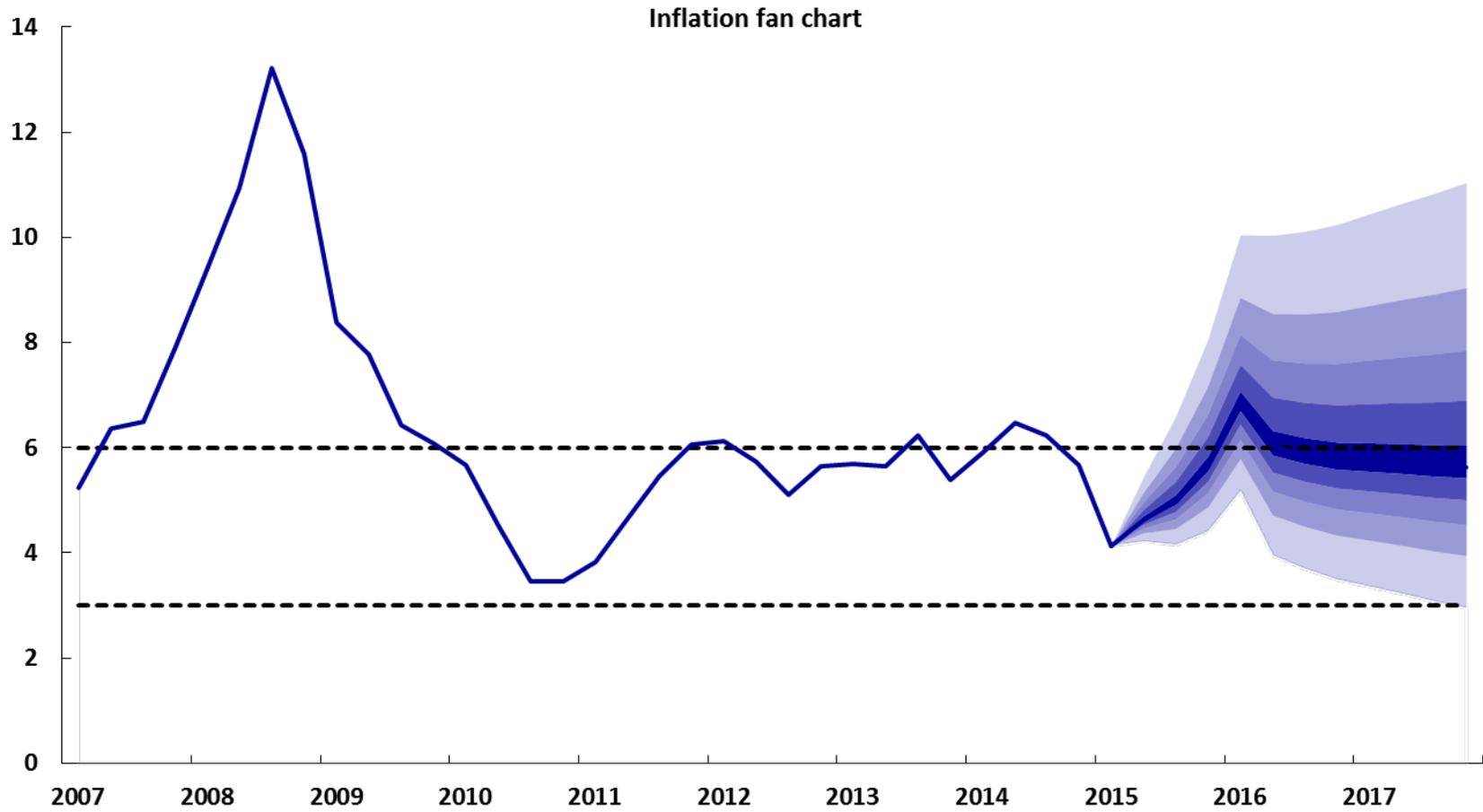
Convergence around the top of the target range



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

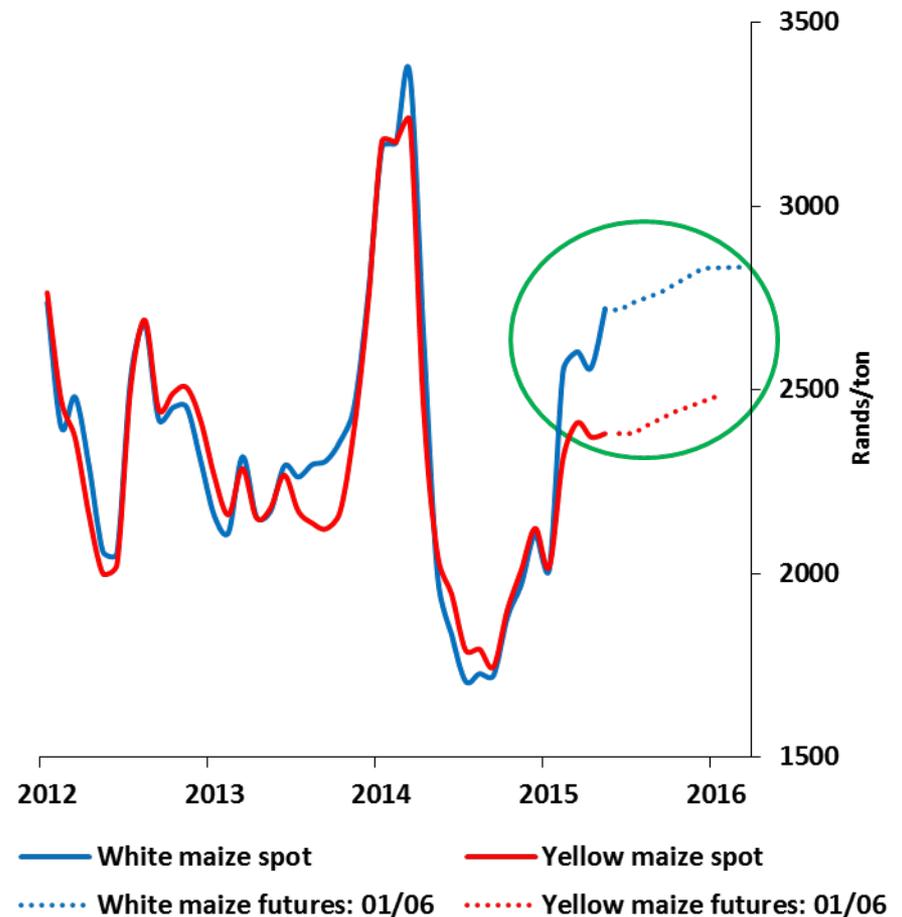
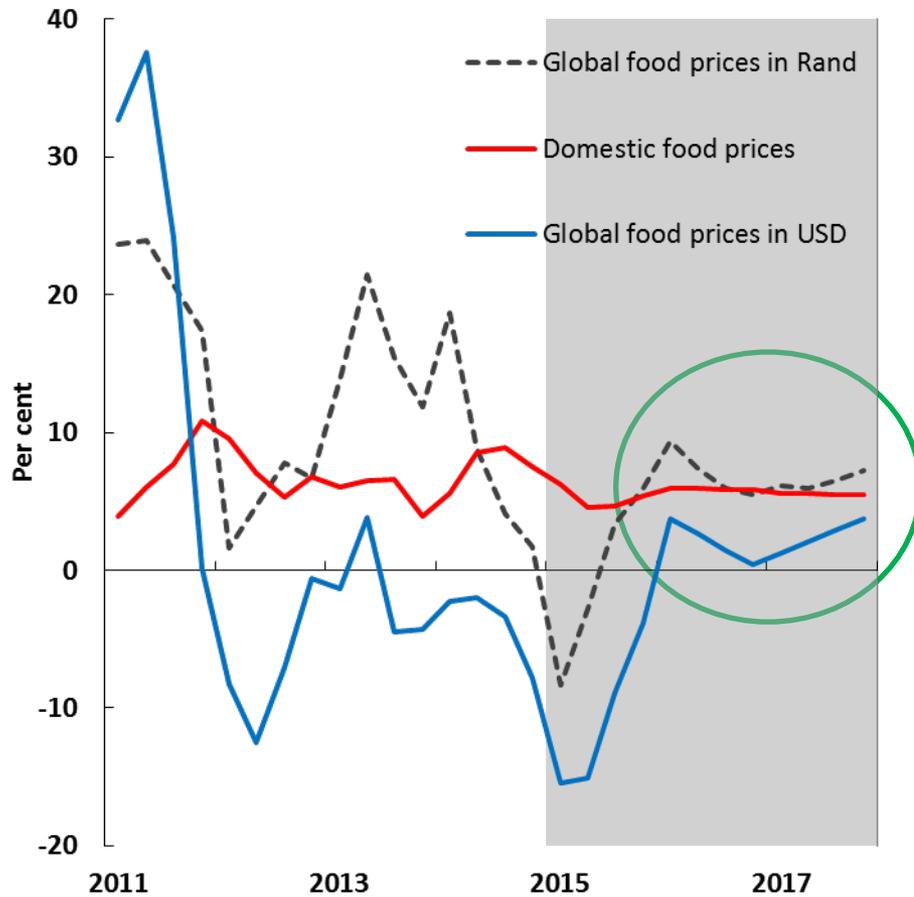
Source: Hassan, Shakill, Siobhan Redford, and Franz Ruch. 2015. Dispersion of Inflation Expectations. SA Reserve Bank, Working Paper (forthcoming).

Forecast at top of the target and risks to the upside



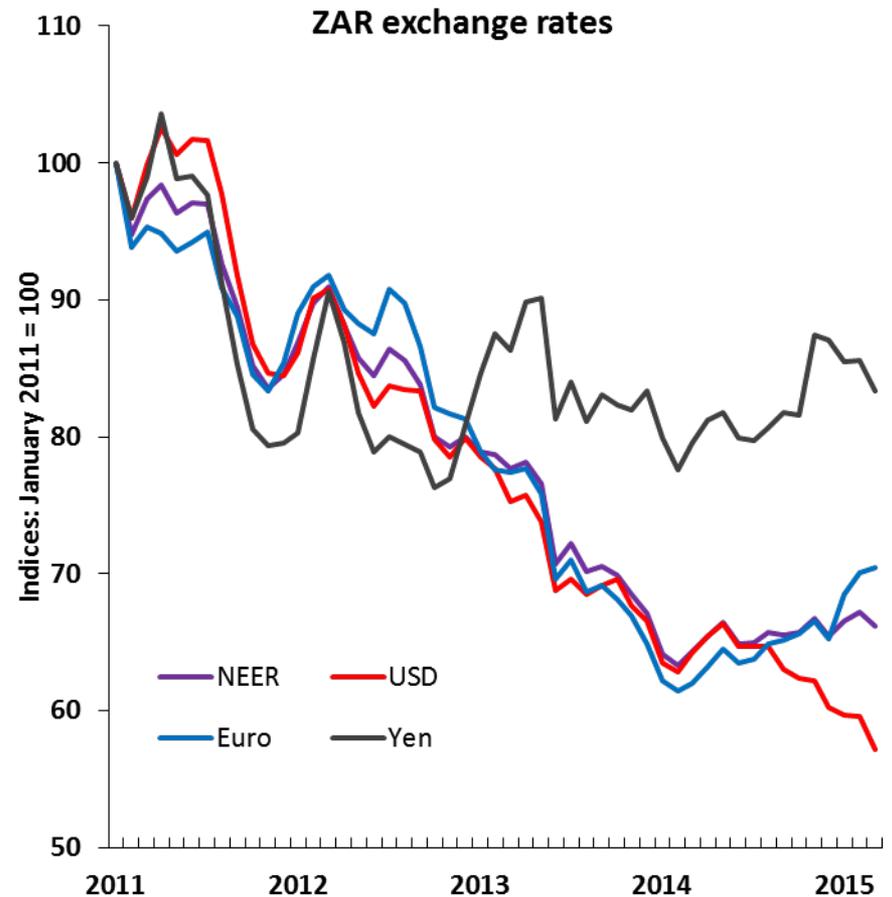
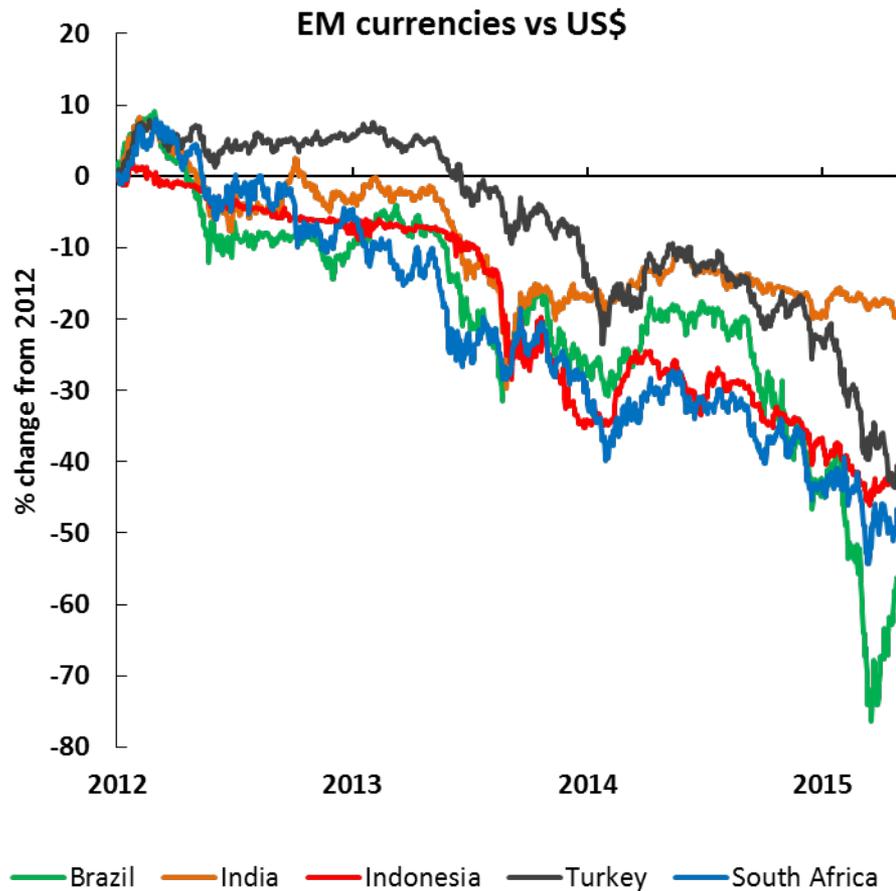
Source: South African Reserve Bank

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

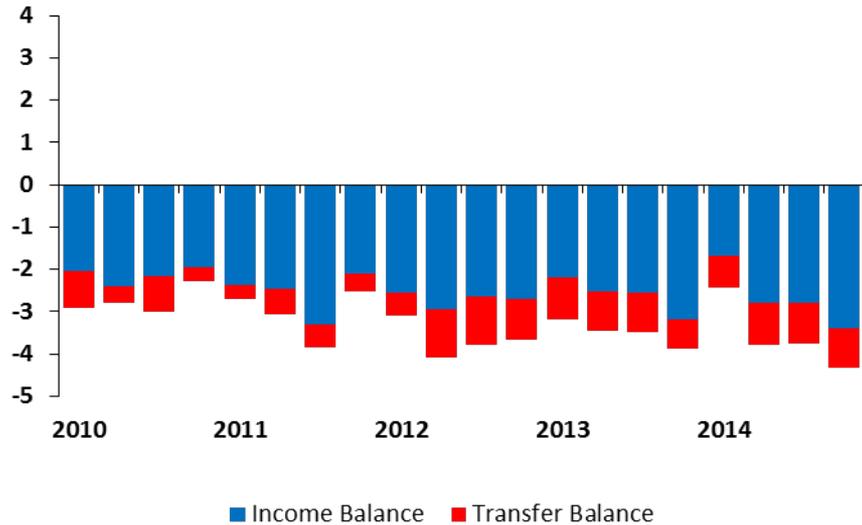
Depreciation to the USD sustained but EMs still exposed



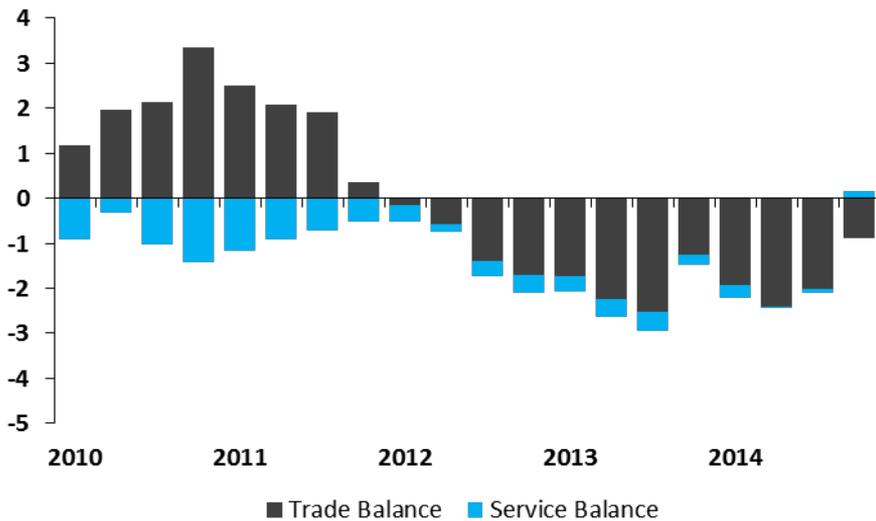
Sources: Bloomberg and South African Reserve Bank

South Africa's current account deficit narrowing slowly

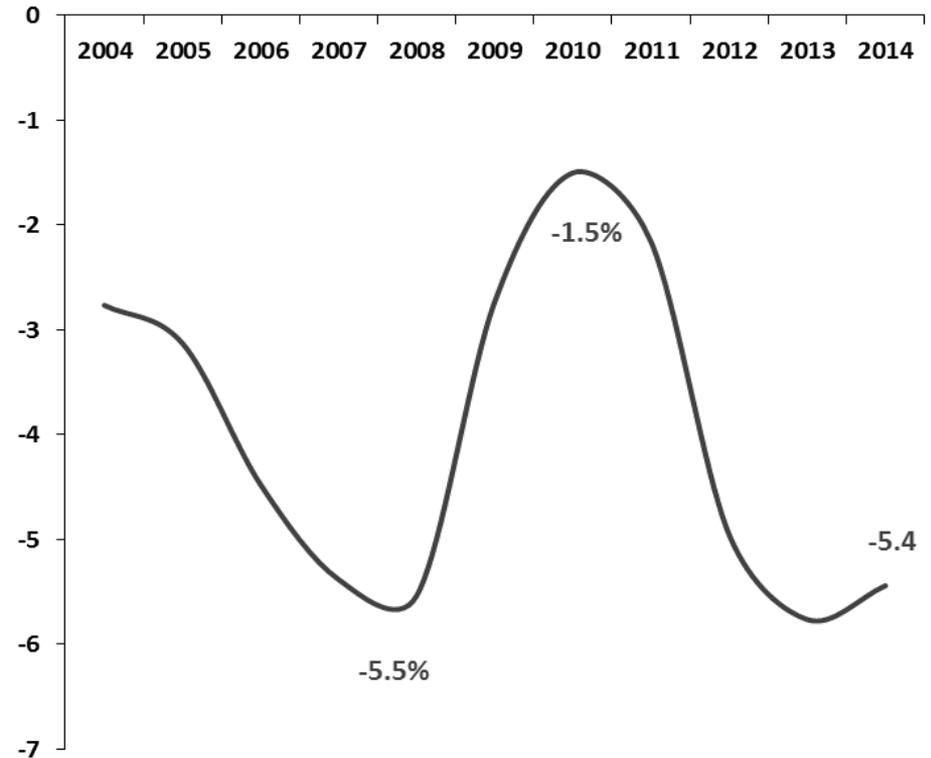
Percentage of GDP



Percentage of GDP

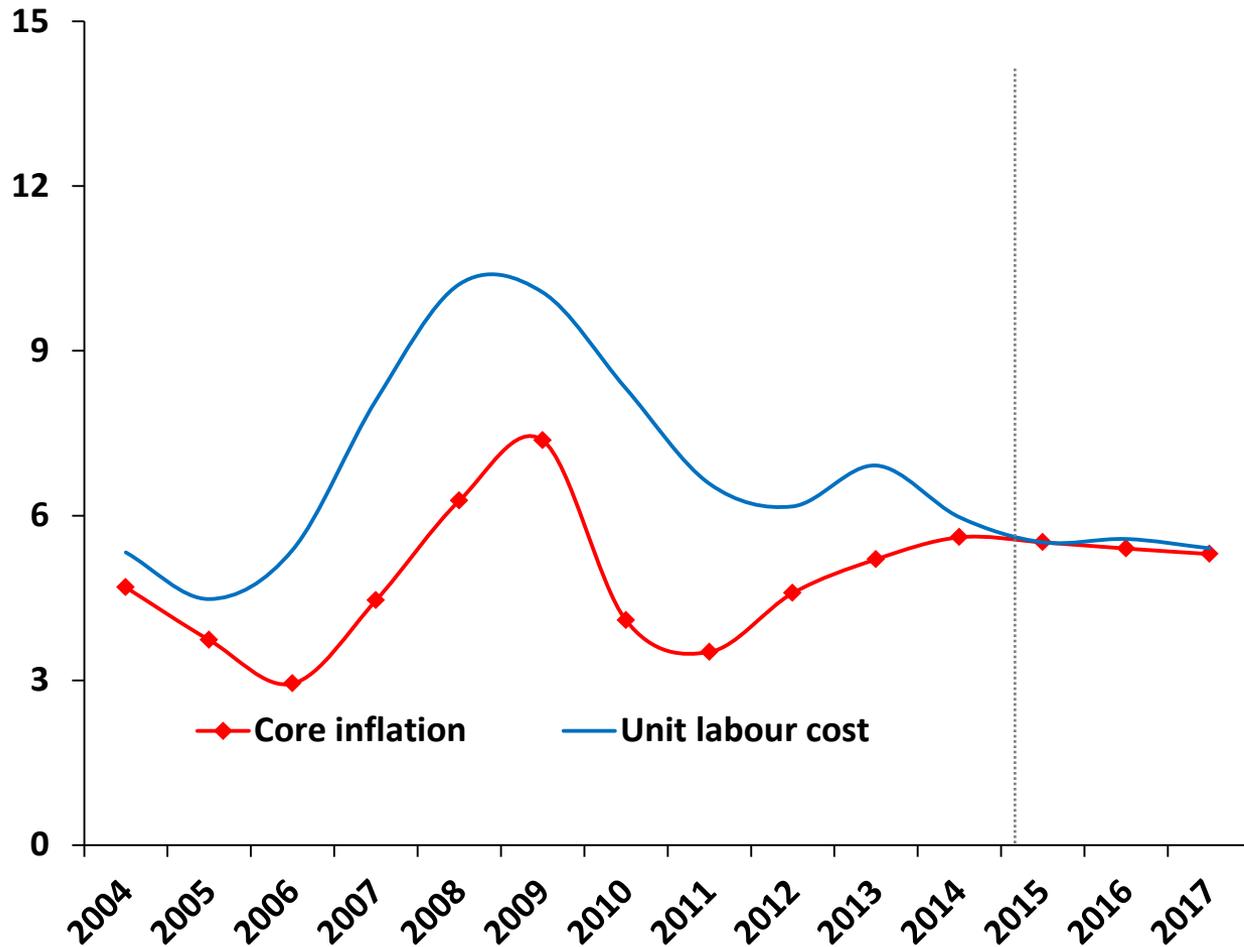


Percentage of GDP



Source: South African Reserve Bank

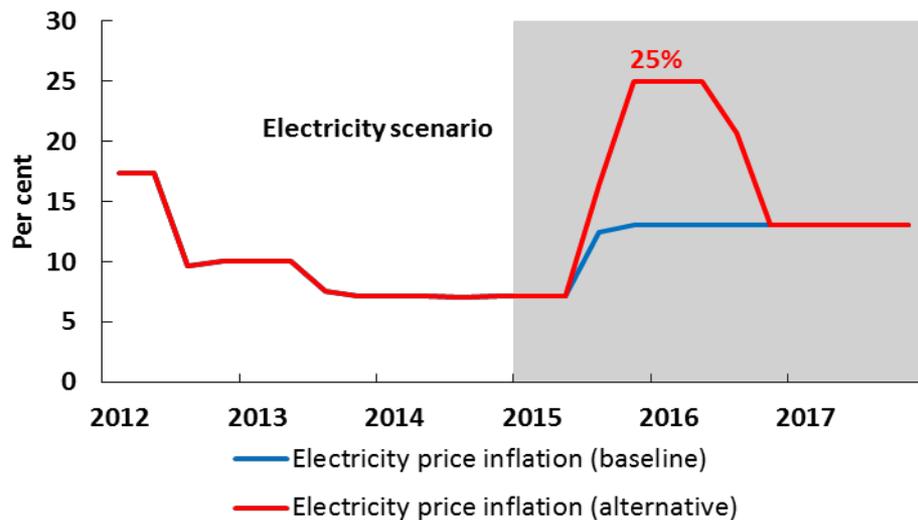
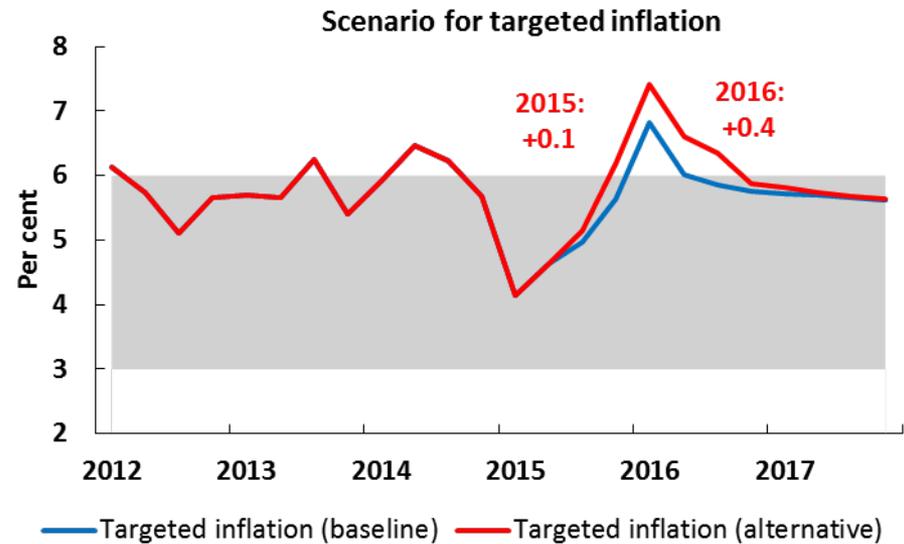
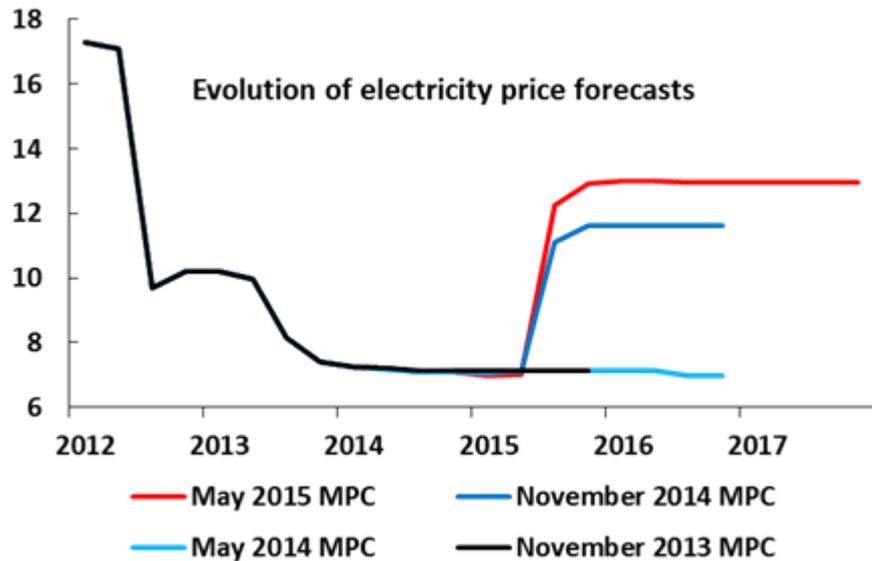
Unit labour costs expected to moderate somewhat, with risks



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

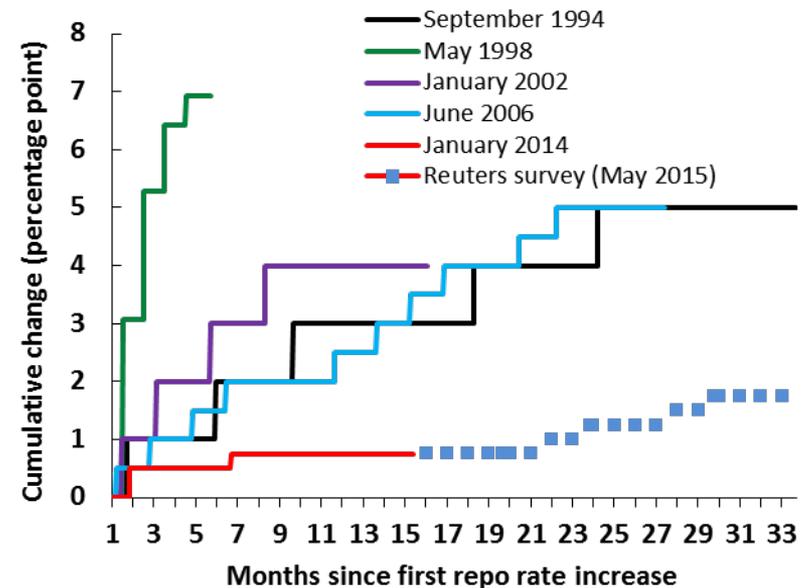
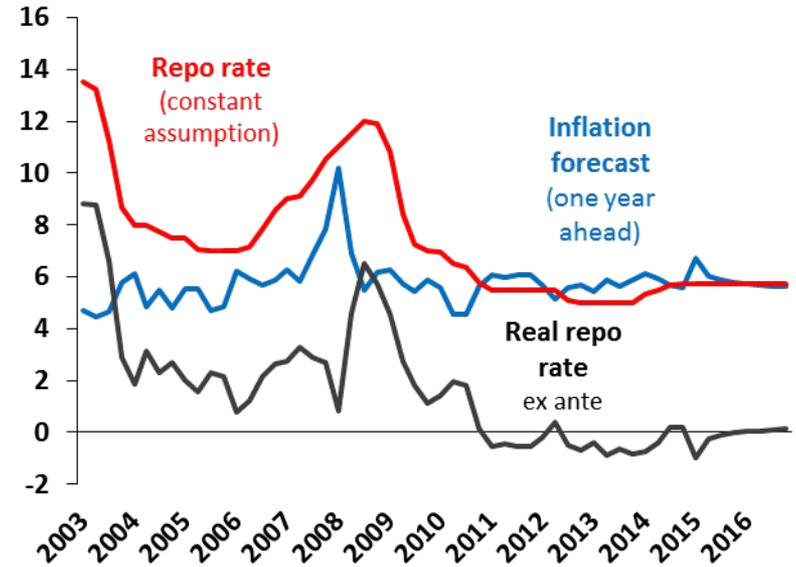
Electricity prices have the potential to shock



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